EY Tax and Regulatory Alert

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Contents

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Indirect Tax

This Section of Tax alert summarizes the Indirect tax updates for the month of October 2018

Judicial Precedents

1. M/s TVS Automobile Solutions Vs Commissioner of GST and Central Excise, Madurai

[2018-VIL-658-CESTAT-CHE-ST]

Background and facts of the case

- M/s TVS Automobile Solutions are engaged in following activities: buying and selling parts as pure trading activity ; indivisible works contract for vehicles ; pure labour and service contract when sale of materials; and divisible contract of goods and rendition of servicing.

- They are also paying service tax at 10.30% for all the services for labour amounts, wherever applicable. In the case of availment of CENVAT credit they have opted to pay 5% of tax in the gross profit on the trading activity as per Rule 6(3) of the CENVAT Credit Rules, 2004 and they will be availing credit for all the input services, except certain input services if used for exclusively rendering any exempted services.

- M/s TVS Automobile Solutions arrived at 5% of difference between sale price on the cost of goods sold, which may be called as gross profit; that in their goods the difference between sale price and cost of goods sold is more than 10% of cost of goods; that such computation was done as per Explanation (C) to Rule 6(3) of CENVAT Credit Rules, 2004 vide Notification No. 13/2011-CE (NT) dated 31.3.2011.

Revenue's contention

- A show cause notice was issued on the appellant for a demand of Rs. 95,94,743/- as Service Tax liability for the period April 2011 to March 2012 with interest and penalty thereon.

- For the period April 2012 to June 2012, a statement of demand was issued on identical grounds proposing demand of an amount of Rs.30,69,417/- with interest and penalty thereon

- The revenue's contention in the show cause notice and the statement of demand are as follows –

  - That the appellant should pay an amount equal to 5% on taxable value determined under Section 67 of the Finance Act, 1994 i.e. 5% of the gross value of the franchisee service and servicing of motor vehicles (both value of goods sold and service charges received).

  - Further, the goods sold to service recipient of franchisee services and servicing of motor vehicles is not trading of goods but is actually sale of goods in the course of providing taxable service; hence value of such goods sold during the course of providing franchisee service and servicing of motor vehicles it to be included in the gross value of taxable services under Section 67 of the Finance Act, 1994; that the assessees are liable to pay an amount of 5% of gross value of exempted services

  - According to the revenue, the goods sold to service recipients of franchisee services and servicing of motor vehicle services is not trading of goods, but is actually sale of goods in the course of providing taxable services (franchisee service and servicing of motor vehicles)

- In light of the above, the revenue is of the view that the value of such goods (sold during the course of providing taxable services) is to be included in the gross value of taxable services under Section 67 of the Finance Act, 1994 and that the assessee are liable to pay an amount of 5% on gross value of exempted services as per Explanation 1(a) to Rule 6(3) and 6(3A) of CENVAT Credit Rules, 2004 read along with Rule 2(e), in addition to payment of 5% on gross profit on trading activity as per Explanation 1(C) to Rule 6(3) and 6(3A of CENVAT Credit Rules, 2004.

- Both the show cause notice and the statement of demand were adjudicated in a common order dated 30.6.2015 (impugned order) wherein the

tax proposed in the show cause notice / statement of demand were confirmed along with interest. Penalties were also imposed as proposed in the respective show cause notice / statement of demand.

- Aggrieved, the assessee filed an appeal before the Tribunal for relief

Appellant's contention

- The appellant's contention was that buying and selling parts as a pure trading activity, which is governed by the definition of "exempted services" read with explanation to 1(C) to Rule 6(3) they have remitted 5% amount equivalent to duty after working out differences between sale price and the cost of goods sold.

- They also perform divisible contract of goods and rendition of servicing on motor vehicles. Here again, sale of parts constitute pure trading. They have already remitted a sum equivalent to duty in terms of explanation 1(C) to Rule 6(3) i.e. paying % on the value arrived at between the difference of sale price and cost of products.

- They executed indivisible works contract involving painting, tinkering and repair of accident vehicles. They further pointed out that the entire consideration including the cost of materials, consumables and labour is offered to service tax, being a works contract. They have neither claimed exemption nor cleared the goods as non-taxable sale transaction. Having paid service tax on the entire value, the question of applying explanation 1(C) to Rule 6(3) for these transactions does not arise.

- They also render pure labour and service contracts which do not involve any transfer or sale of materials. Service tax has been remitted on the entire labour cost and here again Explanation 1(C) to Rule 6(3). The assessee concluded that the request to pay a sum equal to duty for the entire sales turnover, is clearly impermissible and is sought to be re-assessed. They do not have any other transaction at present to be governed by explanation 1(C) to Rule 6(3) . Thus, the request to pay a sum equal to duty for the entire sales turnover is clearly impermissible and is sought to be re-assessed.

Court's findings and order

- The court observed that the appellant had sold spares during the course of provision of taxable services namely MRS as is evident from the sample invoices available in the file wherein the appellant had indicated the same vehicle registration number which was serviced in the sale invoice also thus connecting the sales to the services provided by them. In respect franchisee service also the franchise was not given for servicing of motor vehicles under the brand name of TVS and the spares required for such service were also sold by TVS. Thus in respect both types, the sale had a direct connection to the services rendered by TVS and so the value of such goods said would form part of the gross value of service in terms of section 67.

- There is clear evidence in the invoice to show that the goods were sold and that there was no evidence on record to show that they had availed Cenvat on such goods; the value of such goods sold during the course of provision of services were eligible for the exemption under Notification No12/2003 ST dated 01.03.2003 for the purpose of service tax However for the purpose Rule 6(3) (i) of CCR such value had to be treated as an "exempted value" terms of the definition of exempted service which is defined under Rule 2(e) of the CCR.

- The revenue has not given any findings to support that the exempted value had to be taken in to account and therefore the notice was liable to pay an amount equal to 5% of such "exempted value" in terms of Rule 3(3) (i) of CCR read with the above definition of exempted services "provided under cause (e) of Rule 2 of CCR. Therefore the order of the Adjudicating Authority is a non-speaking order.

- The order of the adjudicating authority has not addressed the allegations and concerns raised in the show cause notice but has instead veered off into other areas which have not been alleged in the notice or in the statement of demand.

- The points and arguments raised by both sides will be addressed by the adjudicating authority, after giving sufficient opportunity to both parties to present their case. All the appeals are allowed by way of remand.

2. Commissioner of GST & Central Excise, Chennai

Vs

M/s Mahindra & Mahindra Ltd

[2018-VIL-660-CESTAT-CHE-CE]

Background and facts of the case

- The respondents, M/s Mahindra & Mahindra Ltd are engaged in manufacture of motor vehicles. During scrutiny of ER-I Returns, for the months of December 2008, April 2009, June 2009 and November 2009, it was noticed that the respondents had removed 16 numbers of motor vehicles (prototypes) (2200CC – 7 Seater) to their unit Nasik on returnable basis. Since there was no sale involved, the department requested the respondents to re-determine the value under Rule 11 r/w Rule 8 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 and arrive at 110% of the cost of production under CAS-4.

- The respondent contended that Rule 8 was not applicable in their case and that they had adopted the future sale price of the motor vehicles in terms of Rule 4 and had discharged appropriate duty.

- According to the department that the assessable value adopted by the respondents was not correct and show cause notice was issued proposing to demand duty, interest and for imposing penalties.

- After due process of law, the Commissioner vide impugned order held that the valuation is to be done under Rule 4 and that Rule 11 r/w Rule 8 is not applicable.

- The assessable value adopted by the assessee was increased by the adjudicating authority and differential duty was confirmed under Rule 4. The assessee had paid the said enhanced differential duty. Aggrieved by the dropping of the demand as raised in the show cause notice as well as penalties, the department has filed the present appeal.

Appellant's Submission

- The appellant submitted that the respondents did not file any appeal or cross-objections and therefore the findings of the Commissioner that the goods (prototypes) are marketable and excisable requires no interference. The issue therefore is with regard to only valuation.

- The prototype motor vehicles were cleared by the respondents to their own unit at Nasik for testing their road worthiness as a prerequisite prior to manufacture and commercial marketing of similar model motor vehicles. They have adopted the value of existing similar motor vehicles sold subsequently under Rule 4 of Central Excise Valuation Rules 2000.

- The appellant argued that the word "such goods" and the value of the prototypes cannot be the same as motor vehicles which are commercially marketed. As prototypes vehicles are distinct from the similar motor vehicle models sold subsequently, adoption of the value of such vehicles for valuation of prototypes cannot be in accordance with Rule 4 of Central Excise Valuation Rules 2000.

- The appellant further submitted that when the prototype vehicles are sold for the purpose of testing of road worthiness, the situation is akin to the prototype vehicles being used / consumed in the manufacture of motor vehicles and therefore Rule 8 would be applicable for valuation. Thus, when there is no subsequent sale of the excisable goods, the adjudicating authority ought to have considered the valuation of these goods under section 4(1)(b) r/w Rule 11 and Rule 8 ibid namely 110% of the cost of production and should not have resorted to Rule 4 and therefore the demand proposed in the show cause notice may be confirmed.

Respondent's Submission

- The respondent submitted that the prototypes were cleared to their unit at Nasik on returnable basis for extensive testing at the testing track facility located therein so as to determine their quality and road worthiness. On successful and satisfactory testing, the respondent undertakes production of the motor vehicles in line with the prototypes. After the testing process, the prototype models are scrapped / destroyed or kept as display pieces. Thus goods were cleared by the respondent for testing on payment of excise duty.

- For the said purpose, the price at which the vehicles are likely to be sold after commencing

commercial production was adopted by the respondent in terms of Rule 4 of Central Excise Valuation Rules 2000. The prototypes are not captively consumed and therefore Rule 8 is not applicable. The prototypes are not consumed by the respondents for manufacture of further motor vehicles. Such prototypes are final product by themselves and cannot be said to be consumed in the manufacture of further motor vehicles.

Decision taken

- According to Rule 126 of Central Motor Vehicle Rules, 1989, a prototype of every motor vehicle shall be subject to testing by designated Government Departments or Research Associations or Testing Institutes to ascertain the compliance of provisions of the Act and Rules. The said Act itself uses the word "prototypes". Only after certification by such authorities can the manufacturer of motor vehicles manufacture and market the motor vehicles.

- The similar model vehicles which are commercially manufactured can be said to be copies of the prototypes. It cannot be then said that these prototypes are consumed in further manufacture of motor vehicles. Thus Rule 8 of Central Excise Valuation Rules 2000 will not apply to such a situation.

- Therefore, The appeal filed by the department is dismissed.

3. M/S A.M. Motors Vs Kerala Authority for Advance Ruling Authority

[2018-VIL-197-AAR]

Background and facts of the case

- In the motor vehicle industry, demonstration vehicle is an indispensable tool for promotion of sales by providing trial run to customers. It is a business requirement that motor car dealer shall compulsorily acquire the demonstration vehicles from principal supplier. These purchases are capitalized in the books of accounts excluding tax components. These demo cars are used for demonstration purpose for the prospective customer and after a specific period of time, they are sold off for the book value, paying the applicable taxes at that point of time.

- M/s. A.M. Motors approached the Authority of Advance Ruling, seeking classification if input tax credit on the motor car purchased for demonstration purpose of the customer can be availed as credit on capital goods and set off against output tax payable under GST in the case of a motor car dealer.

- M/s. A.M. Motors has stated that the demo car is purchased against tax invoice and reflected in the books as capital assets. As per their business norms, every sales outlet is bound to maintain at least three demo cars.

Observation of Authority for Advance Ruling

- The demo car is an indispensable tool for promotion of sales by providing trial run to customers and to understand the features of the vehicle.

- The suppliers of vehicles supplied demo cars against tax invoices. The applicant capitalizes the purchase in the books of accounts. The capital goods which are used in the course or furtherance of business, is entitled for input tax credit. As the impugned purchase of demo car is in furtherance of business, the applicant is eligible for input tax credit.

- Furthermore, this activity does not come under the negative clause, as after a limited period of use as demo car, the vehicles are sold at the written down book value.

- However, the availability of input tax credit shall be subject to the condition, that in the case of supply of capital goods on which input tax credit has been taken, the registered person shall pay an amount equal to the input tax credit taken on the said capital goods reduced by such percentage points as may be prescribed or the tax on the transaction value of such capital goods determined as value of taxable supply, whichever is higher.

Ruling

- Input tax paid by a vehicle dealer on the purchase of motor car used for demonstration purpose of

the customer can be availed as input tax credit on capital goods and set off against output tax payable under GST.

4. M/S Global Exim & ANR Vs Union of India & ORS

[2018-VIL-440-MP-CU]

Background and facts of the case

- The petitioners have imported Bearings vide Invoice No.1800466 dated 12.06.2018 for trading purpose under transferable Duty Free Import Authorizations, (DFIA's). The said goods are covered under the description of "Bearings" (All types other than Engine Bearing)

- The petitioner is a transferee DFIA Holder and entitled to import the goods of the description, quality and within the overall value mentioned in the DFIAs.

- The petitioners sought duty free clearance of the imported consignment of "Bearing" against a transferable DFIA issued to M/s. International Tractors Ltd., Hoshiarpur, and subsequently transferred in the Petitioners name.

- The petitioners are challenging the action of the respondent in denial of duty free import of Bearings on the ground that the imported goods are not covered by the DFIA and technical specifications, quality and characteristics of goods imported must match with the inputs to be used in the export product

Petitioner's Submission

- In terms of Clause 4.2.6 of the FTP, once transferability is endorsed, the authorization holder may transfer DFIA or duty free inputs except fuel and any other item(s) notified by DGFT. Meaning thereby, once the export obligation is discharged and transferability endorsement is made by the officers of the respondent, the license and goods imported there under without payment of duty become freely transferable except the fuel and any other goods notified by the DGFT.

- It is submitted that the endorsement against bearing is mentioned as Bearing (all types other than Engine Bearings) such as ball bearing/ Taper/Cylindrical/Needle Roller Bearing is the only requirement to be fulfilled. Once this is fulfilled DFIA benefit cannot be denied to the petitioners.

- The petitioner further pointed out that the Regional Licensing Authorities have endorsed the import item name specifically against serial No.2 to read as Bearing (all types other than Engine Bearings) such as Ball bearing/Taper/Cylindrical/Needle Roller Bearings. Apart from the above endorsement, the Regional Licensing Authorities have not made any additional endorsements. In the absence of any further endorsements, the Regional Licensing Authorities deemed to have permitted import of Bearings without any additional requirement with respect to technical specification, quality and characteristics of the inputs used in the export product. The DFIA transferee is not required to prove, afresh, whether the inputs are actually used in the export product.

Respondent's Submission

- The contention of the respondent is that the petitioner No.1 is seeking duty free import under the duty free import authorization whereas, he has not importing the identical goods which were used in the resultant export products exported by the exporter who obtained DFIA. It is a violation of para 4.1.15 of the FTP and Para 4.32.2 of HBP.

- The respondent submitted that the petitioners being transferee can import the identical items of same specification, which were declared by exporter in the export documents while making shipments. The provisions of notifications and Public Notice, which are applicable for original DFIA holder shall also be applicable for transferee. Transferee cannot have different treatment than original authorisation holder.

- That the DFIA license was issued to M/s. International Tractors Ltd., Hoshiarpur, which was subsequently transferred to the petitioners by M/s. Pushpanjali Floriculture Ltd. and not by M/s. International Tractors Ltd., Hoshiarpur, transfer letter does not provide any description of earlier transferee (Annexure P/2).

Court findings and ruling

- The resultant product is 'Agricultural Tractors' which is not specified under para 4.32.2 of HBP and therefore, the petitioners are not required to correlate the technical specification, quality and characteristics of the imported goods.

- The Transfer Letter issued by Pushpanjali Floriculture Ltd to Global Exim clearly indicates that transfer of DFIA which is permitted as per the provision of Para 4.2.6 of the FTP-(2009-14). The DFILA licenses are freely transferable and accordingly, the DFIA holder transferred the DFIA to Pushpanjali Floriculture Ltd., who inturn restransferred the said DFIA to Global Exim as per Annxures P/2 and P/3.

- The stipulation under Para 4.1.15 inserted vide notification No.31 dated 30.10.2013 to the extent that only those actually used inputs in the export product only shall be imported is not applicable to a DFIA transferee. Once the imported goods are covered under the description, quantity as mentioned within the overall CIF value allowed in the DFIA, irrespective of the ITC (HS) Nos, there is no necessity to satisfy the requirement of Para 4.1.15 of FTP 2009-14 and notification No. 90 dated 21.08.2014.

- There is no provision of redemption of DFIA License after the discharge of export obligation. Once the import goods are covered under the description, quantity as mentioned within the overall CIF value allowed in the DFIA, (as amended upon competition of export), there is no necessity to satisfy the requirements of Para 4.1.15 of FTP. It is impossible to comply the condition which states that those inputs which are actually used in export product for availing DFIA exemption.

- The Regional Licensing Authorities after examining the relevant export documents, has endorsed transferability permitting inputs as specified in the said DFIA. Therefore, DFIA transferee is not required to prove, afresh, whether the inputs are actually used in the export product.

- The petitioner is a bona-fide transferee of the said transferable DFIA cannot be denied exemption from payment of duties on the goods on the ground that only those actually used as inputs in the export product shall only be permitted for import which is applicable to a DFIA holder. Once the DFIA is made transferable by the licensing authorities, the Petitioner is not bound to show the actual use of the imported goods in the export product and is free to import any goods covered under the description and quantity mentioned within the overall CIF value allowed in the DFIA, (as amended upon competition of export), there is no necessity to satisfy the requirements of para 4.1.15 of FTP-(2009-14).

- In view of the above discussions, the writ petition of the petitioners are allowed.

Key Indirect Tax updates

This section summarizes the regulatory updates for the month of October 2018

Notification No. 53/2018 – Central Tax dated 9 October 2018

- The Government vide this notification has amended sub-rule (10) in rule 96 of the CGST Rules. Below are the analysis of the changes :

  - Notification No. 3/2018 – Central Tax dated 23 January 2018 introduced Rule 96 (10) of CGST Rules, with retrospective effect from 23 October 2017, providing that the person claiming refund of IGST on export shall not have received supplies on which the supplier has availed benefits of certain specific notifications, i.e. Notification No 48/2017-Central Tax, dated the 18th October, 2017, 40/2017-Central Tax (Rate) dated 23rd October, 2017 and 41/2017- Integrated Tax (Rate) dated 23rd October, 2017 and Notification No 78/2017- Customs dated 13th October, 2017 and 79/2017-Customs, dated the 13th October, 2017 (pertaining to EOU benefit, Advance Authorization and EPCG benefit, etc)

  - Subsequently, Rule 96(10) was amended by Notification No. 39/2018-Central Tax dated 4th September, 2018 with retrospective effect from 23rd October 2017, in terms of which the condition for claiming refund under Rule 96(10) was bifurcated into two parts, viz; the person claiming refund should not have received supplies on which benefit of 48/2017-Central Tax, dated the 18th

October, 2017, Notification No 40/2017- Central Tax (Rate) 23rd October, 2017and 41/2017- Integrated Tax (Rate) 23rd October, 2017 has been availed; and the person claiming refund should not have himself availed benefit of Notification No 78/2017- Customs dated 13th October, 2017 and 79/2017-Customs, dated the 13th October, 2017 (pertaining to EOU benefit, Advance Authorization and EPCG benefit, etc).

- As a result of the retrospective amendment by Notification No. 39/2018-Central Tax, all registered persons, including importers, who had directly purchased/imported supplies while availing benefits under the EOU/STP/EPCG/AA schemes got ineligible for availing refund of the integrated tax paid on export of goods or services. Thereby, enabling the Department to recover the refund allowed during the period prior to 4th September, 2018 from such registered persons.

- Now, Notification No. 53/2018- Central Tax dated 9th October, 2018, rolled back the amendment made vide Notification No 39/2018, and reinstated the earlier position brought in by Notification 3/2018, which provided that person claiming refund of IGST shall not have received supplies from supplier who has availed benefit under all specific notifications as mentioned above (both GST and Customs).

- Vide Notification No 54/2018- Central Tax dated 9th October, 2018, Rule 96(10) has been further amended prospectively, wherein the conditions stipulated vide Notification No 39/2018 as mentioned above have been reinstated, thereby restricting registered persons who had directly purchased/ imported supplies availing benefit of EOU/STP/AA, to claim refund of Integrated tax paid on export of goods/services.

- However, now a specific relief has been granted for such units with respect to benefit availed under EPCG scheme.

Notification No. 54/2018 - Central Tax dated 9 October 2018

- The Government vide this notification has amended sub-rule (4B) in rule 89 of the CGST Rules.

- Prior to amendment, where a person engaged in export of goods without payment of IGST and claiming refund of unutilized input tax credit, in respect of inputs on which the supplier has availed benefit of Notification No 40/2017- Central Tax (Rate) 23rd October, 2017and 41/2017- Integrated Tax (Rate) 23rd October, 2017, (concessional rate under GST), Notification No 78/2017- Customs dated 13th October, 2017 and 79/2017-Customs, dated the 13th October, 2017 (pertaining to EOU benefit, Advance Authorization and EPCG benefit, etc), refund shall be allowed to such person i.e. claimant in respect of such inputs (received from supplier availing benefit under cited notifications) as well as other inputs and input services to the extent they are used for exports.

- Now, post amendment, it has been specified that where a person is claiming refund of unutilised credit on account of zero rated supplies, without payment of tax, and;

  - The person has received supplies on which the supplier has availed benefit of Notification No 40/2017-Central Tax (Rate) 23rd October, 2017and 41/2017- Integrated Tax (Rate) 23rd October, 2017; or

  - The person claiming refund has himself availed benefit of Notification No 78/2017- Customs dated 13th October, 2017 and 79/2017-Customs, dated the 13th October, 2017

  Refund of unutilised input tax credit shall be allowed to such person in respect of such inputs (on which benefit has been claimed by the supplier) as well as other inputs and input services to the extent they are used for exports.

- Resultant to the said amendment, a person who is himself availing benefit of EOU/STP/AA/EPCG scheme, shall be eligible to claim refund in respect of inputs on which supplier has availed benefit of concessional rate under aforementioned notifications.

Direct Tax

This Section of Tax alert summarizes the Direct tax updates for the month of October 2018

Judicial Precedents

1. M&A Update: Tax Authority raising GAAR on scheme of arrangement

Background and Facts of the case

- The scheme of amalgamation was filed before the NCLT, Mumbai, which provided for amalgamation the Transferor Company/GIPL into and with the Transferee Company/APL, involving reduction of shares held by the Transferor Company in the Transferee Company.
- The Transferor Company held 9.54% stake in the Transferee Company. The Transferor Company was held by the Promoters, which also held 61.17% shares of the Transferee Company. Pursuant to the merger, the Transferee Company was to issue shares to the shareholders of the Transferor Company i.e., the Promoters.
- The rationale of the Scheme, amongst others, was to simplify the shareholding structure and reduce the shareholding tiers, thereby streamlining the Promoters' shareholding in the Transferee Company. Thus, the rationale for the Scheme that the Promoters would become direct shareholders of the Transferee Company or would continue to hold the shares in the same proportion pre and post the merger, was held to be without any justification.
- The Scheme had received approvals of the Board of Directors and shareholders of the Transferor Company and the Transferee Company.
- The independent valuer's report, the merchant banker's fairness opinion and the SEBI observation letter did not raise any objections or highlight any adverse comments.
- However, the tax authority raised objections to the Scheme, stating the scheme to be an impermissible avoidance agreement under General Anti-avoidance Rules (GAAR) provisions, devised with a deliberate intention to avoid tax. The objections of the tax authority are given below.

Tax authority's objections

The tax authority raised objections and contended on the following grounds:

- The Transferor Company is a separate entity and the assets cannot be transferred or distributed directly to the shareholders without paying DDT. Thus, on amalgamation, DDT of INR 134.16 crores would be lost.
- Furthermore, the Transferor Company is into the business of investment and dealing in equity shares, as per the objects clause in the Memorandum of Association of the Transferor Company. Thus, sale of shares of the Transferee Company would have resulted in taxable business income in the hands of the Transferor Company, resulting in a tax liability of INR 287.50 crores
- The Scheme has been formulated with a deliberate measure to evade taxes and, hence, is purely an impermissible avoidance agreement under GAAR provisions.
- The Scheme seems to be a round trip financing through the series of transactions.

NCLT's observations

- The Transferor Company was into the business of investment and dealing of equity shares, primarily holding shares of the Transferee Company, which were purchased in the secondary market at various points in time. Thus, the NCLT observed that the submission by the Transferor Company that it was the holding company of the Transferee Company, was factually incorrect.
- Furthermore, from the analysis of the annual report of the Transferee Company for the year 2016-17, it was noted that the Transferor Company directly owned 9.54% shares, but the Promoters also held shares indirectly in the Transferee Company through other promoter

entities like a trust. Thus, the rationale for the Scheme that the Promoters would become direct shareholders of the Transferee Company or would continue to hold the shares in the same proportion pre and post the merger, was held to be without any justification.

- The Bench perused the financial statements and noted that the Transferor Company had nominal equity share capital, but the Promoters would receive shares worth INR1477.50crores by way of the Scheme, without paying any tax, stamp duty, etc., which was considered to be not in public interest

Petitioner company's submissions

The Petitioner Company relied on several judgements, illustratively:

- Mihir Mafatlal, in which it was held that the Court neither had the expertise nor the jurisdiction to delve on commercial wisdom.
- Sesa Goa, in which it was held that the tax authority had no locus standi to intervene.
- Cairn India Ltd.,-in which the NCLT, Mumbai, had cleared the scheme despite objections filed by the tax authority due to huge outstanding demands etc.

  However, the NCLT noted that the judgements relied on by the Petitioner Company were not specific to the facts of the case.

NCLT's ruling

- The NCLT deliberated upon the contentions raised by the tax authority and concluded that the Scheme would entail huge tax losses to the government, where the Promotors, with a mere investment of INR 48.70 crores would receive shares in the listed Transferee Company worth INR 1,447.50 crores (fair market value of the shares), without paying taxes of INR 421.67 crores.
- Also, the NCLT noted that the Scheme did not comply with the SEBI Takeover Code Regulations, as the Promoters would acquire additional shares above the prescribed limit (i.e., more than 5% of the voting rights within a financial year).
- In furtherance, the NCLT relied on the judgement of the NCLAT in the matter of WiKids Ltd. v. Aventel Ltd. to conclude that a scheme can be rejected if it does not serve public interest.

Considering the above objections, the NCLT rejected the Scheme on the premise of it being unfair, unreasonable and not in public interest.

Source: Gabs Investments & Ajanta Pharma- NCLT (Mum) Order dtd 05-09-2018

2. Supreme Court reaffirms constitutional validity of Aadhaar-PAN linking requirement

Background and Facts of the case

- Section 139AA of the Income tax Act, 1961 (Aadhaar-PAN linking provision), inserted by the Finance Act, 2017 with effect from 1 April 2017, mandates the following compliances by a taxpayer:
  - Aadhaar quoting compliance: Quoting of Aadhaar while securing new PAN and in ROIs furnished on or after 1 July 2017.
  - Aadhaar linking compliance: Linking of Aadhaar with PAN on or before specified date in cases where valid PAN was held by any taxpayer as on 1 July 2017, failing which PAN of such taxpayers would be treated as invalid.
- The Aadhaar-PAN linking provision also confers the power on the Central Board of Direct Taxes (CBDT) to notify the class of taxpayers to whom Aadhaar quoting and linking compliances shall not apply. In exercise of such power, by a Notification dated 11 May 2017, the CBDT excluded the following categories of taxpayers who do not possess Aadhaar:
  - An individual who resides in the states of Assam, Meghalaya and, Jammu and Kashmir;
    or
  - An individual who:
    - Is a non-resident as per the Indian Tax Law (ITL); or

- Is of the age of 80 years or more at any time during the tax year; or
- Is not a citizen of India.

- The object of the Aadhaar-PAN linking provision is to tackle tax evasion by unscrupulous persons by obtaining PAN in the names of fictitious taxpayers, which makes it difficult for the Tax Authority to trace financial transactions where PAN is quoted, to the real owners. Since Aadhaar is a unique identity with biometric parameters, linking Aadhaar with PAN makes it possible for the Tax Authority to identify fictitious PAN and invalidate/eliminate them.

Constitutional validity of the Aadhaar-PAN linking provision upheld by the SC in the Binoy Viswam ruling:

- In June 2017, the Division Bench of the SC, in the Binoy Viswam ruling, upheld the constitutional validity of the Aadhaar-PAN linking provision. However, the SC made its ruling subject to the outcome of the challenge to the constitutional validity of the Aadhaar Act which was, at that time, pending before the Constitution Bench of the SC in a set of various writ petitions.

- As an interim relief, till the validity of the Aadhaar Act was decided by the Constitution Bench, the SC, in the Binoy Viswam ruling, directed that PAN shall not be treated as invalid for a limited class of taxpayers who did not possess Aadhaar and who were not required to file ROI, in case they failed to comply with the Aadhaar linking compliance.

- Meanwhile, the CBDT, vide Circular dated 31 July 2017, permitted filing of ROIs by quoting Aadhaar, but without linking Aadhaar to PAN. But, the relief was conditional upon the taxpayer complying with the Aadhaar linking compliance by 31 August 2017, without which ROIs filed would not be processed by the Tax Authority. During the pendency of the present SC ruling, the said date was extended from time to time, vide various orders , the last being to 31 March 2019. It appears that this due date was for a limited class of taxpayers who filed ROIs for tax year 2016-17 by quoting Aadhaar, but without linking Aadhaar with PAN. The due date for all taxpayers to link Aadhaar with PAN, failing which PAN shall be treated as invalid under the Aadhaar linking provision, is yet to be formally notified by the Central Government.

- In the intervening period, some High Courts (supra) directed the Tax Authority to accept ROIs of taxpayers who had approached the High Court without quoting Aadhaar.

Snapshot of litigation on validity of the Aadhaar Act before the SC

- The matters which were pending before the Constitution Bench of the SC when the Binoy Viswam ruling was pronounced were in relation to two major issues: (1.) Whether the "right to privacy" is a fundamental right granted under the Constitution of India (Constitution). (2.) The challenge to the constitutional validity of the Aadhaar Act on multiple grounds, including on whether it violates the fundamental right to privacy.

- The first issue was decided by a nine-Judge Bench of the SC, vide a ruling dated 24 August 2017, which held that the "right to privacy" is a fundamental right guaranteed under Article 21 of the Constitution.

- The Puttuswamy ruling has dealt with the second issue and has upheld the validity of the Aadhaar Act by a majority ruling (4:1) that it does not violate the fundamental right to privacy.

SC ruling and its impact of upholding the constitutional validity of the Aadhaar Act on the Aadhaar–PAN linking provision

- To recollect, the SC, in the Binoy Viswam ruling, upheld the constitutional validity of the Aadhaar–PAN linking provision, subject to the outcome of the challenge to the validity of the Aadhaar Act.

- Since the Constitution Bench, in the Puttuswamy ruling, has upheld the validity of the Aadhaar Act, the constitutional validity of the Aadhaar–PAN linking provision also stands confirmed. Furthermore, the interim relief granted from the Aadhaar linking compliance by the SC in the Binoy Viswam ruling, also stands vacated.

Source: Justice K.S. Puttaswamy (Retd.) v. UOI [TS-556-SC-2018]

3. Bombay HC on deemed dividend taxation in the hands of the shareholders

Background and Facts of the case

- Taxpayer, an Indian resident individual, held 15% equity shares in an Indian closely held company (CHC) (I Co1/Lender) and 45% equity shares in another Indian CHC (I Co2/ Borrower)
- I Co1 had given a loan/advance to I co2 during the relevant tax year.
- The Taxpayer filed his return of income without considering the amount of loan/advance received by I Co2 from I Co1. The Tax Authority treated such loan as deemed dividend in the hands of Taxpayer shareholder and taxed the same on a protective basis.
- The first appellate held in favour of Taxpayer on the ground that loan was not received by the Taxpayer shareholder but by I Co2 and also that the addition was already made in the hands of I Co2 on substantive basis.
- Tribunal relying on judicial precedents, ruled that the amount was taxable as deemed dividend in the hands of the Taxpayer shareholder as the twin conditions of shareholder holding not less 10% voting power in lending company and substantial interest in the borrowing company stood satisfied. It was further held that there cannot be any proportionate addition of deemed dividend taking into consideration the percentage of the shareholding in the borrowing company, as the ITL does not postulate any such situation.
- Aggrieved, the Taxpayer filed an appeal before the HC.

Taxpayer's contentions

- The deemed dividend should not be taxed in the hands of the Taxpayer shareholder as he was not the recipient of the loan/advance. In any case, if taxes are to be levied, the same to be taxed to the extent of Taxpayer's proportionate shareholding in the borrowing company.
- Further, if there is no specific provision or just a mechanism to tax different shareholders with respect to their proportionate interest, the entire charge under the ITL fails.

HC's ruling

The HC, ruled that the issue decided by Tribunal does not give rise to any substantial question of law and accordingly dismissed the appeal:

- Based on the facts that the Taxpayer was holding more than 10% interest in lender-company and also substantial interest in the borrower-company, the Tribunal ruled that the twin conditions for application of deemed dividend provisions in the hands of the shareholder stood satisfied.
- The Tribunal came to a conclusion based on factual data, being deemed dividend applicability in the present case as Taxpayer, was a shareholder in both the lending company and held substantial interest therein.
- Further, HC ruled that proportionate taxation basis the shareholding pattern des mot give rise to any substantial question of law, as in the present case there is only one common shareholder in the lender and borrower company.
- However, different considerations may arise if there are two or more common shareholders in the lending and borrowing company, in which case it could possibly be argued that the addition ought to be made on a proportionate basis. However, the same was not the issue in the present case and hence was not examined by the HC.
- The HC noted Delhi ITAT ruling in case of Puneet Bhagat Vs Income Tax Officer where proportionate taxation was upheld in the hands of the common shareholders and distinguished the same as in the present case the taxpayer was the only common shareholder for applicability of 5.2(22)(e)

Source: Bombay High Court Judgement dated 3 October 2018 in case of Shri. Sahir Sami Khatib v. ITO -8(2)-3; ITA No. 722 of 2015 and ITA No. 722 OF 2015

Key Direct Tax Developments

1. CBDT extends due date for filing income tax returns and other audit reports to 15 October 2018; no relief for levy of interest for filing tax return beyond 30 September 2018

Detailed Discussion

- In deference to representations made by various stakeholders for extending the due date, the Central Board of Direct Taxes (CBDT) vide order dated 24 September 2018 has extended the due date for filing of return of income (RoI) as well as various reports of audit prescribed under the ITL (including the tax audit reports) from the original due date of 30 September 2018 to 15 October 2018 for the following class of taxpayers:
  - Company;
  - Person (other than a company) who is liable for tax audit or audit under any other laws;
  - Working partner of a firm/Limited Liability Partnership who is liable for tax audit or audit under any other laws for the time being in force.
- While due date for filing RoI is extended, no relief is granted by the CBDT for the levy of interest for filing of RoI beyond 30 September 2018. As a consequence, if the taxpayer files its RoI on or after 1 October 2018 but before 15 October 2018 i.e., within the extended due date, it will be liable to pay an interest @ 1% for one month on the balance amount of tax payable. No interest will be leviable if no tax is payable by the taxpayer due to payment of advance tax or tax deducted at source.

Source: CBDT vide order dated 24 September 2018

2. CBDT issues Final Notification for granting benefit of 10% LTCG for non-STT based shares acquisitions

Detailed Discussion

- The new provision replaces the erstwhile S. 10(38) of the ITL which granted total exemption on long term capital gains (LTCG) arising on transfer of equity shares, units of equity oriented mutual fund and units of business trust (specified capital assets). With the withdrawal of exemption, the new provision provides for taxation at the rate of 10% (as increased by applicable surcharge and cess) on LTCG arising on transfer of specified capital assets subject to certain conditions. Under the new provision, LTCG is computed after granting the benefit of cost step-up with respect to fair value as on 31 January 2018. Accordingly, the gains arising on specified capital asset up to 31 January 2018 are grandfathered.
- One of the conditions to avail the benefit of new provision is that Securities Transaction Tax (STT) is to be paid on acquisition as well as on transfer of equity shares. Further, the new provision empowers the CG to specify transactions of acquisition of equity shares in respect of which condition of payment of STT is relieved. Consequently, LTCG on such shares shall be taxable at the rate of 10% despite non-payment of STT on acquisition. This is akin to exemption available under exemption provision to non-STT based acquisitions as notified under Notification No. 43/2017 dated 5 June 2017.
- Post Union Budget 2018, the Central Board of Direct Taxes (CBDT) had clarified that Notification No. 43/2017 dated 5 June 2017, issued in the context of exemption provision, will be reiterated for the purpose of new provision. With a view to adopt a consultative process, the CBDT vide Press Release dated 24 April 2018 had issued a draft Notification (draft Notification) inviting comments/suggestions from stakeholders. The draft Notification was identically worded as Notification issued under exemption provision.
- The CBDT has now issued the Final Notification under the new provision vide Notification No. 60/2018 dated 1 October 2018 (Final Notification). The Final Notification is almost identically worded as the draft Notification. However, in light of the stakeholder comments/suggestions, a new carve-out has been introduced to protect a transaction of acquisition of existing listed equity shares in the following scenarios:

Transferor of	Transferee of shares	Event of	Benefit of new provision	Condition to be

shares		transfer	available to	satisfied
Partner /Member	Firm/LLP/Association of Persons (AOP)/Body of Individuals (BOI)	Capital contribution	Firm /LLP /AOP /BOI	Acquisition of transferor is not covered by the negative list of Final Notification.
Firm /LLP / AOP / BOI	Partner / Member	Distribution on dissolution or otherwise	Partner/ Member	

- While the additional carve-out provides the benefit of the new provision to the transferee, the transferor at the time of contribution or distribution of equity shares, as the case may be, may not be able to claim the benefit of new provision in absence of payment of STT on contribution/distribution of equity shares. Further, the transferee may not be eligible to claim the cost step-up with respect to fair value as on 31 January 2018, if the transfer of equity shares by way of capital contribution/distribution takes place post 31 January 2018.

Source: Notification No. 60/2018 dated 1 October 2018 (Final Notification) issued by Central Government (CG) in the context of Section 112A of the Income Tax Laws

Key Regulatory amendments

This section summarizes the regulatory updates for the month of October 2018.

Notifications/ circulars issued by Reserve Bank of India (RBI)

1. Liberalization in external commercial borrowing (ECB) policy regarding public sector Oil Marketing Companies (OMCs)

- RBI has liberalized the extant ECB policy framework with respect to availing of ECB by public sector OMCs. The key changes are provided as under:
  - RBI permitted public sector OMCs to raise ECB for working capital purposes with minimum average maturity (MAM) period of 3/ 5 years from all recognized lenders under the automatic route which was permitted to raise only from foreign equity holder with MAM of 5 years only.
  - The individual limit of USD 750 million or equivalent and mandatory hedging requirements as per the ECB framework have also been waived for borrowings for the purpose of availing ECB by OMCs for working capital purposes. However, OMCs should have a Board approved forex mark to market procedure and prudent risk management policy, for such ECBs.
  - The overall ceiling for such ECBs would be USD 10 billion equivalent

Source: A.P. (DIR Series) Circular No.10 dated 03 October 2018

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