EY Tax and Regulatory Alert

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A. KEY TAX UPDATES

Part A - Key Indirect Tax updates

1. Goods and Services Tax

This section summarizes the regulatory updates under GST for the month of November 2019

- The due date for furnishing of the return in Form GSTR-1 extended for registered persons in Jammu and Kashmir having aggregate turnover of upto 1.5 crore rupees for the quarter July 2019 to September 2019 vide notification no. 52/2019-Central Tax dated 14.11.2019.

- The due date for furnishing of the return in Form GSTR-1 extended for registered persons in Jammu and Kashmir having aggregate turnover of more than 1.5 crore rupees for the months July 2019 to September 2019 vide notification no. 53/2019-Central Tax dated 14.11.2019.

- The due date for furnishing of the return in Form GSTR-3B extended for registered persons in Jammu and Kashmir for the months July 2019 to September 2019 vide notification no. 54/2019-Central Tax dated 14.11.2019.

- Circular No. 122/2019 – CGST dated 0511.2019, issued by CBIC directs for generation and quoting of the Document Identification Number (DIN) on any communication issued by the officers of CBIC to the taxpayers and other concerned persons on or after 8th November, 2019.

- **Circular No. 123/2019** – CGST dated 11.11.2019, issued by CBIC by which various issued related to the availment of input tax credit in terms of Rule 36(4) of CGST Rules, 2017 i.e. 20% capping on the ITC rule, have been clarified.

- **Circular No. 124/2019** – CGST dated 18.11.2019, issued by CBIC provides clarification regarding the optional filing of the annual return under Notification No. 47/2019 Central Tax dated 09.10.2019 for those registered persons whose aggregate turnover in a financial year does not exceed two crore rupees.

- **Circular No. 125/2019** – CGST dated 18.11.2019, issued by CBIC describes the procedure and the various documents required to be attached for fully electronic refund process through form GST RFD-01 and single disbursement.

- CGST (Seventh Amendment) Rules, 2019 inserted vide Notification 56/2019-Central Tax dated 14.11.2019 issued by CBIC which primarily relates to the simplification of Annual Return/ Reconciliation Statement.

- The blocking and unblocking of e-way bills as per provisions of Rule 138E of CGST Rules, 2017 to be effective from 21.11.2019 as notified vide Notification No. 36- Central tax dated 20.08.2019.
  As per the said notification, the tax payer will be alerted with a cautionary message and GSTIN will be blocked for generation of e-way bill from next month onwards either as consignor or consignee in case GSTR-3B for the last 2 successive months in GST common portal has not been filed; However, upon filing the return, the GSTIN will get automatically updated as 'un-block' within a day in the e-Waybill system and the tax payer can continue with e-way bill generation without any cautionary message.

2. Customs and Foreign Trade Policy (FTP)

This section summarizes the regulatory updates under Customs and FTP for the month of November 2019

- Exchange rates for conversion of foreign currency to Indian currency or vice versa notified vide Notification No. 85/2019- Customs (N.T.) dated 21st November, 2019.

- The effective date of Sea Cargo Manifest and Transhipment Regulations extended to 16th February, 2020 vide Notification No. 78/2019 dated 31st October, 2019.

- ITC (HS) 2017-Schedule-1 Import Policy amended to the extent of the Exim codes introduced/ deleted/ split/ merged/ changed vide Notification No. 31/2015-20 dated 13.11.2019.

- Conditions for Refund of Deemed Export Drawback in Chapter 7 of the foreign Trade Policy 2015-20 amended vide Notification No. 28/2015-20 dated 31st October, 2019 whereby refund of drawback on the inputs used in manufacture and supply can be claimed on "All Industry Rate" of duty drawback schedule subject to the prescribed conditions.

3. Tax & Regulatory updates

Liberalization of provisions for 'Special Non-resident Rupee' (SNRR) account by Reserve Bank of India

Reserve Bank of India ('RBI'), *vide* issuance of Foreign Exchange Management (Deposit) (Third Amendment) Regulations, 2019 (Deposit Amendment Regulations), enhanced the scope of SNRR account by allowing persons residing outside India to open such accounts for the purposes like external commercial borrowing and trade credit in INR. The highlights of the Deposit Amendment Regulations are as follows:

- Person resident outside India (PROI) is now permitted to open INR SNRR account for the following "business interest" [Business Interest] *(in addition to purpose laid down under Schedule 4 of Foreign Exchange Management (Deposit) Regulations, 2016)*, as follows:

  - Investments made in India;
  - Import of goods and services;
  - Export of goods and services;
  - Trade credit transactions and lending under extant External Commercial Borrowings (ECB) framework; and
  - Business related transactions outside International Financial Service Centre (IFSC) by IFSC units at GIFT city like administrative expenses in INR outside IFSC, INR amount from sale of scrap, government incentives in INR, etc. Such account will be maintained with bank in India (outside IFSC)

- In light of above, it should be noted that the cap of 7 years with respect to the tenure of SNRR accounts shall not be applicable to SNRR accounts opened for the afore mentioned purposes.

- Further, Indian banks, at its discretion, are permitted to maintain separate SNRR Account for each category of transactions or a single SNRR account for a PROI engaged in multiple categories of transactions provided it is able to identify/ segregate and account them category-wise;

- In addition to above, RBI permitted a non-resident nominee to receive the amount due/ payable from the account of a deceased account holder, by credit to his/her NRE account in India, which was earlier only restricted to NRO account.

Source: Notification No. FEMA 5 (R)/ (3)/2019-RB dated 13 November 2019 read with Notification No. FEMA 14(R)/(1)/2019-RB dated 13 November 2019

Part B – Case Laws

1. Goods and Services Tax

i. Srinivasa Transports Vs Commissioner of Central Tax, Vishakhapatnam GST [2019-VIL-708-CESTAT-HYD-ST]

Subject Matter:- The appeal is filed on the issue that whether the denial of CENVAT credit on motor vehicles used by the appellant for providing Port services and Cargo Handling Service is sustainable in law.

Background and Facts of the case

- The appellant is a service provider and pays service tax on Steamer Agent, Custom House Agent, Cargo Handling Services, Port Services-Major Port and Storage and Warehouse Services. The appellant avails CENVAT credit on capital goods as well as on inputs and input services.

- A show cause notice dated 14.10.2016 was issued to the appellant seeking to deny them CENVAT credit on motor vehicles used by them for providing these services on the ground that motor vehicles are not entitled for capital goods CENVAT credit except in respect of some services.

- Rule 2(B) of CCR 2004 which provides for the definition of 'capital goods' was reproduced for reference and the Revenue contended the motor vehicles of which the appellant has availed CENVAT credit did not fit in the definition of capital goods since such motor vehicles were used for Port services.

- The Ld. Asst. Commissioner by his Order-in-Original dated 07.03.2017 disallowed the CENVAT credit on the capital goods amounting to Rs. 10,72,422/- and ordered its recovery along with the interest. A penalty equal to the amount of CENVAT credit disallowed was imposed under Rule 15(3) of CCR 2004 read with Section 78 of the Finance Act,1994.

Discussion and findings of the case

- The appellant submitted that they have been rendering various services including Cargo Handling services under Section 65(105)(zr) of the Finance Act, 1994 which covers them squarely under Rule 2(a)(B) of CCR 2004 for availing CENVAT credit on the capital goods on motor vehicles.

- The appellant submitted that the major portion of tax was paid by them under 'Cargo Handling Services' and 'Port Services'. The appellant asserted that since the vehicles in question were used for cargo handling service also, which was never declined by the Revenue, they are eligible for CENVAT credit on capital goods on these motor vehicles.

- Per contra, Ld. DR asserted that although it is true that the appellant has paid service tax both under 'Cargo Handling Service' and under 'Port services, a perusal of the work order shows that they are essentially composite orders to take care of the entire loading and unloading and transportation activity which appeared to be primarily taken in the Port area. Since the appellant has failed to prove that the motor vehicles in question were used for providing Cargo Handling Services, their appeal may be rejected.

- The hon'ble CESTAT held that as long as the appellant has used motor vehicles for rendering Cargo Handling Services on which they have paid service tax, they are entitled to

CENVAT credit on capital goods. The mere fact that they have used the motor vehicles for some other purposes does not deprive them of their CENVAT credit on the motor vehicles.

Ruling

- It is held that the impugned order passed by the Commissioner (Appeals) is not sustainable and is liable to be set aside and therefore the appeal is allowed in the favor of the appellant with the consequential reliefs.

ii. M/s Mitsuba Sical India Ltd. Vs CCE Delhi-III [2019-VIL-673-CESTAT-CHD-CE]

Subject Matter: The appeal is filed on the issue that whether the denial of CENVAT credit on the construction service availed for construction of manufacturing premises for the manufacture of motor vehicle parts is sustainable in law.

Backgrounds and Facts of the case

- The applicant is engaged in the manufacture of motor vehicle parts and availed construction service for the construction of its own manufacturing premises during the period 2008-09.

- The CENVAT credit availed on the construction service availed during the period 2008-09 was denied and the penalty as per the relevant provision of law was also imposed on the same. Such denial order was passed placing reliance on the CBEC Circular No.98/1/2008-11 and on the decision of the Tribunal in the case of ***Vandana Global Ltd Vs. Commissioner-2018 (16) GST 440 (Tribunal-Chhattisgarh).***

Discussion and findings of the case

- The hon'ble CESTAT observed that the decision in case of ***Vandana Global Ltd. has been set aside by the Hon'ble High Court of Chhattisgarh as reported in 2018 (16) GSTL 462- 2017-VIL-66-CHG-CE.*** The Hon'ble CESTAT has reproduced in its orders, the relevant paragraphs from such decision of the hon'ble High Court of Chhattisgarh.

- The appellant has placed its reliance on the decision of the Tribunal in the case of ***Bellsonica Auto Components India P. Ltd. -2015 (40) (P&H) -2015-VIL-300-P&H-ST,*** which includes the issue identical with the case of the appellant.

- The hon'ble CESTAT has reproduced in its order, the relevant paragraphs from decision in the case of Bellsonica Auto Component India P. Ltd which makes it clear that by an amendment of the year 2011 to Rule 2(l), construction services were excluded from the definition of 'Input service'. Therefore, it explains that prior to the amendment , the setting up of factory premises of a provider for output service relating to such a factory fell within the definition of 'input services'. Also, the amendment of 2011 is not a retrospective amendment.

- In the order, reliance was also placed on judgement of the ***hon'ble Bombay High Court in the case of Coca Cola India Private Limited Vs. Commissioner of C.Ex., Pune-III, 2009 (242) ELT 168 (Bom) =2009 (15) STR 657- 2009-VIL-06-BOM-ST.***, which explains that the assessee can satisfy any of the five categories in which the definition of input service is divided in order to avail the credit of the input service. Thus, input services used in relation to **setting up**, modernization, renovation or repairs of **a factory will be allowed as credit**, even if they are assumed as not an activity relating to business as long as they are associated directly or indirectly in relation to manufacture of final products and transportation of final products upto the place of removal.

Ruling

- It is held that the impugned order passed by the Commissioner (Appeals) is not sustainable and is liable to be set aside and therefore the appeal is allowed in the favor of the appellant with the consequential reliefs.

iii. Kataria Automobiles Private Limited Vs. State of Gujarat [CIVIL APPLICATION NO. 16994 OF 2019]

Subject Matter: The petition is filed for the release of the confiscated second hand goods since the petitioner has already submitted the amount of tax and penalty as per Rule 32(5) of the CGST Rules, 2017.

Backgrounds and Facts of the case

- The goods in question are the second hand goods whose value as determined in terms of Rule 32(5) of the CSGT Rules, 2017 comes out to be less than Rs.50000/-.

- Since the goods were not accompanied by an invoice or e-way during the course of the transport, the respondents proceeded under Section 130 of the CGST Act, 2017 and initiated the proceedings for confiscation of the goods.

Discussion and findings of the case

- The petitioner submitted that while the goods in question were not accompanied by an invoice or e-way bill during the transport, since their value as per Rule 32(5) of CGST Rules, 2017 is less than Rs.50000/-, there was no necessity of providing an e-way bill.

- The petitioner submitted that he has already deposited the amount of tax and penalty, as computed under Rule 32(5) of the CGST Rules, 2017.

- The petitioner further submitted that he is not a fly by night operator and also he has put forth proper explanation in this regard.

- It is held by the hon'ble High Court of Gujarat that the respondents release the vehicles along with the goods contained therein subject to the petitioner filing an undertaking that in case if, ultimately, it does not succeed in the proceedings, it shall deposit the balance amount payable, as may be computed by the respondent authorities.

Ruling

- It is held that the goods be released subject to the petitioner filing an undertaking that in case if, ultimately, it does not succeed in the proceedings, it shall deposit the balance amount payable, as may be computed by the respondent authorities. This shall be without prejudice to the right of the petitioner to challenge any adverse order that may be passed.

iv. **Sutherland Global Services Private Limited Vs. Union of India [IN THE HIGH COURT OF MADRAS WRIT PETITION NO. 4773 OF 2018]**

Subject Matter: The petition relates to the transition of accumulated credit of Education cess, Secondary and Higher education cess and Krishi Kalyan cess into the Goods and Services tax.

Backgrounds and Facts of the case

- The petitioner had a closing balance CENVAT credit balance of input services, education cess and secondary and higher education cess. With the introduction of the GST, the petitioner sought to avail the accumulated credit.
- Revenue rejected the request of the petitioner to carry forward and utilize the credit of cesses.

Discussion and findings of the case

- The petitioner submitted that both, Section 140(1) and Section 140(8) of the CGST Act, 2019 which relates to the transition of the eligible duties, uses the expression, 'CENVAT Credit' and not 'Eligible credit'.
- The petitioner placed reliance on the ruling of Eicher Motor Limited wherein hon'ble Supreme Court quashed Rule 57F of the Central Excise Rules, 1944 which provided for the lapse of credit lying unutilized.
- The Revenue contended that the accumulated credit of EC, SHEC and KKC is dead and gone and there is nothing that the petitioner could claim as having been carried forward. The Revenue placed its reliance on the Delhi HC decision in the case of Cellular Operators Association of India where in it was held that EC and SHEC on one hand and excise duty and service duty on the other hand were always treated as different and separate, and cross utilization is never permitted.
- The hon'ble High Court held that the language of Section 140(1) and (8) makes it clear that the petitioner is entitled to transition the amount of CENVAT credit carried forward in the return and this, in the present case, includes accumulated credit of EC, SHEC and KKC.
- Further, the hon'ble High Court observed there is no notification/ circular/ instruction that has expressly provided that such credit accumulated would lapse. The contention of the Revenue that accumulated credit of EC,SHEC and KKC is dead and gone is not correct as accumulated credit continues in the books of accounts for availment and cannot be said to have been wiped out unless there is specific order under which it lapses.

Ruling

- It is held that the petitioner is entitled to carry forward and utilize accumulated credit pertaining to EC, SHEC and KKC under GST.

2. Customs and FTP

i. JTEKT Sona Automative India Limited Vs. Commissioner of Customs [2019 (11) TMI 257- CESTAT- NEW DELHI]

Subject Matter: The appeal is filed on the issue that whether the 'gear reduction blank' be classified under tariff item 84834000 or under tariff item 87089400 of the Customs Tariff Act, 1975.

Backgrounds and Facts of the case

- The appellant imported a consignment of 'gear reduction blank' from China and classified it under tariff item 84834000 as gears and gearing, other than toothed wheel, chain sprockets and other transmission elements presented separately.

- The goods in question were reclassified under the tariff item 87089400 of the Customs Tariff Act, 1975 by an assessment order. The appellant agreed to pay the differential duty however preferred an appeal before the ld. Commissioner (Appeals) who upheld the assessment order.

Discussion and findings of the case

- The appellant submitted that the classification adopted by the appellant was appropriate in terms of Section XVI of the Customs Tariff Act, 1975 and placed reliance in the case of ***M/s Videocon Industries Limited Vs. CCE, Aurangabad reported at 2009-TIOL-653-CESTAT-MUM.***

- Per contra, the ld. DR placed its reliance on the Section Note of Section XVI and XVII along with the HSN Explanatory Notes which provides that the classification of the goods in question can be determined under Rule 1 of the GR Rules and there is no justification to jump to Rule 3(a) as contended by the Appellant. Further, he placed his reliance in the case of ***Best Case Private Limited [2001 (127 ELT 730 (Tri-Chennai)], Mahindra and Mahindra Ltd. [1986(26) ELT 269(Tri)*** and ***Telco Limited] [2006 (195) ELT 151 (Tri-Mum)]*** in order to support his argument.

- On perusing through the order-in-appeal and considering the cases relied upon by the ld. DR to support his argument, the hon'ble CESTAT has provided sufficient explanation as to why the decisions in the cited cases cannot be applied mutatis mutandis in the case of the appellant.

- In furtherance of the same, the hon'ble CESTAT has commented that interpretative rule 3(a) has not been considered by the Tribunal and the same is per incuriam i.e. by lack of care. The goods in question are parts of steering column which are classifiable under heading 848300 and cannot be said to be the article of Section XVII which are not excluded by Section Note 1(k) to Section XVI.

Ruling

It is held that the imported part need not be classified under the heading 8708 as parts of motor vehicle and therefore the appeal is allowed in the favor of the appellant.

3. Direct Tax

i. Ruling of the Mumbai Income Tax Appellate Tribunal (Tribunal) in the case of Keva Industries Pvt. Ltd. (Taxpayer) [ITA 1883/PUN/2013]

Subject Matter: Whether the Taxpayer was liable to tax under gift tax provisions on the difference between FMV as computed by the Tax Authority by adopting NAV method based on balance sheet as on 31 December 2014, when the transfer of shares happened on 10 and 11 February 2015?

Background and Facts of the case

- The gift tax provisions under the ITL have evolved over a period starting from 2004. Section 56(2)(viia), operative during tax year 2014-15 under reference, provided that where a firm or a CHC receives any shares of another CHC from any person for a consideration less than the FMV, the difference between the consideration paid and the FMV shall be taxable in hands of recipient, if the difference exceeds INR 0.05M.

- Prior to 1 April 2018, the valuation rules for computing the FMV of unquoted equity shares required adoption of NAV method basis the balance sheet of the company as prepared and audited as on the valuation date as per provisions of the Companies Act, 1956. Post 1 April 2018, the valuation rules are modified to specifically provide that in case of company, not being an Indian company, the balance sheet of the company as drawn up on the valuation date which has been audited by the auditor of the company, if any, appointed under the laws of the country in which the company is registered or incorporated needs to be considered.

- The Taxpayer is a CHC in India, in which two Indian directors held equal shareholding. The directors had acquired shares of a Singapore incorporated company (F Co) at the price of Rs. 34 per equity share in 2008. F Co held shares in Indian listed company promoted by the same family to which Taxpayer's directors belonged.

- In 2013, there was change in regulatory requirements which made the direct holding of F Co shares by the directors untenable. To comply with new regulatory norms, the Indian directors incorporated the Taxpayer company and transferred shares of F Co to the Taxpayer in tax year 2014-15. The Taxpayer obtained loan from the Indian directors in order to purchase shares of F Co from the directors.

- The Taxpayer purchased all shares of F Co from its directors on 10 and 11 February 2015 at the price of Rs. 34 per share i.e. at the same price at which the directors had originally acquired those shares in 2008. As per valuation report obtained from an independent valuer, the value of shares of F Co was determined to be USD 0.50 per share (converted at exchange rate of Rs. 68 per USD i.e. Rs. 34 per share). The independent valuer determined the FMV by adopting Discounted Cash Flow (DCF) method, basis financials of F Co as on 31 December 2014 and projections provided by the management.

- The Tax Authority contended that price of shares of F Co computed as per DCF method is unrealistic as the valuer simply relied on the projections provided by the management without any verification and there was a major deviation with the subsequent actual values. The Tax Authority determined FMV for the purpose of gift tax provisions as per NAV method by considering the audited balance sheet as on 31 December 2014 as per Singapore corporate laws and arrived at FMV of Rs. 2719 per share. The Tax Authority taxed the difference between FMV of Rs. 2719 and purchase price of Rs. 34 in the hands of the Taxpayer under gift tax provisions.

- The Taxpayer filed appeal before the First Appellate Authority.

- During the appeal proceedings, the Taxpayer submitted another valuation report prepared by adopting NAV method by auditor of F Co on the basis of F Co's balance sheet as on the date of transfer of shares (i.e. 10 February 2015). The FMV as per this valuation report was negative (i.e. -USD 8.64 per share). This was on account of the fact that the only asset held by F Co were the shares of Indian listed company in which there were disputes between promoters. On settlement of disputes, one family of promoters (comprising Taxpayer's directors) was required to buy over other family's stake for which funds were raised from an unrelated private equity investor by creating charge over shares of Indian listed company held by F Co and promising the private equity investor a fixed internal rate of return (IRR). With substantial reduction in value of Indian listed company shares due to various factors, it was imminent that F Co will be required to part with those shares in favor of private equity investor and the Indian directors of the Taxpayer will also be required to pay additional amount to honor obligation to provide fixed IRR to the private equity investor.

- The Tax Authority contested this report on the grounds that (a) the report was issued by the auditor of the company and not by an independent accountant and (b) the report was not based on audited financial statements of F Co.

- The First Appellate Authority upheld the addition made by the Tax Authority. Being aggrieved, the Taxpayer filed further appeal before the Tribunal.

Issue before the Tribunal:

- Whether the Taxpayer was liable to tax under gift tax provisions on the difference between FMV as computed by the Tax Authority by adopting NAV method based on balance sheet as on 31 December 2014, when the transfer of shares happened on 10 and 11 February 2015?

Tribunal ruling:

Balance sheet for the purpose gift tax must be drawn up as on the date of receipt:

- The definition of "balance sheet" as provided under valuation rules of the ITL requires adoption of balance sheet prepared as on the valuation date which is defined to mean date of receipt of specified property by the taxpayer.

- The Tribunal rejected the FMV determined by the Tax Authority under the NAV method, as the valuation method was incorrectly applied on balance sheet as on the last day of latest accounting year, rather than the valuation date under prescribed valuation rules. Thus, such valuation arrived at by the Tax Authority was not in accordance with provisions of the law.

- The Tribunal also rejected Tax Authority's objection of valuation report not being based on audited financial statements. The Tribunal held that if the auditors have stated that based on review conducted, the auditors believe that the accompanying financial statements are presented fairly, in all material aspects, and in accordance with International Financial Reporting Standards, then such reviewed balance sheet can be adopted for NAV method.

Non-applicability of gift tax provisions to shares of a foreign company prior to 1 April 2018:

- Until tax year 2017-18, the valuation rule did not apply to a foreign company, since the definition of "balance sheet" required preparation of audited balance sheet by an auditor appointed under the Companies Act 1956; whereas Tax Authority had adopted balance sheet prepared under the corporate laws of Singapore.

- The amendment made to the definition of "balance sheet" to specifically include foreign company is prospective in nature and is applicable from tax year 2018-19 onwards.

- The Tribunal held that the gift taxation provisions were not applicable to unquoted shares of foreign company till 1 April 2018 since the computation mechanism failed. Consequently, the charging provisions of gift taxation also failed. For this proposition, the Tribunal relied on ratio of Supreme Court decisions in cases of CIT v. Official Liquidator, Palai Central Bank Ltd (in Liquidation) ((1985) 1 SCC 45) and CIT v. B.C. Srinivasa Shetty (128 ITR 294) (SC) wherein it was held that in absence of computation provisions, the charging provisions cannot be applied.

- Despite such conclusion, the Tribunal did also adjudicate upon merits of the case as discussed hereinafter.

Cognizance of negative FMV as per NAV method on account of encumbrances and overriding charges on assets held by F Co:

- The Tribunal noted that the Taxpayer had furnished another valuation report certified by F Co's Singapore auditor who had computed FMV as per NAV method basis balance sheet prepared as on the date of transfer of shares.

- The Tribunal noted that report mentioned that FMV of shares of F Co determined as per NAV method is USD 2.58 per share. However, the valuation report also mentioned that although the value of F Co shares was USD 2.58 per share, the Indian directors had an obligation towards the private equity investor to meet the shortfall in value of shares and considering this obligation, the value of F Co's shares was, in fact, negative USD 8.64 per share. The Tribunal held that the lower authorities had erred in not considering this aspect.

- The Tribunal held that the Taxpayer had paid a higher purchase price of Rs.34 per share for shares of F Co held by Indian directors rather than the negative value of shares and, hence, the Tax Authority erred in adopting value of USD 2.58 per share.

Acceptance of DCF value of F Co certified by independent valuer:

- The Tribunal also made following observations with regard to DCF method as originally adopted by the Taxpayer:

- Under DCF method, an independent valuer has to rely on the projections of performance of the company as furnished by the management and consider the reasonableness of the management projection based on the purpose of valuation and facts of the case.

- As on the valuation date the independent valuer does not have hindsight knowledge of actual amounts, the actual results may vary from the projection.

- The Tribunal held that the FMV of shares of F Co was negative after considering the encumbrances and obligations under shareholder's agreement. However, as the entire transaction of sale of shares of F Co was undertaken by Indian directors with the sole intention to comply with the regulatory requirements, the transaction undertaken is bonafide in nature. Thus, the Tribunal held that rejection of DCF method of valuation by an independent valuer, being one of the recognized methods, is not proper.

ii. Mumbai Income Tax Appellate Tribunal (Tribunal) decision, in the case of Reliance Jio Infocomm Ltd. (Taxpayer) [TS-710-ITAT-2019(Mum)]

Subject Matter: Whether the definition of "process" under the Indian Tax Law (ITL) can be used for interpreting the undefined term "process" in the royalty definition under the India-Singapore Double Taxation Avoidance Agreement (tax treaty)?

Background and Facts of the case

- The definition of the term "royalty" under the India-Singapore tax treaty, inter alia, includes payments of any kind received as a consideration for the use of, or the right to use, any secret formula or process.

- The term "process", as used in the above definition, is not defined in the India-Singapore tax treaty.

- The term "process" is defined in the ITL to mean transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.

  The above definition of "process" was inserted in the ITL, vide the Finance Act, 2012, to clarify doubts raised on the interpretation of the term "process".

- Article 3(2) of the India -Singapore tax treaty provides that any undefined "term" in the tax treaty shall have the same meaning as it has under the domestic laws of the country applying the tax treaty, unless the context requires otherwise. Article 3(2) is to be mandatorily applied when a "term" is undefined in the tax treaty.

- The Taxpayer, an Indian company, made payments to its sister concern in Singapore for availing bandwidth facility.

- The limited issue under consideration was whether, by applying the definition of "process" under the ITL, provision of bandwidth facility can be considered to constitute royalty under the India-Singapore tax treaty.

Tribunal ruling:

The expression "term" used in Article 3(2) refers to "a word or phrase used to describe a thing or to express a concept". A "term" is, thus, a word that has meaning and refers to objects, ideas, events or a state of affairs. The expression “term”, in addition to being a word, is some kind of a point of reference, whereas a word is only a constituent of language.

Thus, Article 3(2) comes into play only in respect of undefined tax treaty “terms” which are in the nature of “reference points”. It does not apply to all the undefined words and expressions used in the tax treaty.

The expression “process”,’ in itself, is not a “term” or a “reference point”. It does not have an independent existence and is used in the tax treaty in the limited context to define the term “royalty”. Thus, the meaning of the word “process”, as defined under the ITL, cannot be imported into the tax treaty by virtue of Article 3(2).

Even if the word “process” is treated as an undefined “term” under the tax treaty, the definition under the ITL cannot be applied for interpreting the expression “process” under the tax treaty, for the following reasons:

- The definition of the word “process” under the ITL is not a stand-alone definition, but it is defined in the limited context for the purposes of defining the term “royalty” under the ITL.

- There is no doubt that the expression “royalty” is a “term”. However, it is not appropriate to apply Article 3(2) to interpret each word employed in a definition of the tax treaty term (viz., royalty) and then construct its definition as an assembly of the statutory definitions of all such words taken together under the domestic laws. Such an interpretation is too hypertechnical and is beyond the mandate of Article 3(2).

- The Bombay High Court (HC) decision in the case of Siemens Aktiongesellschaft is distinguishable on the fact that in the said case the HC was concerned with a case where the tax treaty language itself required ambulatory interpretation. As against that, the India-Singapore tax treaty does not specify whether an “ambulatory” or “static” interpretation has to be used. Also, in this case, the HC itself referred to a Canadian Court decision and held that a country cannot make a unilateral change in its domestic laws to tax income which is otherwise not taxable under the tax treaty.

- Thus, irrespective of whether an ambulatory or static approach is adopted, there cannot be a unilateral tax treaty override. In other words, a unilateral domestic law amendment cannot be applied to interpret the tax treaty in a manner that it results in alteration of the conclusion that existed under the pre-domestic law amendment period. This proposition is also in line with the principles of the Vienna Convention which requires that the tax treaty should be interpreted in “good faith”.

- The word “process” was judicially defined in a manner unfavorable to the Tax Department and the definition of “process” under the ITL was amended to nullify these judicial rulings. If the amended definition of “process” is imported into the tax treaty, it would result in taxability of income that was not taxable prior to the amendment to the ITL, resulting in a unilateral tax treaty override, which is not permissible.

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