# EY Tax and Regulatory Alert

March 2019

Prepared for ACMA

## Contents



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# Indirect Tax

**This Section of Tax alert summarizes the Indirect tax updates for the month of March 2019**

## Judicial Precedents

### 1. M/s NASH INDUSTRIES (I) PVT. LTD.

**Karnataka AAAR**

**[2019-VIL-08-AAAR]**

### Background

- M/s. Nash Industries (I) Private Limited (herein after referred to as the "Appellant') is a manufacturer of sheet metal pressed components and supplies to industrial customers like Automotive, Banking Hardware, Power Protection, Alternate Energy etc.

- The tools required to manufacture these components were designed and manufactured by the Appellant. Such manufactured tools are billed to the customer and the payment is received for the same but the tools are retained by the Appellant for the manufacture of components

- The Appellant had filed an application for Advance Ruling before the Karnataka authority seeking whether the amortized cost of the tools is to be added to arrive at the value of the goods supplied for the purpose of GST under Section 15 of the CGST Act read with Rule 27 of CGST Rules

- The Karnataka authority held vide its order No. KAR ADRG 24/2018 dated 25 October 2018 [2018-VIL-266-AAR] that the amortised cost of tools which are re-supplied to the applicant free of cost shall be added to the value of the components while calculating the value of the components supplied as per Section 15 of the CGST/KGST Act, 2017

- An appeal was filed by M/s. Nash Industries (I) Private Limited, against the said order dated 25 October 2018, before the Karnataka Appellate Authority of Advance Ruling

### Facts of the case

- The purchase order provided by the recipient/customer is only for the manufacture of components out of the tools supplied by the recipient at free of cost.

- The appellant placed reliance of CBIC Circular No.47/21/2018-GST dated 08 June 2018 wherein CBIC had clarified the position regarding amortization of tool cost supplied free of Cost by the customer, to the value of components manufactured by the component manufacturer:

  - The value of the moulds and dies owned by the original equipment manufacturer (OEM) which are provided to a component manufacturer on FOC basis shall not be added to the value of such supply because the cost of moulds/dies was not to be incurred by the component manufacturer

  - The contract between OEM and component manufacturer was for supply of components made by using the moulds/dies belonging to the component manufacturer, but the same have been supplied by the OEM to the component manufacturer on FOC basis-the amortised cost of such moulds/dies shall be added to the value of the components.

- The appellant submitted that their case is covered in the first situation above i.e. the tool is owned by the OEM (Customer) and supplied at free of cost to appellant. Further, the purchase order is provided for supply of component. As the present case falls under first situation, the cost of the tool is not to be added to the price of component as per the clarification provided by CBIC

### Decision by the Appellate Authority

- It is necessary to understand the contractual arrangement between the Appellant and their customers to see whether the scope of the supply mandates that, the Appellant is to incur a cost for the manufacture and use of the tool but the same has been supplied by the customer free of charge

- In the course of the present appeal proceedings, the Appellant provided with details of the contract and purchase orders placed by their OEM customer M/s Daimler India Commercial Vehicles Pvt Ltd (DICV):

  - The Appellant is required to use DICV Owned Tools concerning the part to be manufactured with the tool. The tool shall be used only for the purpose of fulfilling its manufacturing obligations wider the supply contract. The Tool is developed and manufactured by the Appellant under a specific Purchase Order

  - The applicable GST on the supply of the tool is levied in the invoice raised by the Appellant for the supply of the Tool

  - Once the agreed cost of the tool has been paid by DICV, the title of the tool and all IPR created in the course of the development of the Tool will be transferred to DICV

  - The Appellant is entitled to keep the tool in his premises only as a temporary possession until the completion of the supply of components manufactured using the tool

  - On completion of the contractual relationship, the Appellant is required to return the tools to DICV

- In light of the facts discussed above, the value of the tools, which has already suffered tax and supplied FOC to the Appellant, is not required to be added to the value of the components supplied by the Appellant.

- The ruling given in the appeal proceeding is based on examination of the contract and purchase orders furnished by the Appellant in the case of their customer M/s Daimler India Commercial Vehicles Pvt Ltd. This ruling will apply to other contracts entered into by the Appellant only if the terms and conditions contained therein are the same as those contained in the contract placed before us.

## 2. M/s MRF Limited

## Tamil Nadu AAR
## [2019-VIL-71-AAR]

### Background :

- M/s MRF Limited ('the applicant') intends to enter into an arrangement with M/s C2F0 INDIA LLP ('C2F0'), for setting up an interactive automated data exchange which can be installed for data interaction relating to sale & purchase of goods and services between a Buyer (the Applicant) and a Supplier (any supplier of goods or input services of the Applicant) in compliance to various ethical, accounting and business standards. Both the Supplier and the Recipient of goods or services should register on the platform provided by C2F0

### Question on which Advance Ruling is sought

- Whether the Applicant can avail the Input Tax Credit of the GST charged on the supply of invoice or a proportionate reversal of the same is required in case of post purchase discount given by the supplier of the goods or services

### Submissions by the Applicant

- The Applicant states that since this is a post-invoice discount being offered on optional basis, the same is not captured in the supply contract between the company and supplier

- Hence, once the goods and or the services are delivered and the invoice is booked in ERP and marked as approved to pay, the supplier via C2F0 can take a voluntary decision to accelerate the payment and receive early payment

- The supply of goods/services is made by the supplier to the recipient in terms of the purchase contract and the recipient on receipt of the goods/services takes ITC in the invoice which is paid to the government by the supplier

- Through the use of the automated process, the supply invoices in respect of which the recipient will be prepared to pay the invoices at an early date subject to the supplier accepting to extend certain quantified discount will be offered to the supplier

- On acceptance of the same, the payment of the invoices after considering the discount will be

processed by the recipient of the goods or services. This discount arrangement is not part of the Purchase Contracts or the invoices since it is not known at that point of time whether supplies against the purchase contracts or invoices will be considered for the discount and also the rate /quantum of such discount is not known

- It is a case of offering discount post supply falling under "Cash Discount not agreed before or at the time of supply"

- The Applicant stated that as per Section 15(3) of CGST Act, discount in this case is not allowable for deduction from the price at the time of supply since the same is known either before or at the time of supply. The taxable value for the purpose of payment of GST will be the value as per purchase contract without considering such discount so offered and the supplier is liable to pay tax on the value before discount. The payment shall be made for the invoice value less discount plus GST charged on the value without considering the discount

- Upon acceptance by the buyer (Applicant), a credit note will be issued for the discount allowed by the supplier, post which the Applicant can accept discount and make payment

**Decision passed by the Advance Ruling Authority**

- In the instant case, the invoices are all raised before the payment dates, so the time of supply is the date of raising invoices. All the invoices are uploaded by the supplier in the C2FO software after they are raised.

- From the transactions envisaged in the online platform, it is seen that a schedule is to be defined, based on which approved open invoices and supplier data is picked for offering the same for discounting by the supplier and if agreed by the supplier, the discounted invoices are placed for early payment

- The supplier on raising the invoice (undiscounted price) initially, pays the applicable GST thereon

- The Applicant on receipt of the goods/services and the invoice avails the tax paid by the supplier as credit and thereafter when such invoice is staged for discount against early payment in the C2FO platform and the price is discounted, only the discounted amount is paid by the Applicant to his suppliers and not the amount indicated in the invoice

- Proviso to Section 16 states that where a recipient fails to pay to the supplier of goods or services or both, the amount towards the value of supply along with tax payable thereon within a period of one hundred and eighty days from the date of issue of invoice by the supplier, an amount equal to the input tax credit availed by the recipient shall be added to his output tax liability, along with interest thereon, and the recipient shall be entitled to avail of the credit of input tax on payment made by him of the amount towards the value of supply of goods or services or both along with tax payable thereon

- Accordingly, the recipient (Buyer/ Applicant) is entitled to avail the credit of input tax on the payment made by him alone and if any amount is not paid as per the value of supply and the recipient has availed full input tax credit, the same would be added to his output tax liability.

- Therefore, in the instant case, the Applicant can avail Input Tax Credit only to the extent of the invoice value less the discounts as per C2FO software

## 3. Kodai Cars Private Limited

**Vs**

1. **The Commissioner of Commercial Taxes O/O The Principal And Special Commissioner Of Commercial Taxes, Chennai**
2. **The Assistant Commissioner (ST), Palayamkottai**

**[2019-VIL-102-MAD]**

**Background and facts of the case**

- The instant writ petition has been filed challenging the order dated 27.11.2018, passed by the second respondent in TIN.33795564450/2016-17 which

failed to consider the Proceedings of the Authority for Clarification and Advance Ruling, dated 25.10.2016.

- The petitioner had been directed to pay the tax at the rate of 14.5% on the entire sale value of the used cars, instead of 5%, as per the Proceedings of the Authority for Clarification and Advance Ruling which is binding nature of order by taxing authority.

**Court findings and Order**

- Despite categorical clarification given in the Proceedings of the Authority for Clarification and Advance Ruling, dated 25.10.2016, the respondent has passed the impugned assessment order levying higher rate of tax at 14.5%, based on the entire value of the cars instead of 5% on the value addition of the cars alone.

- When the possible interpretation has been given by the taxing authority namely, the Proceedings of the Authority for Clarification and Advance Ruling, the said interpretation is binding on the respondent.

- The interpretation that is placed by the taxing authority on the law is binding on that taxing authority. The taxing authority cannot be heard to advance an argument that is contrary to that interpretation

- The impugned assessment order is quashed and the matter is remitted back to the respondent for fresh consideration.

- The order is answered in favour of assessee

## 4. Delhi Metro Rail Corporation & Tata Motors

**Vs**

**CCE, Lucknow**

**[2019-VIL-147-CESTAT-ALH-CE]**

**Background and facts of the case**

- The brief facts of the case are that M/s. Tata Motors Ltd. (M/s. Tata) supplied bus chassis to Delhi Metro Railway Corporation (DMRC) by claiming exemption under Notification No.6/2006-CE dt.1.3.2006 (Entry No.90).

- The appellants had paid 10% of the total value of bus chassis in terms of Rule 6 (3b) of Cenvat Credit Rules, 2004.

- As per Notification, the DMRC has provided the required Central Excise Duty Exemption Certificate certifying that the goods are parts of the inventory maintained by DMRC and shall finally be owned by DMRC. The said certificate has been obtained by DMRC on 14.06.2007.

- Later on, the Revenue entertained a view that the buses have been procured by DMRC in connection with Metro Link Service in which the buses will be handed over to private operators on operate and transfer basis on the value of buses.

- According to the Revenue such transaction would signify that the buses have neither been procured by DMRC nor will be owned by DMRC. Therefore, M/s. Tata has failed to fulfil the condition No.18 under exemption Notification No.6/2006-CE dt.1.3.2006.

- Consequently, show cause notice was issued on 18.7.2008 to demand duty on 120 bus chassis cleared to DMRC and to impose penalties on all the appellants.

- The appellants are in appeal against impugned orders wherein the benefit of exemption Notification No.6/2006-CE dt.1.3.2006 has been denied. Consequently, demand of duty has been confirmed against M/s. Tata Motors Ltd. and penalties on all the appellants have been imposed.

**Court findings and order**

- The goods in question have been procured by DMRC in Metro Feeder bus service, therefore, the use of bus is for MRTS project.

- The sole reason to deny the benefit of exemption notification is the agreement between DMRC and its operators.

- As per agreement after five years the operator shall become the owner of the bus. In fact, operators have never completed contract and agreements were not rescinded.

- Consequently, the DMRC remains the owner of the buses in question, therefore, on that ground the benefit of exemption notification cannot be to the appellant.

- Another issue raised by the Revenue is that the chassis in question are not inventory or equipment or machinery or rolling stock. Motor vehicles do qualify as machines and bus chassis cleared by the appellant qualify as machinery under Sl.No.90 of the notification.

- It is admitted that these bus chassis purchased by DMRC from M/s. Tata are used as feeder bus service to carry passengers from various routes of metro and vice versa are integral part of the Delhi MRTS project and DMRC is the owner of the buses, therefore, DMRC has rightly issued certificate in terms of Notification No.6/2006-CE dt.1.3.2006 and M/s. Tata is entitled to avail exemption notification and have rightly cleared chassis in question without payment of duty.

- The impugned order is set aside and appeal is allowed.

## 5. Gypsy Rubber Industries Vs Commissioner of Central Excise

**[2019-VIL-123-CESTAT-MUM-CE]**

### Background and facts of the case

- The brief facts of the case are appellant are manufactures of Polyurethane Moulded Parts of Chairs of various models and polyurethane moulded seats for motor vehicles.

- Appellant had claimed the classification under 94019000 and 94012000 respectively and availed SSI exemption under Notification No.8/2003-CE dated 01/03/2003.

- Revenue is of the view that the classification of the same should be under 39263010 as “Polyurethene moulded form seat cushion” and the benefit of said notification is not available.

### Court findings and order

- Appellants are supplying polyurethene foam blocks cut into different shapes. These are further used in the manufacture of chairs or motor vehicle seats.

- It is seen that the items manufactured by the appellants are basically cushion for seats - In view of the chapter note 1 (a) to Chapter 94 Section XX, these are not covered under Chapter 94. Therefore, they cannot be classified under Chapter 94 as claimed by the appellants

- The ld. Commissioner (Appeals) has correctly found that the products manufactured by the appellant is polyurethene form in the required shape to be used as cushion for revolving chairs are furniture, as such they do not find any entry under Chapter 94 and in views of the specific entry under Chapter 3926 30 10 and as clarified by the CBEC, the products are to be classified under CETA Heading 3926 3010.

- the appellants are eligible for cum duty benefit in order to verify the eligibility of the appellants for Cenvat Credit and for quantification of demand after allowing cum duty benefit, the case is remanded to the jurisdictional authority.

- The appeal is partially allowed.

## 6. M/s Apollo Tyres Limited Vs Union of India

**[2019-VIL-78-GUJ-CE]**

### Background and facts of the case

- The brief background is that the petitioner is a Public Limited Company incorporated under the Companies Act, 1956, with factory at Limda in Vadodara District, is engaged in the manufacture of pneumatic tyres.

- The petitioner also manufactures at its factories in Perambra and Kalamasserry in Kerala as well as in Orgdam in Chennai, Tamil Nadu.

- While selling these tyres, during the period 28.08.2002 till 26.05.2017 covering the period from August, 1997 to October, 2016 covered by the 25 Show Cause Notices, the petitioner was entitled to arrive at an assesable value after deducting the Government levies from the Net Dealer Price.

- In the present case, the 25 Show Cause Notices concern only the aspect of deduction of Government levies which include turnover tax, octroi / entry tax leviable in the respective States in the country.

- During the aforesaid period, such Government levies were being averaged based on a costing done by the petitioner's Chartered Accountants and such averaged Government levies were adopted for the purpose of deduction from the Net Dealer Price.

- The 24 Show Cause Notices in question impugned were issued inter alia raising the ground that such averaged / equalized deduction of Government levies is not admissible and consequently demanding differential excise duty.

- Petitioner had challenged the impugned show cause notices which have been taken out of the call book.

**Court findings and order**

- The respondents after keeping the impugned show cause notices in the call book, have not chosen to follow up it for unduly long period.

- It is very evident that it was only after the filing of this petition, the impugned show cause notices have been taken out from the call book and notice for personal hearing was issued to the petitioner.

- The act on the part of the respondents of keeping the impugned show cause notices in call book for unduly long period, without disclosing any reason for delay is arbitrary in exercise of powers and is also in violation of provisions of Section 11A of the Customs Act .

- The impugned notices are quashed and set aside. Assessee petition is allowed.

## 7. M/s Uttam Toyota Vs CCE & ST, Ghaziabad

**[2019-VIL-113-CESTAT-ALH-ST]**

**Background and facts of the case**

- The brief facts of the case are that an audit team conducted in the appellant's unit in September, 2007 and noticed that the appellant has wrongly availed Cenvat credit and has not paid service tax under the category of Business Auxiliary Service.

- Therefore, two show cause notices for the period October, 2003 to March, 2008 and April, 2009 to March, 2010 were issued to deny the credit inadmissible to the appellant and to demand service tax under the category of Business Auxiliary Service.

- The matters were adjudicated and the demand on account of service tax under the category of Business Auxiliary Service and denial of credit on various input services were confirmed along with interest and penalties were also imposed. The credit was denied due to the below reasons :

  - Repairs and Maintenance Service of Audio System - Not related to Output Service.

  - Event Management - No Evidence to establish nexus between input service. Reimbursed by the manufacturer therefore not admissible

  - Advertising Service - No evidence to establish between input and output service. Reimbursed by the manufacturer therefore not admissible.

- Chartered Accountant Service- Not having been utilized at the premises of providing output services.

- Security Service, Insurance Service, Repairs & Maintenance Service, Test inspection Services, Air travel Agent Services, Consultancy Services - No evidence if these services are received at Ghaziabad Showroom or Outside

- Against those orders, the appellant has filed this appeal.

**Court findings and order**

- There is no provision in the Cenvat Credit Rules to deny credit if any service is availed outside the business premises.

- The assessee can avail the service outside the factory premises during the course of their business of manufacturing.

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- Admittedly, the said services have been received by the assessee during the course of their business of manufacturing, therefore, they are entitled to avail credit on these services

- The appellant did not have agreement with the bank to act as their agents and they are only carrying out an executory function such as to collect forms from the customers.

- The assessee was not providing Business Auxiliary services to the bank and hence, no service tax is leviable.

- The appellant undertakes replacement of spares and render services thereon and raised invoices upon M/s. TKML towards realization of the amount attributable to the said free service rendered to the customer.

- The demand on the services rendered by the appellant on account of warranty charges is not sustainable in terms of Circular No.96/7/2007-ST dt.23.8.2007.

- The service tax cannot be demanded from the appellant on the value of spare parts/consumables utilized during the course of provision of services in the capacity of Authorized Service Station.

- The credit cannot be denied to the appellant and no service tax can be demanded from the appellant, therefore, no penalty is imposable on the appellant.

- The impugned order is set aside and assessee appeal is allowed

## Key Indirect Tax updates

## This section summarizes the regulatory updates for the month of March 2019

**Corrigendum to Circular No. 76/50/2018-GST dated 31 December 2018**

CBIC has issued the above corrigendum the valuation methodology for ascertainment of GST on Tax collected at source (TCS) under the provisions of the Income Tax Act, 1961. The same has been summarized hereunder:

- Earlier vide the above mentioned circular, it was clarified that in accordance with Section 15(2) of CGST Act, taxable value for the purposes of GST shall include the TCS amount collected under the provisions of the Income Tax Act since the value to be paid to the supplier by the buyer is inclusive of the said TCS.
- However, several representations were received from the stakeholders and the matter had been re-examined in consultation with the Central Board of Direct Taxes (CBDT). The CBDT has clarified that Tax collection at source (TCS) is not a tax on goods but an interim levy on the possible “income” arising from the sale of goods by the buyer and to be adjusted against the final income- tax liability of the buyer.
- Accordingly, CBIC has issued the said Corrigendum clarifying that for the purpose of determination of value of supply under GST, **Tax**

**collected at source (TCS) under the provisions of the Income Tax Act, 1961 would not be includible** as it is an interim levy not having the character of tax.

## Notification No. 2/2019-Central Tax (Rate) dated 7 March 2019

- Composition scheme for supplier of goods or services with a tax rate of 6% having annual turnover in preceding year upto INR 50 lakhs w.e.f. 1 April 2019.

## Notification No. 10/2019-Central Tax dated 7 March 2019

- Exemption from registration for any person engaged in exclusive supply of goods and whose aggregate turnover in the financial year does not exceed INR 40 lakhs w.e.f. 1 April 2019.

## Notification No. 11/2019-Central Tax dated 7 March 2019

- Prescribed 31 July 2019 as the due date for filing of FORM GSTR-1 for taxpayers with aggregate turnover upto INR 1.5 crores for the quarter ending June 2019.

## Notification No. 12/2019-Central Tax dated 7 March 2019

- Prescribed 11th day of the subsequent month as the due date for filing of FORM GSTR-1 for taxpayers with aggregate turnover of more than INR 1.5 crores for the period April 2019 to June 2019.

## Notification No. 13/2019-Central Tax dated 7 March 2019

- Prescribed 20th day of the subsequent month as due date for furnishing of FORM GSTR-3B for the period April 2019 to June 2019.

## Notification No. 14/2019-Central Tax dated 7 March 2019

- Extended the threshold limit of aggregate turnover for availing Composition Scheme u/s 10 of the CGST Act, 2017 to INR 1.5 crores w.e.f. 1 April 2019.

## Circular No. 92/11/2019-GST dated 7 March 2019

This Circular has been issued by the Ministry clarifying various aspects of promotional schemes such as taxability, valuation, availability or otherwise of Input Tax Credit in the hands of the supplier.

| S. No. | Scheme Name | Clarification by Ministry |
|---|---|---|
| 1 | Free samples and gifts | Goods or services or both which are supplied free of cost (without any consideration) shall not be treated as "supply" under GST. No Input Tax credit is available to supplier in terms of section 17(5)(h) of CGST Act, 2019 |
| 2 | Buy one get one free offer | In case of "Buy one get one free" offer, the one item which is supplied without any consideration is not an individual supply of free goods but a case of two or more supplies where a single price is being charged for the entire supply. Taxability of such supply would be dependent upon as to whether the supply is a composite supply or a mixed supply and rate of tax would be determined accordingly. ITC on input goods, services and capital goods used for such offers is available to the supplier |
| 3 | Discounts including 'Buy more, save more' offers, post supply/ volume discounts | Amount of such discount will be excluded from the value of supply subject to satisfaction of parameters of section 15(3) of CGST Act. ITC on input goods, services and capital goods used for such goods is available to the supplier |
| 4 | Secondary Discounts – Not known at the time of supply | Financial / commercial credit note(s) can be issued by the supplier in cases where conditions under Section 15(3)(b) are not being satisfied.<br><br>Such secondary discounts which do not satisfy the conditions under Section 15(3)(b) shall not be excluded from the value of supply. ITC is available in the hands of supplier. No impact. |

# Direct Tax

**This section of tax alert summarizes the Direct tax updates for the month of March 2019.**

## Key Direct Tax Developments

### 1. Mumbai Tribunal accepts applicability of 'make available' condition to development and transfer of technical plan or design

**Background**

- Under the Income Tax Law (ITL), Fee for technical services (FTS) means any consideration for rendering managerial, technical or consultancy services. Under the Double taxation avoidance agreement (DTAA), the FTS definition is restricted to those technical or consultancy services which, *inter alia*, make available technical knowledge, experience, skill, knowhow or processes or consist of the development and transfer of a technical plan or a technical design.

- The Taxpayer, a company incorporated in the UK and a resident in the UK, is involved in the business of providing engineering design and consultancy services to Indian customers through its Indian affiliate, BHEI. As a part of such services, the Taxpayer provides structural and MEP (Mechanical, Electrical and Public Health) engineering for various buildings. For the tax year under consideration, the Taxpayer filed its return of income declaring NIL income.

- In the course of assessment proceedings, the Tax Authority observed that the Taxpayer had earned INR 10.9 Mn by way of providing consulting engineering services to BHEI and had also received INR10.1m from BHEI as a cost recharge towards common expenses incurred at the head office (HO expense).

- The Taxpayer submitted that since it had not made available any technical knowledge or skill to BHEI while providing engineering consultancy services, such amount would not qualify as FTS and has to be characterized as business income

- Under the DTAA, such business income cannot be brought to tax in India in the absence of a permanent establishment (PE) of the Taxpayer in India. The Taxpayer further submitted that the amount received towards HO expense is not taxable in India, since such amount is a part of cost allocation made on a cost-to-cost basis without any profit element.

**Tax Authority's contentions**

- The services include supply of design/drawing to BHEI and the provision of other services are ancillary to the supply of designs and drawings. BHEI is responsible to the Indian customers and BHEI had sub-contracted certain specialized services (like master planning, acoustic engineering, environmental engineering etc.) to the Taxpayer, in the absence of the necessary skills with BHEI.

- As per the DTAA, payment received for development and transfer of a technical plan or a technical design would be in the nature of FTS, irrespective of whether it also makes available technical knowledge, experience, skill, knowhow, etc. Furthermore, since the Taxpayer provided technical/engineering consultancy advice as well as technical design to BHEI, enabling it to further apply and re–apply such technology for rendering services to its customers in India, the condition of "making available" was satisfied.

- The cost recharge relates to and is ancillary to the provision of consulting engineering services which has been held to be in the nature of FTS and, hence, taxable in India.

- The First Appellate Authority (FAA) agreed with the Tax Authority's contention on the premise that provision of a specific design and drawing requires application of mind by various technicians having knowledge in the field of architectural, civil, electrical and electronic and overseeing its implementation and execution at

site in India by the Taxpayer's technical personnel would amount to making available technical services.

- Aggrieved by the ruling of the FAA, the Taxpayer filed an appeal before the Tribunal.

**Tribunal's ruling**

The Tribunal held that the amount received towards consulting engineering services is not in the nature of FTS under the DTAA, since the Taxpayer did not "make available" technical knowledge, experience, skill, knowhow or processes to BHEI, through the development and supply of a technical plan or a technical design. Such amount should be treated as "business profits" and in the absence of a PE of the Taxpayer in India, it cannot be brought to tax. Similar conclusion applies in respect of cross-charge of HO expense which is in the nature of FTS.

The Tribunal made the following observations:

**FTS provision under the DTAA requires "make available" condition to be read in conjunction with "development and transfer of technical plan or design"**

- A careful reading of the FTS Article of the DTAA clarifies that the words "development and transfer of a technical plan or technical design" is to be read in conjunction with "make available technical knowledge, experience, skill, knowhow or processes".
- As per the rule of *ejusdem generis*, the words "or consists of the development and transfer of a technical plan or technical design" will take color from "make available technical knowledge, experience, skill, knowhow or processes".
- Technology is considered to have been made available when the recipient of such technology is competent and authorized to apply the technology contained therein independently as an owner, without recourse to the service provider in the future.

**Evaluation of "make available" condition in the facts of the present case**

- The technical designs/drawings/plans supplied by the Taxpayer are project-specific and cannot be used by BHEI in any other project in the future. Thus, the Taxpayer has not made available any technical knowledge, experience, skill, knowhow or processes while developing and supplying the technical drawings/designs/plans to BHEI.
- Reliance was placed on the Pune Tribunal decision in the case of Gera Developments Pvt. Ltd. in the context of the FTS Article under the India-US DTAA, wherein it was held that mere passing of project-specific architectural, drawings and designs with measurements does not amount to making available technical knowledge, experience, skill, knowhow or processes. Unless there is transfer of technical expertise skill or knowledge along with drawings and designs and if the taxpayer cannot independently use the drawings and designs in any manner whatsoever for commercial purpose, the payment received cannot be treated as FTS.

*Source: [TS-76-ITAT-2019(Mum)]*

## 2. Supreme Court reverses its earlier ruling and allows 100% deduction for new units undertaking "substantial expansion" for fresh five years

**Background**

- The ITL contain provisions for grant of profit-linked tax holiday for industrial undertakings in some specified areas. Each provision is targeted at a specific class of undertakings which are set up within a prescribed qualifying period in specified areas and subject to fulfilment of prescribed conditions. The object of granting such incentive is the economic and industrial development of backward areas. The general trend of such incentives is that the incentive period starts from a year ("initial assessment year") in which the undertaking begins to manufacture or produce any article or thing.

- Prior to insertion of Section (S.) 80-IC, vide the Finance Act, 2003, the tax holiday for industrial undertakings set up in specified backward areas was governed by S.80-IA up to tax year 1998-99 and S.80-IB from tax year 1999-2000 onwards. Similarly, S.10C, inserted with effect from tax year 1998-99 offered tax holiday for undertakings set up in the North-eastern region up to tax year 2002-03.

- The Finance Act, 2003, inserted S.80-IC with a view to give effect to a package of fiscal and non-fiscal concessions announced by the Central Government for certain Northern and North-Eastern states of India

- For units based in specified areas of Northern states of Himachal Pradesh (HP) and Uttaranchal, S. 80-IC allows a two-tier income-linked tax holiday at a prescribed percentage for 10 years viz., a full tax holiday (100%) of profits for the first five years followed by a partial (25%/30%) tax holiday for the next five years. In contrast, the tax holiday period for units located in North-Eastern States is full 100% of profits for 10 years.

- Tax holiday is available either to: (a) a new unit which begins to manufacture or produce qualifying articles or things or (b) an existing unit which implements "substantial expansion".

- "Substantial expansion" is defined to mean an increase of investment in plant and machinery by at least 50% of the book value of plant and machinery (before claiming depreciation in any year), as on the first day of the tax year in which substantial expansion is undertaken. Objectively defined "substantial expansion" (i.e. incremental investment > 50% of existing book value) is a new feature of S.80-IC as compared to its predecessor provisions.

- The qualifying period within which unit should begin to manufacture/produce or complete "substantial expansion" in certain specified areas of HP and Uttaranchal was between 7 January 2003 and 31 March 2012.

- The unit should also satisfy certain other conditions, *inter alia*, that it should not be formed by splitting up or reconstruction of a business already in existence or it should not be formed by transfer to a new business of machinery or plant previously used for any purpose (commonly referred to as "formative conditions").

- Tax holiday period of 10 years begins from the "initial assessment year" which is, *inter alia*, defined to mean the tax year in which the unit begins to manufacture or produce articles or things or completes substantial expansion.

- S.80-IC also contains a specific overall period limitation which states that the total period of deduction under the predecessor provisions and S.80-IC cannot exceed 10 years.

**Facts**

- The Taxpayer had established new units in specified areas of HP and Uttaranchal within the qualifying period. For such new unit, Taxpayer treated the year of manufacture or production of articles of things as the initial assessment year.

- The Taxpayer claimed 100% deduction for the first five years from the year of set up of new industrial units which was allowed by the Tax Authority.

- Subsequently, in the sixth year, the Taxpayer undertook substantial expansion of the existing unit by way of investment in plant and machinery exceeding 50% of book value as on first day of the fifth year. The Taxpayer claimed the year of completion of substantial expansion as "initial assessment year" qua the whole of unit and claimed 100% deduction for the entirety of the profits of the unit (including substantially expanded portion) from sixth year by contending that it became entitled to a fresh five-year tax holiday period for claiming 100% deduction by virtue of completion of substantial expansion.

- The Tax Authority disallowed the claim by holding that the Taxpayer had already claimed deduction of 100% of profits for the first five years from the date of set up of new unit and, hence, restricted the deduction to 25% of

eligible profits for the said year. Accordingly, the Tax Authority held that the Taxpayer was entitled to only 25%/30% deduction from the sixth year to the tenth year and cannot avail a fresh five-year tax holiday for 100% deduction on account of substantial expansion.

- Further, the Tax Authority contended that, for the purpose of claiming benefits under S. 80-IC, taxpayers can have only one "initial assessment year".

- The FAA and the Tribunal ruled against the Taxpayer and upheld the Tax Authority's action of restricting the deduction to 25% from the sixth year onwards. Being aggrieved, the Taxpayer appealed to HP High Court (HC).

- The HP HC clubbed the Taxpayer's case with that of many other taxpayers, who had completed "substantial expansion" during different time periods and based on plain and literal interpretation of S. 80-IC, the HP HC ruled in favor of the Taxpayer and permitted a fresh tax holiday claim of 100% from the year of substantial expansion subject to total period of exemption not exceeding 10 years from the date of commencement of manufacture. The HC held that (a) there is no bar on having more than one "initial assessment year". (b) Since S.80-IC benefit is geared towards additional investment, the Taxpayer can claim 100% deduction for a fresh five-year period within the overall period of 10 years by making a "substantial expansion" during the qualifying period. (c) Substantial expansion cannot be confined to one expansion. As long as the requirement of S. 80-IC is met, there can be multiple substantial expansions within the qualifying period.

- Aggrieved, the Tax authority appealed before the Supreme Court (SC) wherein the Division Bench ruled against the Taxpayer in the case of Classic Binding Industries and restricted the claim of deduction to 25% of profits from year of substantial expansion.

- The Division Bench distinguished the SC ruling in the case of Mahabir Industries relied upon by the Taxpayer. In Mahabir Industries case, the taxpayer claimed 100% of profits as deduction under S.80-IB for the initial five years and thereafter carried out a substantial expansion during the qualifying period under S. 80-IC. The SC, in that case, allowed deduction of 100% of profits under S.80IC for the balance five years period by reckoning "initial assessment year" from the completion of substantial expansion. The Division Bench distinguished Mahabir Industries ruling on the ground that it involved deductions under two separate sections whereas in the case before the Division Bench, the Taxpayer claimed deduction under S. 80-IC itself by considering the substantial expansion as a separate event to trigger 'initial assessment year' which was not correct.

- The Division Bench has also clubbed a bunch of other appeals. However, while disposing of appeals, many of the taxpayers were neither served with notices of hearing nor heard. On application being filed by these taxpayers, their appeals were restored for fresh hearing. The Division Bench ruling was recalled for fresh hearing. Tax authorities had also filed Special Leave Petition before SC in certain taxpayers matters. All these appeals and Special Leave Petitions were clubbed together for the hearing by the Larger Bench.

**Issue before the Supreme Court**

Whether the Taxpayer, who had set up a new unit during qualifying period and thereafter completed substantial expansion before sunset date, was entitled to 100% deduction for a fresh five-year period?

**Larger Bench ruling**

The Larger Bench ruled in favor of the Taxpayer by allowing the enhanced claim of deduction of 100% of profits from the year of completion of substantial expansion, subject to total period of exemption under S.80IC not exceeding 10 years. It further stated that the Division Bench ruling is erroneous for the reason that it was delivered by referring erroneously to the definition of "initial assessment year" as provided in a different provision viz. S. 80-IB(14) and without having regard to the definition of "initial assessment

year" under S. 80-IC itself which is materially different in its scope.

The Larger Bench decision is based on the following principles:

- The definition of "initial assessment year" mentioned in S. 80-IB could not have been the basis of determination of initial assessment year under S. 80-IC since S. 80-IC itself encompasses the definition of "initial assessment year".

- S. 80-IB (14) starts with the words '"for the purpose of this section". Thus, 'initial assessment year' defined therein is relatable only to the deductions that are provided under the provisions of S. 80-IB, namely, in respect of profits and gains from certain industrial undertakings other than infrastructure developmentundertakings.

- S. 80-IC is materially different from S. 80-IB , since S.80-IC is a special provision in respect of only those undertakings established in particular States viz., Sikkim, Himachal Pradesh, Uttaranchal or any of the North-Eastern States.

- The interpretation of "initial assessment year" contained in S. 80-IC(8) is materially different. As per S.80-IC, "initial assessment year", means the year in which the undertaking or the enterprise (i) begins to manufacture or produce article or things; or (ii) commences operation; or (iii) completes substantial expansion. Thus, undertaking or enterprise can have more than one "initial assessment year" for S.80IC depending upon the relevant event.

- Further, S. 80-IC provides 100% of profits and gains for first five initial assessment years commencing with the initial assessment year and thereafter 25%/30% of the profits and gains. The deduction @ 25% for the next five years in on the assumption that the new unit remains static without involving substantial expansion thereof. However, the moment substantial expansion takes place, another "initial assessment year" is triggered. This new event entitles that unit to start claiming deduction @ 100% of the profits and gains from year of substantial expansion.

- The purpose for which S. 80-IC was enacted was to encourage the undertakings or enterprises to establish and set up units in the aforesaid States in hilly areas to make them industrially advanced States as well. Having regard to the objective of the provision, 100% of profits and gains is allowed even when there is substantial expansion of the existing unit. As substantial expansion referred to in the provision would result in increase in production as also generation of more employment, the year in which substantial expansion is carried out is treated as "initial assessment year".

- The Larger Bench referred to SC ruling of five-judges bench (Constitution Bench) in the case of Commissioner of Customs v. Dilip Kumar and Co in support of the proposition that Statute must be interpreted according to intention of the legislature. Constitution Bench did also hold that where statutory provision is open to more than one meaning, court is to choose the interpretation which represents the intention of the legislature.

- The Larger Bench endorsed the SC ruling in the case of Mahabir Industries and held that there can be two initial assessment years under S.80IC also; one for setting up of new unit and another for substantial expansion.

*Source: Larger bench ruling for [TS-75-SC-2019]*

### 3. Bombay HC reaffirms that treaty provisions override the provisions of the Income tax Act ('the Act')

Question of law: *"(i) Whether the Tribunal was correct in law and on facts in coming to the conclusion that sec. 206AA of the Income Tax Act, 1961 does not override the provision of sec. 90(2) of the Income Tax Act, despite the fact that sec 206AA starts with a non-obstance clause?"*

**Facts of the case:**

- During the assessment stage, the Assessing Officer (AO) noticed that assessee had deducted TDS @ 10% while making payments to a non-resident. He further noticed that the payee did not have PAN and in view of section 206AA of the Act, he held that assessee had to deduct TDS at higher rate of 20%. Eventually, department filed an appeal before the Pune Tribunal which was ruled in favour of the assessee by the Tribunal.

- In subsequent years, the assessee filed an intervenor Application before the Hon'ble Hyderabad Special Bench in case of Nagarjuna Fertilizers and Chemicals Ltd.

- The case was represented jointly by Litigation Team and BU Team and the Hon'ble Tribunal ruling in favour of assessee held that there was tax liability on the payee at a lower rate as per the DTAA and therefore by virtue of S. 90(2) of the Act, assessee was spared with the liability to deduct tax at higher rate as per provisions of section 206AA of the Act.

**Ruling of the HC**

- While dismissing the Department's appeal, the Hon'ble Bombay High Court relied on the Delhi High Court decision in case of Danisco India Pvt Ltd (404 ITR 539) (Del), wherein the Hon'ble High Court relying on the Tribunal order in assessee's case had ruled favourably holding that the interpretation of the Tribunal was correct.

- With this decision, the Bombay High Court has reaffirmed that Treaty provisions override the provisions of the Act.

*Source: ITA No. 548 of 2016*

# Key Regulatory amendments

**This section summarizes the regulatory updates for the month of March 2019.**

**Notifications/ circulars issued by RBI**

**1. RBI issued the Trade Credit framework**

RBI has issued the revised Trade Credit framework under Foreign Exchange Management (Borrowing and Lending) Regulations, 2018. Key changes of the said revised framework for Trade Credits (TC) are as under:

- **Amount:** The amount upto which TC can be raised has been increased to USD 50 million or equivalent per import transaction under the automatic route, earlier the limit was USD 20 million. Further, the limit for oil/gas refining & marketing, airline and shipping companies has been enhanced up to USD 150 million per import transaction.

- **Period of TC:** Period has been reduced to three years for import of capital goods from five years. For non-capital goods, the period shall be up to one year or the operating cycle, whichever is less. For shipyards/ shipbuilders, the period of TC for import of non-capital goods can be up to three years.

- **Trade Credits in Special Economic Zone (SEZ)/Free Trade Warehousing Zone (FTWZ)/ Domestic Tariff Area (DTA):** TC can be raised by a unit or a developer in a SEZ including FTWZ for purchase of non-capital and capital goods within an SEZ including FTWZ or from a different SEZ including FTWZ. Further, an entity in DTA is also permitted to raise TC for purchase of capital / non-capital goods from a unit or a developer of a SEZ including FTWZ.

*Source: A.P. (DIR Series) Circular No.23 dated 13 March 2019*

## 2. Amendments to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000

- Government of India, Ministry of External Affairs, issued the Order S.O. 1549(E) dated 21 April 2017 ('Order') implementing the Security Council Resolution on Democratic People's Republic of Korea and pursuant to this, RBI has made amendments to the Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 **('**FEMA Capital Account Transactions') to insert the following clauses with respect to the transactions undertaken with citizens and/ or residents of Korea:

- *"(c) No person resident in India shall undertake any capital account transaction which is not permissible in terms of Order, as amended from time to time, of the Government of India, Ministry of External Affairs,* ***with any person who is, a citizen of or a resident of Democratic People's Republic of Korea, or an entity incorporated or otherwise, in Democratic People's Republic of Korea****, until further orders, unless there is specific approval from the Central Government to carry on any transaction.*

- *(d) The existing investment transactions, with any person* ***who is, a citizen of or resident of Democratic People's Republic of Korea,*** *or an entity incorporated or otherwise in Democratic People's Republic of Korea, or any existing representative office or other assets possessed in Democratic People's Republic of Korea, by a person resident in India, which is not permissible in terms of Order, as amended from time to time, of the Government of India, Ministry of External Affairs shall be closed/liquidated/disposed/settled within a period of 180 days from the date of issue of this Notification, unless there is specific approval from the Central Government to continue beyond that period."*

- In addition to above, RBI has amended the FEMA Capital Account Transactions to include undertaking of derivative contracts as a permissible capital account transactions in Schedule I and Schedule II of the aforesaid regulations. The RBI has also provided the definition of 'derivative' and the same is reiterated as under:

*'Derivative' means a financial contract, to be settled at a future date, whose value is derived from one or more financial, or non-financial variables."*

*Source: Foreign Exchange Management (Permissible Capital Account Transaction) (First Amendment) Regulations, 2019 dated 7 March 2019 read with Foreign Exchange Management (Permissible Capital Account Transaction) (Amendment) Regulations, 2019 dated 26 February 2019*

## 3. Voluntary Retention Route (VRR) scheme for investments by Foreign Portfolio Investors (FPIs) in Indian debt securities

- The VRR is a new channel of investment available to FPIs to encourage them to invest in Indian debt markets, over and above their investments made through the existing route.

- The objective of VRR is to encourage FPIs to commit long term investments into debt markets while providing them more operational flexibility to manage their portfolio by making the investments under this route free of macro-prudential and other restrictions, otherwise applicable to FPI investments in debt securities.

- The RBI has accepted certain suggestions made by the stakeholders (in response to the discussion paper on VRR) such as considering cash balance in Rupee accounts in calculating CPS, extension of period for investing 75% of the CPS to three months and providing custodians with the power to regularize minor violations.

- The VRR is subject to conditions relating to minimum retention period, requirement to invest within the time prescribed from the date of allotment and certain restrictions on exit prior to end of the retention period.

- FPIs may need to consider the merits of VRR prior to participating in this route. For foreign credit funds which have shown significant

interest in the Indian debt market following the introduction of a comprehensive bankruptcy law in India in 2016, this route may provide them with one more option for structuring investments into India.

- The investment in VRR shall be open for allotment from 11 March 2019.

*Source: A.P. (DIR Series) Circular No.21 dated 1 March 2019*

**4. Re-insurance and composite insurance brokers registered with IRDA permitted to open foreign currency accounts in India**

- RBI has amended the Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2015 permitting re-insurance and composite insurance brokers registered with Insurance Regulatory and Development Authority of India (IRDA) to open and maintain non-interest bearing foreign currency accounts in India for the purpose of undertaking transactions in the ordinary course of their business.

*Source: FEMA Notification no. G.S.R. 160 (E) dated 27 February 2019*

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