EY Tax and Regulatory Alert

August 2021

Prepared for ACMA

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INDIRECT TAX

Part A - Key Indirect Tax updates

Goods and Services Tax

This section summarizes the regulatory updates under GST for the month of August 2021

- **Notification No. 29/2021- Central Tax dated 30.07.2021** is issued by CBIC to appoint the 1st day of August, 2021, as the date on which the provisions of Section 110 and Section 111 of the Finance Act,2021 shall come into force.

- Section 110 of the Finance Act, 2021 suggests omission of Section 35(5) of the CGST Act,2017 which stated the requirement to get the accounts audited by a Chartered Accountant or a Cost Accountant and submit a copy of the annual accounts and reconciliation statement for the registered persons whose turnover exceeds the taxable limit.

- Further, Section 111 of the Finance Act, 2021 suggests substitution of Section 44 of the CGST Act, 2017 and states that a self-certified reconciliation statement shall be furnished electronically along with the annual returns for every financial year.

- **Notification No. 30/2021- Central Tax dated 30.07.2021** is issued by CBIC to introduce amendments in Rule 80 of the CGST Rules,2017 and states that every registered person other than those referred to in the second proviso to section 44, an Input Service Distributor, a person paying tax under section 51 or section 52, a casual taxable person and a non-resident taxable person, whose aggregate turnover during a financial year exceeds five crore rupees, shall furnish a self-certified form GSTR-9C along with the GSTR 9 on or before 31st day of December following the end of such financial year.

- **Notification No. 31/2021-Central Tax dated 30.07.2021** issued by CBIC exempts the registered person whose aggregate turnover in the financial year 2020-21 is up to INR two crore, from filing the annual return for the said financial year.

- **A new Functionality on Aggregate Annual Turnover was deployed on the GST portal** to enable the taxpayers to see the exact Annual Aggregate Turnover (AATO) for the previous FY, instead of just the two slabs of Above or Up to Rs. 5 Cr.

- The taxpayers can also see the Aggregate Turnover of the current FY based on the returns filed till date.

- Further, the taxpayers have also now been provided with the facility of turnover update in case taxpayers feel that the system calculated turnover displayed on their dashboard varies from the turnover as per their records.

- This facility has been extended to all the GSTINs registered on a common PAN. All the changes by any of the GSTINs in their turnover shall be summed up for computation of Annual Aggregate Turnover for each of the GSTINs.

- The taxpayer can amend the turnover twice within a period of one month from the date of roll out of this functionality. Thereafter, the figures will be sent for review of the Jurisdictional Tax Officer who then can amend the values furnished by the taxpayer.

- **Advisory for taxpayers regarding blocking of the E-way bill generation facility to resume after 15th August, 2021:** The government has decided to resume the blocking of EWB generation facility on the EWB portal, for all the taxpayers in terms of Rule 138 E (a) and (b) of the CGST Rules, 2017, from 15th August onwards.

- Thus, after 15th August 2021, the System will check the status of returns filed in Form GSTR-3B or the statements filed in Form GST CMP-08, and restrict the generation of EWB in case of:

- Non filing of two or more returns in Form GSTR-3B for the months up to June, 2021 and
- Non filing of 02 or more statements in Form GST CMP-08 for the quarters up to April to June, 2021

- Hence, the government had advised the taxpayers to file the pending GSTR 3B returns/ CMP-08 Statement immediately.

Customs and Foreign Trade Policy (FTP)

This section summarizes the regulatory updates under Customs and FTP for the month of August 2021

- **Circular No 18/2021 dated 31.07.2021** was issued by CBIC to revise the Authorized Economic Operator (AEO) programme and to allow the facility of auto-renewal of AEO-T1 validity for continuous certification based on continuous compliance monitoring.

- Taking into account the difficulties faced by AEO-T1 (including MSME AEO-T1) entities in seeking renewal and with a view to reduce compliance burden, the Board has done away with the need of seeking periodic renewals for AEO-T1 certification;

- Further, it has provided that all AEO-T1 entities certified on or after April 1, 2019 shall stand migrated to the auto renewal process w.e.f August 1, 2021;

- However, it has also apprised that such facility is subject to submission of annual self-declaration through the AEO online web portal and review thereof which has to be filed between October 1 to December 31 each year. Those AEO entities who are certified between January 1 to December 31 of each year are exempt from filing annual declaration for that year.

- **Circular No 19/2021- Customs dated 16th August,2021** introduced additions in Circular no 38/2016 to enable Pr. Commissioners/Commissioners of Customs to decide the amount of security' required in case of provisional assessments where there is a reasonable belief that the case involves misdeclaration of origin or value addition in terms of Rule 6(I)(a) of CAROTAR,2020.

- **Instruction No.18/2021-Customs dated 17.08.2021** was issued by CBIC in regard to the verification of the preferential Certificate of Origin and to address the difficulties faced by the trade in implementation of the CAROTAR,2020 Rules.

- The Board has observed that bulk verification requests are being referred from the field formations to the Board for getting the verification done from the Verifying Authorities, without citing appropriate grounds and without mentioning any specific information to be sought from the Verification Authority. As a result, trade facilitation is heavily impacted and also there is a heavy burden on the Board office and the Verification Authorities to get the requests processed and attended to within the time frame.

- In this regard, the Board has drawn attention to Para 4 of Circular no. 38/2020 – Customs dated August 21, 2020 and stated that strict compliance of this provision must be adhered to.

- It has also clarified that if the product of a given manufacturer has already been verified following the verification process, subsequent consignments of the same manufacturer imported with a claim to meet the same originating criteria, may not be considered for verification again. However, if there is a reason to believe that the same product in a subsequent consignment does not meet the originating criteria on account of modification in manufacturing or other origin related criteria, verification may be requested.

- It further emphasized that upon forwarding verification request to the Board under Rule 6(1)(b) of CAROTAR, 2020, the proper officer must clearly indicate the reason to believe why goods are not meeting the prescribed origin

criteria and also enlist specific information required to be obtained from the Verification Authority that the officer considers necessary to determine the origin.

- **<u>Instruction No.19/2021-Customs dated 17.08.2021</u>** was issued by CBIC to clarify the scope of Section 151A of the Customs Act, 1962 in relation to the instructions and clarifications issued by Directorates/ Commissionerate's/ Audit.

- It stated that Board alone can issue instructions/ directions (i) in classification of goods, (ii) with respect to levy of duty thereon, (iii) for the implementation of any other provision of Customs Act or of any other existing law, in so far as they relate to any prohibition, restriction or procedure for import or export of goods.

- Further, the Directorates/ Commissionerates /Audit shall not issue any Circulars/Reports/Alerts which are in the nature of interpretation/clarification/ prescription for the sake of uniformity on the matters covered u/s 151A of Customs Act.

- **<u>Press release on the launch of Compliance Information Portal (CIP) dated 04.08.2021</u>** was issued by CBIC for the launch of Compliance Information Portal (CIP) at www.cip.icegate.gov.in/CIP for providing free access to information on all Customs procedures and regulatory compliance for nearly 12,000 Customs Tariff Items.

- For using CIP, one can simply enter either the Customs Tariff Heading (CTH) or the description of the goods in question to get information to step-by-step procedures, regulatory compliances requirements like License, Certificates, etc., for imports as well as exports. This includes import and export through posts and courier, import of samples, reimport and reexport of goods, self-sealing facility for exporters and project imports.

- Moreover, the CIP has a feature of pan India map showing all the Customs seaports, airports, land customs stations etc. It also contains addresses of the regulatory agencies and their websites.

- **<u>Notification No.16/2015-2020 dated 09.08.2021</u>** was issued by DGFT to extend the period of modification of IEC for FY 2021-22 by one month i.e. till August 31, 2021;

- In case where there are no changes in IEC details same also needs to be confirmed online

- Further, no fee shall be charged on modifications carried out in IEC during the period upto 31st August, 2021.

- **<u>Notification No.17/2015-2020 dated 10.08.2021</u>** was issued by DGFT in order to notify that DGFT may, through a notification impose certain restrictions or prohibitions on the items enlisted in this notification.

  This was amended in order to be in line with the international agreements.

- **<u>Notification No.19/2015-2020 dated 17.08.2021</u>** was issued by DGFT to introduce certain guidelines and rates for the new Remission of Duties and Taxes on Exported Products Scheme. Some of the clarifications issued as provided below:

- It was clarified that the objective of the scheme is to refund the currently un-refunded duties and indirect taxes and the same shall not be available in respect of the duties and taxes already exempted, remitted or credited.

- A rebate would be granted to the eligible exporters at a notified rate as a percentage of the FOB value with a value cap per unit of the exported product, wherever required, on export of items which are categorized under the notified 8 digit HS codes. Further, for certain export items, a fixed quantum of rebate per unit has been notified. The rates notified have been annexed under Annexure 4R.

- Moreover, the rebate is allowed subject to receipt of the sale proceeds within the time

allowed under the Foreign Exchange Management Act,1999, failing which such rebate shall be deemed to have never been allowed. The rebate would not be dependent on the realization of export proceeds at the time of issue of the rebate.

- It was also clarified that the scheme would be implemented through end to end digitization of issuance of the rebate amount in the form of a transferable duty credit/ electronic scrip (e-scrip), which will be maintained in an electronic ledger by the CBIC.

- Furthermore, the e-scrips would be used only for payment of duty of Customs leviable under the First Schedule to the Customs Tariff Act,1975, viz the customs duty.

- Additionally, for the purpose of audit and verification, the exporter would be required to keep records substantiating the claims made under the Scheme.A monitoring and audit mechanism with an IT based Risk Management System(RMS) would be put in place by CBIC, Department of revenue to physically verify the records of the exporters on sample basis. The sample basis for physical verification will be drawn objectively by the RMS, based on risk and other relevant parameters.

- Further, for a broad level monitoring, an Output Outcome framework will be maintained and monitored at regular intervals.

- A new Para 4.55 was introduced which specifically categorizes the ineligible supplies under the scheme. A comprehensive list of the same is provided in the notification.

- **Trade Notice No 11/2021-22 dated 28.07.2021** was issued by DGFT for introducing a new online module for filing of electronic paperless application for Export Authorization for SCOMET items w.e.f 05.08.2021.

- All applicant exporters seeking export authorization for SCOMET items are advised to apply online by navigating to the DGFT website (https://www.dgft.gov.in) -> Services -> Export Management Systems -> SCOMET.

- All the existing pending applications (as on 05.08.2021) will be automatically migrated to this new system and will be processed as usual at DGFT (HQ).

- Further the following processes will also be made available online as part of this new SCOMET Module:

  - Authorisation for Site Visit by the foreign entity(ies) wants to the Premises of the Indian Manufacturer /exporter;

  - Type of IEC to check production processes for SCOMET Export Items; and

  - Post Reporting of Export of SCOMET Items, Software/Technology in following cases:
    a. Export of chemicals permitted to specified countries without authorisation
    b. repair and return of imported SCOMET items after repair abroad
    c. return of SCOMET items (imported /indigenous) after demo/ display/ exhibition/ RFP/ RFQ/ tender etc, abroad
    d. Stock and Sale
    e. Global Authorisation for Intra-company Transfer (GAICT)
    f. Others, if mandated in export authorisations

- **Trade Notice 12/2021-22 dated 28.07.2021** was issued by CBIC for introduction of deemed exports application module.
- Henceforth, the following applications are required to be submitted online through the importer/exporter's dashboard on the DGFT Website:
  i. Refund of Terminal Excise Duty (TED)
  ii. Grant of Duty Drawback as per AIR and
  iii. Fixation of Brand Rate for Duty Drawback

- The method for such application has been elucidated in detail in the notification.

- **Trade Notice 13/2021-22 dated 04.08.2021** issued by DGFT states that all the IECs/Firms, who have been issued duty credit scrip under scheme of Rebate of State and Central Levies and Taxes (RoSCTL) for shipping bills with Let Export Order (LEO) up to March 31, 2020 must get the related e-BRCs uploaded in DGFT portal by respective AD banks latest by 15.09.2021,failing which action as per para 4.96 of Handbook of Procedure as notified vide Public Notice 58/2015-2020 would be initiated by the jurisdictional RAs.

- **Trade Notice 14/2021-22 dated 04.08.2021** issued by DGFT states the online procedure for transfer of Advance Authorization/ EPCG Authorization in case of amalgamation/ de-merger/ acquisition, etc.

- The applicant would request for amalgamation/ de-merger/ acquisition of IEC by navigating to DGFT website →Services →AA (or EPCG) → Transfer of Authorisation.

- Post approval of the IEC request, the firm may apply for amendment of each of their AA/EPCG authorizations separately.

- The request would be auto-submitted to the concerned jurisdictional RA from which the Authorization was issued.

- On approval of the request the given authorization would be amended and the updated details would be transmitted electronically to Customs.

- **Public Notice 20/2015-2020 dated 06.08.2021** was issued for extension of the last date for exports/ replenishments/ imports/ drawals of precious metals as calculated under various sub paras 4.82, 4.83, 4.84 of Handbook of Procedures, 2015-20 expiring between 01.02.2020 and 30.06.2021 by six months.

Direct Tax

Part-A Key Direct Tax updates

1. CBDT issues rules prescribing methodology for computation of relief under Minimum Alternate Tax on account of Advance Pricing Agreement (APA) or secondary adjustment

Background

- As per Income tax Law (ITL) every company shall be liable to pay MAT at the rate of 15% (plus applicable surcharge and cess) on its book profit, in case tax on the total income of a company computed under the normal provisions of the ITL is less than the MAT liability. Book profit for this purpose is computed by making certain adjustments to the profit disclosed in the profit and loss account prepared by the company in accordance with the provisions of the Companies Act, 2013.

- The difference in the tax on total income of company computed under normal provisions of ITL and the MAT paid on book profits, is provided as a MAT credit to the taxpayer.

- Prior to FA 2021, the computation of book profit under MAT did not provide for any adjustment on account of additional income of past year or years included in books of account of financial year on account of APA entered with the taxpayer or secondary adjustment provisions which require an adjustment in the books of accounts of the taxpayer and its Associated Enterprise (AE) to reflect that the actual allocation of profits between the taxpayer and its AE are consistent with the transfer price determined as a result of primary adjustment.

- The secondary adjustment is required where a primary adjustment to the transfer price occurs in one of the following circumstances:
  - Voluntarily made by the taxpayer in the tax return
  - Made by the tax officer and accepted by the taxpayer
  - Determined by an APA entered into by the taxpayer
  - Made as per the safe harbour rules
  - Resulted from a Mutual Agreement Procedure (MAP) resolution

- In order to address the lacuna in the MAT provisions, Finance Act 2021 amended the ITL to enable the CBDT to prescribed rules and procedure to provide relief in the case of a taxpayer being a company, where there is an increase in book profit of the financial year due to income of past year or years included in the book profit, on account of an APA entered into by the taxpayer or on account of secondary adjustment required to be made under the ITL.

- The Assessing Officer (AO) shall, on an application made to him in this behalf by the taxpayer, recompute the book profit of the past year or years and MAT payable, if any, by the taxpayer during the relevant financial year, in the prescribed manner. It is at the discretion of the taxpayer to opt for the new provisions and it shall apply only if the taxpayer has not availed MAT credit in any subsequent financial years.

- The amendment, which is effective for tax years beginning 1 April 2020, was also made applicable for tax years prior to 1 April 2020 subject to the condition that no interest will be payable on account of refund, if any, arising under this provision.

- Pursuant to the above amendment, the CBDT has now notified a new rule for computation of relief in MAT payable by a taxpayer for the financial year and prescribed the procedure for claiming such relief.

Computation of relief under MAT in case of APA or secondary adjustment:

The tax payable by the taxpayer under MAT for the financial year shall be reduced by the amount computed as follow:

(A-B) – (D-C),

- If the value of (A-B) – (D-C) in the formula is negative, relief shall be deemed to be 0.
- For the purpose of the above formula, past income shall mean the amount of income of past year or years included in the book profit of the financial year on account of secondary adjustment or APA.
- On application of the above relief, the MAT credit allowed to the taxpayer shall also be reduced by the amount of relief allowed under the said rule.
- The following procedure should be followed for claiming the relief:
  - The taxpayer shall make a claim for relief in Form 3CEEA electronically by uploading signed printout of said Form in the manner specified by the Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), as the case may be.
  - Form 3CEEA shall be verified by the person who is authorised to verify the return of income of the taxpayer.
  - As part of Form 3CEEA, the taxpayer is required to furnish details of the past income and value of A, B, C and D in the above prescribed formula.

Value of A, B, C, D for computing relief:

A: It denotes tax payable by the taxpayer under MAT on the book profit of the financial year including the past income. However, it shall be deemed to be 0, if there is no tax payable under MAT on the book profit of that financial year including the past income.

B: It denotes, tax payable by the taxpayer under MAT on the book profit of the financial year after reducing such book profit with the past income. However, it shall be deemed to be 0, if there is no tax payable under MAT on the book profit of that financial year after reducing the book profit with the past income.

C: It is an aggregate of tax paid by the taxpayer under MAT on the book profit of those past year or years to which the past income belongs. If in any past year or years there is no tax payable MAT on the book profit of that year (s), the tax payable for such year or years shall be deemed to be 0.

D: It is an aggregate of tax payable by the taxpayer under MAT on the book profit of past year or years, referred to in item C, after increasing such book profit with the relevant past income of such year or years. However, if in any past year or years there is no tax payable under MAT on the book profit of that year or years after increasing the book profit with the relevant past income of such year or years, the tax payable for that year or years shall be deemed to be 0.

2. India has proposed to remove retrospective applicability of indirect transfer provisions

Background

- Prior to 2012, the issue of taxability of gains arising from transfer of shares of a foreign company deriving substantial value from assets in India (indirect transfer) was a subject matter of intense litigation in India.
- In January 2012, in a landmark judgment, the Indian Supreme Court (SC), in the case of Vodafone BV ruled that transfer of shares of a company incorporated outside India would not be taxable in India.
- However, considering the fact that the verdict of the SC was inconsistent with the legislative intent, Government of India (GoI) introduced certain "clarificatory" changes to the Income Tax Act (ITA) vide Finance Act, 2012 (FA 2012) with retroactive effect from 1 April 1962, to clarify that transfer of shares or interest in a foreign entity would be taxable in India, if such shares derive substantial value from assets located in India.
- Pursuant to such amendment, the Indian tax authority issued demand orders in 17 cases including in the case of Vodafone and Cairn Group.
- Further Finance Act 2012, provided that any demand order/ notice etc. issued under the ITA in respect of indirect transfers undertaken prior to the 2012 amendment would continue to be valid. This was done to overcome the SC verdict in the case of Vodafone.

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- Out of the 17 cases, assessments are still pending in two cases owing to a stay granted by High Court. Furthermore, in four cases arbitration was invoked under the Bilateral Investment Protection Agreements (BIPAs) with United Kingdom and Netherlands. Out of the four arbitration cases, the Arbitration Tribunal has ruled in favour of the taxpayers in two cases viz., in the cases of Vodafone and Cairn.
- The move of the GoI to levy retrospective taxes has been hugely criticized on the grounds that it militated against the objective of GoI to provide tax certainty and damaged India's reputation of an attractive investment destination. The retrospective amendment was considered to be breach of India's obligation under the BIPAs on the basis that India failed to provide stable, predictable and foreseeable tax regime and retroactive amendments are inimical and fundamental affront to the principles of legal certainty.
- In the past few years, GoI has been undertaking major reforms in the financial and Infrastructure sector to create a positive environment for the investors. However, the retrospective amendment and the criticism around such amendment continues to be a sore point for the investors.
- Considering the importance and the need to attract foreign investments into India, especially post the economic set back due to COVID-19, GOI has proposed to remove the retrospective effect of the FA 2012 amendment.
- In this regard a bill has been passed in the Lok Sabha (the lower house of Indian parliament) titled "The Taxation Laws (Amendment) Bill, 2021" (Bill) on 6 August 2021. The proposals of the Bill are aimed at achieving the following objectives:

- No levy of taxes on indirect transfers undertaken prior to 28 May 2012 (specified date)
- No assessment to be made/no enforcement of tax demand/ no notices to be issued in respect of indirect transfers undertaken prior to the specified date
- Nullification of demand orders already raised/assessment made/ penalty levied in respect of indirect transfers undertaken prior to the specified date on fulfilment of specified conditions (viz. withdrawal of pending litigations)
- Refund of taxes collected pursuant to demand order issued in respect of Indirect transfers undertaken prior to the specified date. However, such refund would be without any interest.
- Amendment of FA 2012 (which provided for the validity of notices/ orders passed in respect of indirect transfers undertaken prior to the specified date) to provide that such notices/ orders shall cease to apply subject to satisfaction of the specified conditions.

Proposal by CBDT

The Bill proposes to withdraw the retrospective applicability of indirect transfer provisions by proposing as follows:

A. Provisions relating to assessment and penalty order in respect of income arising from indirect transfer undertaken prior to the specified date

- Following orders (specified orders) are not to be passed if it pertains to income arising from indirect transfer undertaken prior to 28 May 2012:
  - Assessment order u/s 143/144 / 153A/153C
  - Reassessment order u/s 147
  - Rectification orders u/s 154 for enhancing the assessment or reduces a refund or otherwise increases the tax liability.
  - Order 201(1) for deeming a person to be assessee-in-default for failure to withhold taxes u/s.
- In cases where a penalty order or any of the specified orders have already been passed in respect of indirect transfer undertaken prior to the specified date, then the same shall be deemed to never have been passed if the taxpayer satisfies the following conditions (specified conditions):
- The taxpayer should either withdraw or submit an undertaking to withdraw any pending appeals, writ petitions, civil appeals, in such form and manner as may be prescribed in respect of income arising from indirect transfer undertaken prior to the specified date.
- Taxpayer shall withdraw or submit to withdraw any proceedings for arbitration, conciliation or mediation initiated by the taxpayer in respect of income arising from indirect transfer undertaken prior to the specified date in such form and manner as may be prescribed. Further, the taxpayer is to withdraw or submit an undertaking to withdraw any claim in such proceedings.
- The taxpayer shall submit an undertaking waiving its right to seek any remedy or claim which may otherwise be available to the taxpayer under any other law or agreement for the time being in force or under any international agreement entered into by India in such form and manner as may be prescribed.
- Such other conditions as may be prescribed by the Central Board of Direct Taxes (CBDT).

B. Amendment to the Finance Act 2012

- FA 2012 which inserted the indirect transfer provisions under ITA also provided for a validation provision under Section 119 of the FA 2012 itself. The validation provision provided that any notices or demand orders passed or taxes levied, imposed or collected in respect of indirect transfer prior to the enforcement of FA 2012 would remain valid without prejudice to any judgement or order of any Court or Tribunal.

- Through this validation clause, FA sought to ensure that past notices, demand, taxes levied/demanded etc. which would have otherwise become invalid due to the SC ruling in Vodafone (supra) were made valid.

- In light of the proposed removal of the retrospective applicability of indirect transfer provisions, this Bill provides that the validation clause shall not apply if the taxpayer fulfils the specified conditions listed above.

C. Refund upon cancellation of assessment/ Inapplicability of notices issue

- Any refund that becomes due to the taxpayer as a consequence of any assessment or demand order or recovery becoming invalid as indicated above, shall be granted to the taxpayer. However, there would be no payment of interest on such refund amount.

Effective date

- The Bill will take effect from the date it is enacted into law. Taxpayers will need to wait for the enactment of the Bill and conditions to be prescribed by CBDT to take benefit of this opportunity to close litigation for past years.

3. CBDT extends date under section 3 of the Vivad se Vishwas Act

- Under the Direct Tax Vivad se Vishwas Act 2020 (hereinafter referred to as "VSVA"), the amount payable by the declarant is stated in the table under section 3 of the VSVA.

- As per the latest notification dated 25th June 2021, the last date of payment of the amount (without any additional amount) has been notified as 31st August 2021. Further the last date for payment of the amount (with additional amount) under VSVA has been notified as 31st October, 2021.

- Considering the difficulties being faced in issuing and amending Form no 3, which is a prerequisite for making payment by the declarant under VSVA, it has been decided to extend the last date of payment of the amount (without any additional amount) to 30th September, 2021. Necessary notification to this effect shall be issued shortly.

- It is, however, clarified that there is no proposal to change the last date for payment of the amount (with additional amount) under Vivad se Vishwas Act, which remains as 31st October, 2021.

4. CBDT extends due date of electronic filing of various Forms

- On consideration of difficulties reported by the taxpayers and other stakeholders in electronic filing of certain Forms under the provisions of the Income-tax Act,1961 read with Income-tax Rules,1962 (Rules), Central Board of Direct Taxes (CBDT) has decided to further extend the due dates for electronic filing of such Forms. The further details are as under:

- The application for registration or intimation or approval under Section 10(23C), 12A, 35(1)(ii)/(iia)/(iii) or 80G of the Act in Form No. 10A required to be filed on or before 30th June, 2021, as extended to 31st August, 2021 vide Circular No.12 of 2021 dated 25.06.2021, may be filed on or before 31st March, 2022;

- The application for registration or approval under Section 10(23C), 12A or 80G of the Act in Form No.10AB, for which the last date for filing falls on or before 28th February, 2022 may be filed on or before 31st March, 2022;

- The Equalization Levy Statement in Form No.1 for the Financial Year 2020- 21, which was required to be filed on or before 30th June, 2021, as extended to 31st August, 2021 vide Circular No.15 of 2021 dated 03.08.2021, may be filed on or before 31st December, 2021;

- The Quarterly statement in Form No. 15CC to be furnished by authorized dealer in respect of remittances made for the quarter ending on 30th June, 2021, required to be furnished on or before 15th July, 2021 under Rule 37BB of the Rules, as extended to 31st August, 2021 vide Circular No.15 of 2021 dated 03.08.2021, may be furnished on or before 30th November, 2021;

- The Quarterly statement in Form No. 15CC to be furnished by authorized dealer in respect of remittances made for the quarter ending on 30th September, 2021, required to be furnished on or before 15th October, 2021 under Rule 37BB of the Rules, may be furnished on or before 31st December, 2021;

- Uploading of the declarations received from recipients in Form No. 15G/15H during the quarter ending 30th June, 2021, which was originally required to be uploaded on or before 15th July, 2021, and subsequently by 31st August, 2021, as per Circular No.12 of 2021 dated 25.06.2021, may be uploaded on or before 30th November, 2021;

- Uploading of the declarations received from recipients in Form No. 15G/15H during the quarter ending 30th September, 2021, which is required to be uploaded on or before 15th October, 2021, may be uploaded on or before 31st December, 2021;

- Intimation to be made by Sovereign Wealth Fund in respect of investments made by it in India in Form II SWF for the quarter ending on 30th June, 2021, required to be made on or before 31st July, 2021 as per Circular No.15 of 2020 dated 22.07.2020, as extended to 30th September, 2021 vide Circular No.15 of 2021 dated 03.08.2021, may be made on or before 30th November, 2021;

- Intimation to be made by Sovereign Wealth Fund in respect of investments made by it in India in Form II SWF for the quarter ending on 30th September, 2021, required to be made on or before 31st October, 2021 as per Circular No.15 of 2020 dated 22.07.2020, may be made on or before 31st December, 2021;

- Intimation to be made by a Pension Fund in respect of each investment made by it in India in Form No. 10BBB for the quarter ending on 30th June, 2021, required to be made on or before 31st July, 2021 under Rule 2DB of the Rules, as extended to 30th September, 2021 vide Circular No. 15 of 2021 dated 03.08.2021, may be made on or before 30th November, 2021;

- Intimation to be made by a Pension Fund in respect of each investment made by it in India in Form No. 10BBB for the quarter ending on 30th September, 2021, required to be made on or before 31st October, 2021 under Rule 2DB of the Rules, may be made on or before 31st December, 2021;

- Intimation by a constituent entity, resident in India, of an international group, the parent entity of which is not resident in India, for the purposes of sub-section (1) of section 286 of the Act, in Form No.3CEAC, required to be made on or before 30th November, 2021 under Rule 10DB of the Rules, may be made on or before 31st December, 2021;

- Report by a parent entity or an alternate reporting entity or any other constituent entity, resident in India, for the purposes of sub-section (2) or sub-section (4) of section 286 of the Act, in Form No. 3CEAD, required to be furnished on or before 30th November, 2021 under Rule 10DB of the Rules, may be furnished on or before 31st December, 2021;

- Intimation on behalf of an international group for the purposes of the proviso to sub-section (4) of section 286 of the Act in Form No. 3CEAE, required to be made on or before 30th November, 2021 under Rule 10DB of the Rules, may be made on or before 31st December, 2021.

Key Regulatory updates

This section summarizes the regulatory updates for the month of August 2021

Department of Economic Affairs ('DEA'), Ministry of Finance ('MoF') notifies increase in sectoral cap for foreign investment in insurance companies from 49% to 74%

The DEA has amended the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 notifying the increase in sectoral cap for foreign investment in insurance companies in line with Press Note 2 (2021 Series) issued by Department for Promotion of Industry and Internal Trade ('DPIIT'). The key features are:

- Sectoral cap of foreign direct investment and aggregate holding by way of total foreign investment (including portfolio investors) in insurance companies under automatic route has been increased from 49% to 74%;

- Applications for foreign direct investment in private banks having joint venture or subsidiary in insurance sector may be addressed to the Reserve Bank of India for consideration in consultation with the Insurance Regulatory and Development Authority of India, in order to ensure that the limit of foreign investment applicable for the insurance sector as specified above is not breached.

- The condition that the control and ownership of insurance company should be in the hands of resident Indians has been done away with. Instead, it has been prescribed that in an Insurance company having foreign direct investment, the following should be resident Indian citizens:

  - a majority of its directors;
  - a majority of its Key Management Persons; and
  - at least one among the Chairperson of its Board, its Managing Director and its Chief Executive Office

- As per the amendment, insurance companies having foreign investment shall comply with Indian Insurance Companies (Foreign Investment) Rules, 2015 and applicable rules and regulations notified by the Department of Financial Services or the Insurance Regulatory and Development Authority of India from time to time.

Source: Foreign Exchange Management (Non-debt Instruments) (Second Amendment) Rules, 2021 dated 19 August 2021

Part B- Case Laws

Goods and Service Tax

1. M/s Santosh Distributors [Kerala AAAR-2021 (7) TMI 789]

Subject Matter: Ruling wherein the AAAR held that the additional discount given to the customers/dealers post the activity of supply to would be considered as a consideration under GST and thus would be leviable to GST.

Background and Facts of the case

- The appellant is an authorized distributor of M/s Castrol India Ltd. ('Castrol'). Castrol has two types of dealers – normal dealers and workshops, sales to whom are made by distributors like the appellant.

- Castrol announces various types of discount schemes to dealers and workshops. The Appellant is entitled to discounts announced by Castrol to dealers plus a discount rebate of 4.3%.

- The Appellant is obliged to give the discounts as announced by Castrol to appellant's dealers and in turn is entitled to receive said additional discount rebate from Castrol.

- Hence, there are two sets of transactions which are of relevance to this proceeding, namely :

  1. The transaction of sale between Castrol and its distributors/appellant (hereinafter "Transaction 1")
  2. The transaction of sale between the Distributor/appellant and its customers, viz. dealers or workshops (hereinafter "Transaction 2")

- Among the various discounts offered by Castrol, some discounts are not known at the time of supply. If some additional discount is agreed with Castrol and to be offered to dealers after the point of time of supply, the Appellant is obliged to give the additional discount to Appellant's customers/dealers and is in turn entitled to this post sale additional discount.

- In cases where the post-sale discounts were not known at the time of supply, Castrol issue a financial credit note. In relation to such credit notes, there is no reduction of the transaction value or of the tax paid, sought under Section 15(3)(b) of the CGST Act.

- In respect of the above, the following issues were placed before the AAR:

  - Whether the discount provided by Castrol to their dealers through the appellants as explained above attracts any tax under the GST Laws

  - Whether the amount shown in the commercial credit notes issued to the appellant by Castrol attracts proportionate reversal of Input Tax Credit

  - Is there any tax liability under GST laws on the appellant for the amount received as reimbursement of discount or rebate provided by Castrol as per written agreement between Castrol and dealers and also an agreement between Castrol and distributors.

  - In relation to the above questions, the AAR had passed the following orders:

- The additional discount given by Castrol through the applicant is to offer a special reduced price by the applicant to the customers/dealers and hence the amount represent consideration paid by Castrol to the applicant for supply of goods by the applicant to the customer/dealer. Therefore, this additional discount reimbursed by Castrol to the applicant is liable to be added to the consideration payable by the customer to the applicant to arrive at the value of supply under Section 15 of the CGST/SGST Act in the hands of the applicant.

- Castrol issuing the commercial credit note is not eligible to reduce his original tax liability and hence the applicant will not be liable to reverse the ITC attributable to the commercial credit notes received from the supplier.

- Aggrieved of the above decision, the appellant has filed the instant appeal before the Appellate authority.

- The Appellant had contended that the post-sale discounts, as being not eligible for deduction from the transaction value, are therefore part of the transaction value on which GST has been paid.

- It further contended that The impugned order creates a basis of taxation which would result in double taxation as an element of the price which has already been taxed in respect of Transaction 1 is also sought to be taxed once again in as part of the transaction value of Transaction 2.

- The appellant had also held that the impugned order has failed to appreciate the legal significance and impact of the issuance of credit notes in terms of Section 15 and Section 34 of the CGST Act read with the Circular No. 92, dated 7 March 2019. Discount/credit note cannot be construed as consideration as defined under Section 2(31) of CGST Act.

- Moreover, he had stated that there is nothing under the CGST Act which states that trade discounts offered by the supplier and/or commercial credit notes issued by the supplier must be treated as an additional consideration in the hands of the distributor who supplies the said products to the dealers/consumers. Section 15 of the CGST Act which provides for 'Value of Supply' does not provide for such an interpretation.

- The AAAR referred to the provisions of value of supply under the CGST Act,2017 and inferred that the value of supply will exclude discount only if the discount granted is in the agreement with the provisions of Section 15(3) of the CGST Act,2017. The quantum or the percentage of discount has to be specifically provided in the agreement which is entered before or at the time of supply.

- The Authority had also referred to the definition of Consideration under the CGST Act, 2017 and held that the discounts so offered as per instructions of the supplier of goods/principal company are completely reimbursed by the supplier of goods/principal company. Thus the additional discount given by M/s. Castrol to the appellant is a consideration to offer the reduced price in order to augment the sales. This additional discount squarely falls under the definition of the term "consideration" as specified under Section 2(31) of the CGST/SGST Act.

Ruling

- In light of the above observations by the Authority, it was held that the additional discount reimbursed by Castrol is liable to

be added to the consideration payable by the customers or dealers and the appellant is liable to pay GST at an applicable rate on the same.

- Additionally, the commercial credit notes will not reduce the original tax liability and the appellant would not be liable to reverse the ITC attributable to the commercial credit note.

2. M/s Saddles International Automotive & Aviation Interiors Private Limited [Andhra Pradesh AAR -15/AP/GST/2021]

Subject Matter: Ruling wherein the Authority had held that the Car Seat would be classified under HSN 8708 and attract GST at the rate of 28%.

Background and Facts of the case

- The Applicant is mainly engaged in the business of manufacture of car seat covers and other allied accessories necessary for the seats.
- They sell the manufactured seat covers to the Car seat makers who affix the seat covers onto the seat and thereafter the seat is affixed to the motor vehicle.
- The Applicant has so far classified the 'seat covers' under the HSN 8708 and paid applicable GST at the rate of 28%.
- The Applicant has sought advance ruling on the following questions:
    - Whether the product named 'Car Seat Covers' merits classification under HSN 9401? If not, what is the correct classification applicable for the car seat covers?
    - Is Sl. No. 435A of Schedule IV of Notification 1/2017- Central Tax (Rate) dt 28.06.2017 applicable to 'Car Seat Covers'? If not, what is the applicable entry under the said notification?

Discussions and findings of the case

- The applicant submitted that the 'seat covers' are rightly classifiable under HSN 9401 as the 'seat covers' are essential parts of 'seat' without which seat can be rendered dysfunctional. A seat cover has various uses for a seat which include protection of the seat, absorption of heat to keep the car cool and user comfortable, etc.
- The applicant further contended that for any product to be classified under Chapter 94019000, the same has to be in the nature of 'part' of 'seat'.
- Referring to various case laws, the applicant had held that a part is an integral element of a machinery or equipment without which the specific product cannot function. Whereas an accessory is something which is complimentary to the main product and can be used in various equipment or machines.
- The seat covers help to assemble and complete the structure of 'seats'. Further, 'car seat covers' can be used with 'seats' and nothing else. Hence, the 'seat covers' must not be qualified as an accessory, but as a part of the seat.
- The applicant also made reference to the 'functional test' and stated that as per the mentioned test, goods are to be classified in terms of the functions for which they are put to use. Hence, the seat covers must be judged on the basis of the functions they perform which is giving a comfortable position to the drivers and passengers and giving stability to the seat.
- Accordingly, the seat covers function as an integral component of the seat and merit classification under HSN 9401.

- Moreover, the explanatory notes to chapter 94 states that the "heading also covers identifiable parts of chairs or seats, such as backs, bottoms and arm-rests (whether or not upholstered with straw or cane, stuffed or sprung) and spiral springs assembled for seat upholstery.

- In furtherance to the above, the applicant had submitted that chapter note 87 cover various equipment which are affixed to the motor vehicles and specifies an exhaustive list for what would be covered under the chapter. None of the entries therein relate to 's/eats' or 'parts'.

- The applicant ,hence, contended that a specific entry relating to seats and any part of the same is covered under chapter 94 as opposed to the general heading of Chapter 87. Further, going by the common parlance test and usage test for classification, it held that the seat cover must be classified under chapter 97.

- However, the Authority referred to the definitions of parts and accessories and observed that the seat covers cannot be construed to be a part of the seat by any means. It further contended that they are meant for protection of the seat and the functional value of the seat cover is the comfort and convenience it extends to the driver and the passengers. Thus, the 'seat covers' are not essential parts of the seats, but are accessories that enhance their functional value.

- The AAR further held that even in general trade parlance or by specific usage, the 'seat covers' are considered as accessories and customized as per the preferences of the clients.

- It also held that car seat covers were classified under the heading 8708 in the case of **Guru Overseas Private Limited vs Commissioner of Central Excise** as well. This was further strengthened by the clarificatory circular issued by CBEC vide circular no 541/37/2000 dated 16.08.2000 in which it was mentioned that the car seat covers were classified under heading 8708 as accessories of car seat.

Ruling

- Basis the above observations, the AAR held that 'car seat covers' fall within Serial no 170 under HSN 8708 Schedule IV of Notification No-01/2017-Central Tax(Rate) dated 28.06.2017 attracting GST at the rate of 28%.

Part B – Case Laws

Direct Tax

1. Global Santafe Drilling Company [127 taxmann.com 802 (Mumbai - Trib]

Subject matter: Mumbai Tribunal rules business income received in foreign currency to be converted at year end exchange rate despite variation with rate adopted by payer for withholding

Background

- Rule 115 of the Income-tax Rules, 1962 (ITR) provides mechanism for conversion of income received in foreign currency. Explanation 2(c) thereof provides for adoption of year end exchange rate (telegraphic transfer buying rate-TTBR) for the income chargeable under the head “business and profession”. However, the proviso to Rule 115(1) also provides that if the income is subjected to withholding under Rule 26, the exchange rate on date on which tax is required to be withheld needs to be adopted.

- The taxpayer is a non-resident and engaged in the business of charter and hire of oil drilling rig. During the tax year 2013-14, it received income from resident payer in foreign currency on which payer withheld taxes by applying exchange rate as on date of withholding.

- It appears that, in its return of income, the NR taxpayer applied year end exchange rate for converting the said income and not the exchange rate adopted by payer for withholding purposes. This resulted in a mismatch of INR 92.97m between income offered by the taxpayer and the income appearing in Form 26AS of the taxpayer.

- The exchange rate applied by the payer for withholding purposes was higher as compared to the year end exchange rate adopted by the taxpayer.

- The Tax Authority took the view that the income is required to be converted in terms of the proviso to Rule 115(1) i.e. the rate as on the date on which withholding was required to be made. Hence, the Tax Authority sought to assess the taxpayer on such higher income appearing in Form 26AS.

- On Taxpayer’s appeal, the first appellate authority ruled in favour of the taxpayer. He held that Explanation 2(c) to Rule 115(1) clearly provides methodology for conversion of business income received in foreign currency and thus, the income needs to be converted as per this rule i.e. by adopting the TTBR as on the last day of the tax year. Further, the rate applied by payer of income for withholding purposes is not relevant for computation of income in hands of recipient taxpayer. Having decided that year end exchange rate needs to be applied, the first appellate authority directed the Tax Authority to verify whether year end TTBR rate was correctly applied by taxpayer.

- The Tax Authority appealed to the Mumbai Tribunal.

Tribunal’s ruling

- In a very short ruling, the Mumbai Tribunal ruled in favour of taxpayer and upheld the order of the first appellate authority.

- The Tribunal stated that it is possible, in fact inevitable, that there may be variations in the income computed in the hands of the taxpayer by applying year end exchange rate and the income converted at exchange rates on the date of payment by the payer. Therefore, there was no infirmity in the order of first appellate authority.

2. **M.M. Aqua Technologies (Taxpayer) [TS-645-SC-2021]**

Subject matter: SC rules that interest liability discharged by issuing debentures tantamount to "actual payment", deduction allowed under Income Tax Laws

Background and facts

- S. 43B of the ITL provides that certain business deductions are allowed only on "actual payment", even where taxpayers follow the mercantile method of accounting. S. 43B, inter alia, covers deduction for interest on any loan or borrowing from a certain financial institution for which a deduction is allowed only in the year in which actual payment is made.

- In 2006, an Explanation was introduced in S. 43B to clarify that conversion of interest on an existing loan into a fresh loan will not qualify as "actual payment" for the purpose of S. 43B. This Explanation was given retrospective effect from 1 April 1989 i.e., the date from which the clause relating to the restriction on interest deduction was inserted in S. 43B.

- The Taxpayer had taken loans from multiple Lenders. The original terms of the loans provided that in case of default of repayment of the principal and interest, it could result in conversion of 20% of the amount in default into equity capital of the Taxpayer at the option of the Lenders. Also, there was a possibility of repayment of loan and interest as per the revised terms and conditions as stipulated by the Lenders at the time of each default.

- In the year under consideration (tax year 1995-96), the Taxpayer faced a financial crunch and defaulted in making payment to the Lenders. While the Lenders did not exercise the option of conversion into equity, they agreed on a "rehabilitation plan" pursuant to which the Taxpayer issued convertible debentures to the Lenders in lieu of the outstanding interest and other charges.

- As a result of these debentures issue, interest of INR28.4m was effectively paid to the Lenders and the amount was claimed as deduction by the Taxpayer in its tax return for that year.

- The tax authority rejected the Taxpayer's claim under the view that issuance of debentures does not amount to an "actual payment" of interest. The tax authority alleged that issuance of debentures was not as per the original terms and conditions on which the loans were granted and subsequent change in the terms of the agreement would be contrary to S. 43B of the ITL.

- Upon appeal, the first appellate authority ruled in favor of the Taxpayer. It observed that discharge of the liability of interest through issuance of debentures under the rehabilitation plan was in accordance with the terms and conditions of the original loan agreement.

- Furthermore, debenture is not postponement of liability, rather it a valuable security which is freely negotiable and openly quoted in the stock market. Since the Lenders had accepted the debentures as effective discharge of interest liability of the Taxpayer, it would amount to actual payment of interest under S. 43B of the ITL.

- The second appellate authority (Income Tax Appellate Tribunal or Tribunal) upheld the order of the first appellant authority on the following basis:

  - The parties have agreed between themselves that the interest would be funded and convertible debentures would be issued in an amount identical to the funded interest and that this arrangement would be accepted by both of them as actual discharge of the liability to pay interest. It is not open to the tax authority to intervene or rewrite the commercial arrangement to allege that interest liability was not discharged.

- There is no specific mode prescribed under S. 43B for making payment of interest liability. Reference was made to the Delhi Tribunal decision in the case of Subhra Motel Pvt Ltd v. CIT, which held that the expression "actually paid" in S. 43B is not qualified by the words cash or cheque or draft or any other specific mode, which is a requirement for claiming deduction of statutory payments like contribution to provident fund, superannuation fund, gratuity fund etc.

- In the year of redemption of debentures, the Taxpayer has not claimed any deduction in respect of the interest liability. The Lenders have also offered the payment to tax as business income and, hence, there is no loss of revenue.

- At the time of adjudication of the issue by the HC, Explanation to S. 43B was introduced in the ITL with retrospective effect from 1983. Furthermore, the issue for adjudication was incorrectly framed and recorded as relating to discharge of interest liability through a "term loan" (instead of issue of debenture). Under the incorrectly framed issue, the HC held that the issue is squarely covered by the Explanation and it negates the Taxpayer's contention that interest which has been converted into term loan is deemed to be "actually paid". In light of the insertion of the Explanation, the Taxpayer cannot claim deduction under S. 43B of the ITL.

Issue before the SC

Whether the payment of interest by way of issue of debentures amounts to "actual payment" as contemplated by S. 43B of the ITL.

SC's ruling

- The SC reversed the HC's ruling and held that the HC was erroneous in concluding that interest had been converted into a "loan". Furthermore, the SC held that since the issue was wrongly framed before the HC, it reached the wrong conclusion as the key word "debentures" was missing in the question framed before the HC.

- The object of S. 43B, as originally enacted, is to allow certain deductions only on actual payment. This is made clear by the non-obstante clause contained in the beginning of the provision, coupled with the deduction being allowed, irrespective of the years in which the liability to pay such sum was incurred by the Taxpayer according to the method of accounting regularly employed by it. In other words, only "actual payment", as contrasted with incurring of a liability, can allow for a deduction. Furthermore, S. 43B does not refer to the mode of payment, as is a requirement for claiming deduction of certain other statutory payment to be paid in cash or cheque or draft or any other mode.

- The issue is only if interest can be said to have been actually paid by the mode of issuing debentures. The following facts, in the present case, support that interest liability has been "actually paid" by means of issuance of debentures in the year under consideration:

  - As per the rehabilitation plan agreed to between the parties, debentures were accepted by the Lenders in discharge of or "in lieu of" the debt on account of outstanding interest.

  - It is also clear that there was extinguishment of liability to pay interest, not only from the accounts produced by the Taxpayer but also from the accounts of the Lenders, which reflect the amount received by way of debentures as its business income.

- The Explanation is not applicable in the present case:

  - Explanation 3C, which was introduced for the "removal of doubts", only made it clear that interest that remained unpaid and has been converted into a loan or borrowing shall not be deemed to have been actually paid. In the present case, issue of debentures by the Taxpayer was, under a rehabilitation plan, to extinguish the liability of interest altogether.

  - The Explanation was introduced to plug a loophole whereby taxpayers were misusing S. 43B by not actually making the interest payment but converting it into a fresh loan and claiming the deduction. However, in the present case, no misuse of S. 43B was found by the first and second appellant authorities. Thus, the Explanation cannot be brought to the aid of the tax authority in the facts of present case.

  - The tax authority had relied on the SC judgment in the case of CIT v. Gujarat Cypromet Ltd., where outstanding interest liability towards financial institutions were paid off using funds received by taking a loan from Industrial Development Bank of India (IDBI) and, subsequently, a credit entry of "IDBI Loan" appeared in the financial statement of the taxpayer. In this case, the SC had disallowed the deduction by applying Explanation to S. 43B. The SC found that the Explanation was squarely attracted in that outstanding interest had not actually been paid but, instead, a new credit entry of loan now appeared, bringing the case within the express language of the Explanation. This is far removed from the facts of the present case and, hence, is distinguishable.

  - The SC restored the order of the second appellate authority (supra).

- Even if there is ambiguity in the interpretation of the Explanation, three well-established canons of interpretation support the Taxpayer:

- Since the Explanation was introduced with the object of plugging a loophole i.e., misuse of S. 43B, bona fide transactions of actual payment are not meant to be affected by it. Reliance was placed on the SC's own ruling in the case of K.P Varghese v. ITO.

- A retrospective provision which is for the removal of doubts cannot be presumed to be retrospective if it alters or changes the law as it earlier stood. Reliance was placed on the SC's own ruling in the case of Sedco Forex International Drill. Inc. v. CIT. To this extent, the Explanation should be considered as only explaining the purport of S. 43B and not adding any new condition to it.

- Any ambiguity in the language of the Explanation shall be resolved in favor of the Taxpayer. Reliance was placed on the ruling of Cape Brandy Syndicate v. Inland Revenue Commissioner, as followed in Vodafone International Holdings BV v. UOI.

- Accordingly, the SC set aside the HC's order and allowed deduction under S. 43B in favor of the Taxpayer.

3. M/s Tweezerman (India) Private Limited [TS-301-HC-2021(MAD)-TP]

Madras HC disallows deduction for extraordinary high profits of an export-oriented unit (EOU) arising due to close connection with related party customer

Background

- Section (S) 10B provided for tax holiday for 100% export-oriented units (EOUs) engaged in manufacture and export of article or things or computer software for a period of ten consecutive tax years from the total income of the taxpayer. S. 10B(7) read with S. 80(IA)(10) empowers the Assessing Officer (AO or tax authority) to restrict the profits claimed for deduction/ tax holiday where it appears to the AO that owing to the close connection between taxpayer (eligible for tax holiday) and any other entity, the course of business is arranged to produce more than ordinary profits to the taxpayer. In such case, AO can recompute the eligible profits of taxpayer entity for the purposes of the tax holiday deduction.
- Separately, transfer pricing provisions under Chapter X of the ITA regulate the pricing of transactions between associated enterprises. S. 92 requires that any income arising from an international transaction or specified domestic transaction should be computed at an arms-length price (ALP). S. 92C prescribes 5 methods for computation of ALP. The burden of proving the arm's length nature of a transaction lies with the taxpayer. Further, S. 92CA empowers AO to refer specific transactions to a transfer pricing officer (TPO) for determination of ALP where it considers it necessary or expedient to do so.

Facts

- Taxpayer, an Indian company, was a manufacturer of beauty products and a 100%. EOU claiming tax holiday under S. 10B. It exported its goods exclusively to a US company (US Co), which is a related party of taxpayer.

- Taxpayer and US Co have a common foreign shareholder holding 70% stake in the US Co and 32.5 - 35% stake in the Taxpayer.

- For the relevant FY 2003-04, the export sales turnover of Taxpayer was INR 15.06 Cr out of which INR 12.51 Cr was claimed as deduction under S. 10B of the ITA, in respect of the net profits of taxpayer.

- The Tax authority made a reference to the TPO to determine the ALP. The Taxpayer submitted a computation before the TPO to justify that its profits were at ALP. Such computation was based on one comparable of a German company by applying CUP method. The computation showed that the profits earned by Taxpayer was higher than ALP by INR 3.54 Cr and hence no TP adjustment was warranted.

- But on application of TNMM method, the TPO found that the profits earned by the Taxpayer was higher than ALP by INR 5.18 Cr. While TPO himself could not make any TP adjustment, he recommended the Tax Authority to invoke S.80IA(10) and disallow excess profits of INR 5.18 Cr. At this stage, the Taxpayer furnished a revised computation by adding some more comparables to contend that the excess profit was, in fact, INR 1.29 Cr.

- However, the Tax Authority determined the taxable income of the Taxpayer by disallowing INR 3.54 Cr as excess profits by relying on the first statement furnished by the Taxpayer and treated the amount as income under the head “Other Sources”. The tax authority noted that:

  - Out of the total turnover of INR 15.06 CR, income of INR 12.51 Cr worked out to profit margin of 83.1% which was very high and since the Taxpayer itself had admitted the excess profit as INR 3.54 Cr to TPO, it was accepted by the Tax authority as the amount of disallowance, by excluding it from business profits.

- There was a close connection between the Taxpayer and US Co to which the former was exporting the products as both of them had a common shareholder who had substantial interest in both of them. Further, the abnormally high profits as disclosed by the Taxpayer was claimed as a deduction in India, only to avoid payment of taxes.

- Being aggrieved, the Taxpayer retracted its earlier submission of excess profits of INR 3.54 stating an error in computation and submitted a revised computation of ALP using new comparables. Taxpayer preferred an appeal against the order passed by the tax authority.

- The first appellate authority [CIT(A)] agreed with the order of the tax authority. CIT(A) observed that taxpayer is selling goods only to US Co and it has not proved that rate at which it has sold goods to US Co are at par with rates at which it would sell to an independent party. Further, taxpayer and US Co were closely associated with common foreign shareholder (even if it is holding only 35% in I Co) Accordingly, it upheld tax authority's order but directed it to restrict the disallowance to 83.1% of INR 3.54 Cr since the profit margin earned by taxpayer in the relevant year was 83.1%.

- Both Taxpayer and Tax Authority filed further appeals to the Income Tax Appellate Tribunal (the Tribunal). The Tribunal ruled in favour of the taxpayer and deleted the full disallowance of INR 3.54 Cr. It held that:

  - TPO has verified the ALP and has confirmed that no adjustment on account of transfer pricing was required to be made. This showed that the profits earned by the Taxpayer was at ALP. Intention of transfer pricing is on similar lines as 801A(10). It is to verify and adjust the profits of an eligible business so that under the garb of the eligible business the taxable income of an associated enterprise is not reduced by shifting its income to the eligible business.

  - Even if it is accepted that proceedings under S. 10B(7) read with 80(IA)(10) are separate and independent from TP proceedings, it becomes incumbent upon the AO to specify as to why he feels that the profits disclosed by the taxpayer is higher than the ordinary profits which might be expected to arise. Section 801A(10) does not give an arbitrary power to the AO to fix the profits of the taxpayer.

  - In present case, AO has failed to discharge the onus and he has blindly relied on calculation of INR 3.54 CR which taxpayer erroneously gave before the TPO and later corrected it. AO has not shown as to what he feels is the actual ordinary profits which the taxpayer could have generated.

- Being aggrieved, the Tax Authority filed further appeal before the HC.

Tax authority's contentions before the HC

- The Taxpayer had attempted to evade tax by claiming higher deduction of extraordinary profit on sales made to the US Co with whom it had close connection. The Tribunal's order did not discuss this aspect close association between the Taxpayer and US Co.

- The onus of proving the ALP was with the Taxpayer and it was based on taxpayer's own calculation, that the excess profit was determined at INR 3.54 Cr. The subsequent retraction of its own submission by the Taxpayer was unacceptable.

- It is not true that the Tax Authority had not made any analysis and assessment to determine the excess profits.

- While the TPO had recommended disallowance of excess profit of INR 5.18 Cr based on ALP as per TNMM method, the Tax Authority had judiciously restricted the disallowance to INR 3.54 Cr based on taxpayer's own computation of excess profits over ALP as per CUP method.

Taxpayer's contentions before the HC

- Tax authority has not been able to establish how the Taxpayer and US Co have deliberately organised their affairs so as to generate profits which are more than ordinary profits being earned in the line of business, so as to invoke S. 80IA(10). Onus to prove the above, lies on the Tax Authority, however the same was shifted to the Taxpayer. Reliance was placed on rulings of Vedansh Jewels (P). Ltd2, Schmetz India (P). Ltd3 and A.T. Kearney India Pvt. Ltd to support the above.

HC's ruling

- The HC rejected Tribunal's ruling and decided in favour of the Tax authority. It held that the excess profit of INR 3.54 Cr should be disallowed from deduction under S. 10B and same should be treated as 'Income from other sources. HC's ruling was based on the following

  - The burden of proving the arm's length nature of a transaction lies with the tax payer. If the tax authorities, during audit proceedings on the basis of material, information or documents in their possession, are of the opinion that the ALP was not applied to the transaction or that the tax payer did not adduce adequate and correct documents/information/data, the total taxable income of the tax payer may be recomputed after a hearing opportunity of hearing is granted to the tax payer.

  - As per admitted facts, Taxpayer and US Co were closely associated due to presence of the common shareholder. Further, there was an email correspondence between taxpayer and US Co in which lower margin by US Co was discussed and it revealed that the margins of the Taxpayer were known to US Co.

- Taxpayer's profit margin for the given accounting period was extraordinarily high being 83.1% which was more than 12% of the profit margin of the earlier year.

- In the present case, the TPO and the AO accepted taxpayer's written submissions and determined the excess profit INR Rs.3.54 Crores under CUP method worked out by the Taxpayer itself. The revised calculation by the Taxpayer was rejected as there was no actual error in earlier submission and the revision by adding some more comparables was clearly an 'after thought' to reduce the disallowance. The Tribunal had not discussed this aspect.

- Taxpayer's reliance on the judicial rulings on S. 80(IA)(10) is distinguishable since in the present case the "close association" between taxpayer and US Co and their 'arranged' pricing were adequately substantiated by the tax authority/ CIT(A).

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