ECONOMIC
LAWS
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# RECENT DEVELOPMENTS IN DIRECT & INDIRECT TAX

# Contents

## DIRECT TAX - RECENT CASE LAWS

### Delhi HC[1] held that before initiating action u/s 148, AO must be subjectively satisfied that the income escaping assessment is taxable and said analysis cannot be deferred or subjected to further verification

#### FACTS OF THE CASE

- The Assessee was an overseas entity incorporated in Japan and engaged in the supply of software. It procured software from its vendors on a principal-to-principal basis for purposes of sale/re-sale to its customers situated across the globe including India.
- The Assessing Officer (**AO**) observed that various payments were made to the Assessee in respect of which tax was deducted. However, no return of income was filed by the Assessee. Hence, a notice u/s. 148A(b) of the IT Act was issued by the AO on the ground that said income remained unexplained and appeared to have escaped assessment.
- In response to said notice u/s 148A(b), the Assessee, by placing reliance on the decision of Supreme Court in case of Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT [(2021) 432 ITR 471 (SC)], claimed that the income received from the sale/re-sale of shrink-wrapped software would not amount to royalty. Additionally, the Assessee claimed that in absence of Permanent Establishment (**PE**) in India, business profits could not have been taxed in India.
- The AO passed the order u/s 148A(d) observing that though the Assessee had claimed that the income was exempt, since the Assessee had not filed ITR and the relevant 'end user licence agreement' entered between parties, income could not be claimed as exempt.
- Against the above, the Assessee filed writ petition before Hon'ble Delhi High Court.

#### RULINGS OF THE HIGH COURT

- Delhi High Court observed that in the order u/s. 148A(d), the objections raised by the Assessee have been perfunctorily disposed of. The AO remarked that whether revenue earned from the sale of software can be considered as royalty requires further verification. Similarly, while dealing with the issue of PE, the AO was of the view that the same 'is a question of fact and law and hence need to be verified'.
- As per the High Court, at the stage of initiating action u/s 148, the AO must be subjectively satisfied that income which was taxable has in fact escaped assessment. Findings on the aspect of royalty and PE could not have been deferred or made a subject matter of further verification. Keeping above in perspective, High Court held that the AO has failed to deal with the fundamental challenge raised by the Assessee and quashed the order u/s 148A(d).

**ELP Comments**

*To initiate reassessment proceedings, tax authorities must establish that there is **income chargeable to tax** that has escaped assessment. This judgement of the Delhi High Court will assist the taxpayer to litigate against the reassessment proceedings which are selected by tax authorities without establishing that the income which has escaped assessment is taxable as per provision of the Act.*

[1] Componentsource Company Ltd. v ACIT [WP(C) 7753 of 2024]

## Delhi ITAT[2] held that in absence of FTS clause in India-Thailand tax treaty, technical services rendered constitutes business income which is not taxable in absence of PE.

### FACTS OF THE CASE

- The Assessee was a Thailand based company and rendered business administration, material engineering and development services to its Indian AEs. The consideration received from its Indian AEs was claimed as not taxable in India in absence of Fees for Technical Services (**FTS**) clause under India-Thailand tax treaty.
- The AO accepted that the receipts from the services rendered by the Assessee were in the nature of FTS. However, the AO concluded that in absence of FTS clause in the tax treaty, income should fall under Article 22 (i.e. other income) and should be taxed in India as FTS at 10% as per Section 9(1)(vii) of the IT Act.

### RULINGS OF THE ITAT

- ITAT held that where the business profits of a non-resident include items of income for which specific or separate provisions have been made in other articles of the tax treaty, then those provisions would apply to the items. However, if it is found that those provisions are not applicable then the items of income would have to be considered in Business Income Article.
- The ITAT observed that Assessee has brought on record the evidence which establish that services rendered by it are actually part of business activity and the Assessee does not have PE in India. Thus, where there is no FTS clause available in the treaty with a country, then the income in question would be assessable as business income, which can be taxed in India only if there is a PE in India.

**ELP Comments**

*The judgment underscores the position that the residual Article of 'Other Income' under the tax treaty can be invoked only if income does not fall within the ambit of any other Article of the tax treaty.*

## Delhi ITAT[3] holds that provisions of Section 56(2)(viib) of the IT Act would not be applicable to shares issued to a holding company

### FACTS OF THE CASE

- The Assessee had issued 1,00,000 Optional Convertible Preference Shares (**OCPS**) at INR 1,000 per OCPS to its 100% holding company. The Assessee received a premium of INR 9,90,00,000 on issue of OCPS.
- As per Section 56(2)(viib), share premium received by a company in excess of Fair Market Value (**FMV**) is taxable as income in the hands of the company issuing such shares. Accordingly, AO recomputed the FMV of OCPS at INR 639.17 as against INR 1,000/- per OCPS using NAV method and made an addition of INR 3,60,83,000/- u/s. 56(2)(viib) of the IT Act.

### RULINGS OF THE ITAT

- The ITAT after relying on the decisions of co-ordinate bench[4] held that where the allotment has been made to existing shareholders, the deeming provisions of Section 56(2)(viib) of the IT Act would not ordinarily be applicable.
- Further, the ITAT also agreed with the alternative plea of the Assessee, that NAV method is permissible only in case of issue of equity shares as per Rule 11UA(2) of the IT Rules and the premium charged would be negligible / Nil if shares are considered on diluted basis.

[2] Denso (Thailand) Co. Ltd v, ACIT (ITA No. 1986/Del/2023) (Delhi – Trib.)
[3] ITO v Solitaire BTN Solar (P.) Ltd. (ITA No. 1416/Del/2020) (Delhi – Trib.)
[4] BLP Vayu (Project-1) (P.) Ltd. v. PCIT [2023] 201 ITD 283 (Delhi - Trib.) & DCIT v. Kissandhan Agri Financial Services (P.) Ltd. [2023] 201 ITD 159 (Delhi - Trib.)

- On a common-sense approach, no purpose will be achieved by obtaining benefit by way of excess premium by the Assessee from its own 100% holding company. The purpose behind the insertion of deeming fiction u/s. 56(2)(viib) of the IT Act would not be achieved when the shares are allotted to the same set of shareholders.

**ELP Comments**

*This is a welcome judgement as it reinforces the relevance of the intent behind the enactment of any section and disregards the mechanical application of the anti-abuse provision.*

## INDIRECT TAX - RECENT CASE LAWS

### Bombay HC held that breakwater wall built to ensure the safety of jetty/ ship does not qualify as plant & machinery and thus, ineligible for ITC[5]

#### FACTS OF THE CASE

- The Petitioner is engaged in the regasification of LNG at their plant in Dabhol. LNG is imported via sea to the petitioner's captive jetty and then transferred to cryogenic storage tanks at the regasification plant. A breakwater is installed near the jetty to absorb sea waves and protect the jetty and nearby structures from damage.
- The petitioner sought an advance ruling from the Authority for Advance Ruling (**AAR**)[6], Maharashtra on eligibility to claim Input tax credit (**ITC**) for costs incurred on the reconstruction of the breakwater wall, arguing that it qualifies as plant and machinery. The AAR denied the ITC, stating that the breakwater is immovable property and not essential for the business operations. Accordingly, the Petitioner approached the Appellate Authority for Advance Ruling (**AAAR**)[7], Maharashtra which upheld the AAR's decision, ruling that the breakwater is not considered machinery or equipment in common or technical terms.
- Consequently, the Petitioner filed the present writ petition challenging the AAAR's decision.

#### RULING OF THE HIGH COURT

- The High Court held that the breakwater is constructed to ensure the safety of ships berthed at the jetty and also to allow ship to reach the jetty and remain safe at any point in time, even in extreme weather conditions. The term 'plant and machinery' refers to equipment used in manufacturing or production activities, while the breakwater is constructed solely to ensure the safety of the jetty. Though the breakwater wall is essential for safety, it cannot be classified as 'plant and machinery' as it does not facilitate making of any outward supply of goods or services.
- Accordingly, the High Court upheld the AAAR's order and dismissed the writ petition.

**ELP Comments**

*This ruling focuses on the term 'used for' in defining plant and machinery, emphasizing direct use in making outward supplies. Various judicial precedents[8] under the erstwhile regime have held that the expression 'used for' should be interpreted widely to include direct or indirect or active or passive use. The breakwater, essential for LNG unloading and business continuity, definitely supports operations. This case highlights the need for a more inclusive view of structures critical to business stability while opining on ITC eligibility.*

### Madras HC sets asides the order requiring reversal of ITC on a credit note issued by the supplier for post-sale discounts[9]

#### FACTS OF THE CASE

- The Petitioner received a Show Cause Notice (**SCN**) from the tax authorities regarding six defects in their tax filings. After responding, the Petitioner received an Order addressing all six defects. The Petitioner specifically challenged only defect no. 3 which deals with the reversal of ITC related to credit notes issued by the supplier.
- The Petitioner argued that the credit notes issued by the supplier were financial credit notes. The discount offered by the supplier did not fulfil the conditions laid down in Section 15(3) of CGST Act (which are further clarified by

[5] Konkan LNG Ltd vs. The Commissioner of State Tax and Ors [TS-397-HC(Bom)-2024-GST]
[6] TS-494-AAR-2019-NT
[7] TS-1281-AAAR-2019-NT
[8] Commissioner of Central Excise, Jaipur v. Rajasthan Spinning & Weaving Mills Limited, reported in [2010 (255) E.L.T. 481 (S.C.)], CC vs. Jawahar Mills Ltd reported in 2001 (132) ELT 3 (SC) and State of Punjab and Anr. v. British India Corporation Ltd. [AIR 1963 SC 1459]
[9] Tvl. Shivam Steels vs Assistant Commissioner [TS-384-HC(MAD)-2024-GST]

CBIC Circular No. 92/ 11/ 2019 - GST dated 07.03.2019 ('Circular 92')) and accordingly, this discount was not eligible for reduction from the value of supply. Hence, no reversal of ITC is required. The Order mistakenly concluded that the discount constituted as a service from the Petitioner to the supplier.

- The Respondent argued that the Petitioner should have appealed against all defects, asserting that selective challenges via writ petition are inappropriate.

**RULING OF THE HIGH COURT**

- The High Court acknowledged the existence of an alternate remedy (appeal) but concluded that filing of writ petition under Article 226 is not barred. The High Court found merit in the Petitioner's argument regarding defect no. 3, as it involved a pure legal issue that the Appellate Authority could not remand. Given the erroneous conclusion in the Order, the High Court opted to exercise jurisdiction on this specific matter.
- Upon examining Section 15(3), the High Court held that that the Petitioner has prima facie established that the requirements under Section 15(3) are not met. Consequently, the supplier is liable to pay tax on the full value of supply, and the financial credit notes do not warrant ITC reversal.
- It further held that the assessing officer's conclusion that the taxable person provided a service to the supplier by facilitating increased sales is erroneous and contrary to GST law.
- Accordingly, the High Court set aside the Order.

**ELP Comments**

*This ruling stresses the High Court's willingness to exercise jurisdiction under Article 226 in cases involving pure legal issues, even when an alternate remedy is available. It reaffirms that financial credit notes, issued when post-sale discounts do not meet the conditions specified in Section 15(3) of the CGST Act, do not necessitate ITC reversal. This position has been earlier clarified by various Authorities such as AAR, Andhra Pradesh[10], AAAR, Tamil Nadu[11], AAAR, Kerala[12] and Circular 105[13] (which was subsequently rescinded). The Court's rejection of the assessing officer's interpretation that the petitioner provided a service by facilitating increased sales upholds the established principles of GST law and aligns with industry practice.*

## Calcutta HC holds that payment of tax during search/ investigation etc is not voluntary and therefore, cannot be retained by Revenue without proper acknowledgement[14]

**FACTS OF THE CASE**

- The assessee made a payment of tax during the course of search but there was no intimation given to the assessee regarding non-payment or short payment of taxes. The assessee claimed they were compelled to pay INR 30,00,000/- under threat of arrest, coercion and undue influence during the course of search.
- Consequently, the assessee filed a writ petition seeking a refund of the amount paid during the search. However, the petition was dismissed. The assessee subsequently appealed against the dismissal of their petition.

**RULING OF THE HIGH COURT**

- The High Court held that, according to the Instructions[15] issued by the CBIC, there should generally be no circumstances necessitating the recovery of tax dues during course of search or inspection or investigation proceedings. Any voluntary payment by the taxpayer should be based on an accurate ascertainment of their

[10] Vedmutha Electricals India Pvt Ltd [2023 (6) TMI 1051 – AAR, AP]
[11] MRF Ltd [2019 (8) TMI 307 – AAAR, Tamil Nadu]
[12] Santosh Distributors [2021 (7) TMI 789 – AAAR, Kerala]
[13] Circular No. 105/24/2019-GST dated June 28, 2019
[14] ATR Malleable Casting Private Limited & Ors. Vs. Inspector of Central Taxes [TS-396-HC(Cal)-2024-GST]
[15] Instruction No. 1/2022-23 dated May 25, 2022

liability for non-payment/ short payment of taxes.

- In this case, such an ascertainment had not occurred and no intimation regarding non-payment or short payment of taxes was given to the assessee. Therefore, it was held that the payment of INR 30,00,000/- made during the course of search could not be considered voluntary. The High Court determined that the amount must be refunded, as it could not be retained by the revenue without proper acknowledgment.

**ELP Comments**

*This ruling aligns with prior judgments from various High Courts (Karnataka High Court[16], Delhi High Court[17], Madras High Court[18]), reinforcing that payments made during searches and investigations cannot be deemed voluntary. Tax authorities often compel taxpayers under coercion, but this ruling clearly states that such practices are unacceptable. Taxpayers must understand that payments cannot be forced during searches and should only be made based on a clear understanding of their actual tax liabilities.*

## Orissa HC permits rectifying errors occurred while filing of Form GSTR-1[19]

### FACTS OF THE CASE

- The Petitioner inadvertently reported the B2B supply for one of its customers under the head B2C when filing GSTR-1 for FY 2020-21 and 2021-22. Accordingly, the Petitioner requested the Authorities to rectify the GSTR-1 so that Customers could claim ITC.
- However, the Authorities denied the request, stating that the deadline for rectification of the forms had lapsed and no further indulgence could be granted to the Petitioner. Hence, the Petitioner has filed the writ petition.

### RULING OF THE HIGH COURT

- The High Court held that allowing the Petitioner to correct this error will not result in any loss to the Authorities, as there will be no loss of tax revenue involved, given that there is no tax escapement. The rectification is solely to benefit the ITC, enabling the Petitioner's customer to claim it. If the rectification is not allowed, it would unfairly disadvantage the Petitioner. Therefore, the High Court granted the permission to resubmit the corrected GSTR-1, changing the supply classification from B2C to B2B for FY 2020-21 and 2021-22. The Court allowed the petition and directed the authorities to accept the correction manually within four weeks.

**ELP Comments**

*In various instances in the Bombay High Court[20] , Karnataka High Court[21] and Orissa High Court[22] etc, taxpayers have been allowed to amend GSTR-1 even after the deadline for rectification to enable them to avail the benefit of ITC. This ruling aligns with that precedent, reinforcing the principle that genuine errors should not prevent taxpayers from correcting mistakes, especially when no tax revenue is at risk.*

[16] Bundl Technologies Private Limited vs. Union of India [WP No. 4467/2021]
[17] Vallabh Textiles vs. Senior Intelligence Officer & Ors. [WP No. 9834/2022], *Neeraj Paper Marketing Ltd vs. Special Commissioner, Department of Trade and Taxes, GNCTD & Ors [2023 (12) TMI 293 -Delhi High Court]*
[18] Shri Nandhi Dhall Mills India (P) Ltd vs. Senior Intelligence Officer, Director - [2021] 127 taxmann.com 31 (Madras)
[19] M/s Chintamaniswar Constructions Pvt Ltd, Bhubaneshwar vs. The Chairperson, CBIC & Ors [2024-TIOL-1124-HC-Orissa-GST]
[20] Star Engineers (I) Pvt Ltd vs. Union of India & Ors. [WP 15368/2023]
[21] M/s Wirpro Limited vs The Assistant Commissioner of Central Taxes & Ors [2023 (1) TMI 499 - KARNATAKA HIGH COURT]
[22] Shiva Jyoti Construction vs. The Chairperson, CBIC & Ors [WP No. 18216/2017]

## Andhra Pradesh AAR held that the supply of the aggregate and recovery of royalty charges are independent supplies[23]

### FACTS OF THE CASE

- The Applicant is engaged in the manufacture of aggregates from boulders purchased from licensed quarries and trading thereof. The quarry lease holders undertake the activity of mining and extracting boulders which are in turn sold to the applicant. The quarry lease holders are making a payment of royalty to the licensors of the mines at the rate of 18% and classifying the service under HSN 997337.
- While issuing tax invoice to the Applicant, the quarry lease holders are charging GST at the rate of 18% on royalty charges under HSN 997337 and GST at the rate of 5% under HSN 251710 on boulders value. A similar position has been adopted by the Applicant as well.
- However, the customers of the Applicant insisted that GST at the rate of 5% shall be charged on royalty charges contending that the transaction qualifies as a composite supply. Accordingly, the Applicant filed the application for advance ruling.

### RULING OF THE AAR

- The Authority held that the supply of the aggregate and recovery of royalty charges do not fall under the purview of mixed supply or composite supply but are two independent supplies.
- The Authority concluded that GST at the rate of 5% would be applicable on supply of aggregates and GST at the rate of 18% would be applicable on royalty charges.

**ELP Comments**

*If the transaction were treated as a composite supply leviable to GST at 5%, it could lead to accumulation of ITC as royalty on input side suffers 18% GST. The industry typically follows the practice of discharging GST at 18% on royalty charges and 5% on the supply of aggregates. While the ruling lacks detailed reasoning, it is nonetheless a positive outcome as it affirms the prevailing practice within the industry.*

## Andhra Pradesh AAR held that liquidated damages are liable to GST[24]

### FACTS OF THE CASE

- The Applicant is a licensed electricity distribution company. For maintenance and expansion of its transmission network, the Applicant enters into contracts with suppliers and contractors which generally includes clauses for imposition of penalties for delay or non-performance i.e. for recovery of liquidated damages.
- The Applicant sought an Advance Ruling on the issue of whether GST would be applicable on the penalties, i.e., liquidated damages collected by it for breach of contract.
- While placing reliance on various rulings[25] given during the service tax regime, the Applicant contended that receipt of liquidated damages on the grounds of breach of contract cannot be subjected to tax as the liquidated damages are not consideration for either tolerating an act or refraining from action.
- Further, the Applicant relied on Circular No. 178/ 10/ 2022-GST dated 03.08.2022 ('Circular 178') to contend that liquidated damages cannot be said to be a consideration received for tolerating the breach or non-performance of contract. They are rather amounts recovered for not tolerating an act or situation and to deter such acts. Thus,

[23] M/s R.V. Minerals, 2024 (7) TMI 152.
[24] M/s Transmission Corporation of Andhra Pradesh Limited, 2024 (7) TMI 155.
[25] Rajcomp Info Services Ltd. v. Principal Commissioner, CGST & C. Ex., Jaipur-I Reported In 2023 (73) G.S.T.L. 237 (Tri. - Del.); South Eastern Coalfields Ltd. v. Commr. Of C. Ex. & S.T., Raipur Reported In 2021 (55) G.S.T.L. 549 (Tri. - Del.); Madhya Pradesh Power Transmission Co. Ltd. v. Principal Commissioner of CGST & C. Ex., Bhopal Reported In 2023 (385) E.L.T. 152 (Tri. - Del.).

the said activity does not fall within the purview of Entry 5(e) of Schedule II.

**RULING OF THE AAR**

- The AAR held that various rulings[26] have been passed during the GST regime where it has been held that liquidated damages are to be treated as consideration for an act of tolerance of non-performance, and thus, liable to GST.
- With regard to the cases relied upon by the Applicant and Circular 178, the Authority held that these are not universal and absolute in nature. Further, placing reliance on para 7.1.6 of Circular 178, the Authority held that payments, even though they may be referred to as fine or penalty, are incidental to the main supply and if the main supply is taxable, they shall also be taxable and vice versa.
- The Authority, therefore, concluded that compensation amounts paid by the defaulting party to the non-defaulting party for tolerating the act of non-performance or breach of contract falls within purview of Entry 5(e) and thus, liable to GST.

**ELP Comments**

*This ruling contradicts the clarification provided in Circular 178, unsettling established law and potentially setting a negative precedent. Notably, all the rulings cited by the AAR were given before issuance of Circular 178, which explicitly states that liquidated damages should not be treated as consideration for tolerating a breach of contract. It is pertinent to note that the CESTAT Chennai[27] recently set aside the service tax demand on liquidated damages by relying on Circular 178, which further highlights the inconsistency in the AAR's ruling.*

## Madras HC confirms validity of timely filed online appeals despite late submission of hard copy[28]

**FACTS OF THE CASE**

- The application for refund claim was rejected on 13.04.2022 against which the Petitioner filed an appeal before the Appellate Authority online on 29.06.2022 which was within the allowable time limit of three months provided u/s. 107 of CGST Act read with Rule 108 of CGST Rules. However, the hard copy of the appeal was submitted on 23.05.2023. The Respondent rejected the appeal on the ground of delayed physical submission of documents. Accordingly, the Petitioner has challenged the appellate order through a writ petition.
- The Petitioner argued that the appeal was filed within the prescribed time limit and contended that late submission of the hard copy constituted a procedural lapse, which should not invalidate the appeal.

**RULING OF HIGH COURT**

- The High Court held that Rule 108 clearly indicates that the requirement of filing of the order appealed against only becomes applicable where the order is not uploaded on the GST Portal. In the instant case of the Petitioner, the copy of the order was duly uploaded on the GST portal and thus, online filing date should be considered as the date of filing the appeal. It was further ruled that the procedural delay in submitting the hard copy should not undermine the validity of the appeal.
- Consequently, the Madras HC annulled the Order and directed the Respondent to consider and dispose of the appeal on its substantive merits.

[26] Maharashtra State Power Generation Company Ltd., [2018 (70 GST 411)]; Fastrack Deal Comm (P.) Ltd. (GUJ/GAAR/R/58/2020); Amneal Pharmaceuticals (P.) Ltd. (GUJ/GAAR/R/51/2020).
[27] M/s. Bharat Heavy Electricals Limited v. The Commissioner of G.S.T and Central Excise [Service Tax Appeal No. 41500 of 2019].
[28] M/s Sunbeam Generators Pvt. Ltd. v. The Additional Commissioner (Appeals-I), Nungambakkam, Chennai [WP No. 16140 of 2024].

**ELP Comments**

*This judgment underscores that procedural lapse, such as the late submission of hard copies, should not invalidate appeals that are timely filed online. The ruling emphasizes the importance of considering the substance over procedural technicalities to ensure justice is served.*

*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:*

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