EY Tax and Regulatory Alert

December 2020

Prepared for ACMA

Contents

S. No.	Particulars	Description
Part A	**Key Tax Updates**	
1.	**Goods and Services Tax (GST)**	Key Circulars and Notifications • Notification issued in relation to waive penalty payable for noncompliance QR Code on B2C transactions till 31.03.2021 • Notification issued in relation to products for which 8 digit HSN Code shall be included in GST Invoice • Notification issued in relation to time limit for compliances and actions by any authority in respect of anti-profiteering measures u/s 171 due from 20.03.2020 to 30.03.2021 is extended to 31.03.2021 • Notification issued in relation to provisions of Section 119, 120, 121, 122, 123, 124, 126, 127 and 131 of the Finance Act 2020 thereby amending the provisions of CGST Act shall come into effect from 01.01.2021 • Trade Circular on General Procedure for GST Audit under Section 65 of Maharashtra GST Ace, 2017
2.	**Customs and Foreign Trade Policy**	Key Circulars and Notifications • Instruction issued for verification of Preferential CoO in terms of CAROTAR Rules • Instruction issued for processing of duty-drawback in 3 days, implements NCTF's recommendation.
3.	**Direct Tax**	Key circulars and notifications • CBDT issues second round of Frequently Asked Questions in relation to "Direct Tax - Vivad Se Vishwas Act 2020" • CBDT to validate ICAI generated UDIN for uploading Tax Audit Report (vide Press Release dated 26-11-2020
4.	**Regulatory**	Key Circulars and Notifications • Reserve Bank of India ("RBI") amends Foreign Exchange Management (Export and Import of Currency) Regulations, 2015 ("FEMA 6R") • Department of Economic Affairs ("DEA"), Ministry of Finance ("MOF") amends Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("NDI Rules")

Part B	Judicial Precedents	
	Goods and Services Tax (GST)	
1.	**M/s. Surat Mercantile Association [T[TS-1049-HC-2020(GUJ)-NT]**	Ruling wherein the High Court writ petition filed wherein the Association has challenged the constitutional validity of Section 16(2)(c) of CGST Act, 2017 which imposes restriction on the buyer which states that the credit shall be availed only when the tax on the transaction has been paid to the exchequer.
2.	**M/s. Material Recycling Association of India [2020(8)TMI11]**	Ruling whether the provisions of Section 13(8)(b) r.w.s. 2(13) and 8(1) of the IGST Act,2017 are ultra vires and unconstitutional or not.
3.	**M/s Malyalam Motors Pvt. Ltd. [TC-1077-HC-2020(KER)-NT]**	A writ petition was filed allowing to discharge tax liability in equal successive monthly instalments.
	Direct Tax	
1.	**Aesseal India Pvt. Ltd (Taxpayer)- Pune ITAT [TS-601-ITAT-2020(PUN)]**	Pune Tribunal allows capitalization of forex loss on external commercial borrowings deployed for acquisition of domestic capital assets in pre-ICDS era
2.	**Biocon Ltd (Taxpayer)- Karnataka HC [TS-608-HC-2020(KAR)]**	Karnataka HC upholds Special Bench ruling allowing ESOP discount as a deductible expenditure
3.	**Amarchand & Mangaldas & Suresh A Shroff & Co[1] (Taxpayer), a partnership firm- Mumbai ITAT- [TS-666-ITAT-2020(Mum)]**	Mumbai Tribunal grants tax credit for taxes withheld in Japan on professional income; endorses uniform interpretation of tax treaty
4.	**M/s Abbey Business Services India Pvt Ltd (Taxpayer)- Karnataka HC- [TS-655-HC-2020(KAR)]**	Expense on reimbursement on seconded employees is not FTS, hence No TDS to be deducted; Distinguishes from Centrica ruling

INDIRECT TAX

Part A - Key Indirect Tax updates

Goods and Services Tax

This section summarizes the regulatory updates under GST for the month of December 2020

- **Notification No. 89/2020, dated 29.11.2020** issued by CBIC, to waive off penalty for Non-compliance with QR Code on B2C transactions from 01.12.2020 till 31.03.2021.

- **Notification No. 90/2020, dated 01.12.2020** issued by CBIC, to specify the products for which the taxpayer has to include 8 digit HSN Code in Tax Invoice.

- **Notification No. 91/2020, dated 14.12.2020** issued by CBIC, **to extends the due date to 31.3.2021, for compliances and actions by any authority in respect of anti-profiteering measures u/s 171 due from 20.03.2020 to 30.03.2021.**

- **Notification No. 92/2020 and 94/2020, dated 22.12.2020** issued by CBIC, to amendments in Central Goods and Service Tax Rules, 2017. Some of the key relevant changes are highlighted below –

- Restriction on availment of Input Tax Credit (ITC) as per Rule 36(4) of the CGST Rules 2017 (limited to 105% of the matched credits w.e.f. 1 January 2021)

  - The claim of ITC in respect of invoices not furnished by the corresponding vendors has now been reduced to 5% from the existing 10%.
  - Further, the words 'uploaded' (in the context of uploading of Form GSTR-1 by the suppliers) have now been replaced with the word 'furnished'. This could imply that the vendors shall now be required to 'file' their return in Form GSTR 1 as opposed to cases where records would have been saved/uploaded on the portal but return may not have been filed. (Please note that the status of records saved or filed can be checked basis Form GSTR 2A by the recipient).

- Suppliers shall not be allowed to file return in Form GSTR 1, if the return in Form GSTR 3B has not been filed for preceding two months. The said rule shall ensure timely tax payment by the suppliers by filing Form GSTR 3B on timely basis (to be effective from a date to be notified).

- Restrictions on use of amount available in the Electronic Credit Ledger (Introduction of Rule 86B in the CGST Rules with effect from 1 January 2021)

  - The rule has been introduced to restrict utilisation of available balance in the Electronic Credit Ledger for discharge of output liability.
  - If turnover of taxable supplies (other than exempt supply and zero-rated supply) is more than INR 50 Lacs in a month, then not more than 99% of the amount available in the Electronic Credit Ledger can be used to set-off the outward liability.
  - The above restriction, however, shall not apply in below cases -

    (a) businesses/stakeholders have paid more than INR 1 lacs as income tax liability in the preceding 2 years;

    (b) taxpayers (registered under GST) who have received a refund of more than INR 1 lacs on account of unutilised input tax credit either as a supplier of zero-rated services or on account of inverted Duty Structure in the preceding financial year;

(c) businesses where at least more than 1% of the total output tax liability has been paid in cash in the current year applied cumulatively, up to the said month in the current financial year;

(d) where registered person is a Government Department, PSU, local authority or statutory body.

Note: The above rule could have been introduced to restrict taxpayers who have availed fraudulent tax credits, while providing relief to taxpayers with proven track record. As an impact, there could be potential cash flow challenges to taxpayers (who do not fulfil the above conditions) and therefore one may need to analyse the impact of said rule in more detail.

- Changes in e-waybill related rules (amendment in Rule 138/138E of CGST Rules - Narrowing the validity of an e-waybill)

- With effect from 1 January 2021, the validity of an e-waybill has been reduced insofar as the erstwhile limit of 1 day validity for a distance of upto 100 kms has now been increased to 200 kms. This means that only 1 day validity shall be provided to cover a distance of 200 kms (as against 100 kms prevalent hitherto).

- Further, Rule 138E which restricts generation of an e-waybill for default in filing of returns, has now been amended to provide that the portal will restrict e-waybill generation if the businesses have not furnished the return whether in Form GSTR 1 or Form GSTR 3B for the consecutive two tax periods (instead of earlier two months). Persons whose registration has been suspended under Rule 21(1)/(2)/(2A) are also restricted from generation of e-waybill (to be effective from a date to be notified).

- Changes in the process of obtaining a new registration under GST (amendment in Rule 8(4A) of the CGST Rules – to be effective from a date to be notified)

- The registration provisions are being amended to include biometric-based Aadhaar authentication and obtaining photograph in case where applicant has opted for Aadhaar authentication.

- In case, where Aadhaar authentication is not opted for, verification of specified KYC documents shall be carried out.

- Further, in addition to the above, verification of the original copy of the documents uploaded with the application in FORM GST REG-01 shall also be done at one of the Facilitation Centres to be notified.

- Increase in time limits for granting of GST registration (amendment in Rule 9 of the CGST Rules)

- The time for system-based registration has been enhanced from 3 days to 7 days. This would mean that, the department shall be required to review and grant registration within 7 days against 3 days as provided earlier from the date of filing of registration application.

- Further, where the applicant does not opt for Aadhaar authentication or where department feels fit to carry out physical verification, the time limit for grant of registration shall be 30 days instead of 7 days.

- Inclusion of instances where a GST registration can be cancelled (amendment in Rule 21 of the CGST Rules)

The rule has been amended to include instances where GST registration can now be cancelled, where –

Input Tax Credit has been availed by a registered person in violation of the provision of

Section 16 of the CGST Act 2017 or rules made thereunder.

- Liability declared in Form GSTR 1 is in excess of liability declared in Form GSTR 3B for one or more tax periods (please refer note below).

- Registered person has violated the provisions of Rule 86B (discussed above).

Note: There could be cases where liability declared in Form GSTR 3B is different from the one declared in Form GSTR 1 on account of various adjustments (such as adjustment of prior period liability). Therefore, operation of this rule may need to be explored further in such instances.

- ▶ Changes in rule relating to suspension of GST registration (amendment in Rule 21A of the CGST Rules)

- In case where proper officer has reason to believe that the registration of person is liable to be cancelled, the opportunity of being heard shall not be granted in such cases.

- Further, basis comparison/analysis of the liability declared in Form GSTR 3B with outward details furnished in Form GSTR 1 and inward details furnished in Form GSTR 3B with the details appearing in Form GSTR 2A/2B and such other analysis as may be notified, which results in significant differences or anomalies indicating contravention of the provisions of the Act or rules, the registration shall stand suspended and an opportunity shall be provided to the taxpayer to explain such differences before registration is restored.

Also, vide Notification No 92/2020-Central Tax dated 22 December 2020, various provisions of the Finance Act, 2020 (No. 12 of 2020) have been notified with effect from 1 January 2021. Amongst others, Section 16(4) of the CGST Act has been amended to delink availment of ITC on debit notes with reference to the date of issuance of the original invoice. This would mean that the time limit for availing Input Tax Credit in case of debit notes will not be required to be ascertained with reference to the date of the original invoice and the same will be required to be calculated independently in accordance with the provisions of Section 16(4) of CGST Act, 2017.

- ▶ Other provisions inserted vide Finance Act 2020 notified with effect from 01.01.2021

- Persons voluntarily registered under GST can also make an application for cancellation of registration.

- Commissioner/Additional Commissioner/Joint Commissioner are empowered to extend the time limit for making application for revocation of cancellation of registration subject to sufficient cause shown.

- Proviso to Section 31(2) that which enables the power to Government to specify the category of services or supplies where Tax Invoice shall be issued within such time and in such manner (This proviso provides legal backing to Rule 54(4) - E-ticketing requirements for admission to exhibition of cinematographic films in multiplexes).

- TDS Certificate shall be furnished by the deductor to the deductee in prescribed form and manner.

- Certain Penal provisions - Section 122(1A) & 132.

- ▶ **<u>Trade circular No. 13/2020, dated 21.12.2020</u>** issued on General Procedure for GST Audit under Section 65 of Maharashtra GST Act, 2017.

The relevant contents of the above-said Trade Notice have been briefly stated hereunder:

- Procedure of GST Audit

- The GST audit is carried out with prior information to the RTP which is the notice of information to the RTP in form ADT – 01

- Along with the ADT-01, the AO may also call for certain information which the RTP should keep ready at the time of visit or may send in advance physically or through mail to the Audit Officer.

- Scope of Audit

- The AO will ascertain the correctness of Returns and Annual Returns filed by the dealer under GST Act which includes:

(a) verification of books of accounts maintained by the RTP
(b) verification of sale invoices and purchase invoices i.e. Outward & Inward supplies
(c) verification of sales purchase journals ledger, cashbook
(d) verification of delivery challans, e-way bills, dispatch proofs
(e) verification of bank statements and every other document or piece of evidence to ascertain the correctness of turnover and the correctness of claims made through returns.

- The AO is expressly authorised to make enquiry as to whether the RTP has filed returns and made payments under other allied laws, such as Profession Tax, etc. Depending upon the facts the auditor may also ask for returns or any other information related to Income Tax, and filings under the Companies Act also if it is required for GST related compliances, etc.

Customs and Foreign Trade Policy (FTP)

This section summarizes the regulatory updates under Customs and FTP for the month of December 2020

- **Instruction No. 20/2020, dated 17.12.2020** issued by CBIC, for verification of the Preferential CoO in terms of CAROTAR Rules, 2020, pursuant to receipt of significant number of verification requests being returned on account of being deficient leading to delay in verification process and adversely impacting trade facilitation. States the common grounds on which requests are being returned to filed formations

(i) the scanned documents are found to be illegible,
(ii) the certificates are being signed and sent without requisite covering letter to indicate the nature of request or
(iii) the bulk CoOs are sent rather than representative CoOs as required in terms of Board's Circular no. 38/2020 dated 21.08.2020; Directs that where a reference for verification is made to the Board in terms of Rule 6 of CAROTAR, 2020, the same should be complete and follow the established standard operating procedures, prescribed format and timelines, that all proposals should be duly vetted to ensure valid grounds of verification; Explaining that representation from trade are still being received about difficulties being faced on account of multiple queries, suggests to sensitize Officers to ensure that enquiry on origin of the imported goods is initiated only when there are sufficient grounds to suspect origin of a good or where same has been identified as a risk by Risk Management System.

- **Instruction No. 21/2020, dated 16.12.2020** issued by CBIC, for time-bound processing of Duty Drawback claims to reduce pendency and improve rate of disposal of claims. It informs that at the 5th meeting of the National Committee on Trade Facilitation (NCTF), it has been decided that at least 90% of Drawback should be credited within a time period of 3 days. Further, instructs that the refund may be deposited into the customer account in T+2 days. In supersession of the timeline enumerated in Action Plan of CBIC for 2020-21 through letter dated 04.08.2020 wherein the target set for disposing drawback claims is 7 days, requires strict compliance of time-limit given by NCTF for crediting duty-drawback.

Direct Tax

Part-A Key Direct Tax updates

1. **CBDT issues second round of Frequently Asked Questions in relation to "Direct Tax - Vivad Se Vishwas Act 2020"**

   Background

   VSV empowers the Government of India to remove, by order, any difficulty that arises in giving effect to the provisions of VSV. This is subject to the condition that such order is not inconsistent with the provisions of VSV. In exercise of such power, the CBDT had issued the first round of 55 FAQs as part of the April Circular. In deference to several representations seeking further relaxation and clarifications, the CBDT has now issued the second round of 34 FAQs as part of the Circular.

A. **Clarifications on scope/eligibility under VSV:**

- The following types of cases are eligible to opt for VSV:

- **Cases disposed of prior to date of declaration [FAQ 56]**:

  - Appeal/arbitration proceedings pending or time limit to file an appeal is not expired as on SD (specified date) but are disposed of prior to the date of declaration.

  - Amount of disputed tax shall be computed with reference to position as on SD.

- **Cases where operation of assessment order is stayed [FAQ 57]:**

  - Cases where enforceability of assessment order is stayed by High Court (HC)/Supreme Court (SC) whether an appeal is filed against such assessment order or not

  - Writ Petition (WP)/Special Leave Petition pending before HC/SC, as the case may be, shall also be withdrawn.

- **Revision proceedings [FAQ 58]:**

  - Appeal against revision order which contains specific direction and income is also quantifiable.

  - Taxpayer is required to settle all the issues which are subject matter of dispute under revision order and other issues against which appeal is pending or time limit to file appeal is not expired as on SD.

- **Appeal with request for condonation of delay [FAQ 59]:**

  - If conditions stated below are cumulatively satisfied, such appeal is deemed to be pending as on SD and is eligible to opt for VSV:

    - Time limit to file appeal expired between 1 April 2019 to 31 January 2020; and

    - Application for condonation of delay is filed before 4 December 2020; and

    - Appeal is admitted by appellate forum before the date of declaration.

- **Cross objections filed before Income tax Appellate Tribunal (ITAT) [FAQ 60]:**

  - Cross objections are filed and pending as on SD are covered under VSV if principal appeal is also settled along with such cross objections.

- **Miscellaneous Application (MA) before ITAT [FAQ 61]:**
  - MA pending as on SD against an appeal which was dismissed in limine before SD is covered. Also, disputed tax shall be computed with respect to appeal which was so dismissed.
- **Search assessment related clarification:**
  - Block assessment cases are covered if disputed tax involved therein does not exceed INR50M. **[FAQ 62]**
  - If assessment order is framed in case of a taxpayer based on search initiated in respect of another taxpayer, it will be eligible for VSV only if disputed tax is up to INR50M per appeal. **[FAQ 70]**
- **Mutual Agreement Procedure (MAP) related cases [FAQ 64]:**
  - MAP application made in relation to an appeal which is pending or time limit to file appeal is not expired as on SD is eligible for VSV if such MAP applications are not disposed or taxpayer has not accepted MAP decision. However, taxpayer will be required to withdraw MAP application and appeal if opted for VSV.
- **Authority for Advance Ruling (AAR) related cases [FAQ 65]:**
  - WP/appeal filed by the tax authority which is pending before HC/SC, as the case may be, against an AAR ruling in favor of taxpayer is eligible if the total income is quantifiable.
  - Further, since issue is covered in favor of taxpayer, only 50% of disputed tax is payable.
- **Set-aside proceedings before Commissioner of Income-tax (Appeals) [CIT(A)]/Dispute Resolution Panel (DRP) [FAQ 66]:**
  - Proceedings set-aside to the file of CIT(A)/DRP are deemed to be pending before CIT(A)/DRP and are eligible to opt for VSV.
  - Taxpayer is required to settle all issues either pending in appeal or time limit to file an appeal is not expired as on SD while settling set-aside proceedings.
- **Prosecution relation [FAQ 67]:**
  - Cases where appellate authority quashed prosecution complains or decided in favor of taxpayer and no further appeal is filed by the tax authority with or without request for condonation of delay on or before the date of declaration are eligible.
- **Summary assessment [FAQ 71]:** Appeal filed against summary assessment can be settled under VSV provided adjustments in summary assessment are not pertaining to arithmetical error or any apparent incorrect claim in tax return.
- **Expansion of scope of VSV in respect of identical issues which are in consideration before HC/SC for different assessment year [FAQ 75]:**
  - There may be cases where an identical issue which is raised in assessment or which is in appeal in respect of taxpayer for one of the tax years may be pending in appeal before HC or SC for another tax year. Income-tax Law (ITL) provides for a facility to taxpayer to avoid multiplicity of appeal for different tax year/s in respect of identical issue pending before HC/SC.

- This is to be done by filing a declaration with the tax authority in specified cases requesting the tax authority to apply the decision of HC/SC in respect of the first mentioned tax year when it becomes final to other tax years. In doing so, the taxpayer would need to provide declaration that it would give up its right to appeal or pursue litigation on that issue for such other tax years.

- In such case, once declaration of taxpayer is admitted by the tax authority for such other tax years, the assessment or appeal is disposed of by the appellate forum without waiting for final decision for such tax years. However, once the final order of HC/SC is received, the tax authority/appellate authority will have to modify their order for other tax years on that issue if the same is not consistent with HC/SC order.

- Similarly, the tax authority may postpone filing of appeal in respect of such covered issue before the ITAT till the time the same is finalized by the HC/SC subject to certain conditions by making an application on that behalf to the ITAT. Thus, in such cases the appeal for such other tax years technically will not be pending once application is accepted under the ITL.

- The CBDT clarified that the issues covered by such declaration or application filed on or before SD for such different tax years would be deemed to be pending on SD and hence would be eligible for settlement under VSV.

- Appeal filed by the taxpayer under section 248 of the ITL for being declared as a person not responsible for withholding taxes on payments other than interest made to a non-resident is eligible to opt for VSV **[FAQ 72]**

The following types of cases are ineligible to opt for VSV:

- **Revision proceedings [FAQ 58]:** Appeal against revision order which contains general direction and income is not quantifiable

- **Settlement Commission cases [FAQ 63]:** Proceedings pending before Settlement Commission or WP filed against the order of Settlement Commission.

- **Denial of charity registration [FAQ 69]:** Appeal against denial of charity registration to a trust

- **Prosecution related proceedings:**

  - Where prosecution has been initiated against tax withholding default by a taxpayer in tax year on or before date of filing of declaration, the same cannot be settled under VSV. **[FAQ 68]**

  - Where prosecution is initiated in one tax year, taxpayer would be debarred from opting for VSV in respect of all appeals for that tax year. Thus, where prosecution is initiated in respect of one issue which is not in appeal, taxpayer cannot opt for VSV even in respect of other issues which are under appeal for that year. However, if prosecution is initiated for one tax year, taxpayer can opt for VSV in respect of other tax years as long as the taxpayer is otherwise eligible to opt for VSV for that tax year. **[FAQ 73 and 74]**

B. Clarifications on computation of disputed tax

- **Effect of notice for enhancement of assessment [FAQ 76]:** Notice for enhancement of assessment issued by CIT(A) after SD and before issuance of this Circular will be taken into account for computing disputed tax. However, any notice of enhancement of income issued post the date of issue of this Circular and before 31 December 2020 will not be included in determining the amount of disputed tax.

- **Effect of additional ground [FAQ 77]:** Additional ground raised on or before SD in relation to an appeal shall also to be taken into account in computation of disputed tax.

- **Different appeals on same issue [FAQ 78]:** Where appeal is pending in respect of assessment and reassessment order for the same issue, both the appeals are required to be settled under VSV and disputed tax on such settlement would be the higher of tax liability determined under assessment and reassessment order in respect of that issue.

- **Manner of adjustment of prepaid taxes against disputed and undisputed tax liability [FAQ 79]:** Prepaid taxes in the form of Tax Deducted at Source (TDS)/Tax Collected at Source (TCS) will have to be first adjusted with respect to relevant income to which it relates, whether disputed or undisputed. The other prepaid taxes including TDS and TCS which cannot be allocated to specific income would need to be apportioned between the disputed and undisputed tax liability.

C. Clarifications on consequences of settlement under VSV:

- **Appeal against penalties not related to quantum appeal to be settled separately [FAQ 80]:** Appeal against penalties that are not related to quantum assessment (such as, for failure to get accounts audited, for failure to furnish transfer pricing audit report, for receipts in excess of INR0.2M by modes other than prescribed banking channels) are not waived upon settlement of appeal relating to quantum assessment, and such appeal is required to be settled separately.

- **Unexplained loan addition cannot be capitalized upon settlement under VSV [FAQ 81]:** Where addition was made in respect of unexplained loan credited in the books of a taxpayer and appeal against such addition is settled under VSV, the taxpayer cannot capitalize such unexplained loan in its books by crediting capital account.

- **Immunity extended to directors and partners in case of declaration filed by company or partnership firm [FAQ 82]:** In case of a declarant who is a company or partnership firm who settles an issue under VSV, benefit of immunity from prosecution in respect of such issue is also extended to directors and partners of such declarant.

- **Consequential relief for settlement of dispute involving failure for tax deduction at source [FAQ 84, 85, 86 and 88]:**

  - In case of failure to withhold tax at source, the ITL provides for disallowance of expenditure in the hands of the payer for the year in which failure to withhold tax took place. The ITL allows consequential relief to the payer by granting deduction in the year in which tax, in respect of which the default took place, is deposited.

  - However, if payer settles its appeal in respect of failure to withhold tax under VSV, FAQ 31 of the April Circular allows consequential relief to the payer by way of concession by granting deduction of expenditure in the year in which failure to withhold tax took place as against in the year in which tax is deposited. It is now clarified that such benefit of FAQ 31 of the April Circular is not available where payer has already claimed consequential relief in the past under the ITL by claiming deduction when tax was deposited. **[FAQ 86]**

- In a case where, payer failed to deduct tax at source on an income which was also not offered by the payee in its return, and payer as also payee is in appeal or arbitration against default for tax deduction at source and against assessment of such income, respectively:

  - Scenario 1: If payer first settles its appeal or arbitration under VSV by paying tax, payer would get complete waiver from interest and penalty. Payee would get credit for tax paid by the payer. However, payee would be required to pay interest and penalty, if any, with reference to such income. Payee can also subsequently settle its appeal or arbitration under VSV without paying any tax but after paying 25% of disputed interest or penalty, if any.

  - Scenario 2: Alternatively, if payee first settles its appeal or arbitration under VSV by paying tax, payee would get complete waiver from interest and penalty. Payer would not be required to pay any tax since tax is already recovered from the payee under VSV. However, payer would be required to pay interest and penalty, if any, with reference to default in deduction of tax at source. Payer can also subsequently settle its appeal or arbitration under VSV without paying any tax but after paying 25% of disputed interest or penalty, if any. **[FAQ 84]**

- Under Scenario 1, if payer settles its appeal or arbitration under VSV by paying more than 100% of the disputed tax (say, because payer discharges disputed tax after 31 March 2021 but on or before the last date to be notified), tax credit in hands of the payee would still be restricted to 100% of the disputed tax. **[FAQ 85]**

  - In respect of proceedings initiated against the payer for default in deduction of tax at source, where separate orders are passed for tax and interest (and separate appeals are filed), once payer settles appeal involving default in deduction of tax at source under VSV, there would be complete waiver of interest levied for such default. **[FAQ 88]**

- **No consequential relief upon payer settling appeal involving disallowance of expenditure due to default in tax withholding [FAQ 83]:** If payer settles its appeal involving disallowance of expenditure (for the year in which failure to withhold tax took place) under VSV, no consequential relief will be available in proceedings against the payer for default in tax deduction at source initiated qua such expenditure.

- **Waiver of interest relating to disputed penalty [FAQ 87]:** If appeal relating to disputed penalty is settled by paying 25% of disputed penalty, interest relating to such penalty (such as, interest for delayed payment of such penalty) would be waived.

- **Revision of declaration [FAQ 89]:** Declaration can be revised any number of times by the taxpayer, before the DA issues a certificate.

2. CBDT to validate ICAI generated UDIN for uploading Tax Audit Report (vide Press Release dated 26-11-2020

- In an effort to weed out fake/ incorrect Tax Audit Reports, Income-tax e-filing portal has integrated with ICAI for validation of Unique Document Identification Number (UDIN) generated by CAs for certifying and attesting documents uploaded through the e-filing portal; This follows Income Tax Department's ongoing initiative to integrate with other Government bodies and agencies; A grace period of 15 calendar days from the date of submission of audit report/ certificate in e-filing portal is awarded to CAs unable to generate UDIN within the date of submission.

Key Regulatory amendments

This section summarizes the regulatory updates for the month of December 2020

Reserve Bank of India ("RBI") amends Foreign Exchange Management (Export and Import of Currency) Regulations, 2015 ("FEMA 6R")

The RBI has amended FEMA 6R to insert a new regulation providing powers to RBI that it may, in public interest and in consultation with the Central Government, restrict the amount of Indian and/or foreign currency, that a person may bring into or take outside India , on a case to case basis and prescribe such conditions as it may deem necessary.

Source: Foreign Exchange Management (Export and Import of Currency) (Second Amendment) Regulations, 2020 dated 3 December 2020

RBI issues circular for facilitation of external trade ('Circular')

The RBI has issued Circular with a view to further enhance ease of doing business and quicken the approval processes in export transactions by delegating additional powers to Authorised Dealer Category – I banks (AD Banks). The key features of the Circular are as follows :

- **Direct dispatch of shipping documents**

- In terms of the erstwhile guidelines, AD Banks were permitted to regularize cases of direct dispatch of shipping documents by exporters to overseas consignee or his agent, up to a limit of USD 1 million per export transaction

  Pursuant to the Circular, the said limit of USD 1 million per export transaction has been done away with. Accordingly, the AD Bank can regularise such cases without any monetary limit subject to compliance with prescribed conditions.

- **Write off of unrealized export receivables**

- The erstwhile procedure for obtaining approval from AD Bank in cases of write off of unrealized export receivables has been revised in order to provide greater flexibility to the AD banks to reduce the time taken for according such approvals

- **Set-off of Export receivables against Import payables**

  The extant guidelines provide for set off of export receivables against import payables subject to certain conditions. These conditions have been revised and the key changes are as follows :

- As per the erstwhile guidelines, set-off was permitted only in respect of same seller and buyer.

- However, as per the revised guidelines, AD Banks have been delegated powers to consider requests for allowing set-off by Exporters/Importers with their overseas group/associate companies either on net basis or gross basis, through an in-house or outsourced centralised settlement arrangement, subject to compliance with certain conditions.

- **Refund of Export Proceeds**

- In terms of the export regulations, AD Banks have been given the power to permit refund of export proceeds from India in case the goods are to be reimported into India on account of poor quality within a period of 3 months from the date of inward remittance.

- As per the revised guidelines, AD Banks have been given the power to permit refund of export proceeds in instances wherein re-importing of goods has not been possible as the exported goods had reportedly been auctioned or destroyed in the importing country, subject to submission of satisfactory documentary evidence

Source : A.P (DIR Series) Circular No. 08 dated 04 December 2020

Department of Economic Affairs ("DEA"), Ministry of Finance ("MOF") amends Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 ("NDI Rules")

The DEA, MOF has amended the NDI Rules. The key amendments are as follows :

- **Multilateral Bank/Fund of which India is a member exempted from provisions of Press Note 3 of 2020 ("PN 3 of 2020") dated 17 April 2020 issued by Department for Promotion of Industry and Internal Trade ("DPIIT")**

- In terms of the amendment introduced by PN 3 of 2020, any foreign investment from an entity incorporated in any of the countries sharing land borders with India ("neighbouring countries") or where the beneficial ownership of such investment is situated in or is a citizen of any neighbouring country, would require prior government approval

- In terms of the amendment, any Multilateral Bank or Fund, of which India is a member, shall not be treated as an entity of a particular country nor shall any country be treated as the beneficial owner of the investments of such Bank or Fund in India.

Changes in Foreign Direct Investment Policy ("FDI") in defence sector introduced by Press Note No 4 (2020) Series dated 17 September 2020 ("PN 4 of 2020") has been notified through the amendments made in NDI Rules **.**

Source : Foreign Exchange Management (Non-Debt Instruments) (Fourth Amendment) Rules, 2020 dated 08 December 2020

Part B – Case Laws

Goods and Services Tax

1. M/s Surat Mercantile Association [TS-1049-HC-2020(GUJ)-NT]

Subject Matter: Ruling wherein the High Court writ petition filed wherein the Association has challenged the constitutional validity of Section 16(2)(c) of CGST Act, 2017 which imposes restriction on the buyer which states that the credit shall be availed only when the tax on the transaction has been paid to the exchequer.

Background and Facts of the case

- The Petitioner has submitted that Section 16(2)(c) of CGST Act, 2017 shall be read down by holding and declaring that ITC can be denied only if buyer of goods or services has colluded with supplier to defraud the revenue and where purchases are in nature of sham transactions.

- The Petitioner has also challenged the demand of reversal of ITC along with interest on mere allegation that supplier has fraudulently obtained the registration.

- The Petition further contended that denying ITC to buyer of goods or services for default of the supplier would tantamount to shifting the incidence of tax from the supplier to the buyer, over whom it has no control whatsoever, is arbitrary and irrational.

- Petitioner has also pointed out the ramifications of such denial of ITC on working capital of a registered taxable person which substantially diminishes its ability to continue business.

Ruling

- Basis above, the Gujarat HC has issued notice to Centre and State Government to file counter-affidavits. The said matter shall be listed on 19 January 2021.

- Please note that in recent past Calcutta HC and Delhi HC has also issued notices to Centre and State Government in similar matters wherein the petitioner has challenged the constitutional validity of Section 16(2)(c).

2. M/s. Material Recycling Association of India [2020(8)TMI11]

Subject Matter: Ruling whether the provisions of Section 13(8)(b) r.w.s. 2(13) and 8(1) of the IGST Act,2017 are ultra vires and unconstitutional or not.

Background and Facts of the case

- The petitioner is an association comprising of recycling industry engaged in manufacture of metals and casting etc.

- The members of the petitioner also act as an agents for scrape, recycling companies based outside India engaged in providing business promotion and marketing services for principals located outside India.

- The members of the petitioner also facilitate sale of recycled scrap goods for their foreign principals in India and other countries.

- Thus, the members of the petitioner association not only deal with goods sold by foreign principals to customers in India but also facilitate sale of goods by foreign principals in non-taxable territory to their customers, who are also located in non-taxable territories.

- It is the case of the petitioner that the members of the petitioner association have no role to play in the actual sale and purchase of recycled scrap as the goods supplied by foreign clients to its purchasers are directly shipped by the foreign client to the Indian or overseas purchaser and thereafter, such goods are cleared by the purchaser from the Customs authorities on its own account.

- The foreign members of the petitioner association raises sales invoice in the name of the purchaser and the purchaser who may be either Indian or overseas directly remits the sale proceeds to the foreign client.

- According to the petitioner, member of the petitioner association receives only the commission upon receipt of sale proceeds by its foreign client in convertible foreign exchange.

- The members of the petitioner association raise invoices upon its foreign client for such commission received by them.

- Thus, according to the petitioner, the transaction entered into by the members of the petitioner association is one of export of service from India and earning valuable convertible foreign exchange for the same.

- Accordingly, IGST cannot be levied on the members of the petitioner association, who are engaged in the transaction of export of service as stated above as the petitioner members' export of services is covered by the

- Section 16(1) of the IGST Act, 2017 which provides for "zero rated supply" .

Discussions and findings of the case

- It was observed that, from the conjoint reading of Section 2(6) and 2(13), which defines export of service and intermediary service respectively, the person who is intermediary cannot be considered as exporter of services because he is only a broker who arranges and facilitate the supply of goods or services or both.

- The basic logic or inception of section 13(8)(b) of the IGST Act,2017 considering the place of supply in case of intermediary to be the location of supply of service is in order to levy CGST and SGST and such intermediary service therefore, would be out of the purview of IGST.

- Only because, the invoices are raised on the person outside India with regard to the commission and foreign exchange is received in India, it would not qualify to be export of services, more particularly when the legislature has thought it fit to consider the place of supply of services as place of person who provides such service in India - there is no deeming provision as tried to be canvassed by the petitioner, but there is stipulation by the Act legislated by the parliament to consider the location of the service provider of intermediary to be place of supply.

- The contention of the petitioner that it would amount to double taxation is also not tenable in eyes of law because the services provided by the petitioner as intermediary would not be taxable in the hands of the recipient of such service, but on the contrary a commission paid by the recipient of service outside India would be entitled to get deduction of such payment of commission by way of expenses and therefore, it would not be a case of double taxation.

- Further, in view of the Notification No.20/2019 issued by the Government of India, Ministry of Finance whereby Entry no.12AA is inserted to provide Nil rate of tax granting exemption from payment of IGST for service provided by an intermediary when location of both supplier and recipient of goods is outside the taxable territory i.e. India.

Ruling

- Basis the above discussion, it cannot be said that the provision of Section 13(8)(b) read with Section 2(13) of the IGST Act,2017 are ultra vires or unconstitutional in any manner.
- The petition is, therefore, disposed of accordingly.

3. M/s Malyalam Motors Pvt. Ltd. [TC-1077-HC-2020(KER)-NT]

Subject Matter: A writ petition was filed allowing to discharge tax liability in equal successive monthly instalments.

Background and Facts of the case

- The petitioner is engaged in the business of automobile sales.
- The petitioner had filed GSTR-1 returns for the months of February, 2020 to May, 2020, but due to Covid pandemic, could not generate funds to make lump sum payment of the admitted tax.
- Hence, the petitioner, however, intends to pay the arrears of tax due without contesting the same.
- As, petitioner is not in a position to generate the funds necessary for making a lump sum payment of the admitted tax for the said period, and it is therefore that the petitioner seeks a direction from this Court to permit the petitioner to file the returns without paying the entire admitted tax, but ensuring that the payment of admitted tax, together with interest thereon and applicable late fees etc., will be made in instalments.

Discussions and findings of the case

- It was observed that the provisions of the Act do not provide for the payment of the admitted amount shown in the return in instalments, and hence the relief sought for by the petitioner cannot be granted.
- It was further noticed that, the petitioner, is not disputing its liability. It only seeks an instalment facility to pay the tax, together with interest, due to financial difficulties faced by it during the Covid pandemic situation.
- Hence, the petitioner shall be permitted to discharge the tax liability, inclusive of interest and late fee thereon, in equal successive instalments.
- Also, on default of any single instalment, the petitioner will lose the benefit of this judgment and shall be liable to pay taxes in accordance with law.

Ruling

- The Writ Petition is disposed as above.

Part B – Case Laws

Direct Tax

1. **Aesseal India Pvt. Ltd (Taxpayer)- Pune ITAT [TS-601-ITAT-2020(PUN)]**

   Subject matter: Pune Tribunal allows capitalization of forex loss on external commercial borrowings deployed for acquisition of domestic capital assets in pre-ICDS era

   Background

- S. 43A provides for the treatment of exchange fluctuation loss or gain arising on restatement of liability relating to the cost of a capital asset acquired from outside India or to the foreign currency borrowing made specifically for the purpose of acquisition of such asset. In such cases, the cost of the asset is increased or reduced by the amount of exchange fluctuation loss or gain and the depreciation and other capital allowances are allowed on the adjusted cost of the asset. Prior to 1 April 2003, this provision permitted such adjustment on MTM or accrual basis. It was amended with effect from 1 April 2003 to provide that adjustment to the cost of asset towards exchange fluctuation loss or gain can be made only at the time of payment of such foreign currency liability instead of MTM basis.

- The above provision is applicable only in case of imported capital assets. In case of capital assets acquired locally, prior to tax year 2016-17, there was no specific provision in the ITL dealing with tax treatment of exchange fluctuation loss or gain arising on foreign currency liability to acquire domestic capital assets.

- From tax year 2016-17 onwards, S.43AA inserted by Finance Act 2018 and ICDS VI requires exchange fluctuation gain or loss on all foreign currency monetary items (revenue or capital) other than gain or loss covered by S.43A (in relation to imported capital assets) to be recognized as taxable income or deductible expense on MTM basis while computing business income.

Facts

- The Taxpayer is an Indian company engaged in the business of developing designs and drawings, manufacturing mechanical seals and sealing systems.

- The Taxpayer availed external commercial borrowings (ECB) for acquisition of domestic capital assets. During the tax years 2011-12 and 2013-14, the Taxpayer incurred MTM exchange fluctuation loss on restatement of ECB, which was debited to the Profit & Loss Account. The Taxpayer claimed that, S.43A was not applicable as ECB was not utilized for acquisition of imported capital assets, and such MTM exchange fluctuation loss was deductible as revenue expense in computing its taxable income. The Taxpayer relied on the SC ruling in the case of CIT v. Tata Iron and Steel Co. Ltd., in which the SC held that cost of capital asset and cost of raising money for purchase of capital asset are two different and independent transactions and the manner of repayment of forex loan does not affect the cost of capital asset.

- Tax authority disallowed the Taxpayer's claim of revenue expense stating that MTM exchange fluctuation loss was notional in nature. Tax authority also rejected the Taxpayer's alternative claim of capitalizing such loss to cost of domestic capital assets for the purposes of depreciation.

Tax authority relied on the SC decision in case of Sutlej Cotton Mills v. CIT wherein the SC held that any forex loss which arises to a taxpayer would be ordinary trading loss if the foreign currency is held by the taxpayer on revenue account. However, if the foreign currency is held by the taxpayer as a capital asset, the forex loss would be capital in nature.

- On the Taxpayer's appeal, the first appellate authority upheld tax authority's order on the ground that in the absence of specific provisions in the ITL, the forex loss on domestic capital asset can neither be claimed as revenue expense nor be capitalized for the purpose of depreciation. Aggrieved, the Taxpayer appealed further to the Tribunal.

- Before the Tribunal, the Taxpayer withdrew the plea for deduction of MTM loss as revenue expense and raised the alternative plea that such loss should be capitalized to cost of domestic capital assets for the purposes of depreciation. To counter the tax authority's objection about MTM loss being notional in nature, the Taxpayer relied on the SC decision in the case of CIT v. Woodward Governor India Pvt. Ltd. In this ruling, the SC held that any forex MTM loss or gain on MTM restatement of foreign currency monetary items of revenue nature (like cash, bank balance, debtors, creditors, etc.) is not notional and is deductible as revenue expense or taxable as business income in the period in which such forex loss or gain arises, in line with the accounting treatment prescribed by Accounting Standard 11 (AS-11) issued by Institute of Chartered Accountants of India (ICAI).

Issue

Whether forex MTM loss on ECB utilized for the acquisition of domestic capital assets can be capitalized for the purposes of depreciation?

Tribunal's Ruling

The Tribunal upheld the Taxpayer's claim that such forex MTM loss can be capitalized to actual cost of domestic capital assets for the purposes of depreciation, based on the following reasons:

- Tax authority's objection that forex MTM loss is notional is no longer valid in the light of SC decision in case of CIT v. Woodward Governor India Pvt. Ltd. (supra).

- S. 43A is applicable only to the acquisition of imported capital assets. As the Taxpayer has utilized ECB for acquisition of domestic capital assets, S. 43A was not applicable, and the tax treatment of forex MTM loss had to be ascertained on general principles laid down in tax jurisprudence.

- The general principles are enunciated in the SC decision in case of CIT v. Arvind Mills Ltd. (supra), wherein the SC held that, in case of capital assets imported in an earlier tax year, written down value (WDV) of such imported capital assets can be prospectively adjusted by increase in forex liability in the current tax year upon devaluation of foreign currency, such that the taxpayer shall be entitled to depreciation on revised WDV in the current tax year and for subsequent tax years. This SC decision pertained to the period before amendment to S. 43A w. e. f. 1 April 2003.

- Hence, the MTM loss in the present case being capital in nature and not covered by S.43A can be adjusted to tax WDV of the domestic capital asset.

2. **Biocon Ltd (Taxpayer)- Karnataka HC [TS-608-HC-2020(KAR)]**

Subject matter: Karnataka HC upholds Special Bench ruling allowing ESOP discount as a deductible expenditure

Background

- Generally, in a conventional ESOP scheme (Scheme), the employer company undertakes to issue shares to its employees at a future date, at a price usually lower than the current market price.

- In order to be eligible to acquire such shares, the employees are obliged to render services and/or achieve specified benchmarks during the vesting period. The employees acquire the right to exercise the options on completion of the vesting period. Upon vesting, the employee can exercise the options within a specified period. Therefore, the three relevant events during an ESOP lifecycle are: (a.) Grant of options. (b.) Vesting of options. (c.) Exercise of options.

- In India, ESOPs granted by listed companies are governed by guidelines or regulations laid down by the Securities and Exchange Board of India (SEBI), being the regulator for trading of securities. As per the erstwhile SEBI guidelines issued in 1999, ESOP discount, as on the date of grant, is required to be treated as another form of employee compensation by amortizing the discount over the vesting period of the options. As per the extant SEBI regulations, the company must follow the requirements of the guidance note issued by the Institute of Chartered Accountants of India (ICAI).

- As per the provisions of the Indian Tax Laws (ITL), any expenditure which is not covered under any specific sections of the PGBP head, but is laid out or expended wholly and exclusively for the purposes of the business or profession and which is not in the nature of capital expenditure or personal in nature, is allowed as deduction while computing the income from business or profession (business deduction).

Facts

- The Taxpayer, a company engaged in the business of manufacture of enzymes and pharmaceutical ingredients, floated a Scheme and transferred its shares at face value to a separate trust constituted for administering the Scheme.

- The employees of the Taxpayer could exercise the option to buy the shares within the time prescribed under the Scheme. The Scheme provided for vesting of options equally over four years (i.e., 25% in each year) at the end of completion of service in each year.

- The Taxpayer debited pro rata ESOP discount to profit and loss (P&L) statement as employee compensation expenses and claimed it as business deduction for tax purposes.

- The tax authority disallowed the claim on the ground that the Taxpayer did not incur any expenditure and ESOP discount represented a contingent liability since there is no certainty of options getting vested in the employees and/or employees exercising the options.

- The first appellate authority upheld the tax authority’s order. Aggrieved, the Taxpayer appealed before the Tribunal.

- The division bench of the Tribunal referred the case to the SB in view of conflicting decisions between different benches of the Tribunal. The SB ruled that ESOP discount is a deductible expenditure and not a contingent or notional expenditure. Furthermore, ESOP discount is part of an employee's remuneration which is paid to the employees in order to compensate for their continuity of services to the company and, hence, ESOP discount is allowable as an expenditure.

- The SB also held that ESOP discount deduction is allowable on a provisional basis on each vesting date. The exact quantum of ESOP discount is, however, determined on the date of exercise of options i.e., the difference between the market value on the date of exercise and the exercise price represents the cost which is actually incurred by the employer. Hence, deduction provisionally allowed in earlier periods based on vesting of options should be adjusted upwards or downwards based on the market value on the date of exercise (true up adjustment). Such true up adjustment is over and above adjustments that are necessitated on account of lapsing or forfeiture of options.

- Aggrieved by the SB ruling, the tax authority filed an appeal before the HC.

- The HC admitted the appeal on the following issues:

  a. Whether ESOP discount is allowable as deduction in computing business income.

  b. Whether the SB was right in holding that the difference between the market price of shares at the time of grant of option and the offer price amounts to discount to be treated as remuneration for their continuity of service.

  c. Whether the SB erred on facts in not examining the Scheme, from which it is clear that the employees will not get any right in the shares till completion of the prescribed period and, hence, the expenditure claimed is contingent.

- To clarify, the HC did not consider the issue of whether the SB was correct in permitting true up adjustment on exercise of options.

Tax Authority's contentions

- ESOP expenditure was neither incurred nor accrued during the relevant tax year 2003-04 and, hence, it cannot be claimed as business deduction. ESOP discount is a contingent, and not a crystallized, liability which was enforceable during tax year 2003-04. Since the Taxpayer follows the mercantile method of accounting, the expenditure is not allowable during the tax year under reference.

- ESOP expenditure is not real. It is hypothetical, notional and imaginary. Shares were not handed over to the concerned employees and it is up to employees to, whether or not, exercise the ESOPs at any time. Under the mercantile method of accounting, unless legal liability is incurred, the expenditure is not allowable as accrued.

- As the control of shares for the period of the Scheme remained with the Taxpayer, the Taxpayer had neither assumed any liability nor had incurred the same. Furthermore, no amount was actually paid in order to be allowed as expenditure incurred for business purpose.

- The tax authority relied on several rulings of the Supreme Court (SC) in support of the propositions that contingent liability is not allowable as deduction and that no benefit arises at the stage of grant or vesting of options.

Taxpayer's contentions

- ESOP discount is not a contingent liability, but an ascertained one. Since the Scheme provides for 25% vesting every year over four years, the employees acquire definite right of 25% every year with corresponding obligation to the Taxpayer.

- In this regard, reliance was placed on the SC rulings in the cases of Bharat Earth Movers v. CIT and Rotork Controls India Pvt. Ltd. v. CIT, where the SC permitted deduction for leave encashment and warranty liability based on scientific estimation.

- For business deduction, it is sufficient that expenditure is incurred and, hence, grant of ESOPs at a discount would also be an expenditure incurred for the purposes of business deduction. It is only a form of compensation paid to employees and not a short capital receipt of premium.

- The amortization of ESOP discount over grant to the vesting period is in accordance with the accounting treatment prescribed in the SEBI guidelines. It is well-settled that business deduction is allowable on commercial principles of accounting.

- ESOP discount has been allowed as deduction by other HCs in the cases of PVP Ventures Ltd., Lemon Tree Hotels Ltd. (supra). The tax authority had also accepted the Taxpayer's claim and allowed ESOP discount deduction from tax year 2008-09 onwards. Hence, it cannot be permitted to alter its stand.

HC's Ruling

The HC affirmed the SB ruling that ESOP discount is a deductible expenditure and not a contingent or notional expenditure. The reasoning adopted by the HC is briefly as follows:

- **ESOP discount allowable as business deduction**

a. For the purposes of business deduction, expenditure need not necessarily be incurred in cash and actual pay-out is not a prerequisite to claim the deduction. Incurrence of an obligation is also an expenditure allowable as business deduction.

b. Furthermore, as held by the SC in the case of CIT v. Woodward Governor (India) Pvt. Ltd., expenditure also includes a "loss". Hence, issuance of shares at a discount, where the taxpayer absorbs the difference between the market value of shares and the discounted issue price, constitutes an expenditure allowable as business deduction.

c. By undertaking an obligation to issue shares at a discounted premium at a future date, the Taxpayer incurred an obligation towards remunerating the employees for their services, which is nothing but expenditure.

d. It is not correct to equate ESOP discount to short receipt of premium on issue of shares. ESOP shares are not issued with the object of raising capital. Rather, they are intended to earn profits by securing consistent services of the employees.

- **ESOP discount is not a contingent liability but an ascertained liability**

  a. The Taxpayer's Scheme provided for vesting of options equally over four years (i.e., 25% in each year). Hence, the employees have a definite right to 25% of the shares and the Taxpayer is bound to allow the vesting of 25% of the options.

  b. Since the business liability has arisen, which the Taxpayer is obliged to honor, the ESOP discount is allowable as an expenditure, irrespective of the fact that the exact quantum of discount enjoyed by the employees gets determined subsequently on the date of exercise.

  c. ESOP discount does not represent a contingent liability, but an ascertained liability. The SC rulings in the cases of Bharat Earth Movers (supra) and Rotork Controls (supra) support this proposition.

  d. The Taxpayer had claimed deduction of ESOP discount over the vesting period in accordance with the accounting in the books of accounts which are prepared in accordance with the SEBI guidelines.

- **SC rulings relied on by the tax authority are distinguishable**

  a. In Infosys Technologies (supra), the SC was concerned about the consequences for failure to withhold taxes on the perquisite value, being the difference between the market value and the total amount paid by employees upon exercise of options. Hence, it did not assist to decide the issue of allowability of expenses in the hands of the taxpayer. Furthermore, the decision pertains to tax years 1996-97 to 1998-99 when the ITL did not contain any specific provisions to tax ESOP benefits.

  b. The other decisions relied by the tax authority, in fact, support the Taxpayer, since the Taxpayer had incurred definite legal liability. Following the mercantile system of accounting, ESOP discount had been rightly debited as expenditure in the books of account.

- **Concurrence with other HC rulings on allowability of ESOP discount**

  a. The HC concurred with the rulings of other HCs relied on by the Taxpayer in the cases of PVP Ventures Ltd. and Lemon Tree Hotels Ltd. (supra), wherein the HCs allowed deduction of ESOP cost.

- **Consistency with the position adopted in subsequent tax years**

  a. It is pertinent to mention that the tax authority has allowed ESOP discount deduction in subsequent years from tax year 2008-09 onwards. In view of the law laid down by the SC in the case of Radhasoami Satsang v. CIT, the tax authority cannot be permitted to take a different stand in the tax year in question i.e., 2003-04.

3. **Amarchand & Mangaldas & Suresh A Shroff & Co[1] (Taxpayer), a partnership firm- Mumbai ITAT- [TS-666-ITAT-2020(Mum)]**

Subject matter: Mumbai Tribunal grants tax credit for taxes withheld in Japan on professional income; endorses uniform interpretation of tax treaty

Background

- Article 12 of the DTAA provides that FTS income of an Indian resident for services rendered in Japan will be taxable in Japan @ 10%. For the purpose, FTS is defined as consideration for services of a managerial, technical or consultancy nature excluding, inter alia, payments made to individuals for IPS which is covered under Article 14 (IPS Article).

- Article 14 provides that income of an Indian resident from professional services would be taxable in Japan if such resident has a fixed base regularly available to them in Japan for the purpose of performing their activities or they are present in Japan for more than 183 days during any taxable year. For this purpose, "professional service" is defined as income from independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants (IPS Article).

- Article 23 provides for double taxation relief where income of a resident of India is taxed in Japan in accordance with the DTAA. India shall allow credit of taxes paid in Japan from tax on the income in India (FTC Article).

Facts

- The Taxpayer is a partnership law firm in India. The Taxpayer had earned income from rendering professional services in Japan, on which taxes were withheld by Japanese clients at 10% on gross amount of professional fees under Article 12 of the DTAA.

- The Taxpayer had claimed FTC in respect of taxes withheld in Japan during its tax audit in India for the tax year.

- The Indian tax authority denied the claim of FTC stating that the income of the Taxpayer, a partnership firm, qualifies as IPS under the DTAA, not subject to tax in the absence of a fixed base of the Taxpayer in Japan. Hence, the taxes withheld in Japan are not in accordance with the DTAA and not eligible for FTC in India.

- The position of the tax authority was upheld by the first appellate authority. Aggrieved by the above, the Taxpayer preferred an appeal before the Tribunal.

Tribunal's Ruling

On taxability of professional income under the DTAA

- Undoubtedly, there are overlapping areas under the definitions of FTS and IPS under the DTAA inasmuch as income from professional service could get covered under both. However, the following support that the IPS Article of the DTAA is applicable to professional service income of individuals alone:

    - The DTAA has to be read as a whole and the provisions of the DTAA are to be construed in harmony with each other.

- FTS excludes IPS income of individuals. Such exclusion supports that professional income of other entities (non-individuals) is covered by the FTS Article.

- As per the principle of interpretation of "general provisions do not override specific provisions", the IPS Article will be considered as a specific provision for the professional income of individuals alone.

- As per a valid school of thought, Article 14 comes into play only for individuals while Article 7 is for entities other than individuals. It is for this reason that Article 14 was removed from the OECD Model Convention. Reliance was placed on the Mumbai Tribunal ruling of Linklaters LLP v. ITO [(2011) 9 ITR (T) 217 (Mum)].

- In view of the above, the professional income of the Taxpayer, a partnership firm, was rightly subjected to tax as FTS in Japan.

On grant of FTC in India

- FTC is available when any income of an Indian resident is taxed in Japan "in accordance with" the provisions of the DTAA. As per the dictionary meaning, the term "in accordance with" means being in agreement or harmony with; in conformity to.

- For ascertaining whether income is taxed "in accordance with" the DTAA for the purpose of FTC, one has to take a judicious call as to whether the view so adopted by the source jurisdiction is a reasonable and bona fide view.

- Support drawn from the ruling of Canadian Pacific Ltd. v. the Queen, wherein the Federal Court emphasized the importance of uniform interpretation of phrases used in global treaty networks and held that unless the interpretation given in the source country is "manifestly erroneous", the same may be followed in the resident country also to achieve a uniform interpretation of the tax treaty.

- While it may not always be possible to desire uniformity in interpretation due to the law being made by various judges and legal frameworks in which tax treaties are to be interpreted in each country, different treatments by treaty partner jurisdictions can result in hardship to taxpayers.

In view of the above and the conclusion reached on qualification of income as FTS, FTC of taxes withheld in Japan should be allowed in India.

4. M/s Abbey Business Services India Pvt Ltd (Taxpayer)- Karnataka HC- [TS-655-HC-2020(KAR)]

Subject Matter: Expense on reimbursement on seconded employees is not FTS, hence No TDS to be deducted; Distinguishes from Centrica ruling

Background and Facts

- M/s Abbey Business Services India Pvt Ltd entered into various agreements with its group company in UK (UK Co) viz. (i) Outsourcing Agreement to outsource provision of certain process and call centres to a third- party company in India (referred to as third party service provider or TP) where TP would provide services to UK Co and its affiliates. (ii) Consultancy agreement under which taxpayer will ensure that high quality services were provided by TP and for which the taxpayer was compensated at cost plus 12% (iii) Deputation agreement- Employees of UK Co were deputed to taxpayer to facilitate outsourcing agreement. Such deputees provided trainings to some employees of TP in connection with outsourced services.

Issue under consideration

- During the tax year under consideration, taxpayer made certain payments to UK Co in respect of salaries of deputees and reimbursement of expenses incurred on hotel and travel expenditure of such deputees. While taxes were withheld on salary component under the Income tax Act,1961 ("ITA"), no withholding was done on expenses reimbursed which was challenged by the tax authority. Tax authority contended that the employees seconded to India were highly skilled and they rendered technical services on behalf of UK Co. would be taxable as FTS, subject to withholding in India. Heavy reliance was placed On Delhi HC ruling of M/s Centrica India Offshore Pvt Ltd (Centrica ruling) where Delhi HC upheld claim of FTS in similar secondment arrangement.

HC's Ruling

- On the issue of taxability of reimbursement of expense by taxpayer, the HC ruled as below-

- It is evident from deputation agreement that the deputees had to follow instructions and were under the control, direction and supervision of the taxpayer. They worked in accordance with policies, rules and regulations applicable to employees of taxpayer. Further, deputees assisted taxpayer in its business and supervised activities of TP in capacity as employees of taxpayer. Accordingly, for all practical purposes, taxpayer was treated as employer of deputees.

- Accordingly, expenses incurred by deputees and reimbursed by taxpayer does not qualify as FTS under the ITA. Further, there is no requirement to withhold taxes on reimbursement of expenses under the ITA.

- The Centrica ruling is not applicable since it dealt with issue whether any tax liability of the overseas entity arises for provision of services by seconding employees to Indian company and whether this resulted in permanent establishment of overseas entity in India. This is not the issue in the present case which deals with withholding on reimbursement of expenses.

Our offices

Ahmedabad
2nd floor, Shavlik Ishaan
Near. C.N Vidyalaya
Amba wadi
Ahmedabad – 380 015
Tel: +91 79 6608 3800
Fax: +91 79 6608 3900

Bengaluru
12th & 13th floor
“U B City” Canberra Block
No.24, Vital Malia Road
Bengaluru - 560 001
Tel: +91 80 4027 5000
+91 80 6727 5000
Fax: +91 80 2210 6000 (12th floor)
Fax: +91 80 2224 0695 (13th floor)

Ground Floor, ‘A’ wing
Devisee Chambers
11, O’Shaughnessy Road
Langford Gardens
Bengaluru – 560 025
Tel: +91 80 6727 5000
Fax: +91 80 2222 9914

Chandigarh
1st Floor
SCO: 166-167
Sector 9-C, Madhya Marg
Chandigarh - 160 009
Tel: +91 172 671 7800
Fax: +91 172 671 7888

Chennai
Tidal Park
6th & 7th Floor
A Block, No.4, Rajiv Gandhi Salami
Tar Amani, Chennai – 600 113
Tel: +91 44 6654 8100
Fax: +91 44 2254 0120

Delhi NCR
Golf View Corporate
Tower – B
Sector 42, Sector Road
Gurgaon – 122 002
Tel: +91 124 464 4000
Fax: +91 124 464 4050

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Atrocity New Delhi – 110 037
Tel: +91 11 6671 8000
Fax +91 11 6671 9999

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
NOIDA - 201 304
Gautam Bodh Nagar, U.P.
Tel: +91 120 671 7000
Fax: +91 120 671 7171

Hyderabad
Oval Office
18, labs Centre
Hitech City, Madhapur
Hyderabad – 500 081
Tel: +91 40 6736 2000
Fax: +91 40 6736 2200

Jamshedpur
1st Floor,
Shanti Niketan Building
Holding No. 1, SB Shop Area
Bistoury, Jamshedpur – 831 001
Tel: + 91 657 663 1000

Kochi
9th Floor “ABAD Nucleus”
NH-49, Maraud PO
Kochi - 682 304
Tel: +91 484 304 4000
Fax: +91 484 270 5393

Kolkata
22, Camaca Street
3rd Floor, Block C”
Kolkata - 700 016
Tel: +91 33 6615 3400
Fax: +91 33 6615 3750

Mumbai
14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (west)
Mumbai - 400 028
Tel: +91 22 6192 0000
Fax: +91 22 6192 1000

5th Floor Block B-2
Nylon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: +91 22 6192 0000
Fax: +91 22 6192 3000

Pune
C—401, 4th floor
Pinch-hit Tech Park
Yeravda (Near Don Bosco School)
Pune - 411 006
Tel: +91 20 6603 6000
Fax: +91 20 6601 5900

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

For more information, please visit www.ey.com/india

EY refers to the global organization and may refer to one or more of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization.

Ernst & Young LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit www.ey.com/india.

Ernst & Young LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 22 Camaca Street, 3rd Floor, Block C, Kolkata - 700016

- This work product has been prepared by EY LLP on the basis of a scope of work agreed with the Automotive Components Manufacturers’ Association of India (ACMA), and does not purport to be all-inclusive or to contain any information that a prospective reader may expect or desire. Accordingly, if made available to ACMA’s members or any other person or entity, this work product is solely for their information and should not be used, circulated, quoted, relied upon, or otherwise referred to for any other purpose, nor included or referred to in whole or in part in any document without EY LLP’s prior written consent.
- The information in this document has been printed on the basis of data from various EY subscribed databases, media reports, publicly available information, internal data and other reliable sources believed to be true. While every effort is made to ensure the accuracy and completeness of information contained, EY LLP takes no guarantee and assumes no liability for any errors or omissions of the information.
- Due to the dynamic nature of the subjects covered by this document, readers of this document are cautioned that (a) any information contained in this document may not be current after the date hereof, and (b) any forward-looking statements are not predictions and may be subject to change without notice.
- Information in this publication is intended to provide only a general outline of the subjects covered, on the basis of a scope of work agreed with ACMA. It should neither be regarded as comprehensive nor sufficient for making decisions, nor should it be used in place of professional advice. EY LLP accepts no responsibility for any loss arising from any action taken or not taken by anyone using this material.
- This disclaimer forms an integral part of this work product.

EY contacts for ACMA Knowledge Partnership:

- Rakesh Batra, National Automotive Sector Leader – rakesh.batra@in.ey.com / +91 124 464 4532