ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

RECENT DEVELOPMENTS IN DIRECT TAX & INDIRECT TAX

Contents

DIRECT TAX - RECENT CASE LAWS

Tribunal [1]rejects Scheme of Amalgamation for not being in public interest

FACTS OF THE CASE

- Hologram Holdings Private Limited (Transferor Company 1), Swen Holdings Private Limited (Transferor Company 2), and Sulphur Securities Private Limited (Transferee Company) ('together referred to as 'Applicant Companies') had filed a Scheme of Amalgamation (Scheme) with the National Company Law Tribunal, Chandigarh bench ('Tribunal') for approving the Scheme.
- Applicant Companies were in the business of buying, selling, transfer of shares, stocks, bonds, debentures etc and also provided financial services like investment planning, portfolio management consultancy etc.
- The rationale for the Scheme was stated to consolidate their business operations to achieve business synergies, reduction of cost of overheads and to consolidate managerial expertise of the companies.
- As per the report filed by the Income Tax Department ('ITD') before the Tribunal, the Applicant Companies had substantial outstanding tax demands against them for past years. Further the said report alleged that the Transferee Company is a conduit / shell Company. Further there were allegations of fund routing in excess of INR 500 crores and banking transactions reflecting transfer of funds to other Companies allegedly belonging to the same group of Companies. Further, majority of the non-current investments were made in the group Companies, which found to be registered at the same address.
- Basis the ITD report, the Tribunal directed the Registrar of Company (ROC), Delhi and Haryana to conduct the physical verification of the Registered and Corporate Office of the Transferee Company. The ROC in its report observed that no real office exited at the site except for display board mentioning names and CIN of 10 Companies including the name of the Transferee Company.

APPLICANT COMPANIES'S RESPONSE

- The Applicant Companies submitted that the Transferee Company was not a conduit paper Company as it had been regular in filing the return of income tax and filing of balance sheet and annual returns with the ROC and other authorities on time since the date of incorporation.
- The Applicant Companies also Transferee Company undertakes unconditionally and irrevocably to pay the entire demand of income tax of the Transferor Companies as well as Transferee Company if the appeal filed against the said demand is decided in favour of the Income Tax Department. The same was also captured in the Scheme of Merger.

TRIBUNAL OBSERVATIONS

- The Tribunal analysed the financials of the Applicant Companies and found that there was a jump in the profits of the Transferee Company which was not backed by either a credible source of investment or actual assets in the Company.
- The Tribunal concurred with the report of the ITD which stated that there were merely accommodation entries among a clutch of Companies being controlled by one individual.
- The Tribunal observed that given the minimal administrative cost which was far below the industry standards and the inter-se transactions between the Applicant Companies, the stated rationale of achieving the lower overhead costs and attain synergies was not tenable.

TRIBUNAL DECISION

- The Tribunal rejected the application of scheme of amalgamation as it found to be beneficial to its promoters only and were not in the public interest and concluded that the amalgamation was only proposed to legitimise the paper transactions, avoiding the payment of due taxes and for laundering the money.
- The Tribunal also relied on some of the NCLAT/NCLT decision[2] where it was decided that Tribunal has the power to either approve or reject the scheme basis the scheme being just and fair and in the public interest.

[1] LSI-746-NCLT-2024-(CHD)

[2] Wiki Kids Ltd. And Ors. Vs. Regional Director, Southeast Region and Ors. 21.12.2017
Gabs Investments Pvt Ltd. And Ajanta Pharma Ltd. 30.08.2018

- Income tax authorities are like any other creditor may stake their claim before liquidator in the statutory limitation period provided under the IBC Code.
- Restored the matter back to CIT(A) for passing order afresh.

ELP Comments

- *Rejection of the Scheme approval by the Tribunal highlights the importance of legitimacy and genuity in a proposed Scheme of Arrangement. There have been judgements in the past where the Courts have held that a Scheme may not be rejected where the same has been approved by its shareholders and creditors.*
- *It may be pertinent to note that this judgement is in the context of private Companies where the Scheme has been rejected on the premise that the Scheme is not in public interest.*

Bombay High Court [3]upholds income from 'owned' property as 'Income from House Property' vis-à-vis 'Business Income' regardless of assessee being in the business of leasing and hiring.

FACTS OF THE CASE

- Assessee was engaged in the business of leasing and hiring of properties and the rental income thereof were offered as 'Business Income'.
- In respect of a self-owned property, assessee year on year offered the income under the head 'Income from House Property' which was also accepted by the revenue in past assessments.
- For the assessment year in question, the assessing officer (AO) did not accept the income from self-occupied property as 'Income from House Property' and treated the same as 'Business Income'.
- The Commissioner of Income-tax (Appeals) ['CIT(A)'] confirmed the view taken by AO against which assessee filed an appeal before Income-tax Appellate Tribunal (ITAT) where the ITAT decided the issue in favour of assessee and ruled that the benefit of Section 22 of the Income Tax Act, 1961 (ITA) should be available to the assessee. Further, the AO should not take a reverse position without a valid reason when the same has been accepted as income from house property in the past years.
- Aggrieved by the order of the ITAT, revenue filed an appeal before the High Court.

REVENUE'S CONTENTION

- The revenue department submits before High Court that the income from the self-owned property must have been offered to tax under the head 'Business Income' as the primary business of the assessee was of letting out the properties and deriving income therefrom.
- It urged that the provisions of section 22 of the ITA permit a distinction in categorizing income under different heads.
- The department relied on ruling of Hon'ble Supreme Court[4], which dealt with chargeability of income from letting out of properties as 'Business Income' and not 'Income from House Property' if the main object of Company as per memorandum of association was to acquire properties and to earn income from letting it out.

ASSESSEE'S CONTENTION

- The assessee submitted that section 22 of the ITA does not make any distinction on the basis of the assessee's business.
- Further, it submitted that AO accepted the assessee's treatment to tax the same income under income from house property without any material change in the circumstances in the assessee's own case in the previous 3 years. So, revenue's contrary view in the present case was not accepted on the ground of principle of consistency.

HIGH COURT RULING

- The basic requirement of section 22 of the ITA to consider the rental income as 'Income from House Property' was satisfied as the property was 'owned' by the assessee.
- Assessee can categorize the rental income from self-owned property as 'Income from House Property' and rental income from other than self-owned properties as 'Business Income'.
- Revenue's reading of section 22 differently for those in the business of letting out properties would amount to reading something into section 22 than what the provision actually ordains.
- High Court agreed with the ITAT's decision passed in the favour of assessee applying the principle of consistency where AO had accepted the assessee's treatment of charging rental income from self-occupied property as 'Income from House Property' in the previous years.
- Appeal filed by the revenue was dismissed and ruled in favour of the assessee.

[3] Pr. Commissioner of Income Tax-3 Mumbai Versus Banzai Estates P. Ltd. 2024 (8) TMI 365- Bombay High Court
[4] Chennai Properties & Investment Ltd. v. Commissioner of Income-tax, Central-III, [2015] 56taxmann.com 456 (SC)

ELP Comments

- *The High Court has clarified that where the property is 'owned', the income therefrom would be subject to tax under the head 'Income from House Property' and not under the head 'Business Income' even if the taxpayer is in the business of leasing and hiring of properties.*
- *It is pertinent to note that as per the amendments proposed under Finance Bill (No.2) 2024, any income from letting out of 'Residential property' is proposed to be taxed under the head 'Income from House Property'. This may apply even in cases where properties are not actually owned.*

INDIRECT TAX - RECENT CASE LAWS

Gauhati High Court[5] holds that the purchasing dealer cannot be punished in case the selling dealer fails to deposit the tax

FACTS OF THE CASE

- In a batch of Writ Petitions, the taxpayers had *inter alia* challenged the provisions of section 16(2)(c) of the Central Goods and Services Tax Act, 2017 ("CGST Act") before the Hon'ble Gauhati High Court.
- Section 16(2)(c) of the CGST Act states that Input Tax Credit (ITC) will only be available to the recipient if the tax charged in respect of the said supply has been actually paid to the Government.
- Under the GST law, there arose multiple circumstances where the recipient (viz. the purchasing dealer) was being denied the benefit of ITC on account of non-filing of return/ non-payment of taxes by the supplier (viz. the selling dealer). ITC was denied by the Department by relying upon section 16(2)(c) of the CGST Act even though the purchasing dealer was not at fault.

RULING OF THE HIGH COURT

- The Hon'ble Gauhati High Court relied upon the judgment of the Delhi High Court in the case of **On Quest Merchandising India Private Limited vs Govt. of NCT of Delhi [2017 SCC Online Del 11286]** wherein it was *inter-alia* held that a purchasing dealer cannot be punished for the act of the selling dealer in case the selling dealer fails to deposit the tax collected by it.
- The judgment of the Delhi High Court in the case of **On Quest Merchandising *(supra)*** was passed under the VAT regime. The Delhi High Court had *inter-alia* held that section 9(2)(g) of the Delhi VAT Act, 2004 must be "read down" and demand raised against purchasing dealers, who have entered into *bona fide* transaction cannot be sustained. It would be pertinent to note that section 9(2)(g) of the Delhi VAT Act is analogous to 16(2)(c) of the CGST Act. The Departmental SLP (against the Delhi High Court judgment) has also been dismissed by the Supreme Court and hence the matter has attained finality.
- Following the ratio laid down in the case of **On Quest Merchandising (supra)**, the Hon'ble Gauhati High Court has held that the purchasing dealer cannot be punished in case the selling dealer fails to deposit the tax. However, the Department would be free to act in those cases, where the purchase transactions are not *bona fide*.
- The legal question apropos the constitutional validity of section 16(2)(c) of the CGST Act has been kept open.

ELP Comments

- *The judgment comes as a sigh of relief for taxpayers who are facing proceedings for denial of ITC even though they have remitted the tax to the respective supplier. Similar view has recently been taken by the Hon'ble Calcutta High Court[6], Hon'ble Kerala High Court[7] and the Hon'ble Madras High Court[8].*
- *The judgment is also line with the Press Release dated 4 May 2018 (issued pursuant to the 27th GST Council Meeting) which stated that there should not be any automatic reversal of ITC from buyer on account of non-payment of tax by seller.*

Madras High Court[9] upholds Customs AAR-ruling on the classification of components/parts/sub-assemblies of motor vehicles, imported by BMW from group companies

FACTS OF THE CASE

- The assessee-importer is a car manufacturer who had significantly changed its procurement model wherein under the new business model, it intended to domestically procure six essential components/ of motor vehicles viz. (i) engine (along with engine and transmission unit) (ii) axle assembly (iii) exhaust systems (iv) cooling module (v)

[5] National Plasto Moulding vs The State of Assam [TS-469-HCGAUH-2024-GST]
[6] Suncraft Energy Pvt. Limited vs Asst. Commissioner [2023 8 TMI 174 (Cal HC)]
[7] Diya Agencies vs STO [2023 (9) TMI 955 (Ker HC)]
[8] D.Y. Beathel Enterprises [Madurai Bench of Madras High Court – W.P. No. 2127 of 2021]
[9] 2024 (7) TMI 1325 - MADRAS HIGH COURT.

heating, ventilation and air-conditioning unit and (vi) door panels, from independent third-party vendors in India. The domestic vendors shall manufacture and sell these essential parts to the assessee for the manufacture of motor vehicles. The remaining parts were imported by the assessee-importer.

- The assessee sought an advance ruling, *inter-alia*, on the following questions (a) Whether the import of components / parts / sub-assemblies will be classified as motor vehicle under Tariff Heading 87.03 and (b) If the import of components / parts / sub-assemblies will not be classified as motor vehicle, whether the imports will be classified under their respective headings / sub-headings of the Customs Tariff Act, 1975 or under Tariff Heading 87.08?
- In 2015, the Customs Authority for Advance Ruling **(CAAR)** ruled that the import of such components/parts/sub-assemblies will not be classified as "motor car" under CTH 8703 when 6 essential items are to be locally assembled/manufactured by local 3rd party vendors. The import of components/parts/sub-assemblies by the assessee will be classified under their respective headings/sub-headings of the Customs Tariff Act, 1975.
- The Revenue challenged the advance ruling by filing a writ petition before the Hon'ble Madras High Court.

REVENUE'S CONTENTION

- The advance ruling application was not maintainable as the jurisdiction of CAAR under Section 28E(b) of the Customs Act, 1962 is to determine a question in relation to a proposed "activity" of import; that business of import by assessee is already in existence and as such there is no proposed activity.
- As per Rule 2(a) of the General Rules for the Interpretation of the Tariff (**GRI**), incomplete vehicles in unassembled form should have been classified under CTH 8703 as motor vehicles as the imports bear the essential character of motor vehicles and thus cannot be classified as import of its parts.

IMPORTER'S CONTENTION

- The transaction structure of the assessee has undergone a significant change, as under the proposed model, more than 40% of the value of motor vehicle being locally sourced, including the six essential components. That the term "activity" is inclusively defined and hence, must be widely interpreted to include any new business of import proposed to be taken by an existing importer.
- The issue of maintainability of the application cannot be raised as the Misc. Order admitting the application was never challenged before the High Court.
- The imported goods lack the most essential components and in their absence, it is incomprehensible to say that the incomplete or unfinished vehicles (as may be) resemble the essential character of a motor vehicle. Thus, imported goods do not fall under CTH 8703 by application of Rule 2(a). Reliance was placed on *Circular No. 528/128/97 – Cus* dated 05.12.1997.
- Rule 2(a) is applicable where (a) only assembly operations are involved irrespective of the complexity of assembly methods and (b) components themselves are not subjected to further operations. In the instant facts, the six essential components will undergo complex manufacturing operations by domestic vendors who undertake manufacturing activity at their factories.

RULING OF THE HIGH COURT

- A conjoint reading of Section 28E(a) and (b) of the Customs Act shows that the object of constituting CAAR is to give a ruling in advance to remove uncertainty in the mind of an applicant and eliminate the possibility of a dispute before any dispute arises. The term "activity proposed to be undertaken" would include any new business of import/export proposed to be undertaken by existing importer.
- The expression "business" employed in Section 28E must be given a wide meaning to include new model/pattern/modus of import and not business qua product.
- *Sans* a challenge to a Miscellaneous Order admitting the application of the assessee, it is not now open to challenge the maintainability of application after final ruling is issued.
- The import of parts and components cannot be understood as that of motor vehicles when six essential components are being procured from vendors in India. In absence of specified six essential parts, the imports cannot be stated to possess "essential character" of motor vehicle The *sine qua non* for the application of Rule 2(a) of the GRI is that any imported article, which is "as presented", must have the essential character of the "complete or finished article".

- The decision in ***Westinghouse Saxby vs. Commissioner of Central Excise [(2021) 5 SCC 586]*** is distinguishable as the said case dealt with the interpretation of Rule 3 of the GRI and not Rule 2(a).

ELP Comments

*The High Court in its detailed judgment has, by applying the decisions in **Commissioner of Customs vs. Sony India [(2008) 13 SCC 145]** and **L.G. Electronic India Pvt. Ltd. & Ors. vs. Commissioner, Central Excise, Noida-II [(2023) 6 Centax 183 (Tri. -All)] ,** appropriately elucidated that Rule 2(a) of the GRI cannot be invoked to classify parts as complete article, when all the components of the complete article are not presented together at same point in time and thus, the sine qua non for the application of Rule 2(a) is that any imported article which is "as presented", must have the essential character of the "complete or finished article." This decision would have larger ramification on the industry as similar issues are pending at various levels of adjudication/litigation.*

Nine-judge bench of Supreme Court[10] clarifies that States can recover past tax dues on mineral rights only until 1 April 2005

FACTS OF THE CASE

- On 25 July 2024, the nine-judge bench of the Supreme Court pronounced its judgement in the case of **Mineral Area Development Authority & Anr. v. Steel Authority of India & Anr.** (with an 8:1 majority) (in short **'MADA judgment'**) *inter alia* holding that royalty is not a tax. It also held that the power to levy tax on mineral rights vests with the State legislature under Entry 49 and 50 of List II of the Seventh Schedule of the Constitution of India.
- The MADA judgment, therefore, overruled the previous judgment of the seven-judge bench Supreme Court in the case of **India Cement Limited vs State of Tamil Nadu[11] (**in short **'India Cement judgment')** which had held that royalty is a tax.
- An issue arose as to whether the MADA judgment should be given prospective effect or not.

ASSESSEE'S CONTENTION

- It was contended by assessee's that India Cement judgment (1989) held the field for 35 years before it was overruled in MADA (2024).
- Demand for tax under state legislation pertaining to Entry 49 and 50 of List II of the Seventh Schedule had been stayed in terms of the law laid down in India Cement judgment. If State legislatures are allowed to renew the tax demands, end consumers will ultimately bear the burden.
- Since 2015, entities bidding for mineral concessions have submitted their financial bids on the basis of the legal position in India Cement judgment. If MADA is given retrospective effect, it will rewrite commercial bargains underpinning the mineral auctions.
- The doctrine of prospective overruling is well-established in Indian constitutional jurisprudence.
- It was also contended by assessee's that no new tax demand should be made for the period before the MADA judgment (i.e. 25 July 2024).

STATE'S CONTENTION

- The doctrine of prospective overruling is applicable only when the judgment invalidates a legislation or introduces a new interpretation by overruling its earlier decision. The doctrine of prospective overruling has never been applied to situations where the declaration of law attaches validity to an existing tax legislation.
- If MADA judgment is applied prospectively, the consequence will be that India Cement judgment will have to operate till 25 July 2024. Resultantly, all relevant state legislation will be tested on the anvil of India Cement judgment and may be declared *ultra vires*. This consequence is unjust and against public interest. It is important to protect the financial interests of the State as well.

[10] Order dated 14 August 2024 passed by nine-judge bench of the Mineral Area Development Authority & Anr. Vs Steel Authority of India Limited & Anr.
[11] 1990 (1) SCC 12

JUDGMENT OF THE SUPREME COURT

- The doctrine of prospective overruling has been applied by the Supreme Court in situations where the new declaration results in the invalidation of legislation, which would otherwise have been valid under the old declaration.
- The doctrine of prospective overruling is generally not applied while upholding the legislative competence of the legislature.
- There is always a presumption of constitutionality in favour of a statutory enactment. It is based on the theory that the elected representatives are aware of the needs of the citizens and are best placed to frame policies to resolve them. Legislation represents the will of the people and cannot be lightly interfered with unless it transgresses constitutional principles.
- If MADA judgment is applied prospectively, it would result in a situation where the legislation enacted by the States may be invalidated based on a position of law which has been overruled. This would not be a constitutionally just outcome.
- Bearing in mind the consequences that would emanate and the huge delay in proceedings, the Supreme Court *inter-alia* held that:
  - While the States may levy or renew demands of tax in terms of the MADA judgment, the demand of tax shall not operate on transactions made **prior to 1 April 2005**;
  - The time for payment of tax shall staggered in instalments over a period of twelve years commencing from 1 April 2026;
  - The levy of interest and penalty on demands made for the period before 25 July 2024 shall stand waived for all the assesses (regardless of whether they have challenged the levy or not).

ELP Comments

- *Given the peculiar facts of the case as well as the lapse of more than three decades since the India Cement judgment, the Supreme Court has adopted a pragmatic approach. The retrospective levy of tax on mineral rights by States is likely to impose severe financial burden on bidders including many public sector enterprises.*
- *While recognizing the right of the States to levy tax for transactions made on or after 1 April 2005, interest and penalties have been waived. Further, the assessee's have been permitted to pay tax in instalments over a period of 12 years.*
- *Based on statement made by the Solicitor General of India during the proceedings, it appears that many States may forego tax dues that accrued before the MADA judgment. The Supreme Court has left it to the prerogative of the State legislatures to determine whether to forego the dues for the period before 25 July 2024.*

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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