2021 | AWARDS

ENRICHING TAX SPACE

PRESENTS

TECH-DRIVEN EVOLUTION OF INDIAN TAX SYSTEMS

Contents

Editorial

Tax Tech Evolution - A New Chapter for Government and the Taxpayer 5

Goods and Services Tax

GST System: Tax Transformation using Technology innovation 9
M K Sinha (IRS), CEO, Goods and Services Tax Network

Technology Interface in GST 14
Mahesh Jaising, Partner, Deloitte India
Sangita Prakash, Senior Manager, Deloitte Touche Tohmatsu India LLP
Ashish Dhariwal, Manager, Deloitte Touche Tohmatsu India LLP

Tech Driven Evolution of Indirect Tax System in India 17
Prakash Kumar, Former CEO, Goods and Services Tax Network

GST Compensation - Politics Often Goes Beyond Perimeter of What is Engraved in Law! 22
Shailendra Kumar, Founder Editor, TIOL

Foul Years of GST 25
Vijay Kumar, Editor-in-Chief, TIOL

Legality/Constitutionality of TDS/TCS Provisions under GST 28
P R Chandrasekharan, Former Member, CESTAT

The E-way, No Way 30
Vijay Kumar, Editor-in-Chief, TIOL

COVID-19 and GST Council - Need to Prescribe Procedure During Times of an epidemic/pandemic.. 33
Pritam Mahure, CA

Aligning the GST Law with Insolvency and Bankruptcy Code 35
Ankita Shah, Associate Director
Nidhi Gada, Senior Associate, Mazars India LLP

GST - Fake Invoices - Mega Hole in Treasury; Time for Punitive Legislative Measures 39
Shailendra Kumar, Founder Editor, TIOL

Carbon Credits - Whether Taxable under GST? 41
Akash Deep Singh, Principal Associate
Rohit Arora, Associate, DSK Legal

Cancellation of Registration - Refund of Input Tax Credit.................................... 45
Lakshmi Ratna Kancherla, Principal Associate, Lakshmikumaran & Sridharan, Bangalore

Cross Charge under GST: A Necessary Evil............. 47
Rohini Mukherjee, Joint Partner, Lakshmikumaran & Sridharan

GST Incentive Schemes by States - A Dynamic Calculus of Value-Additions.................. 50
V K Garg IRS (Retd.), Former JS (TRU), CBIC and Advisor (Financial Resources) to CM, Punjab

GST Laws-Drafting Infirmities, A Cause of Concern ... 52
R K Singh, Former Member CESTAT and Senior Partner, TLC Legal Advocates

GST-Related Clarifications - Press Releases & Tweets a Risky Culture 54
Shailendra Kumar, Founder Editor, TIOL

Supplies of Goods from SEZ: IGST Required to be Paid Twice under GST Regime, Unintended (?) But True 57
R K Singh, Former Member CESTAT and Senior Partner, TLC Legal Advocates

Is Food Supplied as Prasadam Liable to GST?.......... 59
Dr Nilesh V Suchak, CA
Punit Prajapati, CA

International Taxation

The Global Minimum Tax Rules by the OECD 63
M S Vasan,
Senior Vice President, Hinduja Global Solutions Ltd

OECD-brokered Tax Order, yuck, Disorder - Fiscal 'Squid Game' turns BEPS into 'TEBS'! 67
Shailendra Kumar, Founder Editor, TIOL

OECD-brokered Digital Tax - Doctrine of Pity & Pittance at Play for Non-rich! 70
Shailendra Kumar, Founder Editor, TIOL

International Tax Reform - India Should be Careful.... 72
D P Sengupta, Consulting Editor, TII

OECD's Double Standards on Race To Bottom on Direct & Indirect Taxes.. 77
Naresh Minocha, Consulting Editor, TIOL

Pitfalls of the Platform Economy 80
D P Sengupta, Consulting Editor, TII

Captive Concerns - Whether Negative Working Capital Adjustment Required in TP Proceedings? 85
S Ramanujam, CA

International Law - Upcoming Challenges for India.... 89
Devendra Shanker, Former Principal CIT

Direct Taxation

Simplification in Filing of Personal Income-tax Returns 95
Sudhakar Sethuraman, Partner, Deloitte India
Radhika Viswanathan, Director, Deloitte Haskins & Sells LLP

Technology – Enabling Hassle Free Tax Return Filing Process 97
Samir Parekh, Director, Deloitte Haskins and Sells LLP
Avani Shetty, Manager, Deloitte Haskins and Sells LLP

Time Limit for Assessing Income which Escaped Assessment... 99
Lukose Joseph, CA

Should Faceless Appeals be Trapped in History or Promoted as Futuristic? 101
V Ranganathan, CA &CS

Analysis of Section 115BAA under the Income Tax Law 103
Shubham Agarwal,
CA & Senior Executive, Assurance, Kalyaniwalla & Mistry LLP, Chartered Accountants, Bangalore

Faceless Assessment - Dawn of a New Era 105
Shailesh Sheth,
Advocate & Founder, M/s. SPS LEGAL

Economics behind Different Taxation Rates for Different Heads of Income 110
Smarak Swain, IRS

Taxing LTCG - A Nightmare for Investors................ 113
Nikhil Bhandari,
Assistant Manager - Direct Tax at International Business Advisors, New Delhi

Grandfathering of Investments for GAAR Application Extended - A Rational Move 115
Sandeep Dasgupta, Senior Manager & Zainab Bookwala, Manager, Deloitte Haskins & Sells LLP

Customs Duty

EDI in Customs.. 119
Krishnan Agarwal,
Director, Deloitte Haskins & Sells LLP
Rahul Khurana,
Deputy Manager, Deloitte Haskins & Sells LLP

Yogakshemam Vahamyaham - Oxygenating Taxation Statutes 121
S Murugappan, Advocate

CAROTAR - Protecting the Soul of Atmanirbhar Bharat... 124
Debasish Bandyopadhyay,
Manager-Taxation, Khadim India Ltd.

Rules Transgress Section 30 of the SEZ Act and also Misread Customs Act 126
R K Singh, Former Member CESTAT and Senior Partner, TLC Legal Advocates

Special Valuation Branch & Valuation of Goods Imported from Related Party 128
Jeevesh Mehta,
Advocate and Lead Partner, Maven Legal LLP

Editorial

Tax Tech Evolution - A New Chapter for Government and the Taxpayer

From 2014, the NDA Government has been focusing on the digital way. With the government galloping on digitalisation of tax administration in India , there is a big space left open for corporates to be able to govern their tax function more efficiently, minimise tax risks, and use technology as an enabler to analysis. It has become the need of the hour now with very less time left for the corporate tax function to cope with and respond to the queries.

At the clock of 12 midnight GST was brought in, scrapping all the enactments of centre and states, sharing all the tax revenues on goods and services together and make India - one tax across all states, centre, and union territories.

The COVID pandemic, even though very unfortunate and painful, has brought all under digital payment mode substantially. For a country of our size and with such diverse population, digital way is a herculean task. The Government has very ably maintained the balance – MSME to medium to large scale businesses.

With GSTN portal managing all the transactions including moneys and settlement in line with banking auto clearance mode, it has made all the states comfortable and confer together as members of GST Council to take informed decisions applicable to one and all. E-invoices (putting an end to fake invoices racket) and reconciliation of buyer-seller transactions through portal (2A Reconciliation) and making input tax credit eligibility a genuine and right availment shows what the taxpayer is rightfully eligible to utilize. Availment not being subject to penalty is the right approach. GSTN should become more stable, especially during peak return filing periods as at that time load bearing capacity becomes a challenge. The digitalisation of e-way bills, e-invoicing, QR codes, and amended HSN requirements make a dent on the businesses which are not tech driven and therefore, lag behind.

The TRACES portal, income tax website upgradation, auto filling, population of 26AS data into the tax return is all to make every tax payer go digital and no more manual copies which may be destroyed by unintended fire. Faceless assessment and appellate authorities may be viewed as a real face-lift for the taxpayers, reducing the visits to Aayakar Bhawan and sit across the tax officer. A sincere effort is made in the last couple of years to delete the redundant enactments and enact those, which will facilitate better tax administration and recovery of taxes.

The customs portal has also transitioned to e-assessments and clearances without much human intervention. Computer aided assessment with risk factor added to it, is all adding to the tightening of digital processes in place.

Government's intention is very clear. They want the taxpayer to manage his/her compliance from his/her premises only and not visit any governmental authority. Any information called for, will be responded within a timeframe, and clarified.

On the litigation front, we see the Government withdrawing cases, which are already settled and not take the matter up to appeal just to keep the ball rolling from one officer to another, assuming no responsibility. A clear mandate is given to the Government attorneys to decide on merits and then only argue the case. If already covered, without wasting any time, to withdraw the appeal. These show the right and litigation free attitude of the Government. Also, the commitment which was given by the then Finance Minister in the house that "no retrospective amendment will be made" citing Vodafone is kept sacrosanct till date and all are prospective. This is a great relief for the taxpayers.

Tax Technology – the Digital way, is a new chapter for both the Government and the taxpayer from filing tax returns to answering queries and verification of incomes and taxes paid. Tax technology as a platform is used to make tax compliance closer to 100%. It shows the government and the taxpayer how to manage this transition from hard copy to soft copy. It is a major

disruption by way of automation of processes and new technologies of AI and data science analysis, the interaction between taxpayer, tax office and tax advisors, drastically reducing the cost of compliance. Adoption of new technologies in tax law and administration will be appreciated by tax practitioners, tax administrators and academics throughout the tax community.

- Electronic transmission of the financials and schedules
- Innovative analytical applications
- Block chain in tax law processes
- Process mining in GST
- Data protection – privacy to data submissions

All the historical laws – central excise, VAT, sales tax, or service tax have all lived for decades and fine-tuned. GST law , being as nascent as a new born elephant has quickly positioned itself with all the compartments in proper shape and form. The inverted duty structure or refund processes and central auditing based on taxpayer rating will all move GST to EU VAT standards. I am hopeful that the GST council is always the ears and eyes to correct anomalies and aberrations.

The roadmap from the Government is very clear. GST and Income Tax along with Customs will have to be seamlessly linked to have a free data flow across departments at a click of the button to know the nature, cause and effect of the transactions and tax implications/tax collections deposited by the taxpayer. Taxpayer should keep his business – plain, simple, and transparent. The payment of right tax should be the approach. Any anti-abusive or tax evasive business structures or reorganisations shall always be looked myopic and ascertained for any tax leakages.

Tax function is a specialised role within the corporate set-up requiring in-depth understanding of the tax laws and business models of the organisation. However, along with the technical knowledge, tax teams should be tech savvy to retrieve data and analyse on auto mode to identify variations/deviations in the data entered.

The regulatory ecosystem across the globe has driven businesses to adapt to tax technology. UK, Brazil , UAE are best examples of how digitisation has rewarded them in terms of increase in revenue collections.

Corporates face challenges in terms of accuracy and consistency of data, tax technology process upgradation and tech driven tax function. For Tax technology evolution, government is the prime mover. Businesses will soon follow. Even though the results are mutually beneficial, the transformation is initially forced from a compliance stand-point.

Business should realise that tax technology is a given. If they wish to be compliant and manage their taxes properly, the following points are to be in place.

- Tax function should bring in technology personnel into its team to manage the data flow
- Tax laws should marry the tech processes to bring out the desired results quickly. Tax reconciliation and matching should be carried out with the help of technology.

With global minimum tax being the order of the day, which was not on the horizon even a year ago, businesses should be agile and willing to change to technology driven tax platforms for better compliance and risk management. Tax technology is the only way to achieve effective tax compliance. The tax technology evolution is no more a value-added feature but the core of all the business processes.

To conclude, if business does not adopt technology, Government will be constrained to force its way through. Either way, tax technology evolution should be part of the system in the days to come. Better to be prepared now itself rather than being forced on.

You know what drives the world?
Belief.

Building on belief

With TCS, you experience certainty. We are a knowledge network of the smartest minds and practitioners who apply concept to context for real outcomes.

Visit us at www.tcs.com

THE
MAJESTY
OF THE DIVINE
BEAUTY

Tiles that are inspired by the latest trends in design. A range of textures and finishes that meets the current demand for personalized spaces.

SWAT CERAMIC PVT. LTD.
Survey No. 626/P1&P2,
Opp. Siyaram Granito, Rangpar,
Morbi (Gujarat) - 363 642

info@swatceramic.com

+91-7486022881

- WALL TILES
- FLOOR TILES
- PARKING TILES
- PLANKS
- ELEVATION TILES
- SANITARYWARE
- KITCHEN SINKS
- FAUCETS

PART 1

GOODS AND SERVICE TAX

MARUTI SUZUKI

NEXA

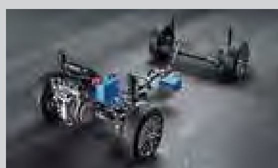
CELEBRATE THE JOURNEY OF SUCCESS.

Move up to premium experiences by driving home the Ciaz.

C R E A T E. I N S P I R E.

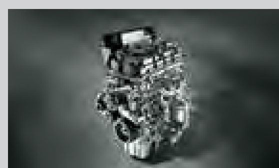
Ciaz

BE IN A GOOD SPACE


Smart Hybrid Technology

Smartplay Studio

Luxurious Interiors


K15 (1.5L) Petrol Engine

NEXA Safety Shield
Standard Across All Variants

- DUAL FRONT AIRBAGS
- ABS WITH EBD
- PEDESTRIAN PROTECTION COMPLIANCE
- COMPLIANT WITH -
  - FULL FRONTAL IMPACT
  - FRONTAL OFFSET IMPACT
  - SIDE IMPACT

Feature and accessories shown may not be part of standard fitment. Black glass shade on the vehicle is due to lighting effect. Images used are for illustration purposes only.

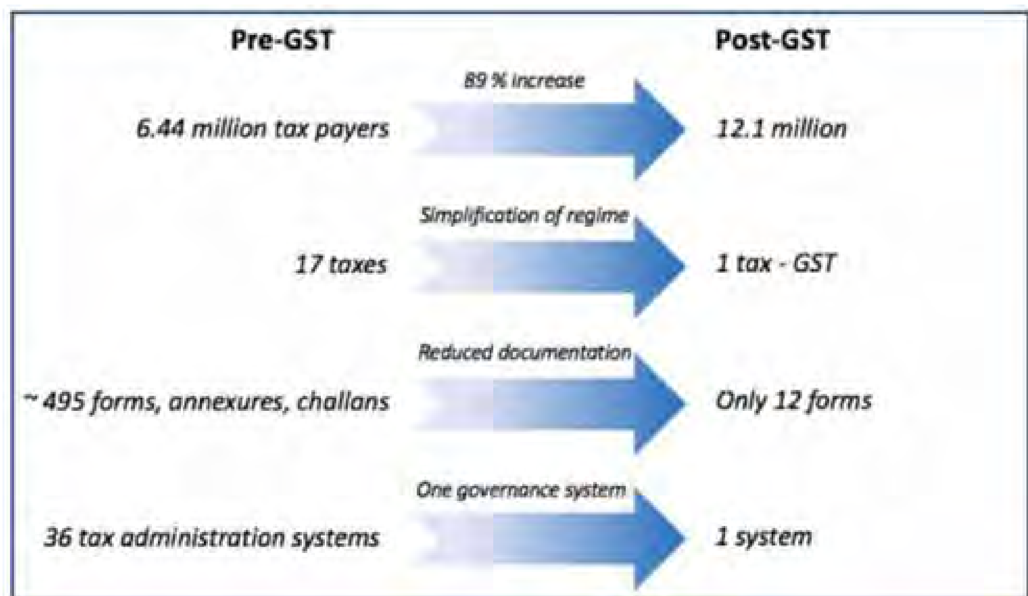
VISIT YOUR NEAREST NEXA DEALERSHIP TO GET EXCITING OFFERS.*

*T&C apply. Offers may vary across variants. Maruti Suzuki reserves the right to withdraw offers at any point in time.

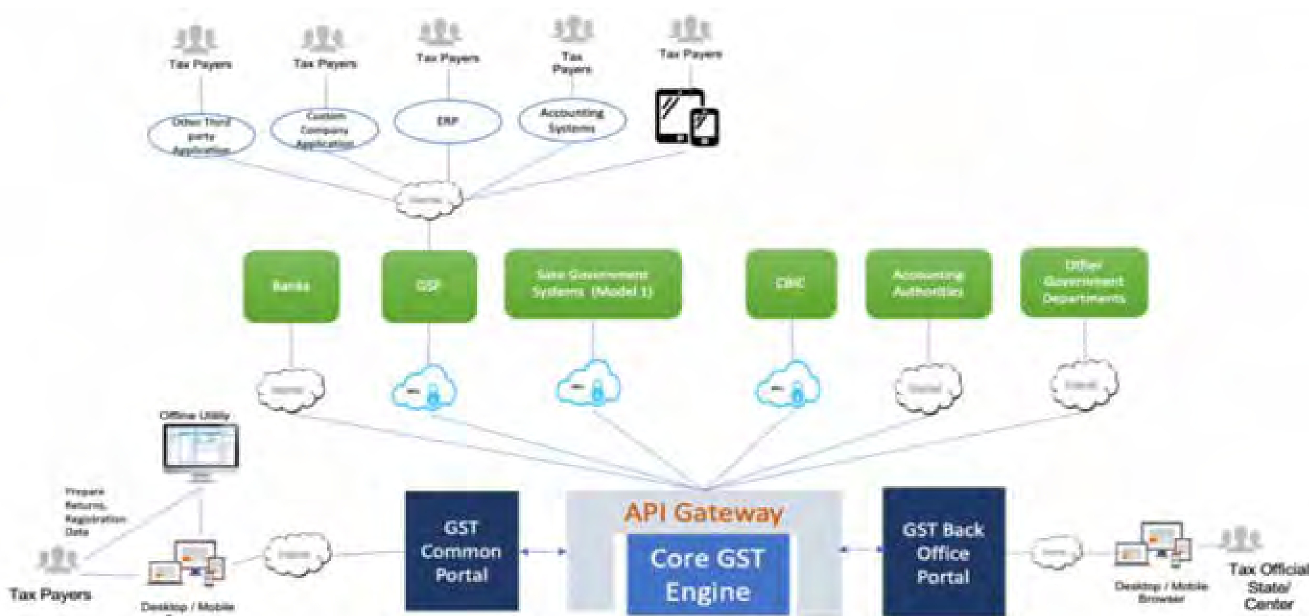
GST System
Tax Transformation using Technology Innovation

M K Sinha (IRS),
CEO, Goods and Services Tax Network

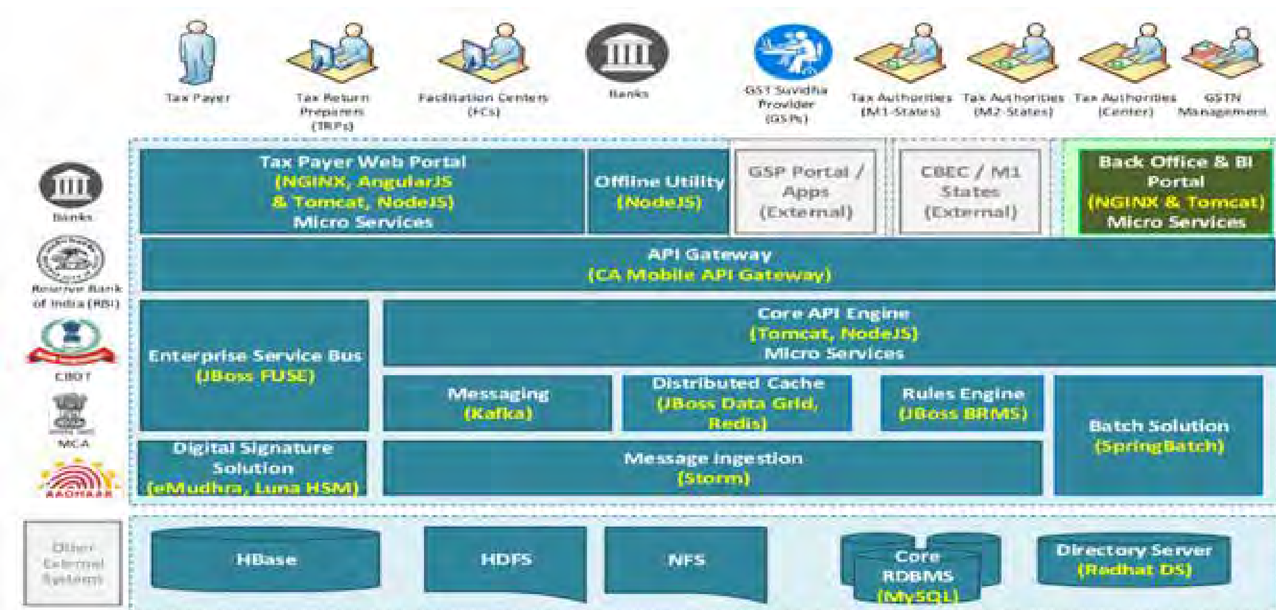
On 1st of July 2017, India ushered the largest indirect tax reform since independence called GST. GST brought together multiple tax regimes administered by various tax authorities including Centre 36 States and Union Territories. It required a unified IT platform for the taxpayers and tax administrations, which was decided to be provided by a specialized Company called GSTN. GST IT System operated by GSTN is a single interface IT platform for all the taxpayers for all the statutory activities, such as payment of taxes, registering for new businesses, filing of returns etc. It also is the back office for all the tax officials.



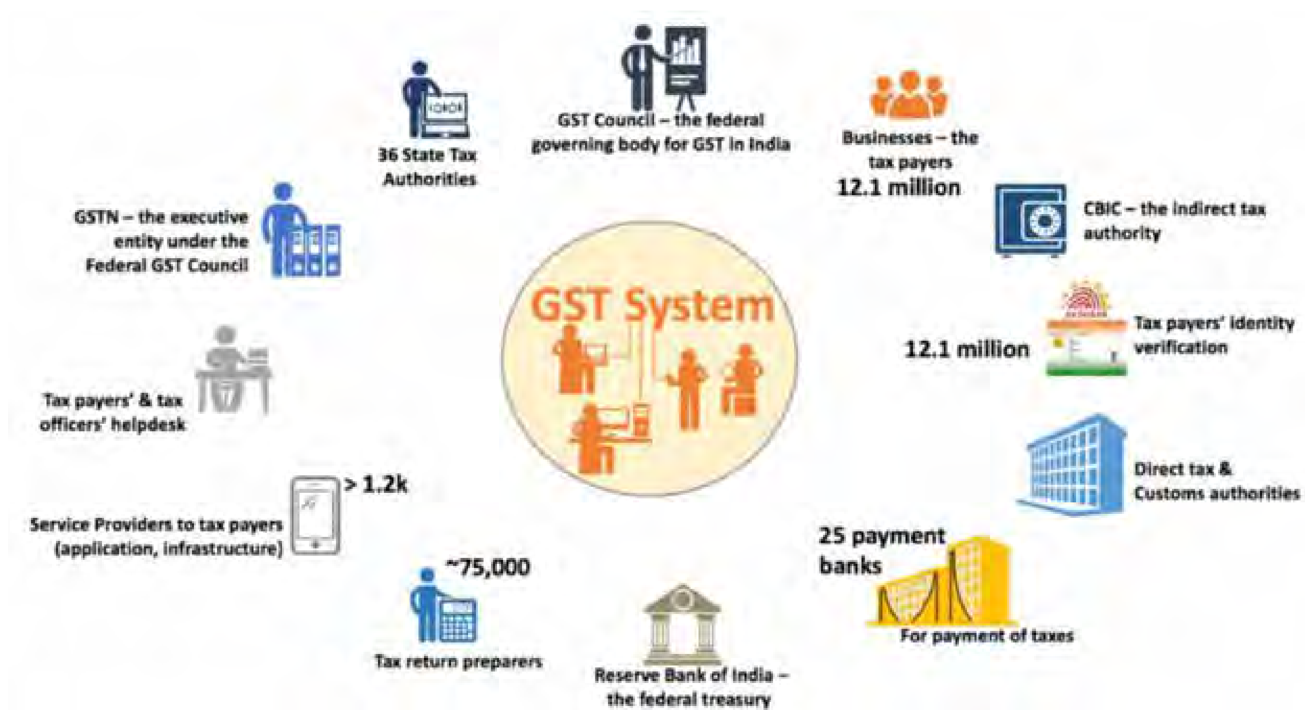
A high capacity, resilient e-governance system: Designing a system of a transformational tax regime by merging tax systems of 36 States/UTs and CBIC into a single system (Common portal) was a significant challenge. The same portal is also available to the tax administrators, known as the Back-office (BO) portal. The use of open source technologies and platform design philosophy (using Microservice based Architecture), enabled GST System to operate without tight integration within GST modules, external entities, technology verticals and platform. Thus, a highly flexible and modular design was adopted. The graphic provided below shows the GST engine that was accessible through an API layer that protected the core system from any external access. The taxpayers had multiple modes of interacting with the GST portal e.g., directly through the web, by way of offline utility, through GSPs (eco-system partners) etc.



Open Source System Architecture: The choice of technology principles, tools and architecture also provided for highly available fault tolerant (HAFT) system ensuring failure proofing. A microservice based architecture has ensured that every feature of GST System like Registration, Return Filing, Appeal Filing, Refund etc. is developed as a service comprising of one or more Restful APIs. The technology stack is shown below where the components of the GST system have been shown that appear in the user interaction at the GST portal. The interaction layer with the external world appears at the top, and the data storage (persistence) is visible at the bottom. It is worth noting that this large GST system has used the 'big data' (Hadoop) system in order to be able to cater for the huge volumes of invoices of businesses.



Scalable Design to Cater to Multiple Stakeholders: The technology and architecture choices has made possible integration of GST System with various entities like States, Banks, RBI, GST Suvidha Providers and many more. The application design and technologies used in GST system has ensured that it is horizontally scalable. This approach has ensured that the system capacity can be increased by adding more hardware in system without making any change in GST Application. To ensure zero data loss and quick recovery in case of disaster a new concept of DC/NDC and DR/NDR across two distinct geographies has been used. A unique design for API based large data exchange is successfully being used in GST System for large data exchange between various entities. This design is now getting emulated in various e-Governance systems across India. The diagram below shows the multiple entities, departments and organisations that the GST system was designed to interface with e.g., CBIC, State tax departments, RBI, banks, GSPs, taxpayers, GST practitioners.



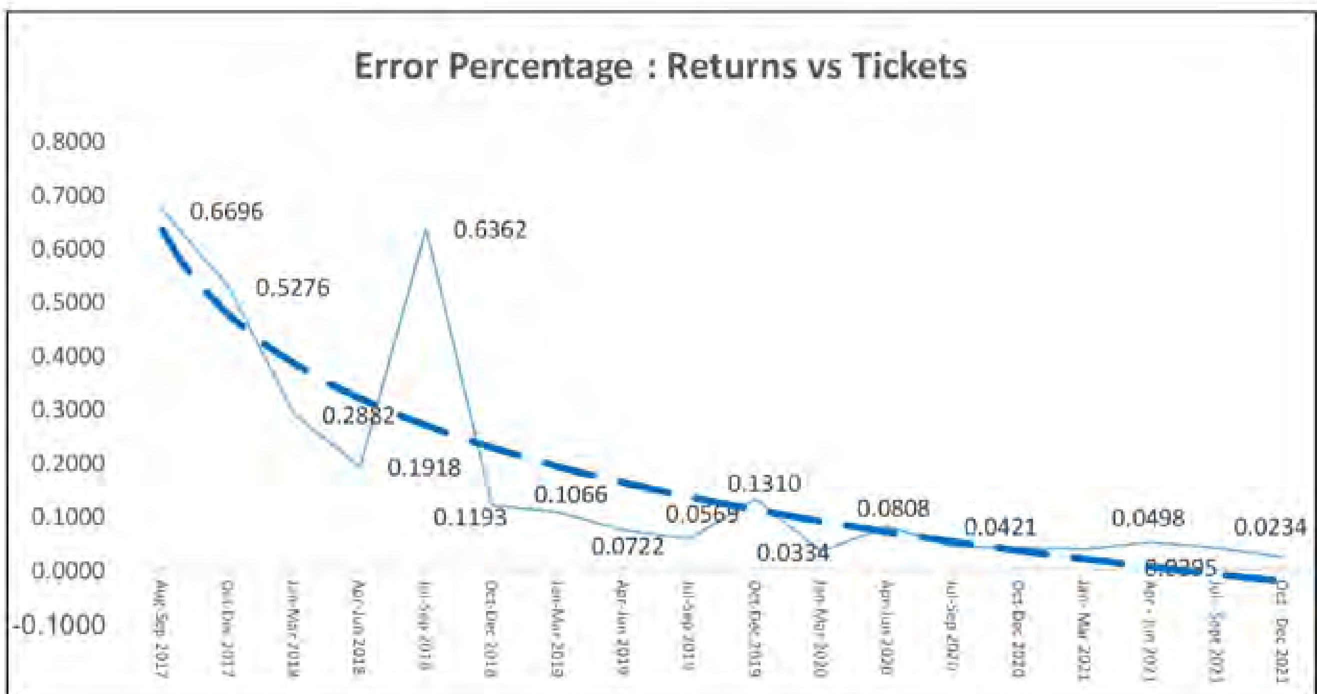
The infographic given below depicts the resilience and load handing capacity of GST System:

Capacity Building and Outreach: Uptake of technology at the launch of GST was an important aspect to be addressed. Training more than 61,000 tax officers in a short period of time on the new system was done by following the train the trainer concept. Training was provided by GSTN to master trainers, who in turn not only trained remaining tax officers but also the taxpayers and consultants through industry and trade associations. GSTN also released more than 40 short duration videos and user manuals for the information on new system to be widely available. Large number of webinars in various languages have been conducted. Even today after every major release of new functionality webinars are conducted in multiple languages which are also live-cast on YouTube.

Benefits of GST System: The GST reform has brought about a massive change in productivity and efficiency amongst its participants including but not only limited to Taxpayers and Tax Officials. Organization of information and digitization of applications in itself brings suitable amount of efficiency in business

processes. The resulting transparency automatically leads to efficiency in transactions between stakeholders. The API based GST system has significantly reduced compliance and transaction cost. With the advent of new technology, the tax compliance has become convenient as the complex business processes have been abstracted in workflow-based system design which are flexible and easy to follow. This has resulted in reduction in turnout time for various activities like registration approval, refund processing, appeal handling etc. The data for the whole country being available at one place can also be used for policy purposes apart from increasing compliance.

Taxpayer and Tax Officer Support: GSTN has established two helpdesks – one each for taxpayers and tax officers each. Both the helpdesks provided call-based support as well as ticket logging, to mitigate the issues being faced by the respective users. As is expected with any new and complex IT system, there were teething problems and challenges faced by taxpayers in the initial rollout stages of the system, which have been addressed expeditiously. The stabilization and familiarity of the system is reflected in the graph given below. As on date, there are less than 2 issues reported for every 10,000 returns that are filed on the GST system which in the initial phase was around 67 issues per 10,000 returns.



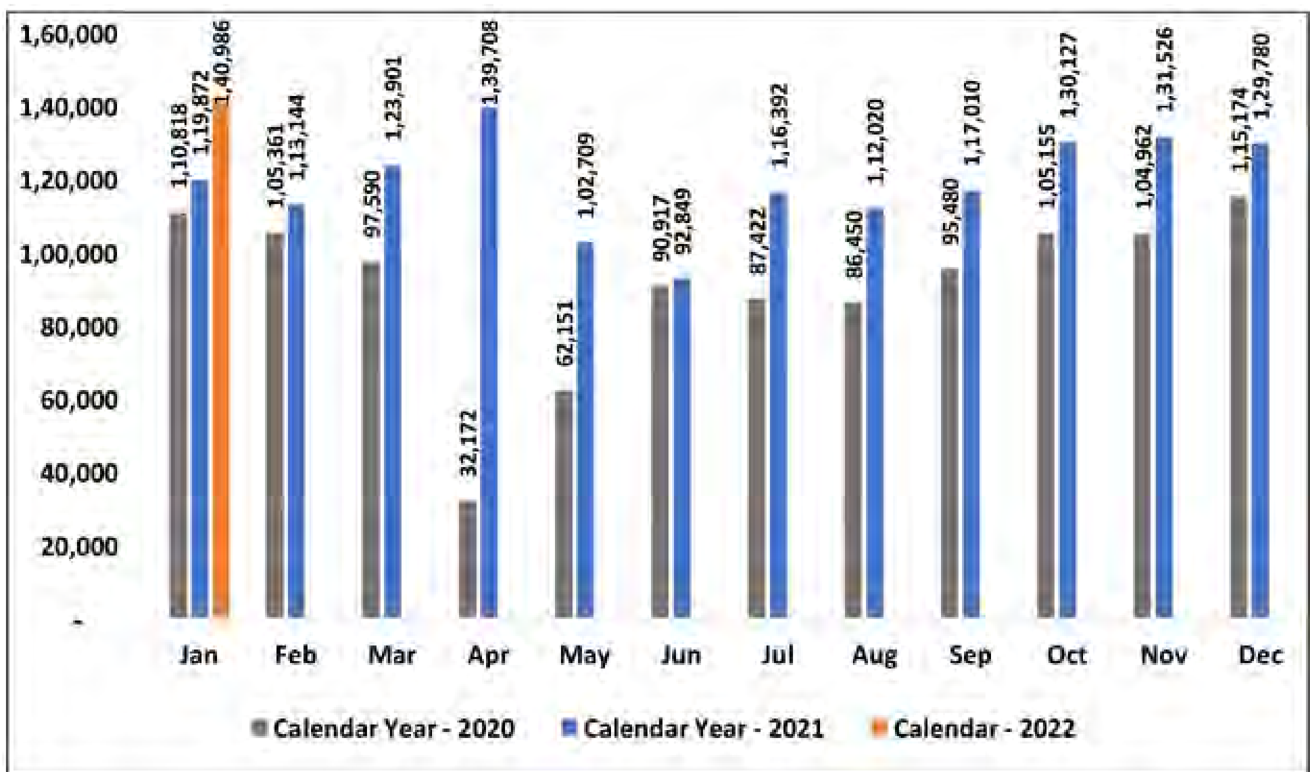
Upgrading Skills and Technologies. GSTN hires resources with contemporary skillsets while at the same time also allowing its employees to upgrade and learn new skills that are aligned with the objectives of GSTN. The latest skillsets that have been onboarded or are in the process are 'data analytics', 'artificial intelligence', blockchain, Devops, process automation, six sigma, etc. GSTN is also enhancing offline tools to provide more freedom at hands of taxpayers to work on compliance related activities offline. It is working on providing prefilled return forms (ex. Prefilled GSTR1 using E-invoice data) wherever possible after having successfully implementing pre-filled GSTR-3B and GSTR-9.

E-way Bill and E-invoice System : e-way bill project that was conceived by the government and launched in 2018 to enable seamless and uninterrupted transport of goods across the country as a single market. E-way bill removed the need to halt at state entry points / check posts, thus adding efficiency to the entire logistics chain. A mobile app provided to the tax administrators gives them access to real time information of the movement of the goods in their jurisdictions. The project has now been expanded to include e-invoice system. At present businesses having turnover above 50 Crore are required to generate IRN (Invoice reference number). E-invoice has the potential of digitizing and formalizing the entire B2B space of the country. The electronic generation and registration of invoices adds efficiency into the business value chain by removal of transcription errors and real-time validation by a registrar. The system capacity is now being enhanced in a two-step approach by adding infrastructure in the existing system as well as adding more e-invoice registrars.

Data Analytics: GSTN had conceived advanced services based on data that would flow into the GST system at the time of writing the RFP and included business intelligence and business analytics as Phase 3 of the project called BIFA (Business Intelligence and Fraud Analytics). This phase 3 has now been operationalised and has emerged as a key function of GSTN. Business Analytics module of BIFA also known as GAIN (GST Analytics and Artificial Intelligence Network) was developed to address the specific needs of the tax administrations, rather than choosing an analytics product available off the shelf in the market.

The GAIN module of BIFA is being extensively used by investigating officer/Audit Officers/Policy Makers. Experienced tax officers, skilled data scientists and data engineers have come together to create customized algorithms based on AI to parse and run deep learning models using rule-based feedback on the modus operandi in the field, which are thereafter scaled up by the team of Managed Service Provider. The BI work has helped the tax administration in computerized selection of entities for Audit, intelligence development, detection of cases, policy formulation support and post investigation data support.

Conclusion: GSTN has provided a state-of-the-art IT platform for implementation of GST in India. It is constantly evolving to improve the taxpayers experience in complying with the GST law on one hand and widening the tax-net on the other. The GST collection figures (domestic plus import) of the last 24 months are the standing testimony of its success.



Technology Interface in GST

Mahesh Jaising
Partner, Deloitte India

Sangita Prakash
Senior Manager, Deloitte Touche Tohmatsu India LLP

Ashish Dhariwal
Manager, Deloitte Touche Tohmatsu India LLP

In the coming years, we are likely to see newer and more advanced technological solutions and experiences to be implemented as a part of tax compliances. Tax departments are not only fast becoming the data powerhouses of the government through technological innovation and disruption, but in many cases are driving these changes. Nothing is a more striking example of this than the implementation of the Goods and Services Tax (GST) law in India.

Before the implementation of GST, technology for collection and implementation of the earlier VAT and service tax laws was fragmented and required high manual intervention. Be it something as simple as filing of returns or as complicated as management of litigation of assessee, there was always a manual intervention required for the process. With the introduction of GST, the country has now adopted technology platform with higher sophistication to help simplify GST reporting and related compliances.

The GST portal handles all verticals - 'registration - compliance - assessment - litigation' with easy-to-understand manuals, FAQs and even timely guidelines to factor in changes. Effectively, GSTN has done to businesses what Aadhar was able to achieve for the citizens of India.

As on date, the GST Network (GSTN) boasts a record number of 1.34 crore taxpayers who have filed over 81.70 crore returns, generated over 41.07 crore e-way bills and uploaded data of over 1,491 crore invoices. Be it the use of integrated tax technology or the use of artificial intelligence (AI), the GSTN, which is a technology driven compliance enforcement portal, has proven to be the real backbone of GST.

[1] https://gstn.org.in/

Automation of returns

Regular enhancements such as auto population of data from e-invoice portal for GSTR 1, GSTR 1 vs GSTR 3B comparison, etc. have eased the compliance burden on assesses by avoiding multiple reporting of the same data to various portals/returns.

The matching of input tax credit (ITC) with auto-populated data in GSTR 2A also makes credit availment more effective and less time-consuming with the use of technology. This is turn improves working capital requirements while ensuring that companies are GST compliant.

As a next step, the government could also explore auto-population and integration of reporting made to multiple tax and financial regulatory authorities. For instance, today, income tax filings and GST filings are undertaken independently although most of the data that flows into the two are identical. This results in duplication of efforts and unnecessary reconciliation efforts.

E-invoicing

In October 2020, India joined the bandwagon of countries adopting e-invoicing as a part of compliance requirement under the GST legislation for B2B supplies made by taxpayers with a turnover exceeding INR 500 crores. The new process brings with it a colossal amount of real time data for analytics by the government to curb the fake invoice menace, thereby resulting in a genuine ITC claim by the taxpayers.

With more than 90 crore e-invoices issued in the last year, India has performed well in providing a fairly glitch free e-invoice portal to its over 1.6 lakh taxpayers required to comply with the provisions under the GST law, as compared to its global counterparts who have implemented a similar technology-based invoice reporting solution.

As per the 4th year report of GST System, the taxpayers having an annual turnover above INR 1.5 crore are around 15% of total taxpayers but they issue 80% of B2B invoices. Making it mandatory for all taxpayers with an annual turnover of INR 1.5 crore and above, and optional for remaining taxpayers will ensure that full benefits of e-invoices accrue to the entire eco-system, without burdening small taxpayers who constitute around 85% of the total taxpayer base. While making it mandatory, the government should keenly look at a simpler and smoother way of integrating the said facility rather than only through GSPs (thereby, omitting the dependency on third party service provider). Such a move would enable more taxpayers to be on-board easily, with the said proposition.

The most apparent advantage of this new system of invoice generation is that it allows standardisation of invoice data, by following a globally well recognised system of PEPPOL (set of technical specifications that can be implemented in existing e-Procurement solutions and e-Business exchange services to make them inter-operable among disparate ERP systems). Companies can leverage this technology to ensure that invoice details provided by a supplier in a standardised format is exchanged with the recipient's ERP system without requiring any data input from the buyer's Accounts Payable teams. Several European countries already exchange standard-based electronic documents over such networks.

Monitoring of compliances

The data provided by assessees on a regular basis coupled with the use of technology-based tools have also assisted authorities in monitoring the compliances of assessee through issuance of automated notices, capturing exact reconciliation items such as reasons of variance in turnover declared in GSTR 1 vis-a-vis GSTR 3B, ITC mismatches, reversals carried out under Rule 42, etc. It has also enabled more robust fraud detection and unearthing of issues that are sophisticated and mature even in the early years of GST.

Data mining and data sharing

At first, the primary function of the technology-based solution was merely to manage the compliances by the assessees. With the primary function in place, GSTN's next focus has been to leverage the data provided by taxpayers into actionable insights, using a combination of business intelligence and AI/ML based models (commonly referred to as BIFA tools) for precise identification of riskier dealers, based on the riskier input supply chain and outward supply chain, abnormal taxpayer behavior in terms of ITC availment, tax payment for catching fake dealer and taking appropriate action, including enforcement.

The tools which have been developed are currently being used by GSTN to map / detect variances among others in GSTR 1 vs. GSTR 3B, GSTR 2A/2B vs. GSTR 3B, ratio of expense to ITC availed, related party transactions etc.

With the power of these technology-based tools, the government has been able to ensure timely and diligent compliances and consequently improve the net GST collections on a month-on-month basis.

As per the recent GST update for November 2021 provided by the National Academy of Customs, Indirect Taxes & Narcotics (apex institute of the Government of India for capacity building in the field of indirect taxation), revenues for the month of November 2021 were 25% higher than the GST revenues in the same month last year and the recent trend of high GST revenues has been a result of enforcement agencies having detected tax evasion cases relating to fake invoices, with the help of various IT tools developed by GSTN that use the return, invoice and e-way bill data to find suspicious taxpayers.

As a next step, the government has also started sharing and comparing the data provided by taxpayers with GSTN with the income tax returns filed by the taxpayers to flag any evasion on account of mismatch of data.

Way forward for using GST data

While technology has made life easier for the authorities with data being available at the click of a button, the government could also look to use this data on other platforms such as – (i) sharing data for the purpose of approval of loans, (ii) identifying risk rating of the assesses through analysis of regularity of filing of returns, and (iii) taxes paid. For instance, the GSTN portal already allows for "taxpayer authentication" that can replace a costly and paper-based effort like the KYC. Details like trade name, address, list of business activities and returns filed are all available for any interested party (including banks) to verify.

Another idea that has recently emerged is to allow invoices uploaded on GSTN to be automatically updated on TReDS. TReDS is a platform that facilitates discounting of invoices for MSMEs from corporate buyers through multiple financiers. While this would entail an amendment to the CGST and SGST Acts, for India to leapfrog into the next decade of ease of doing business, enabling such digital efforts is critical.

With all the data in a central repository, the possibilities of enhancements to the system, increased analytics, interoperability with other systems, improvement in compliance, plugging tax evasions are endless. For instance, there has also been a growing ask on allowing ITC accumulated by taxpayers as duty scrips. The idea is to be able to leverage a powerful system like GSTN for better cashflows or incentives beyond tax reporting/ tax payment alone.

At the end of the day, digital revolution is here to stay and will contribute to the push required for India to catapult into the next phase of digital transformation.

Tech Driven Evolution of Indirect Tax System in India

Prakash Kumar
Former CEO of Goods and Services Tax Network

Tax departments have always been at the forefront of using technology and India is no exception to it. Automation of Sales Tax started in India in few states in late 1980s where focus was on accounting of taxes paid by taxpayers, transcribed from paper Challans received from Banks. Since there was no Internet and desktop PCs were very expensive, the data entry used to take place at the tax office and processed elsewhere to generate taxpayer-wise data or tax ledger, which gave the tax department an idea about growth of taxes paid for various types of taxpayers as well as for geographical locations.

Mid-1990s saw a big change with adoption of new technologies like relational databases, which led to more structured enterprise-wide application leading to connected sales tax departments making it possible to share data, prepare various kinds of reports and use of simple analytics to identify outliers. Delhi, Maharashtra, Tamil Nadu, Karnataka etc. were the front-runners. This was the first wave of department-wide computerisation, with multiple modules like tax accounting module to record taxes paid; return module which had details like gross turnover, taxable turnover, sales using statutory forms; statutory forms module which captured data on utilization of forms; demand and recovery module which had data on demand generated and recoveries made etc. It may sound surprising today that the main driver of automation was management of statutory forms, as misreporting of data in statutory forms by buyers and seller for intra-state B2B sales was thought to be the biggest source of leakage of revenue.

There was no commodity code level reporting at that time. A crude method was adopted under which hundred odd major commodities were identified for tracking. The major commodity sold by a taxpayer was assigned to him and his entire turnover/tax paid was allocated to that commodity. With this approximation, which was largely true for bigger taxpayers, turnover and tax collected for various commodities/commodity groups was tracked month over month. Sectoral growth figures like that of steel, cement etc. published by research organisations was used as yard stick to identify outliers for enforcement action. This was the first ever use of outliers in tax department for enforcement actions,

which used to rely mostly on human intelligence or complaints till then. Taxpayers selling same commodity were also grouped together to generate average growth rate of that commodity and outliers were singled out for closer scrutiny as well as enforcement action.

Move from Sales Tax to Value Added Tax (VAT)

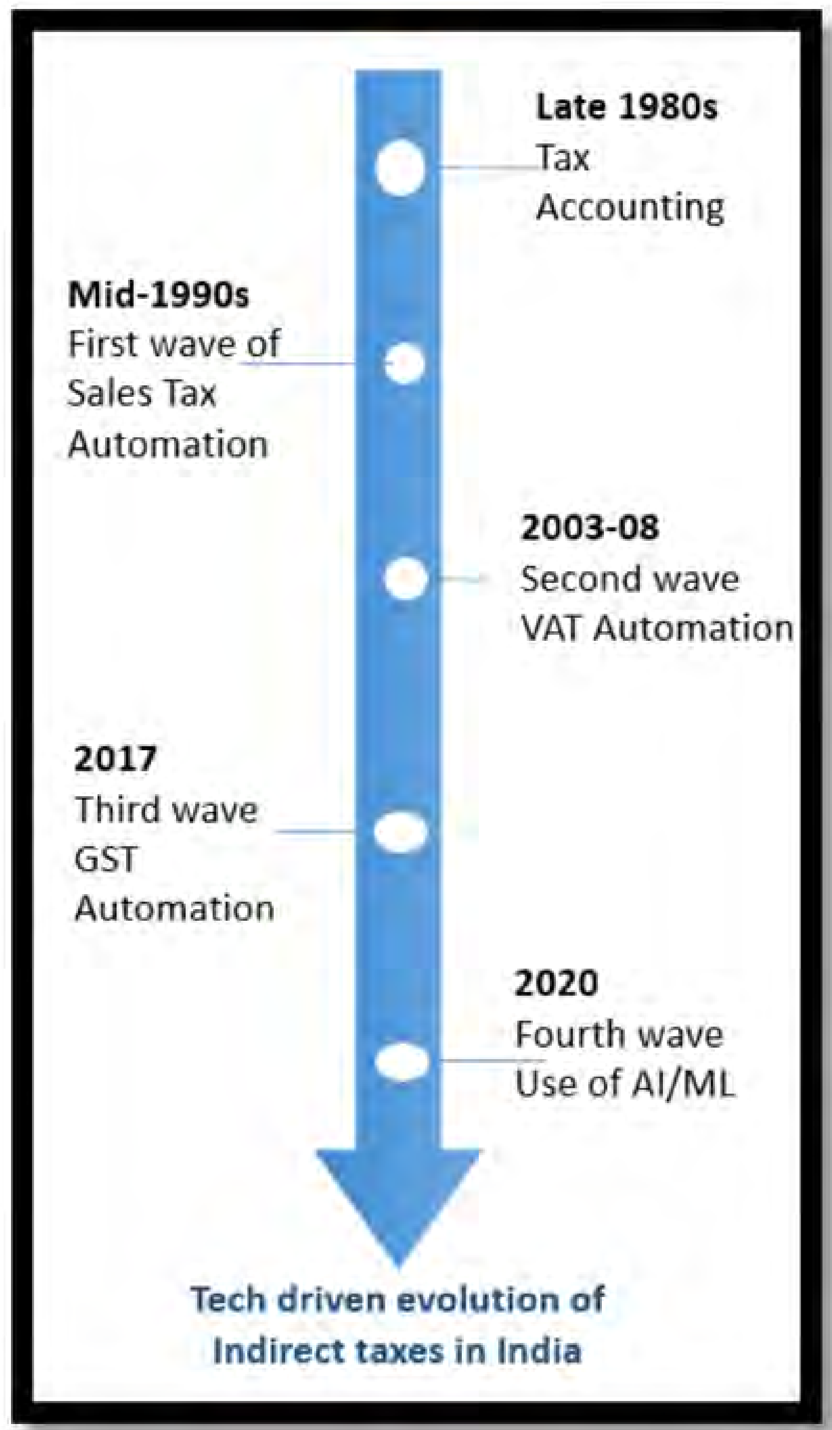
The decade of 2000 saw move from sales tax to VAT. Haryana was the first state to adopt it in April 2003 while UP was the last one to adopt it in 2008. By design VAT required higher level of automation to cross match input tax credit claimed by the taxpayers. Most of the States and UTs adopted IT based systems for managing the VAT. Introduction of 11-digit Tax Identification Number (TIN) led to make TIN unique throughout the country, where first two characters represented the State Code and the next nine characters were left to be designed by the states. TIN was used for identification of taxpayers in the same way PAN is used for identification of assesses under Income Tax Act.

Adoption of unique TIN led to introduction of Tax Information Exchange System (TINXSYS) in 2006 to facilitate effective tracking of inter-State transactions based on statutory forms like C-Form or F-Form. TINXSYS enabled exchange of data regarding the interstate trade amongst state VAT departments. With data on all inter-state statutory forms on TINXSYS platform, department officials could use it for verification of Forms issued by other State Commercial Tax Departments and submitted to them by the dealers in support of claim for concessions. This system was also used by dealer to verify the counter party dealer in any other State before accepting statutory form. Since few commodities are out of GST, TINXSYS is still in use to manage the Statutory Forms used by dealers dealing in those goods and the platform is now managed by GSTN.

The real revolution: VAT to GST

GST unified all indirect taxes at Central and State level and enabled complete portability of input tax credit. At the start of GST, we had to process returns of 10 million taxpayers having more than 300 million B2B invoices every month, a task which was not possible without comprehensive automation. Also, Indian dual GST involves settlement of Integrated GST (IGST), which requires one to look at each line of return which is impossible if attempted manually.

Today, taxpayers from every part of country have one



interface, GST portal, where they do all operations from filing of registration application to filing of return, payment of taxes, making application for refunds etc. The portal provides dashboard to each taxpayers with data on taxes paid, returns filed, ITC available, status of applications filed, tax liability and ITC claimed and accrued for each month/quarter etc. This is also the interface where they get notices for submission of additional information to notice for audit. An application, say that for refund, filed by the taxpayer on GST portal after initial checks for eligibility and furnishing of required information, moves quickly to respective Central or State tax authority to whom taxpayer is assigned. In case tax officer needs more information or additional document, he mentions that on his system and it gets passed on to the dashboard of taxpayer on GST portal along with SMS and email notification. The taxpayer uploads required information or scanned copy of additional document on the portal and immediately it appears in the inbox of the officer. In fact, the system has been designed in such a way that various parts of a process, say audit, at tax department can be broken into multiple parts to ensure faceless audit where table scrutiny can be done by one officer whereas notice could be sent by another and assessment of data/information provided by taxpayer could be processed by the third one, thus completely breaking any nexus which may exist between the jurisdictional tax officer and the taxpayer. While GST portal is the one facing the taxpayers, there are different backend systems for tax officers of central and state governments developed by them, all connected by APIs.

The GST system has been designed as a platform which enables quick integration with other systems leading to integration with IT systems of authorised banks, RBI, Income Tax, Customs, MCA etc. With introduction of e-Invoice, partial auto-drafting of return has become possible. Once e-invoice reporting becomes mandatory for all, GST system will draft the return where only few sets of information like B2C supplies will have to be provided by the taxpayer, thus taking out lot of pain associated with compliance. That will be the ultimate utopia.

The indirect tax system in India has been very quick in adoption of new technology. In fact, in GST implementation, tax administration system was way ahead of taxpayers in use of information technology. The pace has continued with quick adoption of artificial intelligence (AI) to develop tools for sophisticated frauds as well as for policy making.

With Best Compliments From

Post Box No. 40, Mandpiya Choraha, Chittor Road, Bhilwara – 311001 Rajasthan

Phone : 01482- 249010 • E-mail: jankicorp@yahoo.co.in • Website: www.jankicorp.com

DAAWAT

The FINEST

ऐसे बनता है दावत बासमती
सबसे खास.

चुनकर

बचाकर

संभालकर

सजाकर

CREATIVE
NEWTECH
A great business idea

Best Compliment from Creative Newtech Limited

Honeywell
Home Audio

Honeywell
Air Purifier

DUSTOR
Superior Robotic Vacuum Cleanner

The Honeywell trademark is used under license from Honeywell International Inc. Honeywell International Inc. makes no representations or warranties with respect to these products. These products are manufactured by Secure Connection Limited, Hong Kong.

All trade names are registered trademarks of respective manufacturers listed. ©2022 Secure Connection Ltd., Hong Kong. All rights reserved.

For more details visit
www.creativenewtech.com

September 23, 2021; TIOL - COB(WEB) - 782

GST Compensation

Politics often goes beyond perimeter of what is engraved in law!

Shailendra Kumar
Founder Editor, TIOL

How should one describe the outcome of the 45th GST Council meeting on the bank of asphyxiating Gomti river in Lucknow last week? One of the answers can be - It literally rained 'tariff'! If one recalls the folklore of Union Budget Day of yesteryears, the announcement by the Council's Chairperson was no less spectacularly intriguing and punctuated with enthusiastic vim to push the fiscal envelope for higher GST collections! She appeared to be pretty gruntled about having 'effectively' dealt with the compensation-riding pushback coming from the States and putting many fractious issues in the twilight zone such as GIC powers and GST Appellate Tribunal! For quite some time, the Union of India has been mulling over the mid-course correction of the GST rates but for the precocious mutation of the COVID-19 which had rudely snatched away the fiscal leeway of the Central Government!

With the internal audit eminently demonstrating a series of tariff-follies throwing the monthly GST collections in a fiscal gutter, the Union Finance Minister was stiffly determined to raise the tax rates on a large bucket of goods and services - somewhere close to the Revenue Neutral Rate (RNR) of 15.5 % or even higher in some cases. And she is partly there by correcting the inverted duty rates on many goods and by spiking the rates on revenue-promising goods & services such as fruit juice, scented supari, renewable energy projects, cloud kitchens, ice-cream parlours, mining rights and many others.

Cometh the hour, cometh the 'woman'! She also cajoled the States to set up a Group of Ministers (GoM), largely mandated to come up with the ideas for revenue augmentation - a lollipop the States do not wish to miss! The Centre knows for sure that unless the GST Collections steeply leapfrog by another Rs 50,000 Crore to Rs 70,000 Crore in the next one year - a courageous attempt to pass the camel through the eye of the needle!, the States would not stop rattling its cage for extension of compensation provision! The Centre's view is crystal-clear - Increase the tax rates above RNR on as many goods and services as possible in the next

few meetings and strengthen its plank to negotiate with the States baying for an encore of compensation! If the regular GST mop-up grows significantly, the States may be left to howl at the moon!

Whether such a fiscal gluttony would be sustainable in the long-run, largely depends on the concomitant recovery of economic growth Post-Covid! Anyway, the taxpayers are certainly headed for a punch-drunk time! The policy-makers are now sternly resolved not to show much remorse irrespective of factors which may be stifling the businesses such as supply chain bottlenecks, rise in input costs and insipid consumer demands! Why? Because the North Block believes that some of the sectors have had a pretty long run of good times in terms of lower tax rate and it is now their turn to enrich the emaciated revenue kitties! The GoM on Revenue Augmentation is going to submit its report within two months - virtually co-terminus with the next Council meeting and, many more surprises or even shockwaves may spring out of their magic wand!

What one is destined to witness is much stricter fiscal regime in terms of denial of ITC and punitive procedures as the Council has also set up another GoM to discuss ways and means of using technology to further improve compliance. The eye is going to be on e-way bill systems, e-invoices, FASTag data and strengthening the institutional mechanism for sharing of intelligence and coordinated enforcement actions by the Centre and the States. GST scofflaws need not be reminded that the GSTN has bolstered its systemic prowess to generate gigabytes of intelligible data which can be deadlier in enabling revenue sleuths to knock at their doors - more effectively, even with a smidgen of improvement in coordination between CGST and SGST authorities! Going by the spectrum of mandate assigned to the GoM, it is blindingly obvious that the abusers of GST can see a sort of storm gathering against them!

Let me now swirl to the most squabbled issue of compensation. Going by the official statement, the time period for collection of compensation cess has been extended till March 2026 - but only to repay the borrowings and the interest thereon. There is no official utterance from the Union of India on the issue of extension of prevailing compensation to the States. Going by the post-meeting statements of many States ruled by the Opposition parties and also sotto voce muttering of even BJP-ruled States, there is near-unanimity on this issue. And since the Centre parried the issue and did not yield even an inch, the States were deafeningly emphatic in jettisoning any discussion on the issue of inclusion of petroleum products under the GST. If there is any glimmer of hope in any corner of the economy on this issue, it's time to loosen the grip on one's unchained imagination - Not going to happen in the near future!

States are unlikely to spare even a cursorily sympathetic glance at even a truncated proposal to make a ceremonious beginning with the aviation turbine fuel or gas as they themselves seek attention of the Centre towards their doomed resources turning leaner and thinner! And they expect the Union of India to careen toward pulling them back from deepening fiscal abyss! They evidently see petroleum products as their last straw of fiscal freedom to be clutched firmly so that they could play with the tax rates against any fiscal calamity! Given the poignant ground reality that most States have been managing their wallets with high tax rates on liquor and petroleum goods, they are almost united on the issue of extension of compensation for some more years. A good number of them have been insistent on five-year extension. The only odd but largely sensible voice advocating only three years came from the Punjab Finance Minister.

Though ambivalence prevails - Whether the compensation issue has also been referred to the GoM - but the Union of India knows from inside that if the multilateral forum is to be preserved from any possible fractures, a rapprochement is to be hammered out. Charting a solo course not only exemplifies fiscal brinkmanship but also promises a crisis of trust! However, the Union Finance Minister is right when she talks about the Constitution guaranteeing it only till June 2022 but the politician in her knows for sure that politics is a vocation beyond the perimeter of what is written in the law. No commitment is said to be of sanctimonious nature in Politics! Nothing is written in stone!

Multilateralism, inevitable for the survival of a forum like the GST Council, is all about digesting poison pills for long-term good of the GST. Escalating hostility and dividing the Council into rigid blocs would later entail fence-mending of Brobdingnagian proportions! Distrust and exasperation persist more among the smaller States (Sikkim COVID Cess demand is just one example) as the marquee compensation summit promised by the Centre, is yet to be held! Battered they may look, but united they do stand on this issue! Leadership of a multilateral forum warrants sacrifice which creates values tethering all the stake-holders together and such tethering is mirrored in the future decisions originating from the unity at the forum!

I can clearly view that the Union of India's go-it-alone

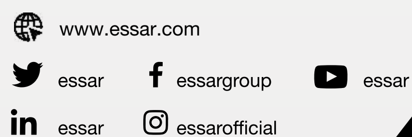
approach would bring in only strife and kerfuffle and it would have to scoop up courage to cagily move forward a few inches and let the issue be a rule-busting event which may defile fiscal sobriety to an extent! Let it not be a bureaucratic trench war! A compromise, of course not at the rate of 14% growth in annual revenue, is not too distant, notwithstanding the fretting and sabre-rattling by the States for the same 'intaxicating' growth rate! Perhaps, for a shorter period of two or three years! All the Centre has to do is to examine the size of its wiggle-room without getting too excited! The harmony within the Council should not be allowed to rest on a few percentage points on a spreadsheet! Political maturity lies in managing the unforeseen consequences of collision between fiscal economics and politics!

Apart from torpedoing these issues, what was expected of the GST Council has apparently been ignored stone-cold! A discussion about the constitution of GST Appellate Tribunal! Though the judiciary has done its job by picking up a wrench to tighten the screws on the Executive but an issue, so close to the taxpayers' heart, was clearly underplayed. It was not even on the agenda of the Council! The Centre has left it to its battery of legal eagles to defend its non-action! Similarly, the singeing issue of GIC impinging on the powers of the Council was overlooked and, strangely, the States also did not find time to rake it up this time. Many issues referred to several GoMs have also been snugly overlooked despite finding a place on the agenda! By extending the shelf life of the NAPA, the Council has once again proved that it devotes little time to debate on the rationale of its decisions which may rattle taxpayers' peace of mind! I sincerely hope that the next Council summit would not treat taxpayers' issues as sacks of potatoes and pay equal amount of heed to them like it does for revenue augmentation! It is more so as COVID-19 has not yet bid sayonara!

With Best Compliments

Corporate Film

Connect With Us



June 30, 2021

Foul Years of GST

Vijay Kumar

Editor-in-Chief, TIOL

On July 01,2017, I wrote in TIOL, GST is here - Enjoy the inevitable.

From 0000 hours of today, every Taxpayer, rather every Indian is assumed to be fully aware of all the pristine legislative provisions, for as they say, 'ignorance of Law is no excuse', especially on the part of taxpayers. Tax officers, lawyers and judges are exempted.

As a nation, we get the tax we deserve and anyway as God runs this country, if there's a problem, He will fix it, somehow. And if you don't believe in God, soon you will.

The Prime Minister said GST is a collective effort - you can't blame anyone individually. All the decisions of the GST Council have been unanimous.

Before a medicine is launched, they usually test it on rats and rabbits, but perhaps no such facility exists or is legally required before a tax is imposed. Unfortunately, unlike the bitter pill, you have no choice with taxation - of refusing to swallow.

Now that GST is in force, I hope the tax officers will read (and perhaps understand) all the simple laws before they embark upon enforcing them. I fervently hope that all the experts and consultants will read and understand those laws before they advise and preach on GST. As of now, we may also seek the help of astrologers, vaasthu experts and godmen.

This great tax experiment started with the slogan 'One Nation, One Tax ,One Market'. What is this one tax?

1. CGST
2. SGST
3. IGST
4. UTGST
5. Compensation Cess with VAT and Excise duty still in vogue on certain commodities.

And as for rates of tax, we have six rates, all berating the unsuspecting taxpayer. One does not really mean one - it is perhaps a jumla. There was the Hawai talk, of not taxing Hawai chappals and air conditioners at the same rate.

It all started with air-conditioners and chappals and ended with milk and Mercedes. Writing in his blog on October 26, 2016, the then Finance Minister Mr. Arun Jaitley stated,

Some have suggested that multiple tax rate is disadvantageous to the GST and would neutralise some of the advantages of a uniform tax structure. The reality is that a multiple tax rate in India is inevitable for several reasons.

Different items used by different segments of society have to be taxed differently. Otherwise the GST would be regressive. Air conditioners and hawai chappals cannot be taxed at the same rate.

The Prime Minister agrees, though his choice of commodities is different. While it was air-conditioners and chappals for Mr. Jaitley, the PM chose milk and Mercedes. In an interview to Swarajya, a day before the first anniversary of GST, the Prime Minister said,

It would have been very simple to have just one slab but it would have meant we could not have food items at zero per cent tax rates. Can we have milk and Mercedes at the same rates? So, when our friends in Congress say that they will have just one GST rate, they are effectively saying they will tax food items and commodities, which are currently at zero or 5 per cent, at 18 per cent.

Once you understand the intricacies of chappals and milk on one side heckling air-conditioners and Mercedes cars on the other side, GST is easy.

The then Finance Minister was emphatic and postulated certain laws as strong as the laws of motion that:

1. *Different items used by different segments of society have to be taxed differently. (Why?)*
2. *Air conditioners and hawai chappals cannot be taxed at the same rate. (Why?)*

And the Prime Minister asks a question, "Can we have milk and Mercedes at the same rates?" and scores a political point against the opposition that it wants to tax food items at 18%.

But if you look at the GST rates, you will find that Agarbatti and Artificial kidney taxed at 5%; Fruit juices, Tooth powder and Sewing machines at 12%; Condensed milk, Kajal, pencil sticks and footwear at 18%; Wall paper at 28%; Diamonds at 3%.

Obviously you cannot charge the same rate for footwear and diamonds. Poor diamonds deserve a less tax. There must be some logic in these rates.

Then, what is this 'One Nation, One Tax' slogan all about. The then FM explained that in Parliament - For one commodity, there will be only one rate in the country.!

Now that's clear; that's what one tax is all about!

And what is this one market if I have to get registered in all the States where I do business? And when can we have 'One Nation, One Tax and one Tax department'?

GST is so simple that chartered accountants, lawyers and judges can't understand it. All the existing issues are brought forward and several added merrily.

A famous poet was asked the meaning of a poem he wrote. He replied, "*when I wrote it, only God and I knew what it meant. It is possible that God knows it still, but as for me, I don't know*".

Malaysia introduced a simple GST; it is far simpler now; they have no GST. This, their Government made possible by issuing a notification that the rate of GST with effect from 1st June 2018 would be zero instead of the uniform six percent they had earlier. They had a single rate of six percent for hawai chappals and Mercedes and everybody complained. And it seems the car sales have zoomed more than that of chappals after GST has become zero. And Samsung launched a new promo - GST (Great Samsung Treat) to celebrate the zero GST.

Even before GST came into force, a former High Court Judge and President of CESTAT said in a speech,

"When I saw the GST Bill, it is mind boggling constitutional complexity. It is neither the exclusive list nor the concurrent list; it's a fourth dimensional animal. It is post Einsteinian Physics. Heisenberg's uncertainty of quantum mechanics is elementary compared to the complexity of this. Even the political complexity of States and Union coming together on a continual basis to ratchet the policy of GST is a huge challenge. It is an economical challenge, it is a political challenge, policy challenge, an administrative challenge; it's an adjudication challenge. So that is the next animal that is waiting to pounce on you. But we have to fight, we have to survive.

Maybe we need an overhaul and we should start with the assumptions that:

1. All taxpayers are not in business for cheating alone.
2. Taxpaying is not the only activity of the taxpayers.
3. Tax Department is not the only agency harassing the taxpayers.
4. Complicating the laws and procedures will not bring in more revenue.
5. Technology should assist the taxpayer and the government instead of making life a nightmare.

6. Taxpayers deserve respect and tax collectors are servants of the State.
7. Tax collectors should assist the taxpayers in compliance, not book cases for the impossible.
8. If the system does not work, it is the fault of the government and not the taxpayers.
9. Taxpayers cannot be punished for the blunders of the government.
10. We can certainly do it. We are capable of running a huge railway system, sending a space probe to orbit Mars, holding elections for about 90 crores voters, perhaps even facing the corona virus. Can't we run a simple tax system?

We should device a system on the broad lines that:

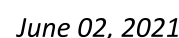
1. The Law is very simple and brief
2. The moment a problem arises, there should be a clarification, preferably in favour of the taxpayer.
3. There should be only one registration for one taxpayer for business anywhere in India.
4. There should be only one tax and one tax authority.
5. All that a taxpayer has to do should be to upload all invoices (input and output), pay the tax at the end of the month and fill in a few fields in an automatically generated return.
6. There should be only one rate of tax (yes, one rate for Hawaii chappals and air-conditioners) and preferably a low rate of 5%.
7. There should be an apex dispute resolution body at the National level consisting of a High Court Judge, CBIC Chairman, an advocate and three members from the trade. Their decisions shall be binding on the government.

And talking of systems, to err is human, but to really foul things up you need a GSTN. Don't crib; any system will have initial teething troubles before they decay into chaotic confusion. We have proved it twice. All those who complain about GSTN should go to the new Income Tax filing site and you will appreciate how great our own GSTN is!

If you (government) poke industries like this, they will run away; But will they?

The Indian citizen knows very well how to face the fury of nature and the calamities it brings, without foreign assistance or an additional Cess on GST. Look at the happy faces in Mumbai enjoying an annual urban flood or the ones swimming against the powers of nature in that God's own land. The Indian taxpayer is no different. He knows how to withstand the fury and might of the Government and its army of officers meant to serve. It is really one of those Indian mystical secrets that quite well-educated, rather rich businessmen suffer silently the hurricane of government fury, just for the fun of running their businesses. In a GST case before the Supreme Court, one of the judges is reported to have stated, "*if you (government) poke industries like this, they will run away*". No! your lordship. They will not run away, they will stand and face all the humiliation, all the difficulties, all the tax terrorism, just to stay in business.

Former Chief Economic Advisor (CEA) Arvind Subramanian, in the course of launching his book "*Of Counsel: The challenges of Modi-Jaitley Economy*", said that GST is not a failure but could have been better, if the recommendations in his report were



Legality/Constitutionality of TDS/TCS Provisions under GST

P R Chandrasekharan, IRS (Retd.)

Former Member, CESTAT, Mumbai;

Former Professor, Dept. of Revenue Chair, National Law School of India University, Bengaluru

It is a cardinal principle of taxation that "no tax shall be levied or collected except by authority of law" -Article 265 of the Constitution of India. However, sometimes, this fundamental principle is given a go by on the altar of "*ease or convenience of tax collection*". The proximate cause for re-visiting this issue is the recent decision of the Supreme Court of India in the case of *Engineering Analysis Centre of Excellence Private Limited (Appellant) vs The Commissioner of Income Tax & Anr.*, 2021-TII-02-SC-INTL-LB.

The issue before the Apex Court in the said case related to characterization of payments made by Indian residents for use/resale of computer software and the liability to deduct tax at source while making payments for the imports of software. The Supreme Court held that, -

"8. If the contention of the Department that the moment there is remittance the obligation to deduct TAS arises is to be accepted then we are obliterating the words "chargeable under the provisions of the Act" in Section 195(1). The said expression in Section 195(1) shows that the remittance has got to be of a trading receipt, the whole or part of which is liable to tax in India. The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not so assessable, there is no question of TAS being deducted. [See: Vijay Ship Breaking Corporation and Others Vs. CIT 314 ITR 309] = 2008-TIOL-197-SC-IT"

(emphasis supplied)

169. *Our answer to the question posed before us, is that the amounts paid by resident Indian end-users/ distributors to non-resident computer software manufacturers/suppliers, as consideration for the resale/use of the computer software through EULAs/ distribution agreements, is not the payment of royalty for the use of copyright in the computer software, and that the same does not give rise to any income taxable in India, as a result of which the persons referred to in section 195 of the Income Tax Act were not liable to deduct any TDS under section 195 of the Income Tax Act………"*

(emphasis supplied)

The ratio of the above decision has relevance and application to the provisions of TDS and TCS contained in sections 51 and 52, respectively, of the CGST Act which read as under:

"51.Tax deduction at source.-(1) Notwithstanding anything to the contrary contained in this Act, the Government may mandate,--

(a) a department or establishment of the Central Government or State Government; or

(b) local authority; or

(c) Governmental agencies; or

(d) such persons or category of persons as may be notified by the Government on the recommendations of the Council, (hereafter in this section referred to as -the deductor), to deduct tax at the rate of one per cent. from the payment made or credited to the supplier (hereafter in this section referred to as -the deductee) of taxable goods or services or both, where the total value of such supply, under a contract, exceeds two lakh and fifty thousand rupees:

..."(emphasis supplied)

"52. Collection of tax at source.- (1) Notwithstanding anything to the contrary contained in this Act, every electronic commerce operator (hereafter in this section referred to as the -operator), not being an agent, shall collect an amount calculated at such rate not exceeding one per cent., as may be notified by the Government on the recommendations of the Council, of the net value of taxable supplies made through it by other suppliers where the consideration with respect to such supplies is to be collected by the operator."(emphasis supplied)

4. A plain reading of the above statutory provisions make it abundantly clear that TDS or TCS has to effected only on the payments made for taxable goods or services received by the specified categories of establishments (in the case of TDS) or on the consideration received by the electronic commerce operator. section 2 of the CGST Act provides the following definitions

"(47) - exempt supply means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods and Services Tax Act, and includes non-taxable supply;

(108) - taxable supply means a supply of goods or services or both which is leviable to tax under this Act;"

5. What can be exempted from tax is only what is leviable to tax (except non-taxable services). This is explicit from the provisions (section 11 of CGST Act and section 6 of the IGST Act) which grants the power to the Central Government to "exempt generally, either absolutely or subject to such conditions as may be specified therein, goods or services or both of any specified description from the whole or any part of the tax leviable thereon" in public interest. Thus, the expression "taxable supply" encompasses within itself part of the "exempt" supply also. Thus, in terms of the TDS and TCS provisions, tax will have to deducted or collected even in respect of an unconditionally exempt supply where tax is not due at all, thereby resulting in collection of tax without authority of law and violation of the constitutional mandate. Another unintended consequence is the re-characterisation of the GST levy from supply of goods and services to making payment of a sum which has huge legal and constitutional implication.

6. Further, a disturbing feature of these provisions is that the tax deduction or tax collection is done by a person who is not liable to pay the tax on the transaction and who has neither the legal authority nor locus standi to assess the tax liability nor the skill or expertise to undertake such activity. Under section 59, it is the registered person who shall self-assess the tax and not the tax deductor or tax collector. Thus, it appears that these provisions fall foul of the Apex Court's decision in the Engineering Analysis case cited in the opening paragraph.

7. Yet another consequence of these provisions is that the suppliers of exempt goods or services to Government Department or PSUs etc. are subjected to the tedious procedure of filing refund claims for the tax deducted or collected without authority of law, which acts as a dis-incentive for making supplies to Govt. departments or PSUs. While they can make supplies to private parties without payment of tax (if their supplies are tax exempt), they bear the burden of TDS/TCS in respect of government supplies apart from the inordinate delay in the receipt of payments from government departments which are not well- known for making quick and efficient payments.

8. Is there a solution to this problem? The answer is a definite YES. As in the case of personal income tax where the income recipient has the option for submission of Form 15G/15H for non-deduction of tax, those suppliers who are exempt from tax can be given a similar option for submission of a declaration for non-deduction or non-collection of tax which the government departments/agencies can include in their returns which can be verified by the tax department. In any case, the payments by government agencies are made through banking channels and there is a trail of the transaction available for audit/verification by the department later. It is hoped that good sense and wisdom will prevail and necessary changes in the GST law will be made sooner than later to overcome the legal infirmities discussed above.

November 04, 2020

The E-Way, No Way

Vijay Kumar

Editor-in-Chief, TIOL

Does Rule 138(7) exist?

In a recent judgement (Bon Cargos Pvt Ltd - 2020-TIOL-1825-HC-KERALA-GST), the Kerala High Court reproduced rule 138(7) of the CGST Act as:

(7) Where the consignor or the consignee has not generated the e-way bill in FORM GST EWB-01 and the aggregate of the consignment value of goods carried in the conveyance is more than fifty thousand rupees, the transporter, except in case of transportation of goods by railways, air and vessel, shall, in respect of inter-State supply, generate the e-way bill in FORM GST EWB-01 on the basis of invoice or bill of supply or delivery challan, as the case may be, and may also generate a consolidated e-way bill in FORM GST EWB-02 on the common portal prior to the movement of goods:

But is this Rule 138(7) notified, effective and enforceable?

A little bit of history is worth a read. Three years of GST has produced so much history that the present is complicated maze. The first CGST Rules came into existence by Notification No. 3/2017 - Central Tax, dated June 19, 2017, and were to come into force with effect from June 22, 2017. On June 28, 2017, the Government by Notification No. 10 /2017 - Central Tax amended the Rules and were to come into force on the July 01, 2017. In this notification, there was a rule 138, which read as:

138. E-way rule.- Till such time as an E-way bill system is developed and approved by the Council, the Government may, by notification, specify the documents that the person in charge of a conveyance carrying any consignment of goods shall carry while the goods are in movement or in transit storage.

Thus, the e-way bill was only an idea with the government as on July 01, 2017. As GST was unfolding dramatically, the Government again amended the rules by Notification No. 15/2017 - Central Tax, dated July 01, 2017, to come into force with effect from the July 01, 2017. But rule 138 and the e-way bill were untouched. Obviously, government had not yet thought of developing the system. Two more amendments by Notification No.7/2017-Central Tax, dated July 27, 2017, and 22/2017-Central Tax, dated August 17,2017, left the rule 138 and e-way rule untouched.

Then came the (Sixth Amendment) Rules in Notification

No. 27/2017 - Central Tax dated August 30, 2017, by which the Government amended Rule 138 to introduce the e-way bill. Clause (7) of the newly amended rule 138 read as:

(7) Where the consignor or the consignee has not generated FORM GST EWB-01 in accordance with the provisions of sub-rule (1) and the value of goods carried in the conveyance is more than fifty thousand rupees, the transporter shall generate FORM GST EWB-01 on the basis of invoice or bill of supply or delivery challan, as the case may be, and may also generate a consolidated e-way bill in FORM GST EWB-02 on the common portal prior to the movement of goods.

But wait, the government was not yet ready with the system - they were ready only with the rules. The amended rule 138 was to come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

By Notification No. 74/2017 - Central Tax, dated December 29, 2017, the Government appointed the February 01, 2018, as date on which the amended rule was to come into force.

But before the appointed date, by Notification No. 3/2018 - Central Tax, dated January 23, 2018, they overhauled the entire yet-to-come-into-existence rule 138. This overhauled rule was also to come into force on February 01, 2018, as proposed in the previous notification. So, on February 01, 2018, Notification No. 27/2017 - Central Tax, came into force and so did Notification No. 3/2018 - Central Tax, dated January 23, 2018, but Notification No. 3/2018 virtually superseded Notification No. 27/2017. So, Notification 27/2017 was in force on February 01, 2018. Realising this, on February 02, 2018, by Notification No. 11/2018 - Central Tax, they rescinded Notification No. 74/2017. That is, there is no appointed date for Notification 27/2017 to come into force. Were they killing a dead notification? But Notification No. 3/2018 still remained.

Then, by Notification No. 12/2018 - Central Tax, dated March 07, 2018, the rule 138 was again substituted and was to come into force on such date as the Central Government may, by notification in the Official Gazette, appoint.

By Notification No. 15/2018 - Central Tax, dated March 23, 2018, the Government notified the April 01, 2018, as the date from which the provisions of this rule 138 would come into force, but there was a catch many missed. Our clause (7) of rule 138, was excluded from the notified appointed date. That means that rule 138(7) was not notified. And it is not notified till date, which means that it is not effective in the statute, that is, it does not exist.

But in the case referred to above, the Kerala High Court mentioned this clause several times, as seen below.

Para 3: Learned counsel appearing on behalf of the petitioner submits that... So when there were two invoices it constituted two consignments as far as the petitioner, who is a transporter, is concerned whereas Sub-Rule 7 of Rule 138 stated the transporter is with obligation to generate e-way bill when the aggregate of the value of the goods carried in a conveyance is more than Rs.50,000/-.

Para 6: I have heard the learned counsel for the parties and appraised the book, I am of the view that the contention of the petitioner in the present writ petitions by relying upon the provisions of Sub-Rule 7 of Rule 138 is wholly fallacious and illegal much less misplaced as Rule 138 falling under chapter XVI pertains to e-way Rules i.e.., the information to be furnished prior to the commencement of the movement of the goods and generation of e-way bills.

Para 7: Emphatic reliance upon the interpretation of Rule 7 that it is the duty of the transporter or the consignor, consignee to generate e-way bill when the aggregate value of the consignment is more than Rs.50,000/- and if otherwise i.e.., less than Rs.50,000/- there is no such requirement is not acceptable….

It looks like both the appellant and respondent were not aware of the fact that rule 138(7) had not come into force - yet. And so perhaps, this fact was not brought to the notice of the High Court. Anyway, the High Court did not agree to accept this rule 138(7), even if it was there in the statute.

What is happening? Isn't this the height of confusion?

This confusion was actually noticed by the Gujarat high Court more than two years ago in the case of Godrej And Boyce Manufacturing Company Ltd - 2018-TIOL-2868-HC-ALL-GST, when it was observed,

It appears that legislative changes were made in such a quick succession that field authorities could not track themselves with such changes and, hence, adhered to compliance of provisions which stood already substituted by new provisions and earlier ones had become otiose.

Notification dated 31.01.2018 whereby Rule 138 was

completely changed by substitution and made effective from 01.02.2018, it appears, escaped attention of authorities concerned, though it is this provision which had to be complied by petitioners. Unfortunately, authorities concerned have completely failed to observe the same. It appears that for the field authorities there was a gross chaos on account of quick changes in relevant provisions, hence, authorities concerned could not appreciate, what provision is supposed to be followed by concerned person and what is actual default, if any, which has been committed by such person.

Petitioners when goods in transit were intercepted and impugned orders were issued, met an unauthorized act and suffered illegal order.

To complete the story, we may observe that Rule 138 again stood substituted by Notification dated 26.03.2018 which has come into force on 01.04.2018 but here also sub rule (7) has not been made effective.

In a Press Note issued on March 10, 2018, the CBIC had clarified,

The provisions of sub-rule (7) of Rule 138 will be notified from a later date. Therefore, at present there is no requirement to generate e-way bill where an individual consignment value is less than Rs. 50,000/-, even if the transporter is carrying goods of more than Rs. 50,000/- in a single conveyance.

Should there be so much noise on a non-existing provision?

The CGST Rules have been amended nearly 50 times in the last 40 months, which means the SGST Rules were also amended 50 times by each State. About 650 Notifications, 200 Circulars, several Press Notes, FAQs and tweets have been given by the Central Government. And the exercise is repeated by 28 states and 9 Union Territories. Mind boggling mountain of Law, ignorance of which, mind you, is not an excuse.

It is said that American roads are not good because America is rich, but America is rich because *American roads are good.* The GST Road is in a terribly bad shape and needs urgent repairs.

With a little technology, we can manage the entire GST structure by just capturing the output invoice and the input invoice - all that a taxpayer has to do would be simply upload his output and input invoices and pay the tax. But then, what will you do with the army of tax collectors?

March 31, 2020

COVID-19 and GST Council

Need to prescribe procedure during times of an epidemic/pandemic

Pritam Mahure, CA

On March 24, 2020, the Union Finance Minister announced a relief package including certain procedural concessions for GST payers. However, this Press Release (dated March 24, 2020) came after the GSTR-3B due date itself (as due date for filing GSTR-3B for February 2020 was March 20, 2020, for large taxpayers and March 22nd or 24th ,2020 for small taxpayers).

It may be noted that the aforesaid relief (dated March 24, 2020) came with a rider which reads - "*6. Necessary legal circulars and legislative amendments to give effect to the aforesaid GST relief shall follow with the approval of GST Council.*"

Why are GST payers still awaiting circulars and legislative amendments?

However, even after a week the GST payers are awaiting legislative amendments (as Press Release sans legislative amendment/ relevant notification may not be workable).

One reason for the missing immediate steps / legislative amendments could be the impediment i.e., non-mention of specific procedure for pandemic under Article 279A of Constitution of India.

Twin mandate under Article 279A of Constitution of India

As per Article 279A (9), "*Every decision of the Goods and Services Tax Council shall be taken **at a meeting**, by a majority of **not less than three-fourths** of the weighted votes of the members present and voting, in accordance with the following principles…*"

Given the specific **twin requirement** under Article 279A, **every** decision by GST Council should be taken:

a. In a GST Council meeting and

b. By a majority of not-less than three fourths

However, due to the corona virus pandemic, the GST Council is unable to conduct meeting (after its 39th meeting held on **March 14, 2020**) particularly since the

pandemic has started threatening and effectively put the entire nation on 'pause' mode.

Can CGST Act come to rescue?

As an interim and exceptional measure, to tide over the challenging times, the GST Council may explore section 148 (which provides for 'Special procedure for certain processes') or section 168 (which provides for 'Power to issue instructions or directions').

Usage of section 148 of CGST Act could be challenging as even section 148 is to be used after recommendations of the Council. Further, section 168 of CGST Act is to be used for the purpose of uniformity in the implementation of GST Act, however, the power bestowed under section 168 and the pandemic being faced does not reconcile.

All said and done, as Constitution of India is supreme, provision of CGST Act may not be able to override the mandatory process under Article 279A.

What to do then?

Article 279A (8) provides as under:

'The Goods and Services Tax Council shall determine the procedure in the performance of its functions.'

Based on the aforesaid provision, the GST Council can, through a video conference immediately provide, separate process to get over impasse like current pandemic (including introduction of process or new section, if required, for such pandemic).

One of the prescribed procedures could be to **empower,** during the interim time period, the **Chairman** of GST Council to take decisions and for uniformity purposes, it is recommendable that such decisions of Chairman should be **applicable in all States**. However, whether the States will agree for handing over their power to Union, even for a brief period, is itself a big question.

However, in the long run, to address such pandemic, Article 279A could be amended (to prescribe procedure for exceptional times).

What about Financial Emergency?

It may be noted that amongst three types of emergencies, Article 360 of Constitution of India provides for 'Financial Emergency'. Article 360 (3) provides as under:

'(3) During the *period any such Proclamation as is mentioned in clause (1) is in operation, the executive authority of the* ***Union shall extend to the giving of directions to any State*** *to observe such canons of financial propriety as may be specified in the directions,* ***and to the giving of such other directions as the President*** *may deem necessary and adequate for the purpose'.*

As per news reports, even a PIL was filed in the Apex Court to declare Financial Emergency. However, in one of the press conferences the Hon'ble Finance Minister informed that there was no move to impose Financial Emergency.

Way forward

Now, whilst, the dust on the aforesaid matter settles, the GST payer will need to wait for the relevant notifications and Circulars for availing the announced relief in GST compliances.

January 28, 2020

Aligning the GST Law with Insolvency and Bankruptcy Code

Ankita Shah
Associate Director

Nidhi Gada
Senior Associate, Mazars India LLP

As the Union Finance Minister (FM) gets ready to present the budget for fiscal year 2020-21, the pre-budget consultations with the representatives of different industry sectors could find their way into FM's budget speech on February 01, 2020.

One of the key issues that Industry Captains want the FM to address is the alignment of the Goods & Services Tax ('GST') Law with the Insolvency and the Bankruptcy Code, 2016 ('the Code').

The Code provides for the order of distribution of the proceeds from sale of assets and the manner in which the past tax dues will be paid. While the Code is enacted to provide a legal framework for timely resolution of insolvency and bankruptcy proceedings which would promote entrepreneurship and is seen as a panacea plaguing the beleaguered domestic industry, it is the inability to pay taxes and non-availability of input tax credits under GST that is threatening to take the charm out of a radical business reform introduced in recent times in India.

Section 238 of the Code states that in case of any inconsistency, the Code will override other laws:

"The provisions of this Code shall have effect, notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law."

However, it is pertinent to note that in its present form, the GST Law does not provide for any specific provision pertaining to payment of taxes to facilitate businesses facing insolvency and bankruptcy proceedings.

As per section 39(10) of the Central Goods and Services Tax, 2017 (CGST): "*A registered person shall not be allowed to furnish a return for a tax period if the return for any of the previous tax period/s have not been*

furnished by him". Since return filing and tax payment is closely linked under GST, taxpayers are not allowed to discharge their current GST dues unless past GST dues are discharged. It is this provision that is causing the most discomfort to companies opting for resolution under the Code.

In *T.R. Ravichandran v. The Assistant Commissioner (ST) & Ors*, MA/1298/2019 In IBA/130/2019, the National Company Law Tribunal, Chennai, directed the GST Authorities to allow the Corporate Debtor to access the GST portal to discharge the current tax dues without requiring it to discharge the tax dues pertaining to the period prior to commencement of the Corporate Insolvency Resolution Process.

The Tribunal held that, "*As to the provisions of GST Act, since section 238 of the Insolvency and Bankruptcy Code having categorically mentioned that IBC will have over riding effect on all other laws which are in contravention to the provisions of the IBC, R1 cannot raise an objection saying since no provisions has been made in GST or in its software to accept such accounts, the business happening in the market after initiation of CIRP through debtor company will come to stand still and in such situation no company under CIRP can function as a going concern."*

While the Tribunal Order only has persuasive value on the GST Commissioner having jurisdiction over the Petitioner in the case cited, this order clearly demonstrates the present and clear need to undertake an amendment in the GST Law to incorporate a proviso under section 39(10) that could make an exception in case of a registered person who has opted for proceeding under the Code so as to allow such persons to discharge their current tax dues without compelling the taxpayer to discharge the past tax dues, so as to align the GST law with the Code.

If the amendment in the GST Law as discussed above, comes in the form of FMs proposal in the Union Budget 2020, it would be seen as timely and pro-active on the part of the Government.

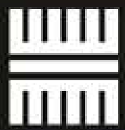
BHARAT
DIAMOND
BOURSE
DIAMOND CENTRE OF THE WORLD

WORLDS LARGEST DIAMOND BOURSE

Bharat Diamond Bourse :
G-Block, Bandra Kurla Complex, Bandra (East), Mumbai - 400 051
Tel : 022 3392 1700 / 3392 1500
support@bdbindia.org | www.bdbindia.org

LUXOR®

Home & Hotel
Interior fabrics
from



Microfibres®

USA - Turkey

Made in Europe

showroom virtual tour

- *stain resistance*
- *anti - bacterial*
- *machine washable*
- *eco - friendly*
- *extra strong with 200000 martindales*

E - 193, RIICO Industrial Area
Mansarovar, Jaipur
302020

911 911 6000

info@luxorfabrics.com

July 18, 2019

GST - Fake Invoices

Mega Hole in Treasury; Time for Punitive Legislative Measures!

Shailendra Kumar
Founder Editor, TIOL

When the much-touted Goods and Service Tax(GST) was introduced in July 2017, the Revenue knew that like all other taxes, a time would come when there would be GST-related frauds. But none in the corridors of power had any premonition that such a time would come so fast, and so early! It has indeed become a common headline in daily newspapers. Let's take a look at some of the sample headlines - "*GST Fraud Alert - With fake companies, fraudsters steal Rs 800 Cr ...*" and "*Delhi Govt cancels GST registration of 1282 traders for fraud ...*". Such headlines in hundreds have become so ubiquitous that the size of the tax evasion has assumed the proportion of a mega scam. As per official estimates, the ITC availment on fake invoices, IGST refund frauds and other types of evasion are speculated to have cost the Exchequer to the tune of Rs 48,000 Crore. This is much more than the sum of total Non-Performing Assets (NPA) of **Rs 40,000 Crore** reported by the RBI for the last fiscal! Such a scale of abuse of Input Tax Credit (ITC) facility which is further going to be liberalised vide section 43A GST, is certainly scarier for any Government. At the going pace it would be clocking close to Rs 1,00,000 crore by the end of third year of GST.

Tax evasion has evidently acquired multiple dimensions or call them *modus operandi* - availment of ITC based on fake invoices; invoice being issued to X but goods being supplied to Y; over invoicing of exports for claiming higher IGST refund; availment of blocked credit, fraudulent refund of accumulated ITC and splitting of a supply to reduce tax liability. A good example is the one where casinos were found to be splitting the transaction value to minimise the GST outgo albeit they were found to be collecting full GST from their customers. And the magnitude of this case is, based on initial estimates, about Rs 6500 Crore.

Let's examine the magnitude and the modus operandi of IGST refund frauds. As per sources, between July 2017 to March 2019, over 31000 exporters have claimed refund of Rs 77000 Crore. With exporters mounting pressure on the government, the Revenue launched special drive and special windows to process such claims. But, a scrutiny of their profiles reveals that only

about 55% of the claimants were regular exporters in the past three fiscals. The remaining 45% were found to be irregular in terms of having no exports records at all in one or two financial years. This clearly indicates that there was a concomitant growth in the number of fly-by-night operators with the increasing ease of claiming refunds sanctioned by the GST Council. A good number of exporters did inflate the value of their exports consignments for claiming higher refunds and the Customs made the cardinal error of not examining the consignments nor developing any risk parameters. It can also be speculated on this premise that some of the Revenue officials might have 'washed' their hands in the favourable flow of refund currents! Refunds were liberally sanctioned!

A detailed presentation on this issue was made before the Committee of Officers prior to the last GST Council meeting. And, as per some SGST sources, the key finding was that **as against a rise of 8% in the number of shipping bills, there has been over 300% increase in IGST refund claims. A quick analysis of claimants' profiles further indicated that about 60% were non-companies such as firms and proprietorship entities.** A quick dive into the data further stunned the analysts - a good swathe of refund was claimed by **such proprietorship exporters who largely filed barely two shipping bills in a month.** More interestingly, **Delhi topped the tally** of States which sanctioned maximum refunds. Unlike Maharashtra and Gujarat which ranked second and third. Delhi recorded 56% of total IGST refund sanctioned.

In this backdrop of grim scenario, the larger question is - What should be done to stop such abuse which has the potential to derail the evolution of GST? Obviously, administrative measures like raids, recovery and arrests alone would not be able to plug this leakage. It has to be a mixed basket of policy and legislative measures. The first step which should be taken is to tighten the process of scrutiny at the stage of registration itself. Thankfully, Aadhaar is going to be made mandatory. Aadhaar with Permanent Account Number (PAN) would enable the GSTN or CGST or SGST officials who approve such registration within 48 hours, to quickly verify their income tax track records of last few years. Such verification would also indicate the kind of funds available in one's bank accounts. If somebody has no verifiable track record of income tax or business or assets either in the name of new company or its Managing Director or partners, the Revenue should fix a threshold for Input Tax Credit (ITC) for certain periods. If somebody furnishes purchase order, advance payment details and some other documents, one may apply for raising the cap on one's invoice which is the mother of rising ITC frauds. In such cases Revenue may even seek minimum bank guarantee (BG) to protect its revenue! Such a rule should be **applied very selectively** only in case of taxpayers showing no track records. Secondly, the threshold may vary for a new company to an LLP to a proprietorship firm. Thirdly, banks should be integrated into the monitoring mechanism so that payment received against invoice raised is not withdrawn in one go or in a systematic manner to defraud the Exchequer. Such registrants should also not be allowed the benefit of ITC on provisional basis. For this purpose, an Explanation in the proposed insertion of section 43A may be added prior to passage of the Finance Bill, 2019.

Let's now move to some possible punitive measures. Going by the organised nature of ITC Fraud Syndicates, the possibility of making such offence a **Predicate offence under the Prevention of Money Laundering Act, 2002** may be explored so that the properties or other assets created by utilising such funds are attached. More **onus should be put on assessees** in case of a fraud - suspension of registration and higher rate of interest on reversal of ITC or recovery of tax stolen. Similarly, **greater onus should be put on Revenue officials** who should do physical verification or risk assessment for all such claims which are above certain sum like Rs 10 lakhs. The rationale is to keep close watch on each claim filed. Depending on the risk scores, Special Audit under section 66 should come handy. A well-oiled verification unit should be kept ready in the field formations. A systemic alert should be generated if inward supplies are less and outward supplies are for exorbitant amounts. Chief Commissioners should be sensitised to keep a watch on high-value invoices raised by suppliers in their jurisdictions and the recipients are outside their jurisdictions. The possibility of fraud is more in such cases.

In a nutshell, if the bleeding of the Exchequer is to be stopped it has become inevitable to initiate a series of policy and legislative measures to make registration a carefully-verified activity. If need be, even physical verification of addresses may be resorted to but before it is done, a detailed SOP should be put in place to minimise the pain such an exercise necessarily causes to an assessee. All such measures would be efficacious and effective if they ensure that no honest or genuine assessee is troubled in the name of verification or it does not degenerate into a money-making machine! Let's hope that only the genuine interests of the Exchequer are protected and it is not seen as a sunshine for making hay!

May 24, 2019

Carbon Credits
Whether taxable under GST?

Akash Deep Singh
Principal Associate

Rohit Arora
Associate, DSK Legal

The necessity of reducing carbon emissions was first recognized at the Kyoto Protocol of the United Nations Framework on Climate Change signed in 1997[2] wherein the member countries, including India, committed to limit and reduce the greenhouse gas emissions.

The Kyoto Protocol also provides for trading of Carbon Credits i.e., emission reduction units through Clean Development Mechanism (CDM). Under CDM, specified parties engaged in project activities resulting in Certified Emission Reductions (CERs) may trade in such CERs. The purchasers of CERs may use such CERs to comply with part of their quantified emission limitation and reduction commitments.

Technically, one Carbon Credit tantamount to reduction of one metric tons of carbon dioxide emissions or emissions of its equivalent gases. Carbon Credits play a beneficial role in terms of supporting the environment as well as ensuring the financial health of the companies engaged in carbon trading. In India, we already have a sophisticated market for such trading. However, trading of Carbon Credits has always been a contentious issue under the indirect taxation laws. In this article, we have examined the taxability of carbon credits under the newly enacted Goods & Services Tax (GST) law.

Going by the legislative scheme of the GST laws, GST is applicable either on goods or services or both. Thus, anything which is neither "goods" nor "services" can never be subject to levy of GST. Being so, for levying GST,s the CER/Carbon Credit should be either goods or services. Section 2(52) of the Central Goods and Services Tax Act, 2017 ("CGST Act") defines the term "goods"

[2]Available at:
https://unfccc.int/kyoto_protocol#:~:text=The%20Kyoto%20Protocol%20was%20adopted%20on%2011%20December%201997.&text=In%20short%2C%20the%20Kyoto%20Protocol,accordance%20with%20agreed%20individual%20targets.; accessed on January 19, 2022.

as "goods means every kind of movable property other than money and securities but includes actionable claims, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply."

Further the term *"services" has been defined as "services means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged."*

From a perusal of the above definitions, it is clear that money and securities have been kept out of the scope of goods as well as services. Thus, if CERs qualify as "*money"* or *"securities*", the supply of the same will not be taxable as being out of the scope of GST laws. A reading of definition of the term "*money*" under Section 2 (75) of the CGST Act makes it apparent that CERs are not money nor they are classifiable under specifically mentioned instruments therein. Moreover, use of such certificates as consideration to settle an obligation has not been recognised by Reserve Bank of India.

With regard to taxability of CER, two school of thoughts are prevailing in the trade, one treats CERs as "*goods*" and thus taxable under GST, while the, the other treats CERs as "*securities*" hence of the view that no GST is payable on CERs.

H. In order to be classifiable as "*goods*", the following criteria must be satisfied:

(a) It must be movable,

(b) It must be marketable

(c) It must not be money or securities

The above criteria were extensively discussed by the Hon'ble Supreme Court in various cases. Some of the relevant cases are as follows:

- In Vikas Sales Corporation v. Commissioner of Commercial Taxes, 2002-TIOL-608-SC-CT-LB, the Supreme Court dealt with the issue of taxability of "replenishment licenses or REP licences" issued under the EXIM policy to provide to the registered exporters the facility of importing the essential inputs required for the manufacture of the products exported. It was held that the license is not only a beneficial interest in respect of a movable property not in possession of the person but is itself a valuable right which is freely transferable. The import license, therefore, must be treated as merchandise and clearly falls within the definition of "goods".

- Tata Consultancy Services v. State of Andhra Pradesh, 2004-TIOL-87-SC-CT-LB, the Supreme Court held that, ""goods" may be tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold and (c) capable of being transmitted, transferred, delivered, stored and possessed."

- Yasha Overseas v. Commissioner of Sales Tax & Ors, 2008-TIOL-97-SC-CT, the Apex Court held that DEPB is identical to REP licenses and qualify as goods on the basis that it is freely marketable and have an intrinsic value.

- In Union of India & Ors v. Sonic Electrochem (P) Ltd. & Anr., 2002-TIOL-212-SC-CX, the Supreme Court dealt with the question of determination of "marketability" of articles. It stated that, "It is difficult to lay down a precise test to determine marketability of articles. Marketability of goods has certain attributes. The essence of marketability is neither in the form nor in the shape or condition in which the manufactured articles are to be found, it is the commercial identity of the articles known to the market for being bought and sold. The fact that the product in question is generally not being bought and sold or has no demand in the market would be irrelevant."

From the above discussion, it can be said that CERs qualify as "goods" as they have intrinsic value and are movable and freely transferable. Moreover, CER's always have had a market of their own.

I. The issue pertaining to determination of the nature of Carbon Credit/CERs as goods, was deliberated under the Notification No. 256/CDVAT/2009/43 dated 13.01.2010 issued by the Commissioner, Trade and Taxes, Delhi VAT under section 85 of the Delhi Value Added Tax of 2004. The Commissioner analyzed the definition of "goods", "dealer" and "sale" under the DVAT in relation to CERs and the cases being Yasha Overseas, Vikas Sales Corporation and Tata Consultancy Services were discussed by the Commissioner in regard to the taxability of CERs as "goods". Thereafter, vide the said Notification, CERs were declared as goods under the DVAT law. Relevant part of the said Notification is as follows:

"A careful examination of the product called Certified Emission Reductions (CERs) commonly known as carbon credits shows that it is a certificate having

market value. There are people/entities who are willing to sell and others who are willing to purchase such certificates. The intrinsic nature and value of carbon credits coupled with their free transferability makes the said product a marketable commodity. The said product is therefore covered under the definition of the term "goods" as it figures in sub-section (1) of Section 2 of DVAT Act, 2004.

Further, any person/company/entity undertaking the activity of sale and purchase of carbon credits (CERs) is a dealer in terms of the definition of the dealer as contained in sub-section (1) of Section 2 of DVAT Act, 2004. The transaction of sale of carbon credits (CERs) by a person/entity to another person/entity constitutes "sale" in terms of the definition of term as contained in Section 2(1)(zc) of DVAT Act, 2004.

12. It is also pertinent to refer to Entry No. 3 of IIIrd Schedule appended to the DVAT Act, 2004 which reads as follows :-

Entry No. 3 of IIIrd Schedule

"01-04-2005

All intangible goods like copyright, patent, rep license, goodwill etc."

The nature, substance and manner/modalities of the trading of CERs (carbon credits) makes the product known as Certified Emission Reductions (CERs) similar to the products mentioned in the said entry. Thus, the item CER is covered by the aforesaid entry."

The Commissioner vide the aforementioned Notification declared Carbon Credits /CERs as goods as they have certain intrinsic value, are capable of being brought, sold, transferred and possessed and are no different from ordinary commodity bought and sold in the market. Hence, its sale is liable to value added tax in the State.

J. Further, Carbon Credits were declared as goods under the Securities Contracts (Regulation) Act, 1956 (SCRA). The National Commodity & Derivative Exchange Limited (NCDEX) vide the Circular No. NCDEX/TRADING-035/2008/080 dated April 7, 2008, notified the launch of future/forwards contract pertaining to CER/Carbon Credit. Further pursuant to the repeal of the Forward Contracts (Regulation) Act, 1952 (FCRA) and amendment to the SCRA, the Central Government vide Notification No. S.O.3068(E) dated September 27, 2016, notified carbon credits as goods for the purposes of clause (bc) of section 2 of SCRA. i.e., to be treated as commodity derivative which is not a security.

K. CERs are alike Priority Sector Lending Certificates (PSLCs) and Renewable Energy Certificates (RECs). PSLCs are tradable certificates issued against priority sector loans of banks so as to enable banks to achieve their specified target and sub-targets for priority sector lending through purchase of these instruments in the event of a shortfall and at the same time incentivizing the surplus banks to lend more to these sectors. REC also known as green energy certificates or tradable renewable certificates certifying that the bearer owns one megawatt-hour (MWh) of electricity generated from a renewable energy resource. Once the power provider has fed the energy into the grid, the REC they receive can then be sold in the open market as a commodity. Therefore, it is evident that CERs, RECs and PSLCs are the certificates having intrinsic value traded in the market.

L. Further, the Central Government issued the Circular No. 34/8/2018-GST dated March 01,2018 and Circular No. 46/20/2018-GST dated June 06, 2018, whereby the applicability of GST on PSLCs and RECs has been clarified. The government vide the latter clarified that RECs, PSLCs etc. are classified under heading 4907 and will accordingly attract GST @ 12 % instead of 18% under the residual head, which was earlier clarified by the Circular No. 34/8/2018-GST dated March 01, 2018. An extract of Schedule II to Notification Number 1/2017-Central Tax (Rate), dated June 28, 2017, which provides for the rate of tax on chapter 4907 goods is reproduced below:

Sr. No.	Chapter/ heading/ sub-heading/ tariff item	Description of goods
128.	4907	Unused postage, revenue or similar stamps of current or new issue in the country in which they have, or will have, a recognised face value; stamp-impressed paper; banknotes; cheque forms; stock, share or bond certificates and similar documents of title [other than Duty Credit Scrips]

M. Now we will discuss the other view prevailing in the business that CERs can classify as securities. "*Securities*" under GST are the same as defined in clause (h) of section 2 of SCRA i.e., "Securities include- (i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate.;

(ia) derivative;

(ib) units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of ten Securities and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

(ii) Government Securities;

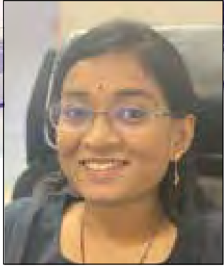
(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights and interest in securities"

Carbon Credits/CERs may be treated as "*Securities*" as they appear to fall under the wide term, "*other marketable securities of a like nature in or of any incorporated company or other body corporate*". If it comes out that CERs are classifiable as securities, same will be out of the scope of term goods and thus not taxable under GST. Recently, a writ petition has been filed before the Bombay High Court, wherein the petitioner has challenged the Circulars no. 34/8/2018 dated March 01, 2018, and 46/20/2018 dated June 06,2018 on the ground that REC scrips qualify as securities under GST. Further, the petitioner has stated that REC scrips are alike duty credit scrips prevalent in the customs law, which are exempt under GST and the same treatment should be provided to REC Scrips.

N. Considering the earlier judicial pronouncement and treatment under VAT regime, the balance seems to be tilting in the favour of CERs being goods and thus subject to GST, however, GST being new law, any interpretation differing from the earlier view cannot be ruled out absolutely. Whatever may be the ultimate outcome of the litigation in this regard, the ambiguity in treatment of REC/Carbon Credits is going to subsist in the trade for a while, considering the fact that it involves probable loss of revenue to the central government. Authors don't think that in case of RECs being declared as securities, revenue department will stop and accept the judgment of the High court as final. An appeal against such judgment is inevitable.

O. Considering the objective, of introducing CERs and RECs, which is reduction of emissions of greenhouse gases and encouragement of use of renewable energy in industry, taxing the supply of CERs and RECs doesn't seem appropriate as increased cost will put extra burden on buyers resulting in to less demand of CERs and RECs. Less demand would inevitably deter the companies to make extra efforts in acquiring carbon credit by cutting on their carbon emission and acquiring means of generating energy though renewable sources. Legislature should take appropriate steps to clarify the ambiguity and sooner would be better.



January 08, 2019

Cancellation of Registration

Refund of Input Tax Credit

Lakshmi Ratna Kancherla

Principal Associate, Lakshmikumaran & Sridharan, Bangalore

Various manufacturers/traders/service providers had registered in multiple States under the Goods & Services Tax (GST) Law as a consequence of realignment of their supply chain model/ presence of a fixed establishment in a particular State. However, the existing registrants are seeking to cancel the said registration due to re-alignment /closure of business etc.

In this article, the author attempts to highlight the fate of input tax credit on cancellation of registration under the GST Law.

The GST Law envisages a detailed procedure to be followed in case the registered person seeks to cancel his registration.

Section 29 of the Central Goods & Services Tax (CGST) Act, 2017 lays down the situations in which the registration can be cancelled, which include closure of business, discontinuance of business etc.

Cancellation of Registration – Status of Input Tax Credit?

Section 29(5) of the CGST Act, 2017 lays down that every person whose registration is cancelled shall pay an amount, by way of debit in the electronic credit ledger or electronic cash ledger, equivalent to the credit of the input tax in respect of:

i. Inputs held in stock and

ii. Inputs contained in semi-finished or finished goods held in stock or

iii. Capital goods or

iv. Plant and machinery

on the date immediately preceding the date of such cancellation or the output tax payable on such goods, whichever is higher, calculated in such manner as may be prescribed.

Rule 81 of the CGST Rules, 2017 provides that the

registered persons intending to cancel the registration is required to file a final return (GSTR-10) furnishing the details of the input tax credit.

Net Effect

- Input Tax credit pertaining to inputs and capital goods lying in stock on the date of cancellation is required to be paid back.

- No express provision laying down the manner of obtaining refund in case of input services lying as balance in the credit ledger even after complying with the obligation under section 29(5).

Position under GST Law - Sacrosanct?

Although the Karnataka Value Added Tax (VAT) Law and certain other State Laws, had a similar provision, insofar as input tax credit is concerned, it is interesting to note that there was no express provision under the Central Excise/Service Tax Law, to obtain a refund of the credit lying in balance at the time of closure of the unit or surrender of registration with the issue being highly contentious.

The issue under the erstwhile law was whether the assessees could obtain a refund of the CENVAT Credit lying in balance on closure of the unit, in terms of rule 5 of the CENVAT Credit Rules(CCR), 2004.

In the case of Union of India v. Slovak Trading Co. Pvt. Ltd. reported at - 2006-TIOL-469-HC-KAR-CX wherein the issue was whether cash refund can be ordered even if there was no specific coverage in rule 5 of the CENVAT Credit Rules, 2002. It was held that –

- Rule 5 of the CENVAT Credit Rules, 2002 does not expressly prohibit the refund of the unutilised credit where there is no manufacture in the light of the closure of the factory.
- Moreover, since the assessee had opted out of the MODVAT scheme the refund of unutilised credit has to be made.
- This case was maintained in the Supreme Court as well.

The Larger Bench of the Tribunal in the case of Steel Strips v. CCEx., Ludhiana reported at 2011-TIOL-656-CESTAT-DEL-LB held that refund cannot be granted where there is no express provision to grant refund under rule 5 of CCR except in the case of exports. It was held that the claim for refund is inconceivable when the right to refund does not accrue under law and that the claim of refund is not a matter of right unless vested in law.

However, various judicial precedents were decided in the favour of the assessees granting refund of the credit lying in balance considering Slovak Trading supra as a precedent.

It appears that the Legislature while requiring the assessee to reverse credit or pay back credit attributable to the goods in stock has not included a specific provision for refund of balance after such utilisation. The non-inclusion of such a provision clearly indicates that only the Revenue wants to unjustly benefit itself without giving corresponding benefit to an assessee by way of refund of unutilised balance of credit on goods and services on cancellation of his registration.

Action Required

Credit pertaining to Inputs/Capital Goods

The fact remains that the credit accrued is a vested right.

The vires of the provision can definitely be challenged on the ground that the registered person has been divested of his vested right.

Under GST Law, the assessees have challenged/sought Advance Rulings on issues pertaining to carry forward of credit but they have not met with success in all such cases. Although, the cases under the erstwhile law and present law are on a different footing, the fact remains that the registered person should be entitled to the refund of the balance input tax credit in cash on cancellation of registration.

Input Tax Credit-Pertaining to Services

Insofar as the credit pertaining to input services is concerned, in the absence of any specific provision the assessees can definitely opt to claim a refund of the balance available. This may result into another round of litigation which would be settled in the favour of the assessee going by the judicial precedents under the erstwhile law.

Parting Remarks

Any clarification from the Government will be useful to the stakeholders involved. It would be a welcome move if such registered persons are permitted to transfer the credit to another unit which is operational in another State or alternatively allow cash refund of the balance available after discharging the liabilities on inputs/WIP/CG lying in stock. Until then, the assessees have to work out different modalities which are in line with the legal provisions in order to avoid loss of input tax credit.

December 31, 2018

Cross Charge under GST

A necessary evil?

Rohini Mukherjee
Joint Partner, Lakshmikumaran & Sridharan

With the advent of Goods & Services Tax (GST) law, trade and industry is grappling with an array of new concepts. One such concept is 'cross charging' for supply of services between two GST registrations of an entity.

Cross charge as a concept

This concept of supplies between distinct establishments, popularly called "*cross charge*" has been a major area of concern for businesses particularly regarding valuing such services. The concept emanates from GST law deeming two separate registrations of a legal person as distinct persons and the supply between such distinct persons, even when made without any consideration, as a deemed supply. In other words, even in the absence of consideration for a supply of goods or services between distinct persons, the same has been deemed as a supply under GST law and GST is required to be paid on such supply.

Identification of services

While it is fairly simple to identify supplies in respect of goods, the same cannot be said for the supplies of services. In the context of services, it is commonplace for the corporate office of an entity to have employees performing functions such as finance, accounting, human resources and legal who work in common for all the business locations of the entity spread across several States. In such case, the employees performing the above functions at the corporate office are supporting the other locations.

A reverse situation also arises where the marketing office of an entity under a particular GST registration provides support services related to marketing to other GST registrations. Apart from these typical situations, there are also a number of supplies from one GST registration to another such as the research and development office located in one State providing research related services to manufacturing locations in other States.

In all these situations, there is provision of services by one GST registration of an entity to another.

Columbia Asia advance ruling

While the concept of cross charge existed under GST law from its very inception, it came to the limelight owing to the ruling of the Authority of Advance Rulings (AAR) in Karnataka in the case of *Columbia Asia Hospitals Private Limited* - 2018-TIOL-113-AAR-GST. The question sought from the AAR was whether the activities performed by the employees at the corporate office in the course of or in relation to employment such as accounting, other administrative and IT system maintenance for the units located in the other States shall be treated as supply. It was observed by the AAR that the employees employed in the corporate office were providing services to the corporate office and hence, there was an employee-employer relationship only in the corporate office. The other offices were distinct persons and, therefore, the employees in the corporate office had no employer-employee relationship with the other offices. Further, the AAR held that the activities performed by the employees at the corporate office in the course of or in relation to employment such as accounting, other administrative and IT system maintenance for the units located in the other States shall be treated as supply. On the issue of valuation of such supply, it was held that valuation would be determined in terms of section 15 of the Central Goods and Services (CGST) Act, 2017. Further, it was observed that the valuation includes all costs; the employee cost also needs to be taken into consideration at the time of valuation of goods or services provided by one distinct entity to the other distinct entities. This ruling has been recently upheld by the appellate AAR - 2018-TIOL-31-AAAR-GST.

Valuation: The key issue

Once it has been established that such supplies are chargeable to GST, since such deemed supplies are between two GST registrations of a single entity, there would not be any consideration for such supply. This brings us to the next pertinent question, what is the value to be considered for payment of GST.

In view of a specific provision under the Valuation Rules which deems the invoice value to be taken as the taxable value for supplies between distinct persons, where the recipient GST registration is eligible for full input tax credit, a reasonable value can be indicated on the GST invoice and GST can be paid on such value.

Concerns of valuation where recipient is not eligible for full credit

The same is not the case where the recipient is not eligible for full credit.

The recipient GST registration may not be eligible for full credit in diverse situations.

The first situation is where the recipient is engaged in an exempt supply. For instance, where the goods being supplied by the recipient GST registration is exempt (example: supply of curd).

Non-eligibility due to restriction in credit

While the above is a clear case of the recipient registration not being entitled to input tax credit, there are other situations. In a case where the recipient registration is engaged in provision of canteen service to its employees which is taxable at 5% with the condition of not taking the input tax charged on goods and services used in supplying the service, the recipient is not eligible for full input tax credit.

Provision of exempt supply to employees

Additionally, there are also instances of recovery from employees towards supplies which are exempt, for instance, service of residential accommodation.

Industry specific concerns

It is worth noting here that there are certain industries such as cement where businesses have power plants which are engaged in generation of electricity, some of which is captively consumed in the same State and some of which is sold to third parties or supplied to other GST registrations. The supply of electricity being exempt under GST, this is also a situation where the invoice value would not be deemed to be the taxable value.

In all the above cases, the invoice value cannot be taken as the taxable value for payment of GST here as well.

What value to adopt where recipient registration is not eligible for full credit?

In the cases where the recipient registration is not eligible for full credit, the law prescribes the options of adopting the open market value, the value of services of like kind and quality or cost plus 10% as the value. Where the value cannot be determined by either of these methods, the law prescribes that the value be determined using reasonable means consistent with the principles and the general provisions of valuation under GST law.

As support services are specific in nature, the open market value is not readily available. Further, since the support services are, in general, not comparable to other services as these are customised services, the services of like kind and quality may not be available.

Cost based valuation method: Concerns

This leaves the businesses with the option of valuing on cost plus 10% basis. The cost to be taken here is the cost of providing the service. It is of utmost importance for businesses to identify these costs to mitigate the possibility of dispute by the department. The exercise of identifying these costs is a daunting task. A proper costing exercise is required to be undertaken to arrive at the cost for providing these services.

A common question faced by businesses is whether while arriving at the cost, the salary of the employees engaged in providing these services is to be included. In the ruling of Columbia Asia, it was observed that as the valuation includes all costs, the employee cost also needs to be taken into consideration at the time of valuation.

In the backdrop of the law as it stands today, where cost plus 10% value is adopted, there is a high likelihood of credit accumulation at the end of the recipient registrations. This is more so in the cases where a major portion of the supplies by the recipient registration are exempt as in such cases, the entire credit or proportionate credit is not available at the end of the recipient. Accordingly, the GST charged under cross charge becomes a cost at the end of the recipient registration.

The trade and industry can consider representing to the Government to suitably amend the valuation rules so that the issue of cost built up owing to the valuation provision is addressed.

FROM INDIA FOR INDIA
BE INDIAN... BUY INDIAN
देश की धरती से जुड़ा

bkt-tires.com

BKT
GROWING TOGETHER

October 03, 2018

GST Incentive Schemes by States

A Dynamic Calculus of Value-Additions

V K Garg IRS (Retd.)

Former JS (TRU), CBIC and Advisor (Financial Resources) to Chief Minister, Punjab

With the objective to attract new investments, it has been a practice for long to refund net Value Added Tax (VAT), in full or part, to new units or those undertaking substantial expansion. After Goods & Services Tax (GST), many States have rehashed these schemes by replacing the VAT to its new *avataar* State Goods & Services Tax (SGST) without realizing the new paradigm. The basic rationale for tax incentives is to bring value-addition activities within a State. Net direct gains to a State in taxes - earlier as net VAT and Central Sales Tax (CST) and now as net SGST - are taken as proxy for such value addition.

In the new paradigm net SGST is not only after deducting SGST on sourcing but also unused Interstate Goods & Services Tax (IGST) credits after utilizing them for paying IGST and Central Goods & Services Tax (CGST) on outputs in that order. To that extent the net SGST will be often far less than the earlier net VAT.

Take an extreme example where a person uses entirely in-house materials and labour for a totally inter-State supply worth Rs 100. With no tax credits the entire IGST will be paid in cash. Contrast this with another situation where he buys inter-State supplies worth Rs 60 but sells his output entirely within the State. With IGST on inputs of 7.2 he would pay the entire CGST of 6 out of tax credits and use the left over 1.2 for SGST, paying the remaining 4.8 in cash (assuming IGST of 12%; SGST & CGST @ 6% each).

Under existing incentive schemes, he will get nothing under the first situation even though the entire value addition has happened within the State. On the contrary, in the second example he would have got 6 as the reimbursement under VAT but will get only 4.2 now, which is still higher than the first situation even though the value addition within the State is a meagre 40% of the first situation.

States need to be conscious that even though they may get far less tax on inter-State output supplies, the value addition within would yield a future tax inflow from those who contributed to this value while in the latter situation the new consumption within the State may end up cannibalizing existing taxes. This revenue

matrix is amply evidenced now with many origin-based manufacturing States doing well in revenues while they were extremely apprehensive before GST.

There are other issues as well. There is no reason to distinguish between IGST and SGST either at input or output stage. SGST can be easily converted into IGST or vice versa by just having a layer of pseudo-manufacturing or even trading. Some States have plugged loopholes relating to trading but with the concept of manufacturing having withered away it is not an easy exercise. The bill-to-ship-to provisions, where goods are billed to one person while actually delivered to another, have made it far easier.

Having already announced schemes, of immediate concern are issues as to how to even calculate net SGST. Is it merely equal to SGST paid in cash or is it the difference between SGST payable and SGST tax credits, ignoring IGST credits? With the recent amendments in law (that are likely to be operationalized soon) the CGST liability is to be first discharged with IGST and thus limiting the availability of IGST for payment of SGST. This will raise the amount of net SGST without any changes on the ground. Job work provisions allow value creation outside new capacities thus compromising the very purpose of such incentives. Can SGST number be so arbitrary that it fluctuates so widely depending on some elementary tax planning?

If the purpose of incentive schemes is to bring value addition within the State, a more correct measure of incentive would be as follows:

First calculate total tax accruing to all States in India from value addition in the incentivising State = [Net IGST + Net CGST + Net SGST] on sale (not mere supply) ÷ 2; let us call it X

The State may then decide to refund a portion of this measure X - depending on its share of all-India GDP or likely local consumption - as incentive.

This will produce even results ordinarily but will fail to address situations where the duty rates vary widely between inputs and outputs. Naturally a unit having principal inputs taxed at higher rate and output taxed at lower rate may even be seeking a tax refund or at least be liable to pay negligible net tax. This will leave little incentive to set up the new unit on grounds of GST benefit. The situation will reverse where the principal inputs are largely exempt or taxed @ 5% while the outputs are liable to tax @ 18% or even 28%.

A possible solution may be to calculate the net value addition based on accounting standards and calculate the total net SGST by applying the applicable SGST rate on such net value addition which should produce more or less the same result as X as per the above formula. The State can then refund a portion of that as stated earlier.

It is thus evident that unless the schemes take note of the new evolving paradigm the incentive schemes will remain ambiguous, difficult to operate or even fraud-prone and divorced from the objective to promote industrialization. Definitely these require a relook.

August 17, 2018

GST Laws
Drafting Infirmities, a Cause of Concern

R K Singh
Former Member CESTAT and Senior Partner, TLC Legal Advocates

While addressing a conference of Chief Justices and Chief Ministers, the Prime Minister pointed out that a lot of litigation was a result of complex/ambiguous language of the statutes and stressed the need for better drafting of laws to ensure clarity and unambiguity. Given the far reaching reformatory and transformational potential of the Goods & Services Tax (GST) laws, there was no better occasion to pay greater heed to the advice of the Prime Minister than while drafting these laws. However, perusal of the GST enactments reveals that these laws are anything but simple and unambiguous. It is almost ironical that while the task of drafting these momentous legislations unarguably required a very high (if not the highest) degree of drafting skills to ensure clarity and unambiguity, so necessary for taxing statutes, such skills do not seem to have been adequately marshalled.

While any number of illustrations can be cited to demonstrate unnecessary complexities, elementary grammatical and syntactical errors and avoidable ambiguities in the language of these enactments, the limited purpose of this article is to point out certain fundamental infirmities, namely, the infirmity in the section defining "supply" (section 7[3] of the CGST Act) and also in the charging section (section 9 ibid). It is trite to say that such fundamental infirmities are totally unacceptable in any taxing statute.

GST regime is '*supply*' based taxation regime but the definition of 'supply' itself is merely an 'inclusive' one.

An inclusive definition of '*supply*' in a taxing statute which levies tax on '*supplies of goods or services or both*' is totally unacceptable simply because an inclusive definition axiomatically can never delineate the exact contours of its coverage and as a necessary consequence gives rise to unavoidable uncertainty.

What makes it even worse is the charging section (section 9 ibid). As per section 9(1),"*there shall be*

[3]Section 7(1) For the purpose of this Act, the expression "supply" includes-
(a) all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business".

levied a tax called the central goods and services tax on all intra-state supplies of goods or services or both…". Thus, as per the charging section 9(1), CGST is leviable on all intra-state supplies of goods or services or both regardless of whether or not such supplies are made in the course or furtherance of business. It is arguably so because the inclusive definition of "supply" in subsection (1) of section 7 ibid does not exclude all forms of supply of goods or services or both which are not made in the course or furtherance of business.

As if this much confusion was not bad enough, Schedule II of CGST Act makes it excruciating. For example, as per Sr. no. 1(a) of that Schedule, "*any transfer of the title in goods is a supply of goods*" regardless of whether or not such transfer is in the course or furtherance of business.

Similarly, as per Sr. no. 2(a) of the said Schedule, "*any lease, tenancy, easement, license to occupy land is supply of services*" regardless of whether or not such lease, tenancy …… is in the course or furtherance of business. (It is pertinent to note that Sr. no.2(b) of the said Schedule specifically mentions "for business or commerce' with regard to lease of buildings and Sr. nos. 2 and 4 of Schedule-I specifically mention 'in the course or furtherance of business', while conspicuously no such qualification exists in Sr. no.1(a) or 2(a) of the said Schedule II). Section 9(1) levies CGST on all intra-state supplies of goods or services or both (the exceptions contained therein are being ignored, not being germane for our purpose) and does not contain any qualification to the effect that such supplies have to be made in the course or furtherance of business (and as stated earlier, inclusive definition of supply in section 7 does not exclude from its scope 'supplies' made 'not' in the course or furtherance of business).

Indeed, the hurriedly-withdrawn clarification given by the Secretary (Revenue) that selling of old jewellery by an individual will be liable to GST was totally in conformity with the language of the law and, as is evident from the above analysis, its withdrawal was on a legally shaky, nay invalid ground that such sale was not in the course or furtherance of business.

In this context, it is also pertinent to refer to section 9 (4) ibid which stipulates that CGST on supplies obtained by registered person from an unregistered person shall be discharged by the recipient. The underlying assumption perhaps was that the person supplying is unregistered because he is not required/ liable to be registered under CGST Act. But the wordings of section 9(4) clearly mean/imply that even if the person making supplies is required/ liable to be registered but has not taken registration, in such a situation also, the registered recipient will have to discharge CGST on such supplies. It does not seem to be problematic at first glance but on careful analysis, it is fraught with untenable consequences. For example, if at a later date it is found that the unregistered person which made the supplies was actually liable to be registered as per law, then he would also be ab initio rendered liable to pay CGST on the supplies made by him and the provisions regarding demand and recovery contained in Chapter XI of the CGST Act would come into full play against him. In such a scenario, when the liability to pay CGST turns out to be of the person who evaded paying CGST by not taking registration, can such a person escape his liability to pay CGST merely because as a consequence of his illegal action of not taking registration, CGST liability was discharged by the recipient of supplies and if recoveries are effected from him as per law (or even if no such recoveries are effected), will the recipient who paid CGST be refunded the amount because as it turned out he (i.e. the recipient) was arguably *ab initio* not liable to pay –and what if the refund is time-barred by then? Also, it is settled principle of law that in the case of disputes whether (and at what rate and value) a certain supply is leviable to CGST is to be determined by the jurisdictional CGST authorities and it is entirely possible that the jurisdictional authorities of the supplier and the recipient may not be the same which will further compound this complication.

While one can generally empathise with the drafters of the GST laws given the tight timelines they had to adhere to, the above fundamental deficiencies/infirmities relating to levy itself can hardly be empathised on that ground. While the GST initiative has been widely well received, the enactments per se have hardly received any kudos and as is evident from the preceding paras, the reasons are easy to fathom.

July 20, 2017

GST-related Clarifications

Press Releases & Tweets a Risky Culture!

Shailendra Kumar
Founder Editor, TIOL

The Goods & Services Tax (GST) continues to be the dominant flavour in the economy. With the Modi Government being able to answer most of the taxpayers' queries either through tweet or TV Channels or other forms of media, most of the issues of the small and medium enterprises appear to have been settled or clarified. And, the general opinion among experts is that the much-expected tumultuous roll-out has finally turned out to be an event least irritating so far! And the GST has been riding a quiet time. With the Ministry of Finance leaving no stone unturned to directly interact with the taxpayers and has indeed shown hitherto unseen approach to use media proactively, the number of problems has dwindled to the minimum. And such a taste of success evidently prompted the Prime Minister to call for the 'GST Spirit' in his pre-Monsoon Session appeal to the Opposition Parties.

Though the Union of India may relish its success for a quiet GST roll-out but several sectoral problems continue to swell. One such sector is the exports. As per rule 96A of the Central Goods & Services Tax (CGST) Rules, a registered person has to execute Letter of Undertaking (LUT) / Bond for export of services without payment of Interstate Goods & Services Tax (IGST). Since the Goods & Services Tax Network (GSTN) has failed to provide this facility online, the Central Board of Excise and Customs (CBEC) quickly stepped in to allow manual filing of LUT to the jurisdictional Assistant Commissioner. Though the format of GST RFD-11 has been accepted by the field officials but exporters have been directed to submit a **DRAFT first** for their vetting and it is causing avoidable delay.

Let me now go to Special Economic Zones (SEZs) which are a stable source of exports and hugely contribute to the recently-recovered growth rate in our exports. There are assessees who have registered their principal place of business and others like SEZ or Software Technology Parks of India (STPI) or Domestic Tariff Area (DTA) units as branches in one particular State. All such establishments have just one GSTIN. Now, what comes to add to the prevailing confusion is the direction to separately register SEZ units online. And if one is not

registered, one is not allowed to execute LUT. This nullifies the principle of ONE REGISTRATION taken for a State. There are many more such sectoral issues which need immediate attention for smooth compliance.

Let me now move to some substantive issues where the substantive powers of the GST Council set up as per Article 279A have come to be questioned in a writ before the Delhi High Court. And the service involved is the legal service which has the inherent potential to grab headlines. It did it in the past when the then Finance Minister, Mr. P. Chidambaram, a lawyer himself, resisted any proposal to tax legal services but Mr. Pranab Mukherjee did it in 2009. And it was done to bring lawyers on equal footing with other professionals who were already under Service Tax net. And the way out was found in the form of Reverse Charge Mechanism (RCM). And the same method was retained even under the GST.

Now, after the Government issued the CGST Notifications, a writ petition was filed before the High Court challenging the vires of the Notifications which, according to the petitioner, do not completely translate the decision of the GST Council in its wordings. Even as the courtroom dexterity had begun to unfold, the Ministry of Finance in its wisdom decided to issue a Press Release clarifying that there is no change in the legal position with respect to the taxation of legal services. And when the second round of hearing began, this mode of issuing clarification through Press Release itself came under heavy assault before the Bench.

Although the Bench has asked the Government counsel to explain the legal validity of such Press Releases, and an affidavit is to be filed at the next hearing, it is true and strange that instead of issuing a Circular the Union Government chose the route of issuing a Press Release for such a clarification. It was indeed a strategic error or one may call it too much reliance being placed on the social media or any form of media to explain a substantive legal provision. Some sort of discipline is required to be followed at the Government level to avoid unnecessary litigation and confusion. A similar error was committed when all the sections of the 101st Constitution Amendment Act were notified deleting several Entries in the Union List of the Seventh Schedule of the Constitution. And, in reply to the raging controversy, the Government only TWEETED that everything is fine with the Notification.

A similar approach continues even today and the Ministry of Finance prefers putting out Press Releases to clarify major legal doubts. The basic purpose of issuing Press Releases is to provide broad information to the media which in turn adds value to the inputs or simplifies the issue for its own readers or does padding of old information to bring continuity in the development of a news item. But a new dimension seems to have been added by the Modi Government which is detested not only by the purists but by the entire legal fraternity and now the Judiciary too. Undoubtedly, major clarifications should come in the form of Circulars and not Press Releases. This is a loose method of dealing with a serious issue. This is also addictive if one goes by the latest releases. In one such release the Ministry of Finance recently clarified even the lower tariff rate on five-star hotels charging less than Rs 7500 room tariff per day. Tax on sale of old jewellery by consumers is another episode. Such a style of clarification may lead to more legal disputes once some field formations refuse to accept the legal authority of such releases and raise a huge demand of tax. The new dimension given to the world of Press Releases may be quick to answer a query but not substantive legal clarifications. Let's wait and watch how the Delhi High Court comments on this Press Release culture at its next hearing in September.

Meanwhile, the challenge in the legal service case is that whether the Union of India is required to use the GST Council's decisions *verbatim* in its Notifications and has no authority to play with the words while giving legal expression to the same INTENT? Going by the Constitution Amendment Act, the GST Council is only a recommendatory body and its recommendations may be altered or rejected by the Parliament which is constitutionally supreme. And when the Parliament has legislated the CGST Act based on the recommendations of the GST Council, can our Courts really stick to the decisions of the recommendatory body for interpreting a legal provision? Although it is a debatable issue but as per my understanding going by the Doctrine of Preponderance of Constitutional wisdom, it tilts in favour of the Parliament.

However, going back to the raging controversy, it *prima facie* appears that the Tax Research Unit (TRU) has not done justice by saving a few words and commas which should have been a part of the expression used in the Notification. Greater clarity should have been the focus of the drafting team but perhaps, to meet the July 1 deadline, they were also short of time. Anyway, a simple answer to overcome this legal impasse is to issue a Circular and put an end to it when there is no change in the INTENT of the GST Council to levy tax on reverse charge basis.

A connected issue in this case is that of mandatory registration of advocates or firms, already registered during the Service Tax regime. When certain assessees are excluded from paying taxes even under the GST laws, where was the need to put onus on all such assessees to take registration and then de-register? Why such fruitless exercise? What purpose does it serve? Once the GST Council has taken a call that certain services are to be taxed under the RCM, why to force the service providers to take registration? The petitioners indeed have a valid point here and the GST Council should quickly take a call to do the needful rather than wait for the Judiciary to direct it to do the obvious.

The GST Council so far enjoys the clean and enviable track record of taking all decisions by consensus and it should not wait for the judiciary to direct it to do the most obvious things to do. Then, a connected question arises - Can our Courts direct a recommendatory body to make a specific recommendation? Anyway, the GST has made an excellent beginning so far and it must be allowed to stick to its stated path of no litigation and confrontation with the taxpayers where the scale of justice is tilted in favour of the taxpayers. It must be remembered that demonetisation was a different sort of drive where Press Releases method worked but the GST is a taxation law enacted by the Parliament and it needs serious methods to clarify doubts.

KHIMJI POONJA

FREIGHT FORWARDERS PVT. LTD.

FOR ABILITY AND RELIABILITY

ISO 9001:2000 CERTIFIED

Dump all your Problems and Anxieties on Our Professional and Experienced Shoulders. Patronised by Leading MNCs, Private and Public Enterprises

SINCE 1946

All Under One Roof

SEA AIR ROAD RAIL

Clearing & Forwarding · Shipping · Air Freight · Transportation · Warehousing · Insurance · Logistics

AIR CARGO OFFICE :

302, Jayant Apartments, Sahar, Mumbai - 400 099.

Tel : 6785 2100, 2681 7328 Fax : 91-022-2681 7644 E-mail : khimji@mtnl.net.in / kpair@khimjipoonja.com

June 07, 2017

Supplies of Goods from SEZ
IGST required to be paid twice under GST regime: Unintended (?) but true

R K Singh
Former Member CESTAT and Senior Partner, TLC Legal Advocates

The purpose of this brief note is to highlight how sometimes unintended and unwelcome consequences emerge in the wake of the enactment of new laws.

At the very outset, it is pertinent to set records straight with regards to impression prevailing in certain quarters that as the Goods and Services Tax (GST) laws have been enacted in the wake of a special Constitutional Amendment, they are somewhat superior to other laws inasmuch as in case of any conflict, the GST laws would prevail. This impression is totally untenable. The 101st Amendment to the Constitution is essentially an enabling provision to allow enactments of the GST laws e.g., Central Goods and Services Tax (CGST) Act, State Goods and Services Tax (SGST Act), Interstate Goods and Services Tax (IGST) Act et cetera. In the absence of the said Constitutional Amendment, the GST laws would be ultra vires the Constitution. There is no basis whatsoever to read into the said Constitutional Amendment anything which would even obliquely imply that the laws enacted in the wake of the said Constitutional Amendment would be in some way superior to the other laws. It is trite to say that every law has to be (enacted) in consonance with the Constitutional provisions. Thus, any law is either intra vires the Constitution, or ultra vires the Constitution; in the latter case it will be struck down by the Courts on that ground alone. There is no such concept as a law being more intra vires of the Constitution vis-a-vis any other law.

Therefore, the GST laws, merely because they are enacted in the wake of a specific Constitutional Amendment, *ipso facto* do not acquire any inherent superiority or precedence over the other laws.

Now coming to the main purpose of this article, section 30 of the Special Economic Zones (SEZ) Act, 2005 stipulates as under:

"S.30. Subject to the conditions specified in the rules made by the Central Government in this behalf:-

(a) any goods removed from a Special Economic Zone to the Domestic Tariff Area shall be chargeable to duties of customs including anti-dumping, countervailing and safeguard duties under the Customs Tariff Act, 1975, where applicable, as leviable on such goods when imported; and (b) the rate of duty and tariff valuation, if any, applicable to goods removed from a Special Economic Zone shall be at the rate and tariff valuation in force as on the date of such removal, and where such date is not ascertainable, on the date of payment of duty."

Thus, as per section 30 of the SEZ Act, supplies of goods from SEZ units will, inter alia, be also chargeable to duty of Customs commonly known as 'CVD' under subsection (7) of section 3 of the Customs Tariff Act .

S. 3(7). Any article which is imported into India shall, in addition, be liable to integrated tax at such rate, not exceeding forty per cent. as is leviable under section 5 of the Integrated Goods and Services Tax Act, 2017 on a like article on its supply in India, on the value of the imported article as determined under sub-section (8).

But, under section 5 of the IGST Act, IGST will be leviable on the inter-state supplies. As supply of goods from units in the SEZ is treated as inter-state supply (refer section 7(5) of IGST Act), IGST will be leviable on these supplies under the IGST Act.

"S. 5(1). Subject to the provisions of sub-section (2), there shall be levied a tax called the integrated goods and services tax on all inter-State supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption, on the value determined under section 15 of the Central Goods and Services Tax Act and at such rates, not exceeding forty per cent., as may be notified by the Government on the recommendations of the Council and collected in such manner as may be prescribed and shall be paid by the taxable person:"

Provided that the integrated tax on goods imported into India shall be levied and collected in accordance with the provisions of section 3 of the Customs Tariff Act, 1975 on the value as determined under the said Act at the point when duties of customs are levied on the said goods under section 12 of the Customs Act, 1962.

Jurisprudentially, there is no bar against levying more than one tax on the same transaction so long as the taxes are levied under valid taxing statutes. It is also to be noted that there is no inconsistency between the provisions of the IGST Act and SEZ Act as far as the context of the above analysis is concerned, and, therefore, the provisions of section 51 of the SEZ Act do not come into play as they are not needed to be invoked at all.

"S. 51(1). The provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act."

The sum total of what is stated above is that supplies of goods from the SEZ units will in-effect be liable to IGST twice (i) under section 5 of the IGST Act and (ii) as part of the aggregate Customs duty leviable under section 30 of the SEZ Act which inter alia will include IGST in the form of CVD by virtue of section3 (7) of the Customs Tariff Act. Thus, to repeat for emphasis, supplies of goods from SEZ units will in-effect suffer IGST twice in the GST regime and resultantly will be at a huge disadvantage vis-à-vis the imported goods which will suffer IGST only once by virtue of the proviso to subsection (1) of section 5 of the IGST Act.

Admittedly, the intention could not have been to in-effect levy IGST twice on the supplies of goods from the SEZ units or to put supplies of goods by the SEZ units at a disadvantage vis-a-vis their imports. The policy makers may like to look into this inadvertent anomaly with a view to initiating rectification measures.

June 05, 2017

Is Food Supplied as Prasadam Liable to GST?

Dr Nilesh V Suchak, CA
Punit Prajapati, CA

Many of the religious places provide "prasadam" in their precincts which is satisfying meals like lunch or dinner or breakfast but call it "prasadam". They charge token amount for such "prasadam" and there is no intention of making any profit out of such charge but sometimes such amount charged is highly subsidized out of other donations by the religious places. Such "*prasadam*" is provided to facilitate the pilgrims visiting such religious places and as a part of the activities related to advancement of religion or spirituality. Will such amount received by religious places like Tirupati Balaji Temple, Somnath Temple and other such religious places attract levy of the Goods and Services Tax (GST) is a moot question that arises after going through the provisions of the Central Goods and Services Tax Act (CGST Act), 2017 and the list of exemptions and rates put in the public domain.

According to the GST rate schedule for goods as discussed in the GST Council Meeting held on 18-19 May, 2017, rate of GST on "Prasadam" [2106] supplied by religious places like temples, mosques, churches, gurudwaras, dargahs, etc. is Nil. It appears clear that "prasadam" like laddus, chikki, or in any form gets clearly covered in this entry and any amount charged for such items would attract Nil rate of GST. However, the pertinent issue is whether the meals like lunch and dinner or breakfast as provided by such religious institutions by charging a token amount can come within scope of supply of "*prasadam*" or not. It appears that the "*prasadam*" should include even food supplied by religious places. In view of this, a view is possible that such bhojan (meal) "*prasadam*" will attract Nil rate of GST.

In terms of provisions of section 7(1)(a) of the CGST Act, 2017, the expression "*supply*" includes all forms of supply of goods or services or both such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business. It appears that a religious place supplying "*prasadam*" in the form of satisfying meals cannot be said to be supplying the same in course or furtherance of any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity. Hence, it appears that such supply of food "*prasadam*" by religious places should

not be considered to be in the course or furtherance of business and hence the same may not be considered as "*supply*" under this clause.

However, in terms of provisions of section 7(1)(d) of the CGST Act, 2017, "*supply*" includes the activities to be treated as supply of goods or supply of services as referred to in Schedule II. In terms of clause (b) of Paragraph 6 of Schedule II, the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (other than alcoholic liquor for human consumption), where such supply or service is for cash, deferred payment or other valuable consideration shall be treated as supply of service. Accordingly, for "*prasadam*" in the form of meals or breakfast supplied by the religious places, if a view is taken by the tax authorities that such activity is clearly to be treated as a supply of services and not that of goods, there are chances of disputes between such religious places and the tax authorities if such religious places have not paid any tax considering it to be goods in the form of "prasadam" which are chargeable at nil rate of GST. In the pre-GST regime, most of these religious places would not face any problems as they normally do not provide such bhojan (meal) "*prasadam*" in an air-conditioned area and all services provided in relation to serving of food or beverages by a restaurant, eating joint or a mess, other than those having the facility of air-conditioning or central air-heating in any part of the establishment, at any time during the year is exempt under Entry No. 19 of Notification No. 25/2012-ST, dated June 20, 2012 as in force from July 01, 2012. However, since the proposed list of exempted services for GST regime does not include even non-air-conditioned premises supplying food, there are chances of unwarranted litigation if department demands GST on such activity of supplying bhojan(meal) "*prasadam*" by taking a view that exemption granted to non-air-conditioned joints is now no more applicable.

It may also be noted that services by an entity registered under section 12AA of the Income Tax Act, 1961 (IT Act) by way of "*charitable activities*" are proposed to be exempted from GST. It is also stated that "*Charitable activities*" may be defined as presently in notification No 25/2012-ST. The said meaning of "*charitable activities*" in Notification No. 25/2012-ST also includes activities relating to advancement of religion or spirituality. Providing "*prasadam*" to pilgrims visiting religious places is one of the activities relating to advancement of religion or spirituality and hence even if the activity of supplying bhojan (meal) "*prasadam*" is treated as service, the same should get exemption under this entry.

It has been a rich tradition of our nation that most of the religious places provide bhojan (meal) "*prasadam*" to persons visiting such places at very nominal charge. These religious places play an important role in advancement of religion and spirituality. Government should unambiguously provide for or clarify that bhojan (meal) "*prasadam*" provided by religious places will not attract any GST so that administrators of such religious places do not have any doubt in their minds about taxability.

Dr. S. L. Peeran, Retired Member(J), CESTAT while participating on the occasion of celebration of Silver Jubilee of our honoured Tribunal, had stated in 2007 as under -

"The Government in its anxiety to increase its collection of Taxes has left no stone unturned to bring within its ambit all and sundry items for Taxation. We had an interesting case wherein the Government proposed to levy tax on "*Prasadam*" distributed by temples without exception to the "*Prasadam*" in the form of "*ladoos*" distributed by Tirupathi Devasthanam. The question before us was as to whether "*Prasadam*" can be taxed? So long as "*ladoos*" are sold in the market as goods, they are taxable. However, once they are presented before the deity and assume a form of "*Prasadam*" or "*Taburruk*" can it be taxed as commercial commodity? The tax authorities had a different view, they considered the "*Prasadam*" as commercial goods, as some money was being collected towards distribution of the "*Prasadam*". But the Tribunal applied the principles of sound reasoning, good conscience and fair mindedness to hold that offerings on the altar of the Lord cannot be considered as a commercial commodity. The Government later issued a notification exempting the "*Prasadam*" from Tax."

We hope that the present Government also applies the principles of sound reasoning, good conscience and fair mindedness and categorically provides for or clarifies that even bhojan (meal) "prasadam" provided by religious places will not attract levy of GST.

PART 2

INTERNATIONAL TAXATION

PASWARA PAPERS LIMITED

AN ISO 9001: 2008 Certified company

Website: paswara.com

Paper Product

High RCT Paper | High Ply Bond Paper | High BF Kraft Paper | White kraft Liner Paper

A New Era of Excellence in **MULTI LAYER KRAFT PAPER** Industry

PASWARA PAPERS LIMITED

Factory: N.H.-58, Paswara Border, Mohiuddinpur, Delhi Road, Meerut (U.P.) INDIA
Contact No. +91-7055003603, 7055003604 E-mail: info@paswara.com

Regd. Office: Paswara House, Baghpat Road, Meerut (U.P.) INDIA
Tel. +91-121-4056536, 4020444 Email: query@paswara.com

The Global Minimum Tax Rules by the OECD

M S Vasan
Senior Vice President, Hinduja Global Solutions Ltd

On the December 20, 2021, the OECD came out with its rules for the much-touted global minimum tax. Having obtained the endorsement of 139 countries (through what means, allurement or threat, I do not know), the OECD has steamed ahead and has now come up with its model rules that will be dutifully followed by the members of the Inclusive Framework (IF) to ensure that very, very large multinationals pay at least 15% of tax on their income wherever they operate. This is being claimed as a big victory for the international tax order.

BEPS started as a response to tax minimisation by digital MNCs and the concept of a minimum tax was nowhere on the horizon. Everybody with any common sense knows that it is an American project to see that its MNCs pay a minimum tax in the USA. The rules are so designed that it is the headquarters' jurisdiction that gets the first right to reap the gains from the new system. The OECD, of course, reminds us that the two-pillar solution was approved by 137 members of the IF and that the rules were developed by the members of the IF and adopted by consensus. The wording is such that it is not clear if the rules themselves were developed by the IF or if it was the OECD secretariat that has done the work since it has been put up for public discussion at this stage.

The OECD has issued multiple documents on the occasion- there are the model rules, there is a fact sheet, there is a summary for nit-wits like me - the Pillar two model rules in a nutshell- and there is an FAQ. The rules divided in ten chapters that run 45 pages followed by definitions of another 15 pages. The model rules are like a template that can (read should) be adopted by jurisdictions in their domestic legislation. So, now the OECD is also dictating the domestic legislations of non-member countries. So much for the much-vaunted tax sovereignty of nations! The Indian budget will be presented on February 01. It is possible that some changes suggested by the OECD are incorporated in the Budget to fulfil the new-found zeal of the administration to toe the OECD line.

Having glanced through the jargon-filled rules, it is not clear to me for whom these are meant. If it is meant for the tax administrators, I must confess that much of it is beyond my comprehension. But be prepared for the western penchant for abbreviations that will be thrown around by 'experts'- the top of which is the top-up tax, ETR, GloBE, IIR, UPTR, STTR and what have you.

The Pillar 2 proposals of the OECD are not compulsory for nations to follow. However, if countries do adopt, the same has to be in accordance with what the OECD dictates. As I have said many times before, the two-pillar solution proposed by the OECD is essentially a transatlantic patch up between the USA and the EU. The developing nations are just sacrificial lambs willingly serving the causes of the erstwhile colonial powers.

Having whole-heartedly endorsed the OECD formula, the developing countries have to decide now whether to follow the OECD lead. There are very few, if any, of multinationals of the developing countries that will come within its purview in any case. In the case of India, there may be some large groups that will be in scope. However, it is doubtful if any of these companies park their intangibles in low-tax jurisdictions. That does not mean that the Indian companies are above board. Many of them are quite adept in playing the game and adroitly use tax havens both for evading and avoiding taxes as also for other nefarious objectives. But, it is unlikely that such companies will be within the scope. Of course, countries have the option of choosing a lower threshold also. But, unless it is a problem of large domestic groups hiding money offshore, there is no point in lowering the threshold. Besides, India is not a capital exporting country and it does not even have a Controlled Foreign Corporations (CFC) rule.

From a revenue gains perspective, the developing countries do not get any significant benefit from the optional provision and need not join in. So, the first dilemma for nations is to decide whether to join the OECD-led proposal for a minimum effective tax rate or not. The only aspect of the Pillar 2 proposal that could be of any revenue gain at all for the developing countries is the one that is known as the subject to tax rule or STTR. The present paper put up by the OECD does not discuss STTR at all and is slated for discussion in 2022 only. In fact, the very reason for the BEPS project, the tax challenges arising out of digitalisation of economies – the original BEPS Action Plan1 that got renamed as Pillar 1 proposal has also not been finalised and has been kicked down the road. So, what the OECD is doing is satisfying its core constituents- the USA and the EU and keep hanging the carrot of some itsy-bitsy tax gains for developing countries to be considered in future. In the meantime, these countries are being coaxed to join in other initiatives. The OECD very astutely got around getting its legitimacy by involving so many developing countries and now is dictating terms to them. It is a bit surprising how the negotiators from all these countries are unable to see through the clever game.

Nevertheless, let us try to decipher what the OECD has come up with. If you go by the summary everything looks very simple. There are just 5 steps involved to attain Nirvana. In step one, one needs to identify the MNC Groups that are within scope and the location of each constituent entity within the Group. The second step involves the determination of the income of each constituent entity; the third step is to determine the taxes attributable to the income of the constituent entity. The fourth step is the calculation of the effective rate of all constituent entities located in the same jurisdiction and the determination of the top-up tax and finally, the fifth step is the imposition of top-up tax under the income inclusion rule and the undertaxed payment rule and voila, you are through. All of these will have to be done under the domestic tax laws of the countries and the OECD has very helpfully attached the readymade draft as well.

But wait a minute. How does one determine which company or group is in scope? The received wisdom is that an MNC group having annual revenue of 750 million Euros will be in scope. *But that is now changed*. To be in scope, the annual revenue of the group entities should be 750 million euros *in at least two of the four fiscal years immediately preceding the tested fiscal year*. And if the fiscal year is for a period other than 12 months, (as used to happen earlier in India before the concept of previous year was changed uniformly to the financial year) the threshold of 750 million would have to be proportionately adjusted. And what happens if there is a corporate restructuring like merger or demerger happens on a particular year. Don't worry, there is whole chapter (6) devoted to that aspect.

All along, the OECD had been preaching the single entity concept that each subsidiary or permanent establishment (PE) is a separate entity dealing at arm's length with each other. Now a group concept though well known in the accounting context is being introduced albeit for a limited purpose. So, it becomes necessary to know which entities form part of the MNE group. According to the draft rules, the group means a collection of entities that are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of these entities are included in the *consolidated financial statements of the ultimate parent entity*, unless these are excluded on grounds of materiality or on the ground that the entity is held for sale (1.2.2) The group concept will also include PE. Interestingly, in the definition section, there is a meaning given to the term 'permanent establishment' as follows:

(a) *a place of business (including a deemed place of business*) situated in a jurisdiction and treated as a permanent establishment in accordance with an applicable Tax Treaty in force *provided that such jurisdiction taxes the income attributable to it in accordance with a provision similar to Article 7* of the OECD Model Tax Convention on Income and on Capital;

(b) if there is no applicable Tax Treaty in force, a place of business (including a deemed place of business) in respect of which a jurisdiction taxes under its domestic law the income attributable to such place of business on a net basis similar to the manner in which it taxes its own tax residents;

(c) if a jurisdiction *has no corporate income tax system*, a place of business (including a deemed place of business) situated in that jurisdiction that would be treated as a permanent establishment in accordance with the OECD Model Tax Convention on Income and on Capital *provided that such jurisdiction would have had the right to tax the income attributable to it in accordance with Article 7 of that model*; or

(d) a place of business (or a deemed place of business) that is not already described in paragraphs (a) to (c) through which operations are conducted outside the jurisdiction where the Entity is located *provided that such jurisdiction exempts the income attributable to such operations*

The definition of PE is thus different from the OECD Model and fixed place of business is replaced by place of business including a deemed place of business. Unfortunately, 'deemed place of business' is not further defined.

So, in a common man's language a subsidiary and a PE is part of an MNC group. But, there are various exclusions. All Governmental entities, international organisations, non-profit organisations, pension funds, investment funds being the ultimate parent entity and a new addition- a real estate development vehicle that is the ultimate parent entity, are excluded. However, for the purpose of determination of the group in scope, these are not excluded from the revenue threshold. There are other complications here that we skip for the purpose of this discussion.

Governmental Entity has been defined as an Entity that meets all of the following criteria set out in paragraphs (a) to (d) below:

(a) it is part of or wholly-owned by a Government (including any political subdivision or local authority thereof);

(b) it has the principal purpose of:

   (i) fulfilling a Government function; or

   (ii) managing or investing that Government's or jurisdiction's assets through the making and holding of investments, asset management, and related investment activities for the Government's or jurisdiction's assets; and *does not carry on a trade or business;*

(c) it is accountable to the Government on its overall performance, and provides annual information reporting to the Government; and

(d) its assets vest in such Government upon dissolution and to the extent it distributes net earnings, such net earnings are distributed solely to such Government with *no portion of its net earnings inuring to the benefit of any private person.*

Besides, under certain conditions, if another entity is owned or controlled by these excluded entities to the extent of 95% or 85% of their value, then that entity is also an excluded entity. 'Value' is not defined.

Then what follows are the equally confusing charging provisions. What one can make out is that it is the ultimate parent entity of an MNE Group, that owns (directly or indirectly) an ownership interest in a low-taxed constituent entity *at any time during the Fiscal Year* shall pay a tax in an amount equal to *its Allocable Share* of the *Top-Up Tax* of that low-taxed constituent entity for the fiscal year. This is the famous *income inclusion rule*.(IIR)

The GLoBE income of each constituent entity is to be determined in accordance with the *financial accounting net income or loss* taken into account for preparing the consolidated financial statement of the ultimate parent entity. Some items like dividends and gains from shares, net tax expenses, gains on revaluation, if any, prior period errors and due to changes in accounting principles are to be excluded. Interesting to note is that there is a provision for *policy disallowed expenses* and the example given is that of illegal payments (bribes). There are complex provisions relating to adjustment of expenses relating to stock options. If transactions between group entities were not recorded at arm's length, necessary adjustments will have to be made. The GLoBE income or loss determined is allocated between a PE and the main entity in line with the local tax rules (whatever that means).

Having determined the income of the constituent entity, the total taxes paid have to be determined as laid down in chapter 4. In the OECD lingo, this is '*covered taxes*' and the '*adjusted covered taxes*'. Covered taxes will basically mean taxes on income or related taxes. There is an elaborate definition of the same in Article 4.2. The adjusted covered taxes will be *current tax expense accrued in the financial accounts* with some adjustments to take into account deferred taxes as well.

After completing this exercise, one has to then determine the effective tax rate paid in a particular jurisdiction by the MNC group. So, for this purpose, *the adjusted covered taxes determined for each of the entities in a jurisdiction will be aggregated and then divided by the net GLoBe income of all such entities in that jurisdiction.* Thus if there are two entities of the MNC group in a particular jurisdiction, one is in a loss another is in a profit, the figure to be taken will be after adjustment of the loss against the profit of the other.

There is also the provision for a *substance based exclusion* (which is a complex calculation representing an excluded routine return on tangible assets and payroll) from the net GLoBE income. This is important for *entities availing any tax incentives*. Essentially, this will reduce the GLoBE income by the *sum of the payroll carve out and the tangible asset carve out* for each entity in a particular jurisdiction excluding investment entities. The payroll carve out is normally equal to 5% of its eligible payroll costs of eligible employees and the tangible asset carve out is 5% of the carrying value of eligible tangible assets located in such jurisdiction. Of course, there are many riders included in rule 5. But, these rates change in case of a transition period of ten years on a sliding scale, starting from calendar year 2023 starting with 10% for payroll and then reducing each year by .2% Similarly, for assets, the rates start with 8% in 2023 and then keep sliding by .2% each year.

Ultimately, the *jurisdictional excess profit* which equals the jurisdictional GLoBE income reduced by *substance based exclusion* will be multiplied by the difference between 15% and the jurisdictional effective tax rate (ETR), giving us the jurisdictional top up tax. This will then be further reduced by any *qualified domestic minimum top up tax,* if any. (The Indian MAT)The top up tax of a constituent entity will then be determined by applying the formula – Jurisdictional top-up tax multiplied by (GLoBE income of the constituent entity/ aggregate GLoBE income of all constituent entities).

That is not all. There will be De Minimis exclusion for jurisdictions where the MNE has either an average GLoBE revenue of less than 10 million Euro or an average GLoBE income or loss of less than 1 million Euro computed *on a three-year average basis*. There will be further safe harbours apparently to limit compliance burden!

If your head is still not reeling, then read on. The ultimate parent entity of the group is responsible for calculating the top up tax for all the low-taxed constituent entities. There are separate rules for all kinds of scenarios including partially owned Parent entities. If the top up tax is not charged through the income inclusion rule or the income inclusion rule does not fully cover the same, then *the under-taxed payment rule* (UTPR) will kick in as a back-stop. Article 2.4 deals with the mechanism for the same and I reproduce the same.

"2.4.1 Constituent Entities of an MNE Group located in [insert name of implementing-Jurisdiction] shall be denied a deduction (or required to make an equivalent adjustment under domestic law) in an amount resulting in those Constituent Entities having an additional cash tax expense equal to the UTPR Top-up Tax Amount for the Fiscal Year allocated to that jurisdiction.

2.4.2 The adjustment mentioned in Article 2.4.1 shall apply to the extent possible with respect to the taxable year in which the Fiscal Year ends. If this adjustment is insufficient to produce an additional cash tax expense for this taxable year equal to the UTPR Top-up Tax Amount allocated to [insert name of implementing-Jurisdiction] for the Fiscal Year, the difference shall be carried forward to the extent necessary to the succeeding Fiscal Years and be subject to the adjustment mentioned in Article 2.4.1 to the extent possible for each taxable year.

2.4.3 Article 2.4.1 shall not apply to a Constituent Entity that is an Investment Entity."

Pure gobbledygook! That is not all. The OECD promises to provide us a Commentary on the various provisions in the near future. And then hopefully, the Indian tax administration will happily apply the same. Having taken credit for the current OECD work, it will be difficult to then take a different line. One has to still wait and see what actually transpires. But, let us end with describing how the OECD itself views the gains to the developing countries.

FAQ 2. *What are the benefits of the global minimum tax rules for Inclusive Framework members and what will be the impact on developing countries?*

"With a minimum effective tax rate of 15%, the GloBE rules are expected to generate around USD 150 billion in additional global tax revenues per year. This includes not only the revenues expected from the application of the rules themselves, but also additional corporate income tax revenues expected from the resulting reduction in profit shifting activity as a consequence of introducing the rules. A jurisdictional effective tax rate of 15% is a big step up from the historically often very low rates on foreign source income of MNEs.

The GloBE rules acknowledge the calls from developing countries for more transparent, mechanical, predictable rules to level the playing field and reduce the incentive for MNEs to shift profits out of developing countries. The GloBE rules are expected to reduce pressure on governments to offer wasteful tax incentives and tax holidays, while still providing a carve-out for certain income that arises from real substance. In addition to this, developing countries are expected to be able to further protect their tax base through the application of a treaty based Subject to Tax Rule (STTR) which will allow countries to retain their taxing right, which they may have otherwise ceded under a tax treaty, on certain payments made to related parties abroad which often pose BEPS risks, such as interest and royalties."

October 14, 2021; TIOL - COB(WEB) - 785

OECD-brokered Tax Order, yuck, Disorder Fiscal 'Squid Game' turns BEPS into 'TEBS'!

Shailendra Kumar
Founder Editor, TIOL

The fiscal bubble shell has burst! The G-7 sponsored fiscal 'Squid Game' played on the OECD (Organisation for Economic Co-operation and Development) turf is over! The 'Mission Bamboozle' stands accomplished with the signing of the OECD-piloted agreement for a New International Tax Order, yuck, Disorder! The final win goes to the club of rich and elite countries! Quite predictable! Never in doubt! But the bizarre news is - The 'bad apple' - the tax havens - in the orchard dizzyingly survives! More strangely and bemusingly, there was no thrumming and humming from the 'victims'! No ding-a-ling! Not even a bit of ding-dong battle!

Why? Was it because a handful of poor and developing countries were condescendingly picked up for various OECD working committees and they failed to sniff the spooky developments! Or, they could not grok the proposed changes lucidly enough, to stare down the barrel! It may also appear that the developing countries ended up being used as a cat's paw? Or, like death, final decisions entered the official communique quietly! Or, being in the know of the real intention of the elite club, they simply quit and ended up facilitating the rich countries to go cha-cha-cha! A long barrel of laugh at the cost of revenue-starved poor and developing countries, *voila*!

Anyway, a history - made of doomy stuff, bad in taste & zombie in effect - was 'sealed' last Friday in Paris and now vetted by the G20 finance leaders in Washington yesterday. It was certainly not whiggish inevitability - victory of progress over status quo-ist! In the run-up to the sealing of the deal, a facade was successfully created, thanks to the refined gimmick like the Base Erosion and Profit Shifting (BEPS) Project which has now put on the 'tattered' attire of TEBS - Trust Erosion & Benefit Shifting Project! The charades stand unmasked, completely! The oft-solemnised slogan of 'Race to the Bottom' has come to be treated like a week-old fish! Rather than stymieing it, the OECD new tax order has ended up gifting a new 'bottom' or a bottom with a reasonably decent depth! This is what 15% global minimum corporate tax rate promises to the countries dubbed as tax havens! Let's recall the first list of EU members which threw tantrums at signing the agreement - Ireland, Hungary and Estonia.

Ireland, in particular, was pivotal for the US as it had ascended to the status of a favourite second home for many American tech giants - clearly a brazen loss of

revenue for the US treasury. Since the rich countries have, post-economic meltdown, run into much grimmer fiscal deficits, the COVID-19 besides and needed higher tax collections to fuel their economic growth, they wanted a new international tax order more desperately than the developing and poor economies. For the intransigent US, every deal was largely a 'Golden calf' unless Ireland was a part of it. The OECD was given this secret mission to cajole Ireland into the deal at any cost! And the OECD did not despair its back-slapping master. It accepted Ireland's demand at the cost of poor countries to raise the threshold for exemption - finally, USD 868 million, leaving a large swathe of Irish companies outside the sweep of the new tax regime. As per some studies, the new tax rate of 15% would only apply to 56 Irish MNEs with about one lakh employees and 1500 foreign MNEs. The prevailing rate of 12.5% will continue to apply to smaller Irish companies.

Ireland was also the one which insisted on deleting the expression 'at least' 15% floor rate. Initially, the widespread speculation was that it would be anywhere between 15% and the Global Intangible Low-Taxed Income (GILTI) rate of 21% but Ireland was simply adamant on nothing above 15%. Even 15% floor rate with high turnover threshold which brings only about 100 MNEs under the fold of new tax order, was good enough for the angst-ridden US as most of these MNEs which make embarrassingly abnormal profit, are residents of America but were parking their profits in tax havens because of high corporate tax rate of 37% in the US. Mr. Trump was the one who slashed it to 21% which Mr. Biden is now trying hard to spike it to 28%. The US was largely focussed on mopping up extra revenue from its own MNEs which, as per one study, have been parking 40% of their profits in tax havens. So, if the floor rate is fixed at 15% with a string of top-up tax in the home country, it would enable the US to collect a major chunk of extra revenue being projected by the OECD under the new tax regime. Critics estimate that almost 60% of OECD-projects gains would be treasured by the rich countries.

In fact, the story was not much different for the EU too as a good number of European MNEs also followed the clichéd route of parking profits in tax havens - assigning intangibles to subsidiaries located there. Out of the global corporate profits of about USD six trillion per annum, about 40% is parked in low-tax jurisdictions like Ireland, Luxembourg, Singapore, Hong Kong, the Caribbean Islands and the British dependencies like the Virgin Islands. Since the 15% floor rate made some hefty sense for the elite club and also a much-disputed beginning of a new tax order in the present digitalised world, most rich economies simply played squint to the needs of the poor and developing countries.

African countries are right when they say that as against nine per cent corporate tax share in total tax collections in the rich world, it is 19% for them as per 2017 data. Thanks to the COVID-19, the corporate tax has ascended in its heft as a potential source of higher revenue collections in the coming years. The tale is no less pale for the Asian and Latin American countries which have huge dependence on corporate tax collections to bankroll their developmental programmes. Then comes the knock-on effect of lower floor rate on existing corporate tax rates in poor and developing countries. They are going to be compelled to reduce it if wooing FDI is one of their priorities! Secondly, it would be naive to believe that it would not have a butterfly effect on the domestic taxation rates. The Argentine Economy Minister cannot be faulted for his observation - Developing countries were forced to choose between 'something bad and something worse'!

The US, albeit armed with the fiscal '*batterie* de cuisine', was so desperate and also scared of no-deal-scenario as it feared a new trade sparring with its own allies like France and UK that even Hungary, a low-tax jurisdiction, also extracted its own pound of flesh from the deal. It forced the OECD to agree to its 10 years phase-in period for the changes rather than 5 years as proposed - a gaping loophole for tax havens to exploit it with impunity! About 48 hours prior to the OECD meeting, the US Treasury Secretary Yellen is reported to have spoken to Estonian Finance Minister to board the OECD bus. Then, a 'black box' reaction! No heed was paid to the odd four who declined to sign the agreement - Sri Lanka, Kenya, Pakistan and Nigeria. Rubbing salt to the wound is the provision of a binding and non-optional dispute resolution process to reassure MNEs that they will not be taxed many times over. A much-feared Gordian knot for the MNEs!

On Pillar one issue, the OECD has come under heavy artillery fire for proposing a fiddly and poppycock calculus to tax super-profit above 10% margin of barely 70 MNEs. Though the OECD paper promises a slice of profits to market jurisdictions but such a slice is not going to be more than a piddly sum - a candy, perhaps! It was also a well-thought strategy to concentrate all attention on tech titans and let others like pharma MNEs escape the radar of sledgehammer. On top of all these, extractives and regulated financial services companies have been kept outside the purview of digital tax. But why? There is no plausible rationale, nor explained by

the OECD! However, any levy on digital income is to be rolled back after the new tax regime comes into play in 2023. However, the Chair of the G20 finance leaders summit at Washington yesterday, the Italian Economy Minister, said that no time limit is finalised for withdrawal of existing digital service tax and Italy may do it not before 2024! Italy collects USD 290 million annually from digital services.

To say the least, I strongly feel that neither the fixing of the floor rate of 15% nor the digital tax solution is going to promote fiscal harmony in the new tax regime peddled by the OECD. The floor rate of 15% is too low to make any meaningful dent into the majestic edifice of tax havens which have deliberately been given an extended lease of life. The race to the bottom to attract investments would continue unabated and MNEs would have wooing tax schemes stitched by the tax havens to park their super profits there. The much-vaunted goal of guillotining harmful tax competition has been short-changed by the new international tax order which is destined to go for 'reconstruction' much sooner than the rich world may expect! The BEPS finally turned out to be a boondoggle project for the poor and the developing world! Time to say goodbye to OECD and labour hard to carve out a comprehensive tax forum at the United Nations which is also rapidly turning into an outlived international body!

October 7, 2021; TIOL - COB (WEB) - 784

OECD-brokered Digital Tax
Doctrine of Pity & Pittance at Play for Non-rich!

Shailendra Kumar
Founder Editor, TIOL

The Pandora Papers amounting to 12 million documents and files, leaked from 14 financial firms dealing with offshore tax jurisdictions, may have exposed the purchases of exotic real estate of at least 35 current and former political leaders but, more than anything else, the 'Pandora's box' has only beamed flashlight on the festering malaise of the extant international taxation order! The rickety and chunky international tax system of more than 100-year-old now tends to embody too many inherent systemic and shambolic frailties including tax avoidance which appears to be the key theme of the latest *exposé*!

The tax havens or secrecy jurisdictions, numbering about 50, have survived and thrived only with the tacit consent of the rich economies. A good number of them have physical proximity to their key financial centres such as London. The rich and famous and plutocrats in the elite and powerful countries who make generous political donations, do need such 'secrecy jurisdictions' to park even their tax paid wealth and they create letter-box companies for the privacy and security reasons!

A large swathe of political leaders and billionaires from developing and poor countries avail the services of such tax jurisdictions either to park corruption money or income subjected to stiff tax rates. Legal structures like Trusts and Foundations sumptuously aid them in accomplishing their 'jihadist' missions! Interestingly, all such tax havens are not offshore. For instance, Nevada and South Dakota in the US luxuriously peddle secrecy through Trusts and offer ghoulish relish to the wealthy across the world! The Pandora Papers have unmasked nothing new except a few dozen names and are certainly not the last in the series! More such tales of hooding wealth would unfold in the future and they cannot be completely geo-fenced by the market-driven Governments!

In the context of global Multinational Enterprises (MNEs), tax avoidance sparking profit-shifting to low-tax jurisdictions and base erosion in the hapless market economies has been a major apple of discord among the world leaders. It all started in 1990s - the cliff for the forces of globalisation. And it continued unabated to such an extent that MNEs began to game the international tax rules amounting to double non-taxation! And the famous victims were both - the home as well as the market economies! It took inordinate amount of time for the rich and developed economies to admit that the single pillar 'constructed' with the 'Fixed Place' bricks, of the International Taxation edifice, negotiated by the League of Nations, stands corroded and dilapidated for the prevailing digital business eco-system in the world!

Digital data has indisputably established itself as one of the most spurring factors of production to ensure higher profitability of a global enterprise. The digital service providers and technology companies have emerged as the vanguards of global economic growth in the 21st century. The turnovers of many of them are far greater

than 88 per cent of sovereign territories. The COVID-19 which may be widely viewed as a ruthless scourge, has further accelerated the digital transformation of the global economy. For the US, its share has grown almost at par with the share of its manufacturing sector in the GDP. Similarly, China has also reaped humongous benefits out of rapid digitalisation of its economy. The digital economy now accounts for almost 15 per cent of the world economy - Worth over USD 15 trillion. Indeed, a major source of tax revenue for many populous and internet-intensive developing countries.

However, a change in the international taxation framework was always short-circuited by the US - the home of GAFA (Google, Apple, Facebook and Amazon)! If we add Netflix and Microsoft, it has come to be dubbed the '**Silicon Six**'! The US always put a spoke in the wheel of change demanded by the developing countries. A trade war spun out when many European economies unilaterally decided to impose Digital Service Tax. India too levied Equalisation Levy. And it sparked much wailing and gnashing of teeth in the form of section 301 Investigation. The US viewed such levies as a bid to wrong-foot its large technology titans. However, these measures did succeed in pumping hot air into a 'perfect storm' and the US under the Biden Administration, decided to go with the views of other members of G-7 which in July month mandated the Organisation for Economic Co-operation and Development (OECD) to construct a new taxation order on two pillars - Pillar one to tax the digital services and Pillar two to fix the floor for global minimum tax - anything but not less than 15 per cent of corporate tax. The OECD is, molecularly speaking a club of rich nations and it does subserve its masters very loyally and efficiently! If a developing or a poor economy expects any shade of fairness in the solutions 'sledgehammered' by it, it would amount to immodesty on part of the 'victim' economy to blame OECD, yuck!

Anyway, let's fly down to Paris where OECD is literally sweating it out in 'litres', perhaps with a shade of morbidity, to break the ice over many cumbersome technical issues teetering in balance for several years! Its SWAT teams of negotiators are arguably operating within the letter, if not the spirit of a new treaty-in-the-making! At the back of its mind, it has the deep-seated fear of its solutions being subjected to blows of cold winds! It has a fright about its solutions which may feed frenzy and cut a wide swath among the developing countries. Interestingly, non-rich countries also appear to be getting frazzled to further study the enigmatic calculus of profit A, B & C which entail six-step complex computation formula to arrive at some tangible sum[1]. And it may, at best, add up to ONE PER CENT of a country's corporate tax collections. This is as per widely reported interview in the Indian Press, of Mr Pascal Saint-Amans, the Director at the Centre for Tax Policy and Administration of the OECD. The reported gain of one per cent would boil down to barely Rs 4500 Crore for India whereas its restrained Equalisation Levy mops up close to Rs 2000 Crore.

Anyway, India would not mind sacrificing some revenue for the larger jihadist cause of building a New International Tax Order provided it is laid on a strong foundation of non-discrimination and fairness. The UN Report on digital taxation has rightly discussed - Why the new levy be restricted only to 100 top MNEs? How would such a high threshold of Euros 20 billion serve the interests of developing countries? Why should OECD compartmentalise profits as A, B & C and that too, only above 10% margins! Secondly, OECD has its eyes fixed on arbitration clause in tax matters, the scent of which a small economy may not tolerate as it nibbles into one's sovereignty! The UN Tax Committee has approved insertion of Article 12B on taxation of digital economy and a simple and neat method has been prescribed in its Model Tax Convention.

Notwithstanding many loopholes in the OECD-hammered two-pillared and much pilloried solutions, most poor and developing economies are likely to sail with the arm-twisting rich countries or simply being geopolitical acolytes of many of them. Certainly not out of naivety! Aha! Yet another reason could be - A pound of flesh is better than aplenty which may not be realised in the near future! Perhaps, the burden of fair expectations has become tiresome and tasteless - Cooling heels for years is indeed painful! That is why they may simply roll with the punches! However, such a solution which may be reviewed only after seven-long years as per the proposal, may suffer wanton cracks much before its first official review as it is going to be premised on jarringly blurred truths!

So far as the Pillar 2 negotiation goes, the floor rate is likely to be set at above 15% but this is to be seen how the US rejigs its tax regime - 21% tax rate under Global Intangible Low-Taxed Income (GILTI) and 28% corporate tax for which the daggers are out between the Democrats and the Republicans. Given the unskirted fact that bipartisan support would be missing for the solutions being hammered out by the OECD, the US Senate is unlikely to approve the new treaty in the near future! Similarly, the ambitious time-frame of 2023 for implementing the new rules may prove to be tougher than climbing a steep cliff if one goes by the Statements of some of the Finance Ministers of EU Member countries. For instance, the Swiss Finance Minister said early this week that 2023 may be too early in view of the time-consuming legal process in Switzerland! I sincerely hope that if a history is on the cusp of being tailored by the OECD, let it be premised on the strong foundation of fairness and mutually serving principles so that the revision of such a history is not warranted too soon!

[1] TII Edit by Mr. D P Sengupta - International tax reform - India should be careful.

August 02, 2021

International Tax Reform
India should be careful

D P Sengupta
Consulting Editor, TII

July 2021 may go down as a momentous month in the annals of international taxation. According to the OECD, on July 01, 2021, 130 members of the so-called Inclusive Framework issued a statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. It is very unlikely that the statement, a 5-page legalese full of acronyms had any significant input from most of the members from the developing countries of the framework. Obviously, it is the handiwork of the OECD Secretariat, which has virtually taken over the work in this area of taxation which is essentially a political exercise of the member nations as represented by their delegates.

The project started in the OECD in response to the outcry of the European countries when the news media started educating the public about the unfairness of the current international tax architecture that developed exactly 100 years ago also as a response to the devastation caused by the rich nations fighting with each other to control the colonies, which are now known as developing countries. In practice, when the work started, it ended up pitting the American digital giants against the European countries.

To have a greater purchase and also to increase the role of the OECD, the project was subsequently renamed the G-20/OECD project. Yet, it is the G-7 , led by the USA that seems to have taken the lead subsequent to the regime change in the USA. Under President Trump, USA had virtually withdrawn from the project. Even under President Obama, the USA's engagement was more in the nature of creating roadblocks. It is because of the US resistance that other nations could not go ahead with the work on the important area of digital taxation. Now, the USA is back and seems to be pushing others to do its dirty job of ensuring that its multinationals do not park funds outside. The US participation in the project is good and welcome but that does not mean that the US exceptionalism as displayed throughout the BEPS project is going to disappear soon.

The G-7 Finance Ministers' communiqué issued on June 05, 2021[2], in paragraph 16 states as follows:

"16. We strongly support the efforts underway through the G20/OECD Inclusive Framework to address the tax challenges arising from globalisation and the digitalisation of the economy and to adopt a global minimum tax. We commit to reaching an equitable

[2]Available at https://www.gov.uk/government/publications/g7-finance-ministers-meeting-june-2021-communique, accessed on January 18, 2022.

solution on the allocation of taxing right s, with market countries awarded taxing rights on at least 20% of profit exceeding a 10% margin for the largest and most profitable multinational enterprises. We will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes, and other relevant similar measures, on all companies. We also commit to a global minimum tax of at least 15% on a country by country basis. We agree on the importance of progressing agreement in parallel on both Pillars and look forward to reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors."

The statement so released created an expected flutter all around the globe and various news media and channels kept discussing the historic announcement. Particularly important was the first reference to the quantum of the so-called amount A representing the share of market economies in the total tax pie from a multinational. In other words, the re-allocation of taxing rights amongst countries. However, the scope of the companies to be covered was modified in the new measure was to apply to most profitable MNCs, not merely the digital and consumer facing ones. This is in line with the US position of restricting the application of the new rules to 100 most profitable companies around the world. It was announced that this will be accompanied by the removal of all digital service taxes levied by a proliferation of countries, India being the first one with its equalisation levy. This was another key demand from the USA.

Subsequently, the US Treasury Secretary who is taking a lot of interest in this area, issued a statement on June 5, 2021 as follows:

"The G7 Finance Ministers have made a significant, unprecedented commitment today that provides tremendous momentum towards achieving a robust global minimum tax at a rate of at least 15%. That global minimum tax would end the race-to-the-bottom in corporate taxation , and ensure fairness for the middle class and working people in the U.S. and around the world. The global minimum tax would also help the global economy thrive, by leveling the playing field for businesses and encouraging countries to compete on positive bases, such as educating and training our work forces and investing in research and development and infrastructure ."

This was followed by the G-7 leaders meet in London on the 13th June. The communiqué issued on that occasion, in paragraph 22 stated as follows:

"We need a tax system that is fair across the world . We endorse the historic commitment made by the G7 on 5 June. We will now continue the discussion to reach consensus on a global agreement on an equitable solution on the allocation of taxing rights and an ambitious global minimum tax of at least 15 per cent on a country-by-country basis , through the G20/OECD inclusive framework and look forward to reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors. With this, we have taken a significant step towards creating a fairer tax system fit for the 21st century , and reversing a 40-year race to the bottom . Our collaboration will create a stronger level playing field , and it will help raise more tax revenue to support investment and it will crack down on tax avoidance."

The two statements read together show a new element being brought in the now decade-long discourse of taxing the digital multinationals- prevention of the race to the bottom in the matter of taxation. A global minimum tax in the form of a modified Global Intangible Low-Taxed Income (GILTI) of the USA was under consideration as pillar 2 but there was no consensus on the exact minimum rate. That seems to have been settled by the USA for the rest of the world at 15%.

But this was a G-7 proposal and people doubted if the other influential members of the G-20 and other members of the developing countries would actually join in. Then, the statement on behalf of the Inclusive Framework was issued by the OECD on July 01, 2021. Surprisingly, the list of 130 countries who apparently issued the statement out of the 139 member countries of the Inclusive Framework also included India and China. In fact, it is some of the members of the developed world and OECD member countries such as Hungary and Ireland that disagreed.

Nevertheless, the G-7 view was also was also endorsed by the G-20 Finance Ministers. Although a bit guarded, the Communiqué stated as follows:

"After many years of discussions and building on the progress made last year, we have achieved a historic agreement on a more stable and fairer international tax architecture. We endorse the key components of the two pillar s on the reallocation of profits of multinational enterprises and an effective global minimum tax as set out in the "Statement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy" released by the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) on July 1. We call on the OECD/G20 Inclusive

Framework on BEPS to swiftly address the remaining issues and finalise the design elements within the agreed framework together with a detailed plan for the implementation of the two pillars by our next meeting in October. We invite all members of the OECD/G20 Inclusive Framework on BEPS that have not yet joined the international agreement to do so. We welcome the consultation process with developing countries on assessing progress made through their participation at the OECD/G20 Inclusive Framework on BEPS and look forward to the Organisation for Economic Co-operation and Development (OECD) report in October."

Before discussing the contours of the proposal, it will be apt to note that by endorsing the G-7 position without any questions, the G-20 seems to have surrendered its initiative and the final outcome will hinge on an agreement between the USA and the European Union members with the rest of the world made to follow the rules formulated by them and the OECD will continue to rule the roost. So much for the new international tax order and nothing seems to have changed over a century in that regard.

We may now see what exactly the Inclusive Framework statement actually proposes. Even though multiple details are yet to be sorted out, what is already there is not much encouraging from the perspective of developing countries like India.

The first thing to note is that the number of Multi-National Companies (MNC) actually targeted by the new rules of distribution of taxing powers in respect of the residual profits of a company, will be handful in that only those with global turnover above 20 billion euros and having a profitability above 10% will be in scope. The profitability threshold will be reviewed after 7 years and may be reduced to 10 billion euros if the programme is successfully implemented. Profitability here means profit before tax/revenue. The crucial question as to which profit – book profits or profits as per some standards or profits for tax purposes remains unanswered as yet. In a subsequent paragraph, it has been mentioned that the relevant measure of profit or loss of the in-scope Multi National Enterprises will be determined by reference to financial accounting income, with a small number of adjustments and that losses will be carried forward. Again, financial accounting norms differ amongst countries and companies. One is not sure how the reconciliation will be done. The initial loss-making digital companies that burn money to capture markets will benefit.

Extractives and Regulated Financial Services stand excluded. While extractives have been excluded apparently in the interests of the developing countries, there is no explanation. Similarly, one does not know about the financial companies. Reports by advocacy groups indicate that banking and financial companies make the maximum use of paper companies in tax havens.

The additional amount A will have to be divided amongst the jurisdictions in which the MNC operates. Therefore, a so-called special purpose nexus rule has been devised as a derogation from the ordinary OECD PE nexus rule. To be applicable to it, the MNC concerned must derive at least 1-million-euro revenue from that jurisdiction. For countries with GDP lower than 40 billion euros , this will be set at 250,000 euros. India's current GDP is roughly 3 trillion dollars. So, the MNC concerned must have revenue from India of 1 million euros or above to be in scope. What happens if it is just less than 1 million? One does not know.

Coming to the quantum of revenue that will be divided, it is stated to be between 20-30% of the residual profits that is in excess of 10% of revenue. This will be divided amongst the eligible jurisdictions using an allocation key based on sales.

Although it is not very clear, there is a further limitation in case the residual profits of an MNC are already taxed in a jurisdiction. There will be a safe harbour in this regard, yet to be worked out. Residual profits of MNCs are now taxed only by the home country. So, this limitation will perhaps be meant for them.

A few other important elements in this sketchy document need special mention. Apart from a promise of finishing the work in respect of Amount B of the blueprint representing a routine allocation using traditional Transfer Pricing methods in respect of marketing and distribution activities for "low capacity" countries, there is no more details. Thus, work on this seems to be clearly separated from the work on Amount A.

A few more areas need special attention before the developing countries including India join the bandwagon, hypnotised by the hype generated in the news media about a global minimum tax.

The concession to market countries in respect of a greater allocation of taxing right in respect of a tiny fraction of the residual profits is supposed to be a package deal . The so- called minimum tax is not part of that package. Thus, agreement in respect of amount A will be signed in 2022 and implemented through a new MLI. But the one of the important aspects of the package is that unilateral

measures like the digital service tax and equalisation levy will have to be abolished.

In this connection, as many commentators have already pointed out, only residual profit in excess of 10% of the revenue is available for taxation. Thus, if the MNC's profit from India is 15%, then 10% of the same is taken out, leaving 5% of the profit and 20% of the same will amount to 1% of the revenue and 30% will amount to 1.5% available for tax in India and India will also have to abandon its EQ levy which is 2% or 6% of total revenue. Besides, equalisation levy is not restricted to only 100 odd companies that the OECD proposal envisages. Therefore, it seems there will not be any gain and in fact, India may lose out.

An additional point to be noted is that the package will apparently be implemented through an MLI. One should note that the USA has not signed the MLI and there is little chance that any other international agreement will pass through the dense system of the USA. Therefore, India should not rush in for signing on to this agreement.

Leaving the discussion on the minimum tax for the time being, we should note another dangerous point which is lurking under the caption - Tax Certainty.

"In-scope MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double taxation for Amount A, including all issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and binding manner. Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism.

Consideration will be given to an elective binding dispute resolution mechanism for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of MAP disputes."

Developing countries have consistently opposed the proposal of mandatory and binding arbitration. Yet the Inclusive framework which comprises mostly developing countries apparently working on 'equal footing' agreed to include in the statement such a proposal with the only exception of the omission of the word arbitration. Tax is a sovereign right of a country and dispute resolution in such matters will have to be found within the domestic system including the tax treaties. It should not be subject to scrutiny by any outside agencies. The OECD has proposed some kind of a panel. But in all likelihood the OECD view will dominate in such mattes, if one considers the recent Supreme Court decision in Engineering Analysis case.

Apart from anything, India should learn from its experience in joining arbitration proceedings in Cairn/ Vodafone. It has been reported that in the Cairn case, the arbitrators charged @ 750 USD/ hour- not day. The total cost of the Tribunal and administrative costs alone in this case was more than 40 lakh dollars.

That brings us to the second pillar of a global minimum tax which has caused such a brouhaha over the world. First thing to note is that it is essentially a rehashed version of the American GILTI renamed as GLoBe (Global anti-Base Erosion Rules) by the OECD. There are several points to note about the second pillar. Most important one is that it is not compulsory for the IF members to sign up. But those that will sign up will have to abide by the OECD rules. Second, and this is more important from a principled point of view, there is a specific exclusion for the USA as is evident from the heading:

GILTI co-existence

"It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GloBE rules, to ensure a level playing field."

Multinationals park their most valuable intangibles in subsidiaries formed in low or no tax jurisdictions and all income emanating from the exploitation of the intangibles get accumulated there and under the extant CFC rules, are not chargeable to tax till the money is repatriated. This is the essence of the OECD BEPS project's origin. If we cut through the clutter of the verbiage used by the OECD, it essentially allows the home country jurisdiction to charge an additional tax on the difference between the tax paid by such subsidiaries and a global minimum tax that has now been agreed to at 15%. The statement clarifies that it is the effective tax rate and not the statutory tax rate of a country that will be considered.

So, how does it benefit the maximum number of the members of the Inclusive Framework? If at all, it may hamper the power of developing countries to fashion their tax policies to attract investments. One must also realise that there is a mushrooming of SEZs across the world including in the developed world such as the UK. The effective tax rates for companies set up in these jurisdictions will be much less than 15%. So, essentially, there will be a transfer of revenue from such countries to the rich countries.

It is true that tax havens have proliferated and low or no tax in those jurisdictions help in draining resources from the developing countries. If a minimum corporate tax of 15% is levied by everybody, then their existence may be threatened. But, here also, one of the main reasons of the existence of these havens is the ease of formation of entities and the anonymity that they provide to transactions carried out through these jurisdictions. These havens were created by the developed economies to facilitate the expansion of their subsidiaries throughout the world. It is therefore unlikely that they will just go away.

From the revenue point of view, what then is left for the developing countries? Well, the carrot seems to be in the form of a subject to tax rule (STTR) that will allow the source countries to a limited taxation right should some payments relating to interest, royalties and yet to be defined, defined payments are not taxed or taxed at below the minimum rate of 15% by the residence jurisdiction. The taxing right for the source country will be limited to the difference between the minimum rate and the tax rate on the payment. The minimum rate for the STTR will be from 7.5% to 9%.

Of course, there are exclusions from the applicability of the proposal. The threshold here is the same as for CBC reporting -750 million euros. Thus, more companies will come under its ambit. Of course, there are exclusions here also. Shipping companies are excluded as are government entities, non-profits, international organisations, pension or investment funds.

All in all, it seems that what started with a bang in 2012 in the name of international tax reform is going to end in a whimper in 2022. India, which is stated to have played an active role in the Inclusive Framework, should be very careful in evaluating the benefits of such a reform before signing on.

July 13, 2021

OECD's Double Standards on Race To Bottom on Direct & Indirect Taxes

Naresh Minocha
Consulting Editor, TIOL

It is time to straighten out the idiom –"Heads I win; tails you lose". This expression should now be reworded as: Head I win; tails I win too in the global taxation arena. The trigger for this forthright message is the Group of seven rich countries (G7's) latest success to revise rules of the game in globalized economy to suit its interests.

The G7 oversaw Organisation for Economic Co-operation and Development (OECD) into clinching a global lop-sided tax reforms pact on July 01, 2021. Lop-sided because it is silent on certain developing countries' 15-years quest to levy customs duty on digital transmission of specified products.

The dichotomy in reforming global direct taxes and indirect taxes has become sharper and alarming after this agreement. More on this delayed indirect taxation reforms a bit later.

The agreement, among other things, moots 15% global minimum corporate tax (GMCT) on multinational Corporations (MNCs) of specified size in e-commerce domain. The preliminary pact is titled ' Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy '.

Issued by the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS), it is signed by 130 countries out of 139 IF members. Peru later became the 131st signatory.

G20 Finance Ministers & Central Bank Governors have dubbed OECD pact as "historic agreement on a more stable and fairer international tax architecture ".

In Communiqué issued after 2-days meeting ending 10th July, they endorsed the key components of the two pillars on the reallocation of profits of multinational enterprises and an effective global minimum tax.

They urged IF to swiftly address the remaining issues and finalise the design elements within the agreed framework together with a detailed plan for the implementation of the two pillars by our next meeting in October. They invited remaining members of IF to join the agreement.

One of the core objectives of this pact is to regulate direct tax competition. It wants to stop the ' race to the bottom ' (RTTB).The unstated objective is to moderate the investment flows to capital-deficient developing countries. The 15% GMCT net is likely to be cast wide to cover all sectors and all MNCs over the medium to long term.

There is nothing wrong in moderating corporate tax

competition for attracting investments, creating jobs and generating tax revenue for financing governance requirements including citizens' welfare. The concern over RTTB, however, appears hollow as it is well-entrenched in the field of the customs duty.

Import duties on thousands of products have touched rock bottom through pacts guided by World Trade Organisation (WTO) and through regional & bilateral free trade agreements (FTAs). This has impacted local manufacturing, jobs creation and customs revenue in developing countries.

Zero-import-tariff regimes hardly enable capital-deficient developing countries to enter into new manufacturing activities or scale up existing economic operations to ramp up their exports.

OECD agreement has dampened prospects of lifting WTO's 1998 moratorium on levy of customs duty on products such as software, films and music, 3D printing and other formats of electronic transmission (ET). These products attract import duty when they are shipped as compact disc, cinematographic films, books and video games, etc.

Mooted by the US in 1998, the Moratorium, has been extended regularly, due to inordinate delay in reaching an accord on levy of customs duty on digital transmission of products. The last extension was agreed by WTO's General Council on December 10, 2019.

WTO's Council on Trade in Services addressed the WTO work programme on e-commerce at its meeting on July 01, 2021. At the conference, a few members articulated their "well-known and divergent positions regarding the moratorium", according a WTO document.

At earlier Ministerial Conferences, members had agreed not to impose customs duties on electronic transmissions. The current extension of the Moratorium runs until the 12th Ministerial Conference. It will be held at Geneva during four-day period ending December 03, 2021.

It is here pertinent to note that India and South Africa had proposed lifting of moratorium in a submission made in 2018. At WTO webinar on CSs on ETs held in July 2020, Prof. Abhijit Das, Indian Institute of Foreign Trade stated: "Removal of Moratorium is important for developing countries from many perspectives, including giving a boost to government revenue as well as for giving fillip to domestic producers of intangible goods ".

Similar concern has been elaborated well in a research paper (RP) captioned ' Moratorium on Electronic Transmissions: Fiscal Implications and Way Forward 'published by United Nations Conference on Trade and Development (UNCTAD) in June 2020. It notes that upcoming or fast-growing new digital technologies such as 3D printing have the potential to "exponentially expand the trade in ET".

As put by RP, " The on-going trend shows that the use of 3D printing is growing very fast and the industry has expanded by 62% in 2019 since 2017. 3D printing has adversely impacted the export competitiveness of the labour abundant countries, shifting the comparative advantage towards capital abundant countries ".

RP adds: "It is therefore urgent for developing countries to support the removal of the moratorium in order to preserve their policy space for regulating the imports of luxury items and generating tariff revenues at the time of crisis. This will also assist their digital advancement by providing a level playing field to their budding digital industry ".

It has proposed a basis for deciding the scope of the Moratorium by using the trichotomy of goods, intangible goods and services. Adopting different classifications of ET, it has estimated the potential tariff revenue losses due to moratorium.

UNCTAD RP and other such works should be considered by IF while sorting out other unspecified issues relating to OECD pact. Even International Chamber of Commerce (ICC), which wants 1998 Moratorium to become permanent feature of digital trade, wants OECD to take call on indirect taxation.

ICC has, however, raised a panic call on the risk of withdrawal of moratorium. An ICC release, dated September 17, 2019, quoted its Secretary General John W.H. Denton AO as saying: "The possible expiry of the moratorium on customs duties on electronic transmissions looms like an iceberg in the already treacherous waters of international trade. The potential disruptions caused by the imposition of tariffs on data could far outweigh any impacts we've seen from recent protectionist escalations. It is vital that governments address this issue with the urgency and attention it requires ".

In an accompanying RP, ICC stated "The moratorium on customs duties on electronic transmissions ("moratorium") has become an indispensable aspect of the modern trading system and a central piece in the 70+ year long-term trend towards an international trading system as free as possible from barriers to the global exchange of goods and services. It is now time to make

the Moratorium permanent by prohibiting customs duties and formalities on electronic transmissions ".

Like ICC, other stakeholders aligned to Western economic interests have lobbied for regularizing the moratorium to help the advanced countries ramp up export of digitalised products.

The Washington-based 'The Software Alliance/BSA' strongly pitched for continuation of Moratorium. In a position paper issued in October 2019, BSA said: "growth and innovation is threatened as countries are considering terminating this agreement and imposing – for the first time ever – customs duties on software, music, film, and other digital products and services transmitted electronically over computer networks. Such duties jeopardize US jobs and exports".

OECD has implicitly favoured continuation of Moratorium in a policy paper on Moratorium debate released during November 2019. The RP says: "careful consideration to all these issues, and not just revenue implications, should be given when thinking about whether or not to extend the Moratorium ".

It adds: "countries may also wish to think about the broader economic benefits that arise from the Moratorium. This includes lower prices for consumers (on whom the costs of tariffs fall), and greater export competitiveness. This broader view of costs and benefits allows for a more holistic understanding of countries' interests in the Moratorium, than a focus on estimates of lost tariff revenue alone ".

An irony in global minimum corporate tax (GMCT) on e-commerce MNCs is the zero duty on hardware and software that go into manufacture information, computer and telecom (ICT) products under WTO's Information Technology Agreement (ITA). ICT is engine of digitalized economy.

How is that RTTB is good under ITA & its ilk when the foremost concern today is to raise tax revenue to finance recovery of economy ravaged by Covid-19 pandemic? ITA would be reviewed by WTO Committee of Participants on the Expansion of Trade in Information Technology Products in September 2021.

An ITA-related agreement is 'Trade and Investment: Multi-Chip Integrated Circuits' (MCICs). It provides for duty-free treatment to MCICs, the building block of digital products. It was signed in 2005 by The United States, the European Commission, Japan, Korea and Taiwan in 2005.

MCICs agreement was arrived at under another group of these nations/jurisdictions. Named the Government/ Authorities Meeting on Semiconductors (GAMS), China is sixth signatory to this arrangement. "National/ regional industry associations may become members of the WSC only if their governments have eliminated", says a document hosted on the website of United States Trade Representative (USTR).

RTTB in customs duty extends to several other sectors. A notable case in point is 32-nation Agreement on Trade in Civil Aircraft (Aircraft Agreement). It mandates signatories to eliminate tariffs on civil aircraft, engines, flight simulators, and related parts and components, and to provide these benefits on a non-discriminatory basis to other signatories.

According to USTR, the signatories have agreed provisionally to provide duty-free treatment for ground maintenance simulators, although this item is not covered under the current agreement. " It entered into force on January 1, 1980, and is one of two WTO plurilateral agreements (along with the Agreement on Government Procurement) that are in force only for those WTO Members that have accepted it ".

Yet another RTTB case in point is the 1994 Agreement on Trade in Pharmaceutical Products under WTO. Under this sectoral pact that has been expanded after periodic reviews, signatory countries agree to abolish import duties on all bulk drugs and their formulations. The customs duty elimination also covers over 7,000 active ingredients & related chemicals used in pharmaceutical supply chains.

Pharmaceutical Imports have grown by almost 14 per cent over the last 20 years, with imports valued at more than US$ 350 billion in 2018. Trade in pharmaceutical active ingredients and chemical components has also grown steadily. " Obtaining tariff and import statistics for these products can be a complex exercise ", says a WTO brief.

One can cite more instances of how G7 and other relatively well-placed nations have worked for zero-duty or low-duty regime to pries open markets of developing countries.

Time has come to end RTTB in both direct and indirect taxation domains to create level-playing field for all countries. Without level-playing field, recovery from unsustainable debt and pandemic would be uneven. The risk of debt-triggered financial meltdown of global economy would remain strong.

March 24, 2021

Pitfalls of the Platform Economy

D P Sengupta
Consulting Editor, TII

In recent days two decisions were rendered relating to the status of gig /platform workers. Both relate to the cab hailing App Uber. One of them rendered by the UK Supreme Court is path breaking and is making waves across the world. The other rendered by an Indian Tribunal follows the beaten path. Although the context of the decisions was different, they do show different approaches to interpretation in assessing the realities of the changing models of doing business.

Coming to the UK decision, the question before the Court was whether drivers working for Uber were entitled to the various labour protection laws that apply to workers. Considering that there is growing outsourcing of work model, the judgement is important for establishing a modicum of protection to the increasing number of workers engaged in the informal work.

Getting around the tax laws and taking advantage of the unworkable rules of international taxation is the hallmark of the new digital multinationals and has been exposed over the years since the financial crisis resulting in the yet-to be finalised rules on digital taxation. The UK decision lays bare that these companies are equally adept in circumventing laws and regulations in other areas as well.

In the Uber UK case, the judgement of the Supreme Court was delivered in the context of claims filed by certain Uber drivers asking for minimum wage and protection under the labour laws of the UK. While adjudicating the claim, the factual matrix and the business model followed by Uber in the UK was examined by the first-tier fact finding tribunal as also by the appellate court that decided against the company and the Supreme Court has finally upheld the verdict of the lower courts.

Uber is a USA based company that essentially operates an App that facilitates contact between those wanting to take a ride and the drivers. However, as in the case of other tech companies, there is a Dutch subsidiary involved that is the owner of the right to exploit the license in respect of jurisdictions outside of the USA.

Most of us have used Uber or a similar App. It is therefore instructive to note the structure and the basic agreements as lucidly brought out in the judgement since these are more or less the same in almost all jurisdictions with perhaps a few modifications here and there. As stated in the order of the UK SC, Uber BV, is a Dutch company which owns the rights in the Uber app. Uber London Ltd. is a UK subsidiary of Uber BV which, since May 2012, has been licensed to operate private hire vehicles in London.

As stated by the Court, Uber's business model is simple. Prospective customers download the Uber app for free to their smartphone and create an account by providing

personal information including a method of payment. They are then able to request rides. To do so, they open the Uber app on their phone and make a request. The Uber app identifies the passenger's location through the smartphone's geolocation system. Using the same technology, the app identifies the nearest available driver who is logged into the app and informs him of the request. At this stage the driver is told the passenger's first name and Uber rating and has ten seconds in which to decide whether to accept the request. If the driver does not respond within that time, the next closest driver is located and offered the trip. Once a driver accepts, the trip is assigned to that driver and the booking confirmed to the passenger, who is sent the driver's name and car details.

At this point the driver and passenger are put into direct contact with each other through the Uber app, but this is done in such a way that neither has access to the other's mobile telephone number. The purpose is to enable them to communicate with each other in relation to the pick-up, for example to identify the passenger's precise location or to advise of problems such as traffic delay. The passenger can also track the driver's progress on a map on their smartphone.

The driver is not informed of the passenger's destination until the passenger is collected. At that point the driver learns the destination either directly from the passenger or through the app if the destination was entered when the ride was requested. When the driver presses "start trip" on his phone the Uber app incorporates route planning software and provides the driver with detailed directions to the destination. The driver is not bound to follow those directions but departure from the recommended route may result in a reduction in payment if the passenger complains about the route taken.

On arrival at the destination, the driver presses "complete trip" on his smartphone. The fare is then calculated automatically by the Uber app, based on time spent and distance covered. At times and places of high demand, a multiplier is applied resulting in a higher fare. Drivers are permitted to accept payment in a lower, but not a higher, sum than the fare calculated by the app. Drivers are at liberty to accept tips but are discouraged by Uber from soliciting them.

The fare is debited to the passenger's credit or debit card registered on the Uber app and the passenger is sent a receipt for the payment by email. Separately, the Uber app generates a document described as an "invoice" addressed on behalf of the driver to the passenger. Uber BV makes a weekly payment to the driver of sums paid by passengers for trips driven by the driver less a "service fee" of 20% of the fare retained by Uber BV. Drivers are prohibited by Uber from exchanging contact details with a passenger or contacting a passenger after the trip ends other than to return lost property. Uber operates a ratings system whereby, after the trip, the passenger and driver are each sent a message asking them to rate the other anonymously on a scale of 1 to 5,

To become an Uber driver, a person can sign up online. They must then attend and present certain documents at the offices of the local Uber Company This process is referred to by Uber as "onboarding".

Individuals accepted as drivers are given free access to the Uber app through their own smartphone or may hire a smartphone for £5 a month from Uber BV configured so that it can only be used to operate the Uber app. Drivers must also bear all the costs of running their vehicles, including fuel, insurance, road tax and the cost of obtaining a private hire vehicle licence.

Individuals approved to work as drivers are free to make themselves available for work, by logging onto the Uber app, as much or as little as they want and at times of their own choosing. They are not prohibited from providing services for or through other organisations, including any direct competitor of Uber operating through another digital platform. Drivers can also choose where within the territory covered by their private hire vehicle licence, they make themselves available for work.

Drivers whose acceptance rate for trip requests falls below 80% - receive warning messages reminding that being logged into the Uber app is an indication that the driver is willing and able to accept trip requests. If the driver's acceptance rate does not improve, the warnings escalate and culminate in the driver being automatically logged off the Uber app for ten minutes if the driver declines three trips in a row. A similar system of warnings, culminating in a ten-minute log-off "penalty", applies to cancellations by drivers after a trip has been accepted. The driver's ratings from passengers are also monitored and the drivers who have undertaken 200 trips or more and whose average rating is below 4.4 become subject to a graduated series of "quality interventions" aimed at assisting them to improve. If their ratings do not improve to an average of 4.4 or better, they are "removed from the platform" and their accounts "deactivated".

In the typical case where "Customer" is an individual driver, the nature of the relevant services and relationships as characterised by the Services Agreement is that Uber

BV agrees to provide electronic services to the driver, which include access to the Uber app and payment services, and the driver agrees to provide transportation services to passengers. The agreement states that Customer acknowledges and agrees that Uber BV does not provide transportation services and that, where Customer accepts a User's request for transportation services made through the Uber app, the driver is responsible for providing those transportation services and, by doing so, creates a legal and direct business relationship between Customer (driver) and the User, to which neither Uber BV nor any of its affiliates is a party.

The agreement also states that the fare is determined by Uber BV but describes it as charged by the driver and as "a recommended amount" which the driver may choose to reduce (but not increase) without the agreement of Uber BV. The clause further provides that Uber BV agrees to remit to Customer on at least a weekly basis the fare less a "service fee", calculated as a percentage of the fare.

British employment law distinguishes between three types of people: those employed under a contract of employment; those self-employed people who are in business on their own account and undertake work for their clients or customers; and an intermediate class of workers who are self-employed but who provide their services as part of a profession or business undertaking carried on by someone else. Some statutory rights, such as the right not to be unfairly dismissed, are limited to those employed under a contract of employment; but other rights, apply to all "workers,

Uber argued that when a request to book a private hire vehicle made through the Uber app is accepted, a contract is created between passenger and driver, to which no Uber entity is a party and under which the driver is solely responsible for providing transportation services to the passenger. It also relied on terms of the written agreements which state that the only role of Uber BV is to provide technology services and to act as a payment collection agent for the driver and that the only role of Uber London (and other Uber UK companies) is to act as a booking agent for drivers.

The Supreme Court however found the argument flawed for the simple reason that there is no written agreement between Uber London and drivers and therefore the nature of their relationship has to be inferred from the parties' conduct, considered in its relevant factual and legal context and the only contractual arrangement compatible with the licensing regime is one whereby Uber London as the licensed operator accepts private hire bookings as a principal and, to fulfil its obligation to the passenger, enters into a contract with a transportation provider (who) agrees to carry out the booking for Uber London.

In this regard, Uber had relied on its contractual Rider Terms whereunder Uber contracts with passengers include a term which states that Uber London accepts private hire bookings acting as disclosed agent for the Transportation Provider as principal and that such acceptance gives rise to a contract for the provision to the rider of transportation services between the rider and the Transportation Provider. Rejecting the same, the Court pointed out that it is trite law that a person (A) cannot create a contract between another person (B) and a third party merely by claiming or purporting to do so but only if A is (actually or ostensibly) authorised by B to act as B's agent. If at all, the Rider Terms establish a contract between drivers and Uber London and there is no evidence that drivers were ever sent the Rider Terms let alone consented to them.

In accordance with basic principles of contract and agency law, therefore, nothing stated in the Rider Terms is capable of conferring authority on Uber London to act as agent for any driver nor of giving rise to a contract between a rider and a driver for the provision to the rider of transportation services by the driver.

The UK Supreme Court rightly observed that the Services Agreement was drafted by Uber's lawyers and presented to drivers as containing terms which they had to accept in order to use, or continue to use, the Uber app. "It is unlikely that many drivers ever read these terms or, even if they did, understood their intended legal significance. In any case there was no practical possibility of negotiating any different terms. In these circumstances to treat the way in which the relationships between Uber, drivers and passengers are characterised by the terms of the Services Agreement as the starting point in classifying the parties' relationship, and as conclusive if the facts are consistent with more than one possible legal classification, would in effect be to accord Uber power to determine for itself whether or not the legislation designed to protect workers will apply to its drivers."

The remuneration paid to drivers for the work they do is fixed by Uber and the drivers have no say in it other than by choosing when and how much to work. Uber exercises a significant degree of control over the way in which drivers deliver their services. The fact that drivers provide their own car means that they have more

control than would most employees over the physical equipment used to perform their work. Nevertheless, Uber vets the types of car that may be used. Moreover, the technology which is integral to the service is wholly owned and controlled by Uber and is used as a means of exercising control over drivers.

The UK SC also compared Uber's method of operation and relationship with drivers with digital platforms that operate as booking agents for suppliers of hotel or other accommodation. The accommodation offered is not a standardised product defined by the platform. Here the customers are offered a choice among a variety of different hotels or other types of accommodation, each with its own distinctive characteristics and location. Suppliers are also responsible for defining and delivering whatever level of service in terms of comfort and facilities etc. they choose to offer. Apart from the service fee, it is the supplier and not the platform which sets the price. The platform may operate a ratings system but the ratings are published in order to assist customers in choosing among different suppliers; they are not used as a system of internal performance measurement and control by the platform over suppliers. Nor does the platform restrict communication between the supplier and the customer or seek to prevent them from dealing directly with each other on a future occasion. The result of these features is that suppliers of accommodation available for booking through the platform are in competition with each other to attract business through the price and quality of the service they supply.

As for Uber's argument that the drivers when logged onto the Uber app are under no obligation to accept trips, the Court pertinently observed: The fact, however, that an individual has the right to turn down work is not fatal to a finding that the individual is an employee or a worker and, by the same token, does not preclude a finding that the individual is employed under a worker's contract. What is necessary for such a finding is that there should be what has been described as "an irreducible minimum of obligation". Uber London in the Welcome Packet of material issued to new drivers referred to logging onto the Uber app as "going on duty" and instructed drivers that: "Going on duty means you are willing and able to accept trip requests" Logging onto the Uber app was thus presented by Uber London itself to drivers as undertaking an obligation to accept work if offered.

Although the UK Supreme Court judgement was rendered in the context of labour laws (the National Minimum Wage Act, 1998 and the Working Time Regulations, 1998) and the interpretation adopted by the UK Supreme Court may not apply in tax cases, what is important to note is that unquestioning adoption of the terms of a written contract may not meet the ends of justice. It is also interesting to note that in this case itself, the taxpayer had relied on a decision rendered by the British Supreme Court in the context of the VAT legislation to interpret the tripartite relationship between a company, its workers and the users. In that case, a company that marketed hotel rooms and holiday accommodation through a website reserved many hotel rooms in its own name, for which it paid in advance. The issue was whether, for the purposes of assessing liability for VAT the company was purchasing accommodation from hoteliers and supplying it to customers as a principal or whether it fell within a category of persons who act solely as intermediaries to whom more favourable tax treatment applied. In analysing the relationship, the Court pointed out that the right starting point is to characterise the nature of the relationship between the company, the customer, and the hotel, in the light of the contractual documentation, that one must next consider whether that characterisation can be said to represent the economic reality of the relationship in the light of any relevant facts, and if so, the final issue is the result of this characterisation.

In that connection, the UK Supreme Court observed that in the matter of characterisation for VAT purposes, the taxable persons are generally free to choose the organisational structures and the form of transactions which they consider to be most appropriate for their economic activities and for the purposes of limiting their tax burdens, although that this is subject to an exception for abusive transactions . Thus, in the hotel case, a customer who subsequently booked one of the rooms would not contract with the company, but would contract through it with the hotelier.

The Indian case: *Uber India Systems Pvt Ltd v. JCIT,* 2021-TIOL-489-ITAT-MUM

The case does not relate to labour laws but to income taxation – not of Uber per se but it relates to its liability as the withholding agent in respect of payments to the drivers. Before discussing the case, we may note that after having been set up as Uber cab in the USA in the year 2009 , Uber entered the Indian market in 2013 and has since slowly expanded and diversified its operation. When it entered India for the first time, it followed the same card only model but subsequently since 2015 also allowed the hirers to pay in cash. As in other countries, there is an Indian subsidiary Uber India Services Pvt. Ltd., set up on August 16, 2013, that is supposed to provide advertisement and other support services to Uber BV, Netherlands to which the intellectual property

was licensed. For its services, it was apparently remunerated on a cost+ basis.

Uber having disrupted the traditional cab business; it is only natural that it has faced and will continue to face legal challenges in different parts of the world. It is obvious from the assessment order that the assessing officer was aware of the developments since he has relied on some cases from such other jurisdictions where the challenge was relating to the status of the drivers under the labour laws.

Taking a cue from some of the findings including the one that was recently decided by the UK Supreme Court for which the lower court's decision was available at the time, he took the position that Uber exercises full control over the selection of the Drivers and on determination of ride fare and issuance of invoices and making payment to the Drivers.

Uber recruits the Drivers, provides training, sets the quality standard, provides rating and has a right to register and deregister and has full control over the drivers; that the so-called agreement with the Drivers cannot be relied upon as they have no real negotiating power. All the clauses of the agreement show that Uber is actively involved in rendition of transportation service by Driver for example issuing invoices, resolving driver complaints, fixing of price, registering or de-registering driver, conditions of vehicle, etc.

We may note that under the Indian ITA, there is an obligation to withhold tax from the payments made to the cab drivers under section 194C of the ITA. We may also note that in the initial phases, Uber gave generous offers/payments to the drivers and it was also reported in mainstream media that some of the Uber drivers were making around INR 80-90,000 per month which is much above the basic exemption limit for the charge of income tax and it is natural that the tax department, ever on the lookout for expanding the tax base through the withholding route, would bestow its baleful gaze to this area. Due to the lockdown and subsequent disruption, the state of such drivers is dismal at present but that is a different story. The tax department, however, did not treat the drivers as employees of Uber in which case also there would have been a liability of withholding but, treating the drivers as independent contractors, latched on to the provision of section 194C that casts an obligation to deduct tax at source on the part of the payer.

The tribunal however relied solely on the agreements and in particular emphasised on the fact that users in India can pay in cash directly to the drivers and that it is only in the case of digital payments that Uber makes payments subsequently after retaining its commission. The tribunal also referred to the fact that in 2014, the RBI had issued a Circular which provided that if the transacting parties are in India, payment could not be collected by Uber BV in a bank account outside India and subsequently after consulting the business model permitted the Indian subsidiary to collect the fares on behalf of Uber BV by opening an account in India for the collection and disbursement function.

To that extent, the Indian model certainly differ but in almost all other aspects the model followed in India is the same as that followed in the UK. Thus, in India also, the drivers have to register giving all the details including their bank accounts, character certificate, list of family members, police verification etc. There is also the onboarding exercise and training given to the drivers as discussed in the UK Supreme Court order.

The tribunal also observed that when the user directly makes cash payment to the driver, the company is not even made aware of the same. This may not be correct as Uber deducts its commission even in case of cash payments. The cash collection is actually adjusted and only the net amount is paid to the drivers. It is mainly in that view of the matter, the tribunal held that the Indian subsidiary could not be held to be the person responsible for payment of hire charges to the drivers. But the analysis of the contractual terms as done by the UK Supreme Court shows that perhaps some deeper examination of the same could have been done by the tribunal. Even thereafter, whether the outcome would have been different is a different issue.

June 24, 2020

Captive Concerns
Whether negative working capital adjustment required in TP proceedings?

S Ramanujam, CA

Introduction

During the year 2001, guided by the international tax models, with a view to expanding the tax base, the Government brought in new provisions in Chapter X under the heading - Special Provisions Relating to Avoidance of Income Tax - commonly referred to as Transfer Pricing (TP) provisions. The main purpose of this new enactment was to determine Arm's Length Price (ALP) in international transactions entered between associated enterprises (related parties). This new enactment changed the income tax landscape in India thoroughly, as it allowed the income tax department to garner more and more revenue in large measure, by expanding the scope to the maximum extent by covering all transactions without making any distinction between capital or revenue transactions. This unexpected move created a plethora of problems for the assessees who were hitherto paying more attention only to revenue transactions entered into with related parties and ensuring that the price charged either for their products or services is closer to the market price. The new thrust exhibited by the department to scrutinise all transactions, that too, by a specialised Transfer Pricing Officer (TPO) created a multitude of problems for the assessees and their advisers, who in turn were forced to engage in high-cost litigation, seeking clear judicial verdicts - which also was not forth coming in full measure till date to their rescue. With a pre-deposit to the extent of 20% of the disputed demand required to fight further appeal before Commissioner of Income Tax (Appeals) (CIT(A)), the ordeal faced by the assessees became worse. Many times, the assessees also feel let down as timely verdicts are not handed and on many occasions, raging controversies are not decided but sidestepped, leaving the assessees to rue their fate.

In this short article, a snapshot of a new controversy that erupted recently in the TP arena is highlighted along with some other well-known disputes that are engaging the parties as of date are indicated. To give a wholesome thrust to the subject, a background to the TP law and the relevant procedures are also given. The discussion here will be confined only to TP in relation to international transactions and not with reference to domestic transfer pricing issues.

Some measures taken by government to streamline the TP proceedings:

Those who are curious to know the new subject of TP are invited to look at the shortest sentence written in an

enactment which is the root cause for all these problems. This section is extracted below:

Section 92(1) - Any income arising from an international transaction shall be computed having regard to arm's length price…

A reading of the section normally should not yield to any ambiguity for any of the parties affected. But for assessees, their main grievance begins at the very first word - 'Any income…' which according to them is not understood by the Department at all, when they find to their surprise many transactions which had no income character are deliberately misconstrued by the Department and TP additions are made.

Without elaborating on the above, let us look at the steps taken by the Government while providing for detailed safeguards in the statute itself so as to not to unduly burden the assessees. Some of these are - (given in a summary form, that too only relevant to the topic)

(i) Every person, who has entered into an international transaction is required to obtain a report duly signed by an accountant in a prescribed form, justifying the price adopted by the assessee and submit it along with his return of income on or before November 30th of every year. This time limit is extended for assessees who have to submit the TP report up to November so as to enable them to access current year data of the comparable companies which could be used as a benchmark to justify the charging of the price by the assessees.

(ii) The Assessing Officer having jurisdiction over the case, while embarking on the assessment proceedings, makes a reference of the above report to the TPO asking him to look at the computation of ALP furnished by the assesee.

(iii) The TPO after scrutinising the report and other explanations offered by the assessee, determines the ALP in writing and forward a copy of his order both to the AO as well as to the assessee.

(iv) In cases where there is a variation made to the ALP by the TPO, the AO first prepares a draft assessment order and asks the assessee to file his objections If any. If the assessee objects to the proposed variations to the ALP, then he can take the matter to the Dispute Resolution Panel (DRP) which in turn will adjudicate all matters within a period of 180 days after allowing a hearing and providing an opportunity to the assessee to explain his views on the proposed additions. The assessee also has an alternative remedy of filing an appeal straight away to the CIT(A) and try his luck there (this topic is not discussed further here).

(v) The DRP's final order passed is adopted by the AO and he in turn will include the same as part of his assessment order. This order can be contested by the Assessee before the Income Tax Appellate Tribunal (ITAT), in case he is not satisfied about the additions made in the assessment.

(vi) The advantage for the assessees of taking the case before the DRP is that they get extra time of 180 days to conserve the probable cash outflow of tax which normally they would have paid upon completion of assessment, that too within 30 days.

(vii) As a part of the new enactment, even the time limit fixed under the Act for the completion of assessment is extended by 12 months.

(viii) Section 92C also provides for any of the 6 methods to be used to determine the ALP: These are - (i) Comparable Uncontrolled Price (CUP) (ii) Resale Price Method (RPM) (iii) Cost Plus Method (CPM) (iv) Profit Split Method (PSM) (v) Transactional Net Margin Method (TNMM) and (vi) such other method as may be appropriate. Detailed steps are also indicated in the Rules enacted in this behalf - see Rules 10A, 10AB, 10B, 10C, 10CA.

(ix) Additionally, there is a variation percentage of 3% on the price adopted by the assessee as the ALP - with that adopted by the AO - which is allowed.

(x) The Act also allows the CBDT to make Safe Harbour Rules (the minimum price expected to be charged in respect of certain transactions) and also the registration of Advance Pricing Arrangements (APAs) valid for a period of 5 years with the parties for determining the ALP.

Few examples of raging controversies:

Despite all the above procedures enacted in great detail, almost every TP proceeding leads to a protracted litigation. Some of the controversies that are pending in the Courts are:

- Selection of comparables (group of entities comprised in a homogeneous group)
- Choosing the appropriate method (out of 6 methods prescribed in the Income Tax Rules, 1967)
- Incurring of Advertisement and Marketing Expenses (AMP) by the Indian Associate Enterprise (AE) which is misconstrued as incurred on behalf of the foreign AE.

The Karnataka High Court in the case of Soft Brands, 406 ITR 513, held that picking of comparables for TP adjustments, applying of filters, etc. do not give rise to any substantial question of law. On the other hand, in

a series of decisions Delhi High Court has looked at many aspects of the TP law including the selection of comparable companies, whether outstanding dues from the customers constitute an international transaction, the application of various methods to determine ALP etc. and rendered elaborate judgments.

Prelude to the present controversy:

One of the methods which is used to determine the ALP by most assessees, especially in the case of software and IT enabled services is the Transactional Net Margin Method (TNMM). To appreciate the present controversy, one should know about the TNM method. Hence some background information is given below about this method.

1. This requires comparison between net margins from the operations of the controlled entities and net margins derived by an AE from similar operations (selection of comparables).

2. Net margin is indicated by determining rate of return on sales or cost or operating assets (profit level indicator or PLI).

3. Functional analysis of the independent entity and the comparables is to be made to determine whether the transactions between the entities are comparable.

Steps involved: (short summary of the rules)

1. Search of comparable companies (to be properly documented): Margins earned by these Companies are benchmarked to the margin earned by the assessee from the international transaction.

2. Functions performed, assets employed, risks assumed (FAR) test: This involves identification of differences between the international transaction and the uncontrolled transactions.

3. Finally, details of adjustments if any made to the price charged by the assessee in accordance with the ALP determined under the rules.

Working Capital adjustment to determine Net margin

As indicated above, a great deal of effort has to be made to identify the correct comparable companies, the margins of which could be benchmarked with that of the international transaction entered into by an assessee. The next step involved is to work out the operating margins of each of these companies and arrive at the mean average. While carrying out this process, many times it is noticed that some companies have no borrowings at all, or, even these companies have negative working capital - meaning thereby that the entire funding requirements too are taken care of by the AE, many a times the parent company itself. In these cases, the question arises whether to achieve uniformity in comparison, a negative working capital adjustment has to made to determine the correct operating margin to be applied in the assessee's case.

(Working capital here is with reference to the capital required to fund the operations for short period of time - say during the completion of operations in a working capital cycle. For instance, in certain Industries, there is always significant cash collection but suppliers are paid after 30 days or so which results in negative working capital).

Bangalore ITAT Decision in-Tivo Tech Private limited - ITAT(Bang) decided on 12-06-2020

A recent case decided by the Bangalore Bench throws light on this issue. The facts of the case are:

1. The assessee is a captive software development company i.e. exclusively catering to its parent company in USA. The assessee is a wholly owned subsidiary of the parent company.

2. The dispute arose in the case for the Ay 2013-14 when the AO made a TP adjustment of Rs. 57 lacs (approx.) which was subsequently enhance to Rs. 79 lacs by the DRP.

3. It was agreed between the parties that TNM Method is the most suitable method to be adopted for determining the ALP.

4. The assessee's financials revealed the following:

Operating Income	Rs 15.08 Cr
Operating cost	Rs 12.50 Cr
Operating profit	Rs 2.58 Cr
Operating margin	20.61 %

The assessee, based on 11 comparable companies' data and after working out the arithmetical mean contended that the average profit margin of the comparable companies is only 12.45% whereas its profit margin is higher. Accordingly, no ALP adjustment is called for in its case.

5. The TPO accepted only 2 companies out of the 10 selected by the assessee as comparable companies and added 5 more companies as comparables and arrived at the arithmetical mean of 20.90%. Thereafter, the TPO added a working capital adjustment to each company's operating profit and arrived at a revised mean of 25.15 %.

6. On the above basis, the Computation of ALP was done by the TPO as under:

ALP Mean	20.90%
Less: working capital adjustment	(4.25%)
Adjusted mean ALP	25.15%
Operating cost	12.50 cr
Revised ALP - 125.15% of the operating cost	15.65 cr
Sale price received	15.07 cr
Adjustment u/s 92 C	0.56 cr

Issue: Whether negative working capital adjustment is to be done?

Assesse's arguments:

1. Working capital adjustment is made for the time value of money lost when credit period is given to customers. However, in this case the assessee is a captive unit which is entirely funded by the AE. The assessee has no borrowings and is fully compensated by the parent on a total cost plus. The assessee has no working capital risk - in other words, it is a risk-insulated service provider to the parent. The only customer of the company is its parent company.
2. The assessee relied on a host of ITAT decisions, the main decision being Adaptec (India) Private Limited, Hyderabad ITAT - decided on 25-03-2015 which was relied upon by the Bangalore ITAT in other similar cases and contended that no negative working capital adjustment is called for.

The Bangalore ITAT, after considering the similarity in facts of the assessee's case with that of the facts in the ITAT decisions referred above, deleted the negative working capital adjustment. Thus, the working of the assessee of the ALP was accepted.

In the author's view, this is the correct approach as one has to look at the costs incurred by the assessee only and should not impute any additional cost as done by TPO, which indirectly enhances the ALP artificially. The ITAT also chose not to look at the dispute regarding the comparable companies to be reckoned for the purpose of determining ALP as the decision rendered by it directing that no working capital adjustment need to be made in these type of cases itself brought the new ALP computed by the TPO within the 3% margin level as permitted under the IT Act.

Contrary view as culled out from various views expressed by others, justifying the negative working capital adjustment:

1. Working capital adjustment is required in all cases as any credit extended to customers will result in cash locked up and will result in the assessee borrowing money from the banks and incur additional cost towards interest on these borrowings.
2. Price is normally related to market situation and remains more or less constant. Since under TNM method profit margins of comparable companies are analysed, it is better every company compared has same set of ingredients in the computation of operating margins - whether it has positive or negative working capital position.
3. Positive working capital adjustment is beneficial to the tax payer whereas negative working capital adjustment is beneficial to the revenue.

Delhi High Court's view on Rule 10 B:

If one looks for additional support in favour of the assessee's view, one may refer to the following decision of the Delhi High Court - some relevant observations on the interpretation of Rule 10 B of the IT Rules: - Li & Fung India Pvt. Ltd v. CIT, 361 ITR 85 (Del) - is extracted below.

"Rule 10B(1)(e) does not enable consideration or imputation of cost incurred by third parties or unrelated enterprises to compute the net profit margin for the application of TNMM. In order to apply the TNMM, the assessee's net profit margin realised from international transaction is to be calculated only with relevance to costs incurred by it and not incurred by any other entity, either third party vendors or AE. Rule 10 B(1)(e) recognises that the net profit margin realised by an enterprise from an international transaction entered into with an AE is computed in relation to costs incurred or sales effected or assets employed or to be employed by the enterprise. It contemplates the determination of ALP with reference to the relevant factors (costs, assets, sales etc.) of the enterprise in question i.e. the assessee, as opposed to the AE or any other third party".

Conclusion

Thus, we have now over a dozen ITAT decisions following the Hyderabad ITAT's view that no negative working capital adjustment is to be made in captive entities operating with full support by their parent AE. However, the department is still not satisfied with this view and is now contesting this issue further subject to the monetary limit fixed by the government for filing further appeals before the High Courts. Here too, one may end up facing the same question again - whether any referable question of law will arise on the issue of adjustment of negative working capital adjustment? Well - the answer may be - NO, if one goes by the Karnataka High Court decision rendered in Soft Brands case. That leads to the next related question - Will all the questions on this aspect end here? Only time will tell.

December 10, 2018

International Law
Upcoming Challenges for India

Devendra Shanker
Former Principal CIT

The issue of international arbitration with regard to direct taxes, as in the case of Vodafone, not only agitates the issue of division of power within a State but also the principles of international law between the States. An issue which seems settled for a while keeps getting unsettled over and over again. If history of jurisprudence is any indication to go by, this and similar issues form the very basics of democratic dispensation of a nation-state as well as the international economic & political order. Accordingly, the present challenge is to come out with a clear solution. The attempt at the moment can only be made to understand the basics and then proceed towards an acceptable solution which, in the present global governance and Information Technology explosion seems a far cry. Given the legal imbroglio, in which international Information Technology giants like Apple, Google, Facebook & Microsoft are involved in issues like anti-trust, anti-dumping, copyright and taxation issues, arbitration proceedings seem to be an alternative. However, the basic tenets of arbitration in all these areas need to be understood, both by the host State and the State of residence of the applicant. Moreover, the authorities under the arbitration have to be vigilant & cautious about their rights, obligations and limitations so that a private Arbitration Tribunal does not transgress into the domain of legislation and judicial process, established by law. The jurisdiction of an Arbitration Tribunal is limited by the scope of Arbitration Agreement. The contents of the Arbitration Agreement would be void, since it is also governed by the provisions of the Indian Contract Act, 1872 to the extent it is not in accordance with the law of the host State. As the technology crosses newer barriers, the existing laws need updating so as to provide for resolution of disputes which will continue to arise, given the endeavor of mankind to strive for newer avenues and even higher monetary profits. This would be a futuristic issue to be decided over a much larger span of time. We therefore come back to the present issue on the two points discussed in following paras.

In an earlier article, while referring to a decision of the Delhi High Court in the case of Vodafone, 2018-TII-33-HC-DEL-INTL, an issue, whether Executive could review and modify a judicial decision through an international treaty on the basis of the principles of international law, was considered. It was also apprehended that if allowed to proliferate, it could become a tool in the hands of the Executive to override any law proclaimed by the Parliament as well as any judicial decision of the highest court of the land. The main reason expounded was that the Revenue authorities

did not present the entire legal position before the High Court. The points which in the humble opinion of this author, could not be considered by the High Court were also indicated. To summarize the entire issue, the following two points were highlighted -

1. That for any person to invoke arbitration proceedings, existence of an 'Arbitration Clause' in any Agreement is an absolute essential condition, which is not provided for in the Bilateral Investment Promotion & Protection Agreement (w.r.t. direct taxes which are imposed by a statute);
2. That with the larger dispensation of power through a detailed constitution of a sovereign (like India) the Executive cannot circumvent a judicial decision taken under a municipal law or a legislation by means of a purely administrative Agreement between States which has not been approved/ legislated by the Parliament of the State applying the Agreement.

1. Existence of an Arbitration Clause in a given Agreement

At the international level, it is well-acknowledged that increasing arbitration & reconciliation in trade & industry is an important requirement for commercial activity. Accordingly, the United Nations Commission on International Trade Law (UNCITRAL) adopted a Model Law with focus on International Commercial Arbitration. In order to provide machinery for the same, the Arbitration & Conciliation Act, 1996 was enacted on August 16, 1996 (hereinafter referred to as Act). The Preamble of the Act specifically mentions adoption of UNCITRAL Model Law of 1985 and that the Act has been adopted to make law regarding arbitration and reconciliation based on the Model Law.

Notably, the word 'arbitration' has not been defined in the Act , except that it covers institutional and ad hoc arbitration. As per UNCITRAL Model Law, arbitration is a means by which the parties to a dispute get the matter settled through the intervention of agreed third person. In other words, arbitration is the process that is carried out pursuant to an Agreement to resolve a disputed matter. Similarly, Halsbury defines 'arbitration' as "… a reference of dispute or difference between not less than two parties for a determination after hearing both sides in a judicial manner by a person or persons other than Court of competent jurisdiction…"

Thus, the most essential requirement for any arbitration proceedings to take place is an existence of an Arbitration Clause in an Agreement:

Section 7 of the Act defines 'Arbitration Agreement' as under

"... Section 7. Arbitration Agreement

1. In this part, arbitration agreement means an agreement by the parties to submit to arbitration all or certain disputes which have arisen or which may arise between them in respect of a defined legal relationship, whether contractual or not.

2. ...

3. ...

4. ...

5. ..."

In view of the provision of the Act of 1996, the necessary ingredient for any legal arbitration could, besides other things, definitely require -

1. That there should be an Arbitration Clause in the Agreement to resolve the dispute within the scope of the Agreement;
2. That there should be a dispute within the scope of the Agreement between the parties, which is capable of being resolved through Arbitration;
3. That any arbitration involving an Indian person (including a juridical person) shall be within the scope of the Act and shall also include international commercial arbitration as defined under section 2(1)(f) of the Act.

Fortunately, the Supreme Court in *Jagdish Chander* v. *Ramesh Chander,* 2015-TIOLCORP-26-SC-MISC, had an occasion to examine as to what constitutes an Arbitration Agreement. In short, it provides for the following ingredients -

a. It should relate to or be relatable to the dispute at hand;
b. There should be an intention of the parties to enter into an arbitration;
c. That parties should have agreed that the decision of the private Tribunal would be binding on them;
d. Where any clause relating to settlement of dispute stipulates anything which detracts from the Arbitration Agreement, it will vitiate the Arbitration Agreement.

Similar to existence of an Arbitration Agreement, it is also a settled position that there should exist a dispute or difference in respect of the Agreement which may be referred as arbitrable dispute. Thus, the nature & extent of the dispute should be in respect of matters covered under the Agreement i.e., directly arising within the scope of the Agreement.

It is at this stage that we can refer to the clauses of respective BIPPAs between India and Netherlands and between India and the United Kingdom:

Article 2. Scope of Agreement

The Agreement shall apply to an investment made by the investors of either contracting party in the territory of the other contracting party, including an investment made through another company wherever located, which is fully-owned by such investor, whether made before or after coming into force or the Agreement…"

Both the above Agreements that are currently in operation include a broad definition of 'investment', which covers "…every kind of asset…" which is followed by a non-exhaustive list of covered assets. Thus, there is scope of expansive interpretation. However, by any stretch of expansion, investment would not encompass within itself the taxes imposed by the law of the contracting party. The taxes are imposed by the legislative arm of the sovereign and provides for a well-laid out procedure for resolution of disputes regarding them. Moreover, both the countries viz., Netherlands & UK, have entered into Double Taxation Avoidance Agreement (DTAA) with India, which provide for resolution of disputes regarding taxes imposed by the contracting parties. The enabling provision as contained under section 90 of the Income Tax Act, 1962, also states that these treaties are also for the promotion of mutual economic relations, trade & investment. Thus, the taxation aspect of any investment is covered under the DTAA and not BIPPA. The DTAA provides for a well-laid procedure for resolution of disputes under the Mutual Agreement Procedure (MAP), for which the resolution machinery and the mode of operation is also provided.

The above clearly indicates that any arbitration w.r.t. direct taxes could take place under Mutual Agreement Procedure (MAP) of DTAA within the scope of limitation provided therein and under no circumstances be taken up under BIPPA, as it does not provide for arbitration regarding direct taxes.

2. Limitation of BIPPA regarding statutory taxes

BIPPAs entered into by the executive of the contracting State are purely administrative in nature and are not approved by the Parliament. Accordingly, unlike DTAA, they do not have force of law and apply only to administrative functions of the Governments. The concepts of international treaty law will continue to apply to the extent that they do not infringe upon the domestic law. Another point to be noted is that BIPPAs were initiated by capital-exporting countries to protect their investment in developing countries and former Soviet Republics. It is therefore understandable why these countries included a very wide definition of 'investment' to protect the interest of their commercial entities. To understand the interaction of international treaty with domestic law, we have to understand the very basic of international treaty implementation and operation thereof.

At this point, it is also important to note that in what manner and to what extent, an Income-tax authority would be able to implement the decision taken by Arbitration Tribunal before which, the authorities might have accepted to participate. The Income-tax Act, 1961 provides for a well-laid procedure & mechanism of appeals before the Commissioner of Income Tax (Appeals), the Income Tax Appellate Tribunal, the High Courts and the Supreme Court. In addition to this, there are provisions for the Dispute Resolution Panel, the Advance Pricing Agreements, the Advance Rulings and the Mutual Agreement Procedures, for which the mode of applying the decisions have been provided for in the Act as well as the Income Tax Rules, 1962. These authorities are recognized under the Income Tax Act, 1961. The BIPPA, however, is not recognized or approved by the Income-tax Act, 1961 or any other statute to be a binding force on Income-tax authorities performing their statutory functions. Even if the Arbitration Tribunal in the UK resolves in favor of Vodafone, it will not be possible for the Income-tax authorities to give effect to such resolution, as it would be extraneous to the Income-tax Act, 1961. Even though it may be claimed that it is an outcome of an international treaty obligation of the Government of India, the Income-tax Act, 1961 does not provide for giving effect to the same. To further appreciate the issue, it is essential to know the distinction on one hand between the customary and treaty rules of international law, and the statutory domestic law on the other. At this point, we can have a look on the UK practice as to their international treaties. The negotiations, signature and ratification of treaties are matters prerogative to the powers of the Crown. If, however, the provisions of the treaty made by the Crown were to become operative within Great Britain automatically without any specific Act of legislation, this might lead to a result that the Crown could alter the British municipal law or take such important step without approval of the Parliament. Therefore, the British practice w.r.t. treaties may be summarized as follows -

1. Treaties which -

a. Affect the private rights of British citizens;

b. Involve any modification of statute;

c. Require vesting of additional power with the Crown;

d. Impose additional financial obligation, direct or contingent, upon the Government of Great Britain;

must receive Parliamentary assent through an enabling act of Parliament and if necessary, any legislation to effect the requisite change must be passed;

2. No legislation is required for certain specific clauses of treaties, provided they do not involve alteration of any municipal law.

In any case, even in Britain, taxes which are imposed by Parliament are no prerogative of the Crown and therefore could not be a subject matter of arbitration proceedings by the Crown. India, being a Common law country, having its own detailed Constitution with specified separation of powers, has similar legal position and limitation.

Even otherwise, leaving aside the legal debate, the BIPPA provides for supremacy of the domestic legislation as provided under Article 11 of the Indo-UK BIPPA:

Article 11. Applicable laws

1. Subject to the provisions of this Agreement, all investments shall be governed by the laws in force of the territory of the contracting party in which such investments are made.

2. Notwithstanding Paragraph 1 of this Article, nothing in this Agreement precludes the host contracting party from taking action for protecting its essential security interest or in the circumstances of extreme emergency, in accordance with the laws normally & reasonably applied on a non-discriminatory basis…"

In the backdrop of the above discussions, the position that emerges can be summed up as -

1. That there is no Arbitration Agreement between India & UK regarding direct taxes, other than the Mutual Agreement Procedure (MAP) under DTAA;
2. That BIPPA covers investment defined therein and therefore the direct taxes are out of the scope of BIPPA and accordingly, there could be no arbitration regarding taxes;
3. That the issue of scope of Arbitration Agreement and the jurisdiction of Arbitration Tribunal got mixed up during the proceedings before the Court in the case under reference;
4. Having accepted the arbitration proceedings under the Indo-Netherland BIPPA, the authorities were left with a limited argument of the abuse of process of law under the Indo-UK BIPPA.

The revenue authorities still have a strong case in their favor to take up the matter with the Supreme Court under sub-section 6A of section 11 of the Act of 1996, to take up a case that no Arbitration Agreement exists regarding direct taxes, in view of the amendment brought into the Act of 1996 in 2015. Having received the decision of the Single Judge bench, the appeal seems to be pending before the Division Bench. Nonetheless, more direct and effective remedy is available through sub-section 6A of section 11, which needs to be considered.

However, if the revenue authorities intend to go ahead with the arbitration proceedings with a view to resolve the dispute in the Vodafone case, it may require an amendment to the Income-tax Act, 1961 or an Ordinance to that effect. Even if Vodafone, which has invoked arbitration proceedings, is able to get an award in its favor, the Revenue authorities have a case to challenge it in terms of Section 34 of the Act of 1996, if it is established that -

i. The subject matter of the dispute is not capable of settlement by arbitration under the laws for the time being in force; or
ii. The arbitral award is in conflict with the public policy in India.

In case of an international Arbitration Agreement, the matter would be covered under Section 48 of the Act of 1996 which provides that arbitration award cannot be given effect to if a Court finds that -

i. The subject matter of difference is not capable of settlement by arbitration under the laws of India; or
ii. The enforcement of award would be contrary to the public policy of India.

Therefore, a word of caution for the parties invoking arbitration w.r.t. direct taxes, would be that it is not automatic to implement the arbitral award under the provisions of the Income-tax Act,1961.

A passing reference may also be made to the huge costs involved in arbitration proceedings which the Revenue authorities would be incurring, for the State Exchequer. The Act of 1996 provides for a fee as per Fourth Schedule which shall be Rs 19.87 lakhs + 0.5% of the claim amount. Moreover, the arbitration with regard to taxes may have very wide ramifications and may open floodgates for more such proceedings by other known non-resident MNCs, whose cases are pending at various levels of adjudication under the current provisions of the Income-tax Act,1961.

Part 3

DIRECT TAXATION

Shri & Sam®
for Better Homes

FIRST IMPRESSION

is a new expression.

4 PCS Double Wall Rose Gold PVD Coating Cup and Saucer - U SHAPE

www.shriandsam.com

Simplification in Filing of Personal Income Tax Returns

Sudhakar Sethuraman
Partner, Deloitte India

Radhika Viswanathan
Director, Deloitte Haskins & Sells LLP

How many of us remember filling up physical copies of tax return forms – rough copy first and then a fair version to rule out errors? What about the serpentine queues outside the income tax office as the due date got closer and the huge piles of tax return forms stacked up at various sections in the tax office? Now, it sounds like a dream, right? Indeed, personal income tax return has come a long way from the days of paper filing. Though initially there was scepticism about the success of the initiative considering the divergent population, availability of technological requirements and taxpayers' difficulties in using the new facility, today, when we look back, we can say that the technological transformation has indeed eased the return filing process to a great extent. Let's take a look at the various changes introduced to simplify the personal tax return filing.

Genesis of the exercise

To start with, the government intended to make the whole experience easy and simple for the individual taxpayer – one they can accomplish on their own without any external support. The first step towards this in the paper era was introduction of the one-page tax return Form "SARAL".

Usage of technology

The use of technology for filing tax returns was a landmark step in the simplification process. This minimised the time a taxpayer took for filing his return besides freeing up the travel and waiting time as the returns could be filed from the comfort of homes. Additionally, e-filing also meant there was no limited time window per day and taxpayers could submit their returns electronically at any time of the day. So, the process became easy and simple, right?

It may not be possible to conclude as such since e-filing came with its own challenges as is the case with any new technology or initiative. However, the tax department came out with online filing support, detailed instructions, FAQs and periodic clarifications to help taxpayers. Nevertheless, it was a learning experience for all concerned and resulted in time and effort in the initial years.

Further, there was one additional step which called for paperwork – the verification process. Taxpayers had to print the ITR-V or the acknowledgement that was generated upon successful submission of the tax return utility, sign it following the instructions and send the physical signed copy to the processing centre at Bangalore. Only when the ITR-V reached the centre, and this was confirmed in the portal, can one be certain that the filing process for the year was complete. This limb was further simplified with the e-verification process that was enabled from Assessment Year 2015-16. Through this, the taxpayer would verify the return submitted using Aadhaar, net banking, etc.

Digitization has also reduced the processing time substantially and taxpayers are now receiving refunds into their bank accounts as early as within a couple of months of filing their return. It also provides a repository for the taxpayer as well as an audit trail for future reference.

Shift in the recent years

The last year saw a paradigm shift with the launch of a new portal and complete change in the e-filing procedure - from using a utility, to answering questions, to make return filing a child's play.

As with any new project, this also came with its own set of challenges. However, one hopes that pending glitches would get sorted soon. This year is also witness to a new facility in the form of Annual Income Statement (AIS) that acts as a one-stop source for all financial information / transactions a taxpayer has done in a particular year.

Exemption from filing of tax return

The last Union Budget provided much needed relief to senior citizens who had pension / income from other sources by exempting them from filing personal tax returns provided specified conditions were met.

Future expectations

Overall, there have been major strides in the arena of simplification of tax return filing. Nevertheless, the individual taxpayer has more on the wish list – exemption from return filing requirement where taxes have been fully withheld at source (and the data being captured in Form 26AS / AIS), being right at the top. This would ease the burden for both the taxpayer as well as the tax department as there would be a significant drop in the number of returns to be processed.

Provision of a platform free of bugs, detailed FAQs, further simplification in the questions to facilitate ease of understanding, complete mapping of income and taxes across schedules (currently it is staggered) and a simplified assessment procedure with a voice-based system whereby taxpayers can record their submissions, are some of the other points in the wish list.

Technology
Enabling hassle free tax return filing process

Samir Parekh
Director, Deloitte Haskins and Sells LLP

Avani Shetty
Manager, Deloitte Haskins and Sells LLP

The strength of India's vast population has ushered in significant economic advantages, which are being reaped through economic growth and prosperity. However, the management of compliances for the vast number of taxpayers also brings in its wake various administrative challenges and burden on the government machinery.

Several aspects such as technological advancements over the last few decades, integration of technology in day-to-day activities of business and individuals, ease of data availability and the unique advantage of Indian entities being the front-runners in developing solutions for technology globally, have provided the necessary thrust for adoption of technology for tax compliances as well. Leveraging the power of information technology brings with it the advantage of accuracy, transparency and speed. This also greatly reduces the time and effort on the part of both - citizens as well as Government officials.

The Indian tax authorities are pioneers in adopting technology for tax processing. The key technological milestones achieved so far are as under:

- The national website for income tax department launched in 2002.
- The electronic filing of returns for tax deducted at source introduced from financial year 2004-05.
- The electronic filing of return was introduced in the year 2006 making it mandatory for corporate taxpayers and optional for other taxpayers, which was later made mandatory for majority of the taxpayers from 2011.
- The Centralized Processing Centre ("CPC") was setup in Bengaluru for bulk processing of e-filed and paper returns in 2009.
- In 2012, TRACES (TDS Reconciliation, Accounting and Correction Enabling System) launched to serve an integrated one-stop platform for the stakeholders to facilitate the services related to TDS operations.
- In 2015, e-assessment proceedings were introduced on pilot basis and by 2021, the department has transitioned to faceless assessment. In addition, even appeals are becoming faceless using technology.
- Project Insights has been launched from 2016 to impart voluntary compliance, deter non-compliance and to promote fair and judicious tax administration. Under Project Insights, there is reporting portal shared with taxpayer wherein the details of financial transactions available with the tax authorities are shared and inputs are requested from the taxpayer for judicious administration and providing fair opportunity of compliance to taxpayer.

A full scale, end-to-end use of technology for tax administrative purposes was introduced successfully with the introduction of the Goods and Services Tax ("GST") in 2017.

The next stage in the evolution is to extend the end-to-end ecosystem to the income-tax administration.

The Hon'ble Finance Minister, Mrs. Nirmala Sitharaman, in her Budget Speech in 2020 had committed to aim to achieve seamless delivery of services through Digital Governance.

The use of technology as an aid in filing income-tax returns ("ITR") is one radical step in this regard. Following are the recent key technological transformations in the area of ITR filing process:

A. Roll out of Annual Information Statement

Form 26AS is the statement of tax payment released by the income-tax department on the income-tax portal. The said Form has been very useful in aligning the records of the taxpayers as well as the Revenue, thus ironing out any discrepancies.

The Central Board of Direct Taxes ("CBDT"), vide Notification dated 28 May 2020, has extended the scope of Form 26AS vide section 285BB of Income-tax Act, 1961 read with Rule 114-I of Income-tax Rules, 1962 with effect from 1 June 2020.

The new Form 26AS is now rechristened as an Annual Information Statement ("AIS"), which will provide a complete profile of the taxpayer for a particular year. The AIS would now report the income details available with the tax authorities as well as the tax payment details. The CBDT has authorised various tax authorities to upload the information received from any officer, authority or body performing any function under any law in the AIS.

The key benefits of the new AIS as notified by the CBDT are as follows:

- Display of information available with the income-tax authorities to the taxpayers;
- Promoting voluntary compliance and enabling seamless prefiling of return; and
- Deter non-compliance.

B. Facility to submit online feedback on the information reflected in AIS

A taxpayer can view AIS information and submit a feedback thereon by selecting the appropriate option from various responses / reasons provided therein.

The feedback provided by the taxpayers will be processed in accordance with the risk management rules framed by the income-tax department and high-risk cases will be flagged for further evaluation.

If the taxpayer submits feedback on AIS, the derived information in Taxpayer Information System("TIS") will be automatically updated on real time basis, which will be used for pre-filling of return.

C. Pre-fill feature

Pre-filling of:

- basic information in the ITR from the data as per PAN records / income-tax portal; and
- entries from AIS

  helps the taxpayer in smooth ITR filing.

The preponement of due dates of various tax reports (such as Tax Audit Report) are intended to enable collation of data which can assist in sharing accurate pre-filled data for filing of ITR.

D. User friendly return preparation utility

A new JSON based filing utility has been notified for tax returns to be filed for assessment year 2021-22 (period from 1 April 2020 to 31 March 2021).

The JSON utility provides a simple user interface wherein the taxpayer can select the relevant heads of income and disclosure schedule. This will enable the taxpayer to complete the entire return smoothly. The taxpayer also has the option to use the pre-fill feature referred above. This is intended to make the filing simpler and adaptive.

Time-to-time alerts and pop-ups in case of a mismatch in data as per the income-tax records and as entered by the taxpayer while filing the return, helps in flawless filing of ITR.

E. Features such as FAQs, user manuals, videos and chatbot / live agent provided in the income-tax portal have further eased the return filing process.

F. Digitisation has also led to a speedy processing of ITRs and quick issue of refunds to the taxpayers.

The early and constant adoption of technology by the Indian tax authorities demonstrates the intention to provide an evolving and robust technology driven interface that would be easily adopted by the taxpayers and the tax authorities alike; with the added advantages of simplifying the processes, ensuring accurate filing and processing of tax returns.

The adoption of technology however has involved a few technical challenges, which are mainly short-term roadblocks on the way to becoming a pro-active and well-defined tax regime.

To conclude, the use of technology in tax has evolved exponentially in India. The country is moving towards "Tax Transparency" by adopting the approach of Reform, Perform and Transform. The taxpayers at their end are required to be up to speed on the changes. The upcoming tax return filing would require a diligent review of the AIS to ensure that any differences are duly rectified before the filing of ITR and in any event, before the processing of the return.

April 16, 2021

Time Limit for Assessing Income which Escaped Assessment

Lukose Joseph, CA

Nowadays compliance portal of income tax department is flooded with information of income, investment, transactions etc and many are in receipt of notice under section 148 which deals with income escaped assessment. So, many have raised query on time limit for issuing such notices and also asked for confirmation whether information posted in compliance portal to be treated as notice under section 148. Hence this write-up.

Finance Act, 2021, amended section 149 of Income Tax Act (ITA), with effect from April 01, 2021, reducing the time limit for reopening assessment to 3 years from the end of relevant assessment year(AY) if the income escaped assessment is below rupees 50 lakh and enhanced the time limit to 10 years from the end of relevant AY if income escaped assessment is rupees 50 lakh or more.

Earlier, the same was 4 years if the income escaped assessment is less than rupees one lakh and 6 years if rupees one lakh and more. Sub clause (c) of clause 1 of section 149 was allowing reassessment up to 16 years if the income in relation to any asset positioned outside India, chargeable to tax has escaped assessment without any monetary limit. That clause is no more there.

Issuing of notice during Financial Year 2021-22

During the year **2021-22**, notice under section 148 can be issued by assessing officer(AO) for any amount with prior permission of prescribed authority for the AYs **2018-19, 2019-20 and 2020-21** .

If income that has escaped assessment is rupees 50 lakh or more pertaining to AYs **2015-16, 2016-17 and 2017-18** notice under section 148 can be issued by AO with prior permission of prescribed authority during the year **2021-22**. If the income that escaped assessment for period 2015-16, 2016-17 and 2017-18 is less than 50 lakh, no notice under section 148 can be issued.

Section 149(1)(b) provides for 10 years for reassessment if income escaped assessment is rupees 50 lakh or more. But for AYS **2011-12, 2012-13, 2013-14 and 2014-15,** notice under section 148 cannot be issued by AO during **2021-22** by virtue of first proviso to amended section 149(1) which provides that "no notice under section 148 shall be issued at any time in case for the relevant assessment year beginning on or before 1st day of April 2021, if such notice could not have been issued at that time on account of being beyond the time

limit specified under the provision of clause (b) of sub-section (1) of this section, as they stood immediately before commencement of Finance Act, 2021." **Said sub-section (before amendment) has a limitation period of 6 years and hence notice cannot be issued for the AYs 2011-12, 2012-13, 2013-14 and 2014-15 even if escaped income is 50 lakh or more.**

No notice under section 148 can be issued during 2021-22 for assessment pertaining to AY 2010-11 or years prior to that.

Attention of readers is invited to third proviso to section 149(1) whereby time or extended time allowed to assessee as per show cause notice issued under clause (b) of section 148A or period during which proceeding under section 148A is stayed shall be excluded. For example, if assessee was given notice for reply pertaining to AY 2018-19 and was given 15 days for reply, that 15 days shall be excluded from time limit and AO can issue notice up to April 15, 2022, even though period of limitation ends on March 31, 2022.

Reply to notice

If you are in receipt of notice under section 148A kindly ensure that officer has recorded reasons for the same, carefully consider the reasons and if the same is already incorporated in your return, inform the AO with a copy of return. If the item is not included in your return, revise the return accordingly. If the reasons are invalid, challenge the validity of notice.

Information in compliance portal

Information posted in compliance portal cannot be treated as notice under section 148.

Time Limit for order

For notices served on or after April 01, 2019, the order under section 147 can be passed within 12 months from the end of financial year in which notice under section 148 was served.

March 16, 2021

Should Faceless Appeals be Trapped in History or Promoted as Futuristic?

V Ranganathan, CA &CS

The idea of faceless appeals can be easily subverted by looking to the past and listing out multiple reasons as to why it is the most injurious idea anyone can come up with, or seen as a disruptive technology-based solution to completely change the state of litigation management in India. It is quite expected that most advocates' association across the country will keep their knives out to agitate this law as soon as it is enacted. Quite likely, the Courts will stay the operation of the law and the concept may be in suspended animation for some time. It is obvious that the faceless way of Courts and tribunals functioning will impact vested interests and equally help the economy to grow faster. The choice is entirely with the society to decide which should predominate in the ultimate decision.

Pendency and delay in disposal of cases in the Indian Courts is legendary. There are many studies over the years looking to the cause and cost of this phenomenon. India ranks very low among its peer group in the aspect of ease of enforcement of commercial contracts and high on aggressive tax recoveries. Both these and many more like the number of under trials languishing in jails are directly attributable to the mess the entire justice administration system is caught up in.

One of the studies available on the internet conducted by the Administrative Staff College of India in 2018 under the stewardship of Dr. Dushyant Mahadik with reference to the situation in the High Court of Bombay and the lower Courts in Maharashtra has copious details on how serious the malaise is compared to many other countries. A lot of information contained in this study should help any reader understand what ails the system here and how the faceless hearing as an idea is almost a silver bullet to metamorphosize the situation. Certainly, the authors of this study had not got the benefit of this concept and hence cannot be faulted for not having factored this in the suggested solution. This idea is the product of a natural evolution in terms of the technological development and in a great measure imbued by the adventitious measures adopted during the pandemic to keep the Courts functional.

The major challenge to faceless adjudication is that the common law system is anchored on the rule of audiatur et altera pars. The absence of hearing is fatal to justice administration. The civil law jurisdictions are

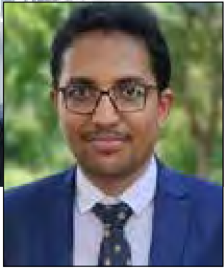
more judge-driven processes and with less accent on advocacy. These are anyway not written in stone and are more historical evolutions of the English and the French being sworn adversaries over centuries pursuing different approaches on every aspect of life. The moot point is - does faceless process threaten this entirely and is there a serious risk of loss of justice to the parties? The answer to this would lie in the manner in which the faceless process would work and it should be facile to ensure that at no point in time the process subverts a consummate hearing or provision of submissions. Since the concept is still in conception, the scheme of administration should take meticulous care to imprint the safeguards such that the parties to the dispute have more than adequate chance to provide all the submissions and are able to ensure that the same is duly recorded by the Court.

Equally, the onus lies on the litigants to clinically provide the correct documentation and see this change as a significantly economical and efficient system and give it the backing it deserves. Imagine saving the cost sometimes of a senior advocate who travels to a Court outside his or her city of residence! It is a tidy fortune and a few such visits obviated can actually change the fortune of some of the smaller businesses! Besides, the saving in waiting time in Courts and Tribunals for the hearing to come up and the avoidance of the frustration of adjournments, especially if the litigant had travelled far to visit the Court, are of immeasurable value to any litigant. The list of benefits is endless and more importantly the saving to the country in terms of the infrastructure cost of adding more Courts and buildings is immense. The existing facilities and personnel may end up being surplus in a few years' time if the faceless concept is earnestly implemented.

It is emphasized that judges and litigants should come to accept a different normal of how cases should be presented and justice administered. With greater emphasis on written submissions and provision of documents, the litigants should be diligent on their part; the judges should step down from their high pedestal and realize that they need to travel the extra mile to optically make the impact that the change in no way dilutes the quality but, in fact, enhances the quality and timeliness. Ideally, the Courts should move towards circulating a draft minute capturing all the facts and legal submissions to help the litigant draw comfort that the subject matter of the dispute stands captured with no omissions and that the judge has not misunderstood any of the facts. In specific cases, where the litigant seeks a hearing for making the proverbial eye contact with the judge, the Court should accommodate, with a clear time limit for both parties. This is just a top-of-the-mind-point but it is possible to improvise and make this system a panacea for the dire state of pendency in our Courts. Ultimately, Courts should put up draft orders for comment and make changes to the conclusion should their wisdom be challenged rightly!

The Income Tax Appellate Tribunal where the faceless format will be introduced has a great opportunity to seize the initiative and the President and the senior members of the institution have a vital role to make this concept succeed not only for the benefit of direct tax litigants but to make this an exemplar for the other Courts to follow. Finally, the bogey that would be raised before the constitutional Courts would be that the faceless appeals, where the case emanating from a particular location could be decided by members located in different cities, would offend the concept of geographical jurisdictions currently in vogue whereby High Courts have jurisdiction on a geographical basis and exercise superintendence over subordinate courts in their geography. The article would get too verbose if the way this could be addressed, is covered herein.

This can be easily addressed and High Courts will continue to enjoy their locus. Of course, it is a subject for a different article; should this construct of multiple High Courts dealing with an all-India statute like income tax and company law need to be relooked and the confusion of conflicting Court decisions should be put an end to by suitably changing the relevant Articles of the Constitution on the jurisdiction of High Courts. It is hoped the chambers of commerce and businessmen will go all out to support this initiative of the Government.



November 13, 2020

Analysis of Section 115BAA under the Income Tax Law

Shubham Agarwal
Senior Executive, Assurance at Kalyaniwalla & Mistry LLP, Chartered Accountants, Bangalore

Overview:

The government vide Taxation Laws (Amendment) Act, 2019 has inserted a new section 115BAA in the Income Tax Act (ITA) with effect from financial year (FY) 2019-20, wherein the corporate tax rate for domestic companies is reduced to 22% subject to non-availment of specified tax exemptions/incentives and other conditions.

Applicability:

All the domestic companies have an option to pay tax at the rate of 22%, subject to the fulfilment of the following conditions: -

- The total income is computed without claiming prescribed deductions or set-off of loss [See below comparative analysis]. -
- The option needs to be exercised within the prescribed time for filing the return of income (ROI) under section 139(1) of the ITA for assessment year (AY) 2020-21 or subsequent AYs.
- Once exercised, such option cannot be withdrawn for the same or subsequent AYs.

The Comparative Analysis between tax liability arising under normal provisions of Income Tax Laws and the tax liability arising under newly inserted section 115BAA is given in the table below:

Category of Income	Tax Liability under Normal Provision	Tax Liability under new Tax Regime under section 115BAA
Basic Tax Rate	25% (plus applicable surcharge and education cess)	22% (plus surcharge at 10% of fixed rate and education cess)
Deductions	Deductions and incentives are allowed	Following Specified Deductions and Incentives Not Allowed, inter alia:

		-SEZ (Special Economic Zones) under section 10AA -Additional depreciation allowance @ 20% under section 32(1)(iia) -The investment allowance for new Plant & Machinery under section 32AC, 32AD -Site Restoration Benefit under section 33ABA -Scientific Research Benefit under section 35 -Accelerated capital deduction under section 35CCC -Skill development project under section 35CCD -Benefits available under section 80A, 80IB, 80IC etc. (other than section 80JJAA
Allowability of brought forward and set off loss	Allowed	Not allowed (to the extent of any of the deductions specified above
Applicability of MAT (Minimum Alternate Tax)	Applicable at the rate of 15%	Not Applicable
Option to opt out of regime	Not Applicable	Not allowed
When option can be exercised	Not Applicable	In any year
Allowability of brought forward MAT (Minimum Alternate Tax) credit	Allowed	Not allowed

Other Points for consideration:

There is no timeline for the domestic companies to choose a lower tax rate under section 115BAA. Therefore, such companies can avail the benefit of section 115BAA after claiming the brought forward loss on account of additional depreciation and also utilizing the MAT (Minimum Alternate Tax) credit against the regular tax payable if any.

CBDT (Central Board of Direct Taxes) has issued a Notification No. 10/2020 dated February 12, 2020 and notified Form No. 10-IC for exercising the option for opting lower or concession rate of income tax by a domestic company under section 115BAA.

The notification states that a domestic company shall exercise the option in accordance with the provisions of sub-section (5) of section 115BAA for any previous year relevant to the AY beginning on or after the April 01, 2020, shall be in Form No. 10-IC.

It further states that the option in Form No. 10-IC shall be furnished electronically either under digital signature or electronic verification code.

Section 115BAA (5) provides that the option shall be exercised by a domestic company in the prescribed manner on or before the due date specified under sub-section (1) of section 139 for furnishing the returns of income for any previous year relevant to the AY commencing on or after the April 01, 2020, and such option once exercised shall apply to subsequent AYs.

June 17, 2020

Faceless Assessment - Dawn of a New Era

Shailesh Sheth
Advocate & Founder, M/s. SPS LEGAL

In Part-I, a bird's eye view of the major reforms undertaken by the Central Board of Indirect Taxes and Customs ('Board') in the field of customs in the recent years was presented. It was explained how these initiatives have catapulted India from its dismal rank at 142 in 2014 to an impressive 63 in 2019 on the World Bank's 'Ease of doing business' Index. In Part-II, the salient aspects of 'Faceless Assessment' were discussed. In Part III, the structure being put in place by the Board for the purpose of 'Faceless Assessment' was analysed. In this concluding part, the salient procedural aspects of the 'Faceless Assessment' are discussed on the basis of the Instructions dated June 05, 2020, issued by the Board. It is finally concluded that this crucial reform undertaken by the Board will certainly change not only the 'Face of the Customs' but also the 'Face of the Country' and propel India into the top 50 countries for 'Ease of doing business on the World Bank's Index.]

A detailed procedure has been laid down by the Board in its Instructions dated June 05, 2020, which is required to be adopted by the Faceless Assessment Groups (FAG) for verification of bills of entry. It may be reiterated here that at present, the assignment to the FAG is restricted only to the 'Non-facilitated' bills of entry filed for the goods imported and primarily falling under Chapters 84 and 85 of the Customs Tariff Act, 1975 (CTA), at Bengaluru and Chennai Customs. Bearing this in mind, let us now have a look at the various procedural aspects elaborately provided for by the Board by its Instructions. Interestingly, the Board has outlined the 'flow of bills of entry' covered under 'Faceless Assessment' in 'Process Flow' forms in Annexures 'A' and 'B' appended to the Instructions.

I. Procedure to be adopted in normal course for the verification of the assessment of bill of entry:

The stage-wise procedure that would normally be followed is explained below:

Stage 1 - Filing of Bill of Entry:

a. The importer shall present the bill of entry on the Customs Automated System i.e., ICEGATE electronically under section46 of the Customs Act, 1962 (CA) and upload all the requisite supporting documents on e-SANCHIT;

b. The selection of bill of entry for verification of self-assessment shall primarily be on the basis of risk evaluation through appropriate selection criteria;

c. The importers are advised to opt for continuity bond option, to avoid fresh registration of bonds every time, in cases where either they have prior knowledge of the requirement of execution of bond

or bank guarantee for the assessment of bill of entry or where filing of such bond/bank guarantee is required in cases such as filing of warehouse bill of entry or in case of opting for provisional assessment or where it is mandated under any duty exemption/ remission scheme claimed by the importer;

d. The assignment of the bill of entry to an officer of the FAG concerned for verification of assessment purposes would be by the Customs Automated System ('CAS').

Stage 2 - Assessment/Re-assessment by the Faceless Assessment Group:

Different scenarios have been visualized and dealt with by the Board so far as the verification of assessment of bill of entry by FAG is concerned and the same are explained hereunder:

i. Confirmation of self-assessment:

- The FAG would undertake the necessary verification on the basis of the declaration made and documents available in e-SANCHIT;
- The FAG may seek additional information/ documents for proceeding with the verification for which queries would be raised electronically, through ICEGATE portal. The importer should provide the requisite information/documents thereof through e-SANCHIT;
- The port of import would undertake the necessary examination and grant customs clearance. Any recalling and reassessment of bill of entry after this stage will be dealt with by port of import;
- After scrutiny of the information/documents provided by the importer, the FAG shall return the bill of entry to the importer for payment of duty after verification.

ii. Where re-assessment is to be done:

- If on scrutiny of the declaration made and additional information/documents, if any, furnished by the importer, the FAG does not agree with the self-assessment, it shall re-assess the bill of entry;
- In case, the importer does not agree with the re-assessment, the FAG shall issue a speaking order under section 17(5) of the CA following the procedure as prescribed.

iii. First check or Second check Examination and/or testing of goods:

- The FAG may, if it considers necessary, either on its own assessment or on the request of the importer, order first check examination or testing of the goods with specific directions or testing parameters to the shed officers at the port of import;
- The responsibility of sending the samples with the requisite test memo would lie with the port of import;
- On receipt of the examination/test report, the same would be fed in the system by the shed officers/ centralised cell and the bill of entry would be referred back to the FAG;
- The FAG would thereafter follow the procedure as prescribed;
- The FAG may, whether in the course of accepting the self-assessment or re-assessing the bill of entry, order for second check examination of the goods;
- The directions of the FAG to the shed officers at the port of import may include :
- verification of original documents;
- defacing the documents;
- taking custody of the documents;
- obtaining NOC from PAGs;
- verification of the Country-of-Origin Certificate; etc.
- The port of import may, if deemed necessary, rope in any external agency for the purpose of verifying the authenticity of any document/s submitted by the importer through e-SANCHIT.

iv. Referring back of the bill of entry by the FAG to PAG:

- If the FAG is of the opinion that prior testing of the goods would take considerable time and the bill of entry should be assessed provisionally, it may refer the bill of entry back to the Port Assessment Group (PAG) at the port of import, following the prescribed procedure and specifying clearly the reasons thereof;
- In the above cases, the bill of entry would be assessed by the PAG at the port of import, after the receipt of the examination/test report;
- In case, the FAG, on the basis of the test and/ or examination report fed by the shed officers/ centralised cell as stated above, finds the goods to be subject to some restriction or prohibition or mis-declared, it shall refer the bill of entry to PAG at the port of import for action including action under section 124 of the CA;
- However, irrespective of the pending assessment at the FAG level, in case the importer requests for storage of the imported goods in a warehouse pending clearance under section 49 of the CA, such request shall be promptly processed by the officers at the port of import.

IIA. Procedure to be followed by the FAG in exceptional circumstances:

- The proper officer of the FAG may, with the approval of an officer not below the rank of the Joint Commissioner/Additional Commissioner, transfer the bill of entry through the CAS to PAG at the port of import for assessment in the following exceptional circumstances:
- Where the FAG has reason to believe that the imported goods may be liable to confiscation in terms of the provisions of section 111 of the CA. In such cases, the reasons for such a transfer shall be duly recorded in the CAS. However, this course of action should be adopted in genuinely exceptional circumstances.
- Where 'related party' transactions are involved warranting investigation by the Special Valuation Branch i.e., SVB [other than cases already covered by an earlier order of the SVB or taken up for investigation by the SVB]. In such cases, the port of import would refer the case to the jurisdictional SVB for further investigation;
- Where, even after several electronic query-based interactions with the importer, the FAG is unable to complete the verification for want of additional documents, test reports, etc.;
- Aside from the above, the FAG may also transfer the bill of entry to the PAG in any other exceptional circumstances, but after due approval of the Commissioner supervising the proper officer.

IIB. Procedure to be followed by the Port of Import in exceptional circumstances:

It is provided that notwithstanding the above, the Principal Commissioner/Commissioner at the port of import may, at any stage pending an assessment at FAG, direct the PAG to pull the bill of entry from FAG to the PAG in the following situations:

- Where a specific alert or intelligence is available pertaining to the said bill of entry or class of bill of entry; and
- Where the Principal Commissioner/Commissioner of Customs has ordered so for reasons to be recorded in writing.

III. Adjudication and Appellate Proceedings:

Needless to say, the assessment of the bill of entry is a quasi-judicial function and therefore, the principles of natural justice need to be followed by the proper officer before assessing the bill of entry in a manner prejudicial to the interests of the importer. Towards this end, the Board has prescribed elaborate guidelines/procedures to be followed for the re-assessment of a bill of entry; provisional assessment; amendments to a bill of entry and issue of demands by the FAG. The Board has also laid down the procedure to be followed for Appellate and Review proceedings. In the ensuing paragraphs, the Board's guidelines on these aspects are briefly summarized:

a. Issue of a speaking order :

The Board has enjoined upon the FAG to pass a speaking order within 15 (fifteen) days from the date of re-assessment of the bill of entry, as prescribed under section 17(5) of the CA where such re-assessment is at variance with the self-assessment done by the importer. However, no such speaking order needs to be issued where the importer confirms his acceptance of the said re-assessment electronically in reply to the query raised by the Assessing Officer (AO).

Essentially, the above prescription by the Board merely embodies what is stated in sub-section (5) of section 17 of the CA.

The Board has further provided that before proceeding with the re-assessment of the bill of entry, the FAG shall grant an opportunity of being heard to the importer and if the same is sought by him, then it may be conducted through video conferencing or other reliable means at the option of the importer.

While the aforesaid guidelines prescribed by the Board are welcome, it may be emphasised here that the AO must convey his proposal to re-assess the bill of entry and the grounds or basis thereof to the importer before granting a hearing to him and passing a speaking order. Unless the importer is put to notice of the proposed stand of the authority and the basis thereof with regard to the re-assessment of the bill of entry, mere grant of a hearing will be an empty formality. An importer obviously cannot be expected 'to shoot in the dark' nor can he be expected to assume what is the case of the Department! Therefore, after verification of the declaration made or the requisite additional information furnished by the importer, if the AO feels the need to re-assess the bill of entry in a manner which is at variance with the claims made by the importer, the AO must communicate the details of the re-assessment as proposed by him and the grounds/basis thereof to the importer beforehand to enable the latter to put his defence in an effective and meaningful manner on record.

b. Provisional Assessment:

Section 18 of the CA provides for 'provisional assessment' in the following circumstances viz.:

- Where the importer (or exporter) is unable to make self-assessment under section 17(1) and makes a request in writing to the proper officer for assessment;
- Where the proper officer deems it necessary to subject any imported goods (or export goods) to any chemical or other test;
- Where the importer (or exporter) has produced all the necessary documents and furnished full information but the proper officer deems it necessary to conduct further enquiry;
- Where the necessary documents or information have not been produced and the officer deems it necessary to conduct further enquiry;

The Board, by its above Instructions, has stated that the FAG may, after obtaining the requisite prior approval for provisional assessment as per the provisions of the CA and the departmental guidelines, assess the bill of entry provisionally.

The bond and bank guarantee in such cases are to be registered by the importer with the Turant Suvidha Kendra at the port of import.

Here, it is necessary to have a brief look at the options available to the importer whenever a claim made by him in the self-assessed bill of entry is being contested by the AO. A dispute may generally arise with regard to a claim relating to classification and/or valuation and/or entitlement to an exemption notification, which would normally have a bearing on the quantum of the duty payable. In such cases, the importer has 3 (three) options available to him, viz.

i. to opt for provisional assessment as provided in section 18 of the CA;

ii. to opt to pay duty 'under protest';

iii. to insist on the issuance of a show cause notice or a 'Note Sheet Order' which would enable him to put his submissions on the record and take the matter to a higher level after adjudication, in appeal, if required.

It is well-known that the option of 'provisional assessment' is generally not favoured by AOs primarily for the reasons viz. one, revenue considerations and two, the onus on the proper officer to finalise the assessment within the specified time limit. This is despite the fact that section 18, inter alia, allows the importer (or exporter) to seek provisional assessment' as explained above. Once the importer has decided to opt for 'provisional assessment' after evaluating the risk factors attached to this option, the AO cannot legally deny him the exercise of such option.

AOs generally insist on payment of duty 'under protest', which not only results in immediate revenue collection but also absolves them of the responsibility of resolving the issue or finalizing the assessment expeditiously. There is yet another factor that plays a major, albeit maybe a subjective role here. When the duty is paid 'under protest', the importer, consequent upon a final assessment in his favour, would be entitled to the refund of duty paid in excess by him. However, it is a common knowledge that getting a refund is not a simple task.

The Board may, therefore, issue suitable Instructions in this regard stressing that seeking a 'provisional assessment' is the right of the importer (or exporter) and he cannot be forced to pay duty 'under protest'. The Board may also lay down a time limit - ideally not exceeding 6 (six) months - for the finalization of assessment by the AO in case where the duty is paid 'under protest' by the importer.

c. Demands under Section 28 of the CA:

The Board has clarified that the issue of demands under section 28 of the CA, adjudication thereof, and handling of audit objections shall be done by the officers of the port of import. Thus, even if the assessment is done by the FAG, the initiation of the proceedings under section 28 would continue to be handled by the officers of the port of import. However, wherever clarifications or inputs from the PAG are required in such cases, Nodal Commissioners are tasked with ensuring coordination between the FAG and the port of import.

d. Appellate Proceedings:

An appeal against any order on re-assessment passed by the FAG shall lie before the Commissioner (Appeals) as per Notification no. 51/2020-Customs (NT).

Thus, to illustrate, an appeal against an order passed as per section 17(5) or section 18 of the CA, by the proper officer of the FAG at Chennai in respect of the bill of entry filed by the importer at Bengaluru, being the port of import, would lie with the Commissioner (Appeals) having jurisdiction over the port of import i.e. Bengaluru.

e. Review Proceedings:

It is provided that the review of any speaking order on re-assessment passed by a proper officer of the FAG, under section 129D(2) of the CA, shall lie with the reviewing authority having administrative control over the proper officer of the FAG.

This guideline is somewhat strange and confusing! A review application against an order passed by the proper

officer of the FAG would lie before the Commissioner (Appeals) who would be having jurisdiction over the port of import, in terms of section 129D(4) of the CA. Moreover, for all practical and legal purposes, the jurisdictional Commissioner of the port of import continues to remain an interested party even if the bill of entry is assessed/re-assessed by the proper officer of the FAG based in a different customs zone. It is, therefore, surprising as to why review powers are vested in the 'reviewing authority' i.e., the Commissioner having administrative control over the proper officer of the FAG and not in the Commissioner having the administrative control over the port of import. This aspect may need reconsideration by the Board.

f. Amendment of Bill of Entry:

The following Instructions are issued by the Board in this regard -

- A facility whereby requests for amendments can be made online via ICEGATE Portal has been enabled by the Directorate General of Systems ('DGS');
- Once the amendments are filed online, the System would queue them before the proper officer of the FAG if the bill of entry is pending for verification with him or else, the requests would be queued to the proper officer of the PAG;
- The amendment fees in terms of Levy of Fees (Customs Documents) Regulations, 1970 can be paid online. The applicable fee will be included in the duty challan for payment;
- Requests for amendments under section 149 of the CA (i.e., Amendment of Documents) and requests after a bill of entry has been returned for payment by the FAG shall be processed by the port of import.

g. Exchange of communication:

Lastly, the Board has provided that for the purposes of the FAG, all communications between the FAG and the importer shall be exchanged exclusively by ICEGATE.

Moreover, the internal communication between the FAGs and the officers of the port of import or *Turant Suvidha Kendra* shall also be exchanged exclusively via electronic mode.

'Faceless Assessment' - The changing face of the Customs:

It may be observed that the successful working of ' **Faceless Assessment**' would need cohesion and close coordination between the Port of Import and the FAG. Here, Nodal Commissioners can be expected to play a vital role. The '**Faceless Assessment**' is like a giant wheel and every cog in this wheel is expected to ensure that the wheel moves smoothly and without any friction!

The rollout of '**Faceless Assessment**' (also commonly referred to as '**anonymised assessment**' or '**virtual assessment**') heralds the dawn of a new era in the Customs Assessment Process. The objectives behind this crucial reform as outlined by the Board in its Concept Paper are -

- To bring anonymity in assessment and cut down the physical interface between the AO and the importer/ broker to the extent technologically feasible;
- To ensure uniformity in assessments across the country;
- To promote sector specific approach and functional specialization;
- To improve workload balance amongst various field formations for efficient utilisation of the resources.

These avowed objectives of '**Faceless Assessment'** would reflect the seriousness with which the Board has embarked upon this reform!

It is also obvious that once, the pan-India rollout is implemented by December 31, 2020, as proposed, **'Faceless Assessment' may not only change the 'face of the Customs' but also the 'face of the Country'**! There is no doubt that it will also propel India into the top 50 countries for '**Ease of doing business**' on the World Bank's Index! There are bound to be some creases and other creases may even appear over a period of time but it is expected that these would be ironed out by the Board.

While the anonymity, uniformity and transparency, amongst other objectives remain the ultimate aims of this reform, '**speed**' of the assessment will also be vital as delayed assessment will not only hurt the importers very badly but also put paid to the whole initiative. 'SPEED ' may be ensured by:

- Scrutiny of documents
- Promptness of action
- Effective Co-ordination
- Equitable Consideration
- Decision

There is much for the importers to look forward in this revolutionary reform initiated by the Board and it is in the interest of all the stakeholders that they strive to ensure its success!

"The laws of a State change with the changing times."

[Aeschylus - Ancient Greek Dramatist]

May 14, 2019

Economics Behind Different Taxation Rates for Different Heads of Income

Smarak Swain, IRS

EXCERPTED FROM THE AUTHOR'S BOOK LOOPHOLE GAMES: A TREATISE ON TAX AVOIDANCE STRATEGIES.

Under the income tax law of any country, the tax rate on some types of income is high and the tax rate on other types of income is low.

For example, in India, the tax on labour ('income from salary') is 30% of the income. Corporate income tax ('income from business and profession') is also 30%. Whereas the tax on capital ('income from capital gains') varies from 10% to 30%. The tax on long term capital gains is 20%. Tax on long term capital gains from stock market is even lower at 10%. Short term capital gains from stock market are 15%. Royalty income from abroad attracts a tax rate of only 10%. A taxpayer can avail of attractive deductions against income from house property and professional income.

Differential tax rates are prone to misuse. A tax dodger may recharacterise their business income to income from house property to suffer less tax. Similarly, business income can be coloured as capital gains to incur lesser tax. Some examples evident from rulings of Tribunals and Courts are as under:

1) A firm **A** takes an office space on rent from its promoter **P** and pays high rent. **A** can claim the rent as deduction on its business income. Promoter **P** gets standard deduction of 30% on their rental income.

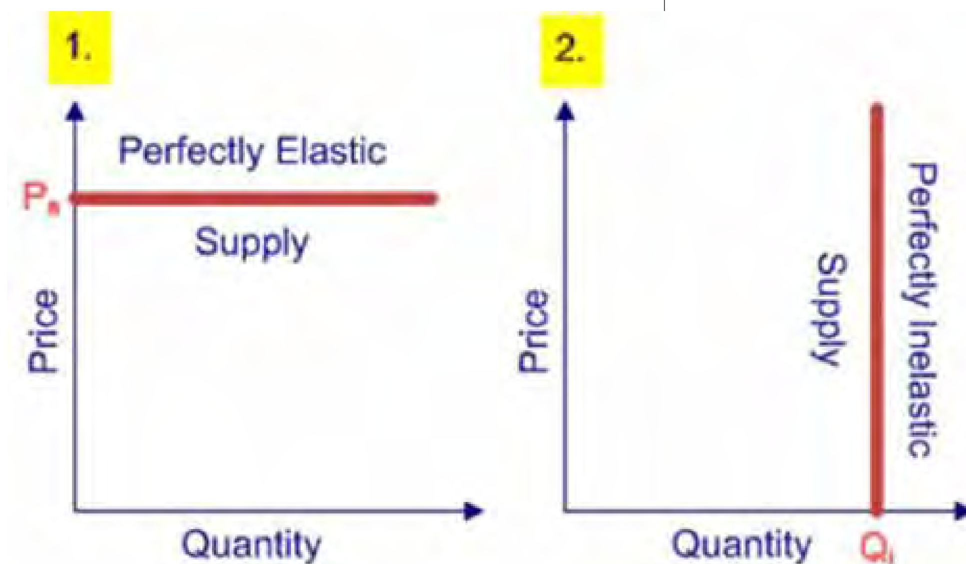
2) A consultant C has to receive consultancy charge payments for giving expert advice to a firm. They can structure it in such a way that a major part of the payment is for 'purchase of know-how'. Technical know-how is an intangible asset, and sale of knowhow results in capital gains, not business income.

3) A firm **B** may award contracts of value less than the upper limit for presumptive taxation to various members of the promoter group, viz. **P1, P2, P3** etc. The members of promoter group will declare income under presumptive taxation provisions at 6% of total revenue. However, they actually do not perform any significant construction work. The firm **B** can then claim deduction on the entire amount in its IT return.

Differential tax rates are, thus, prone to misuse. Yet, almost all countries use different tax rates for different incomes. The rationale for this lies in economics.

The economics of dual tax rate regime

Economists divide sources of income broadly into two: labour and capital. They also believe that when supply of a good is 'inelastic', it is difficult to tax it. Inelastic supply means that the quantity of the good supplied is not affected much by price. Whereas elastic supply means that the quantity of the good supplied is substantially affected by price. A perfectly elastic supply, and a perfectly inelastic supply, look as under:



When a good is more elastic, slight change in price will reduce the supply substantially. When we place a tax on any good, we basically increase the price of that good. So the effect of taxing a good is that the supply reduces. If the good is 'elastic', then the quantity supplied reduces substantially when we tax it. The quantity available in the market reduces disproportionately even when a small tax is levied. Elastic good means *high price sensitivity. Since tax increases price of the good, elastic good means high tax sensitivity.*

On the other hand, an 'inelastic' good is one whose supply changes minimally on change of price. As we impose tax, the price of the good increases. But the supply reduces minimally. So supply of the good in the market reduces by smaller margins even when we impose high tax. Inelastic good means low price sensitivity. Since tax increases price of the good, inelastic good means low tax sensitivity.

Now there are two sources of income (broadly): labour and capital. Labour is highly inelastic: the engineers, the doctors, the supervisors, the workers are not going away if we reduce their wage/salary. So we can afford to take a high proportion of their wage as tax. On the other hand, capital is highly elastic. If you impose a high tax on returns from capital, capital can withdraw from the market. If the return on investment is not satisfactory to the investor, the investor can move his capital to other countries. Alternately, the investor can park his capital in land or gold and not release the capital in the market.

In short, imposing a high tax on capital is risky: it will drive away capital from market and adversely impact the economy. It's unwise for the taxman to kill the golden goose. Hence, capital needs to be taxed at a low rate. However, labour is relatively inelastic. It is difficult to move labour out of the market. Hence, the taxman can afford to tax it at a higher rate.

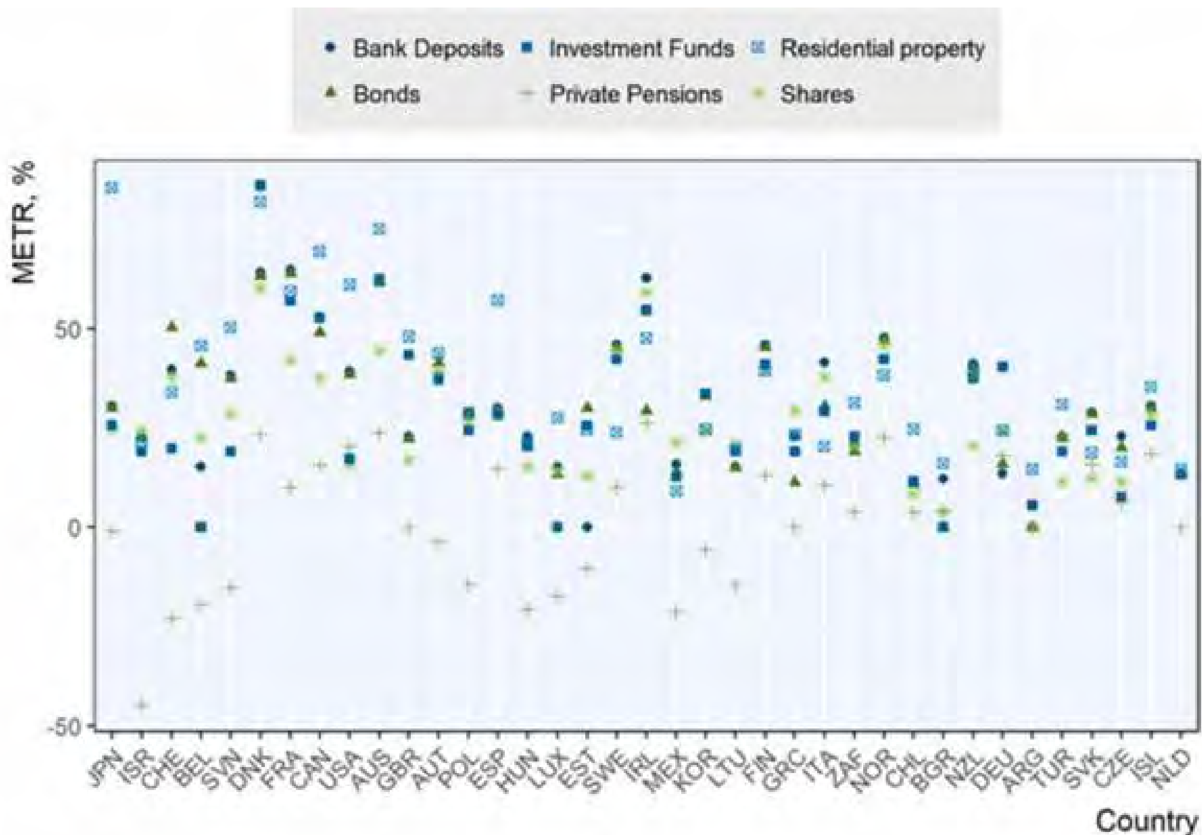
This is the logic behind higher tax rate on labour (such as income from wages, salary, profession, business etc) but lower tax rate on capital (such as capital gains, interest income, income from intellectual capital such as royalty etc).

Economists talk about two approaches to taxation: **comprehensive** taxation and **scheduler** taxation. Under comprehensive taxation, all income is taxed at the same rate. Since all income is taxed at the same rate, there is no arbitrage rate available to a dodger. The administrative and compliance cost of a comprehensive tax system is low. IT returns will also be simple in a comprehensive tax system. On the other hand, scheduler taxation imposes tax at a higher rate on income from labour and a lower rate on the income from capital. It would appear that a comprehensive tax system is a much better approach to taxation than the scheduler system.

Economists, however, say that scheduler taxation is the better approach for maximising revenue while minimising the impact of tax on the market economy. This is because immobile labour should be taxed as much as possible and mobile capital should be taxed just enough to retain them in your economy.

Globally, countries tax capital gains are at a lower rate than salary, business, and professional income. They tax rent (return on capital invested in immovable property) too at a lower rate; royalty (return on intellectual capital) is taxed at an even lower rate than capital gains.

A comparison of tax rates on different sources of income for various countries, as prepared by OECD (Organisation for Economic Cooperation and Development), is as under:



In the above graph, the Marginal Effective Tax Rate (METR) of income from various sources are mapped for various countries. It is clear from the graph that almost all countries apply different tax rates on income from different sources. This increases the scope of arbitrage. New Zealand ('NZL') and the Netherlands ('NLD') apply the same tax rate on all major sources of income. This is an ideal situation. The scope of rate arbitrage is low in New Zealand and the Netherlands, and the cost of tax administration would be lower for the two countries in comparison to countries that tax labour and capital differentially. However, they are exceptions.

Excerpted from the author's book Loophole Games: A Treatise on Tax Avoidance Strategies.

February 27, 2018

Taxing LTCG - A Nightmare for Investors

Nikhil Bhandari
Assistant Manager
Direct Tax at International Business Advisors, New Delhi

The storm that came on February 01, 2018, in the form of the Finance Budget 2018 has blown the equity investors and the stock market. The Budget 2018 proposes to change the way Long Term Capital Gains (LTCG) on equity shares and units of equity-oriented mutual funds are taxed in your hands. The new LTCG tax regime will work for individuals selling equity or equity mutual fund units.

Existing LTCG tax regime

Under the existing regime, LTCG arising from transfer of long-term capital assets (LTCA), being equity shares of a company/ unit of equity-oriented fund/ unit of business trusts, is exempt from income-tax. However, transactions in such LTCA carried out on a recognized stock exchange are liable to securities transaction tax (STT).

Proposed LTCG tax regime

The new LTCG tax regime is proposed to withdraw the above-mentioned exemption.

As per the proposed law, such LTCG shall be taxed at 10% but the tax liability will only accrue when such capital gains exceed Rs. 1,00,000.

After 14 years the Government has brought back the tax on LTCG on equity-oriented shares and units of mutual funds as the existing tax regime was inherently biased against manufacturing sector units and encouraged the diversion of investment in financial assets. This also led to significant erosion in the tax base resulting in revenue loss for the government. The problem was further compounded by abusive use of tax arbitrage opportunities created by these types of exemptions.

As per the reports and statistics, the Government was losing Rs. 50,000 crore every year on account of non-imposition of LTCG tax. So, after demonetisation and GST this step was expected to be taken by the Government to shore up the tax revenues.

Scenarios

Let's take few scenarios to understand the new tax regime:

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Purchase Price of Share (A)	Rs. 100	Rs. 100	Rs. 100	Rs. 100	Rs. 100
Purchase Date	January 01, 2017	January 01, 2017	January 01, 2017	January 01, 2017	January 01, 2017
No. of Shares	1	1	1	1	1
Fair Market Value as on 31st Jan 2018 (B)	Rs. 200	Rs. 200	Rs. 200	Rs. 50	Rs. 200
Sale Date	April 01, 2018	April 01, 2018	April 01, 2018	April 01, 2018	April 01, 2018
Actual Sale Price (C)	Rs. 250	Rs. 250	Rs. 150	Rs. 150	Rs. 50
Cost – Higher of (A) & Lower of (B) or (C)	Rs. 200	Rs. 200	Rs. 150	Rs. 100	Rs. 100
Capital Gains/ (Loss)	Rs. 50	Rs. 50*	NIL	Rs. 50	(Rs. 50)

* The long-term capital gain of Rs. 50 (Rs. 250 – Rs. 200) will be exempt from the tax as the share is sold after January 31, 2018, but before April 01, 2018.

Clarifications & Impact

The income tax department clarifies that the capital gains on listed equities arising up to January 31, 2018, for resident and non-resident assesses have been grandfathered. The exempted category also includes foreign institutional investors (FIIs).

The grandfathered concept implies that all the gains until January 31 will be exempt from any tax. This only means that the income tax will be applied with prospective effect and not with retrospective effect.

LTCG on equity shares or mutual funds is the profit that one realises by selling the equity shares or dissolving their mutual funds that one has held for more than a year. Similarly, if you sell for less than what you paid to purchase the asset it will be considered as Long-Term Capital Loss [LTCL].

Some other important clarifications:

- As the exemption from LTCG will be available for transfer made between February 01, 2018, and March 31, 2018, the LTCL arising during this period will not be allowed to be set-off or carried forward.
- LTCL arising from transfer made on or after April 01, 2018, will be allowed to be set-off and carried forward in accordance with existing provisions of the ITA.
- Therefore, it can be set-off against any other LTCG and unabsorbed loss can be carried forward to subsequent eight years for set-off against LTCG.

The first impact of this new tax regime was seen in the stock market as both indices of BSE (Sensex) and NSE (Nifty) fell drastically, between the plummeting rates of Fixed Deposits (FD) and high rates of real estate, mutual funds were the only option of investment for the middle class of this country.

Taxation on mutual funds can be a real repeller for the equity investment industry as the most attractive part of the mutual funds was the tax-free income which will be changed with the new tax regime.

July 14, 2016

Grandfathering of Investments for GAAR Application Extended - A Rational Move

Sandeep Dasgupta

Senior Manager, Deloitte Haskins & Sells LLP

Zainab Bookwala

Manager, Deloitte Haskins & Sells LLP

General Anti-Avoidance Rules (GAAR) are aimed at empowering revenue authorities with the right to scrutinize tax transactions which they believe are structured solely to avoid taxes. The main objective of introduction of GAAR was to deal with the aggressive tax planning which resulted in a need to view such transactions from a perspective of substance over form. The journey of introduction of GAAR in the domestic tax law has been a matter of great debate. GAAR was first proposed to be introduced in the Direct Tax Code Bill 2009. However, the DTC never saw light of the day.

The Finance Act 2012 introduced the concept of GAAR in the Income-tax Act, 1961 under Chapter X-A. Initially, the said provisions were proposed to be applicable from April 01, 2012, onwards. However, a lot of concerns were raised by various stakeholders regarding the proposed provisions of GAAR which pressurized the Government to defer the applicability of the said provisions by a year.

In the interim, the Government also formed a committee under the chairmanship of Dr. Parthasarathi Shome to evaluate the GAAR Guidelines. In January 2013 the final report of Shome Committee on GAAR was released which compelled the Government to defer the applicability of GAAR provisions by 2 years in its Finance Bill 2013. Later, in September 2013 the draft rules of GAAR were notified wherein income from investments where such investments were made prior to August 31, 2010, were grandfathered. Applicability of GAAR provisions were further deferred to April 01, 2017, by Finance Act 2015 and as it stands today, GAAR provisions shall be applicable from assessment year (AY) 2018-19 onwards.

The foreign investors have been in a long-drawn discussion with the Government recommending amendments in relation to certain provisions of the GAAR. One such recommendation by the investors is the prospective applicability of GAAR provisions which are currently applicable to investments made post August 30, 2010. The recent meeting of the Finance Minister with the representatives of the foreign investors have resulted in some positive amendment coming into force. The Ministry of Finance

amended the Income-Tax Rules, 1962 to provide that GAAR rules will not apply in respect of income from investments made by any person prior to April 01, 2017. The aforesaid amendment has been notified by the Central Board of Direct Taxation (CBDT) through modifications in sub rules 1 and 2 of Rule 10U of the Income Tax Rules 1962, vide Notification no. 49/2016 dated June 22, 2016.

This is yet another rational move by the Government towards reducing tax controversies after the recent protocol to the India-Mauritius Tax Treaty aimed at curbing double non-taxation of income of foreign investors. With the said protocol phasing off the relief of taxation of capital gains by grandfathering the investments made prior to April 01, 2017, an aligned legislation in case of application of GAAR provisions is an investor friendly move.

While there are issues unaddressed as regards GAAR, what is commendable is the seeming intent of the Government in addressing contentious issues to permeate positive signals amongst foreign investors about India being an investor friendly jurisdiction.

Part 4

CUSTOMS DUTY

DIGITAL STUDIO

DESIGN UI/UX DEVELOPMENT DIGITAL

Imagine . Create . Execute

+91 9891203558 | +91 9911378213

info@4thdimension.in | www.4thdimension.in

EDI in Customs

Krishnan Agarwal
Director, Deloitte Haskins & Sells LLP

Rahul Khurana
Deputy Manager, Deloitte Haskins & Sells LLP

In line with the dynamic needs of businesses, Customs is continuously rationalizing and modernizing its procedures through the adoption of electronic data interchange (EDI) and global best practices.

A need to adopt digitalization in Customs was felt in 1992, based on a study conducted by the National Informatics Centre (NIC) and the Central Board of Indirect Taxes and Customs (CBIC). Later in 1994, another study laid down the software requirements of the Indian Customs Electronic Data Interchange System ('ICES') that led to the launch of a pilot project for connecting all the players involved in international trade with Customs electronically.

Over the course of time, the Customs department has stabilised the system and invested in state of art IT infrastructure to host it. Parallely, Customs has also developed risk management system to make its operations effective and efficient. ICES is now operational at 252 major Customs locations and handles around 98% of India's international trade in terms of import and export consignments, significantly benefitting trade and industry.

ICES, being one of the easiest and most effective ways to transfer/exchange data between trade partners and Customs, offers various other advantages, such as reduced trade interaction with government agencies, enhanced data accuracy, acts as a central repository of information, substantial time reduction in examination and processing of information, increased transparency in trade transactions, paperless environment etc. Clearly, the aim is to introduce continuous technology-based Customs clearances with zero/less direct interaction between the trade partners and Customs authorities.

The single-window interface for facilitating trade (SWIFT) was introduced in 2016 as a part of "ease of doing business" initiatives. The single window project was implemented to facilitate trade across borders. SWIFT enabled businesses to file their documents for clearance of goods through common entry points and harmonized regulatory compliance system by simplification and a single window. The required permissions, if any, from other regulatory agencies would be obtained online without the trader having to approach such regulatory agencies. The SWIFT platform with EDI and ICEGATE is yet another example of Indian Customs using a technology driven approach to deliver improved services to its stake holders.

The introduction of a faceless assessment scheme is another such initiative to optimise customs processes and improve the ease of doing business. Also, with the introduction of CAROTAR Rules, 2020 appropriate changes to capture the mandatory declarations were made in the EDI.

By way of introducing digitization and technology driven measures, Customs has opened a host of opportunities to reform the cross-border clearance ecosystem, with appropriate safeguards and risk management. The trading partners including importers, exporters, CHAs as well as others engaged in international trade, are no longer required to prepare and submit a voluminous paperwork with Customs authorities. All these digital initiatives would reduce interface with governmental agencies, reduce time and cost of doing business.

Although the EDI system has facilitated industry to move to an automated system and a paperless trade, there are still certain difficulties that need to be addressed. The tariff rates are typically made effective from the date of issuance of notification and the EDI system should be able to support such changes on a real time basis so that the changes are reflected while filing the bill of entries by importers even on the date of issuance of notifications. Further, the delay in such changes in ICES would lead to short/excess payment of duty further adding up to interest and penal consequences.

Another important aspect is that the lack of complete integration with all other agencies such as custodians, GSTN etc. in the supply chain, quite often leads to difficulties faced in cases such as those requiring amendments of BOEs. Therefore, complete integration of ICES with the system of other regulatory authorities/ agencies such as GST, DGFT, RBI etc., would go a long way in improving the performance of EDI and reducing the cost and time of transactions.

India's Customs procedure and administration have always been considered to be requiring reforms, to improve the ease of doing business. By adoption of technology driven procedural reforms that balance both the regulatory requirements along with technological enhancement, the CBIC has been relentlessly working for providing best solutions to trade and industry.

The given technological reforms will provide the required push to trade and industry and will also bring in global competitiveness to Indian trade.

June 03, 2021

Yogakshemam Vahamyaham
Oxygenating Taxation Statutes

S Murugappan
Advocate

In levying taxes and in shearing sheep it is well to stop when you get down to the skin - Austin O' Malley - Ophthalmologist and Professor of English literature.

The authority to levy taxes and to provide exemption from payment of taxes, when needed, are traceable to the sovereign power vested with a State. Tax and equity do not go hand-in-hand. They can be diametrically opposite. But it does not mean that while levying taxes, one can totally ignore logic or reasoning. The taxes also cannot be excessive. Well before Austin uttered the above aphorism, 18th century French Statesman Jean Baptiste Colbert observed that "*the art of taxation consists in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of hissing*".

The issue of taxing oxygen, necessary to ***breathe*** by the sick, is taxing the nation at the moment when its attention can be usefully focussed elsewhere. While granting basic customs duty exemption for oxygen concentrators imported by individuals as gift, the Union Government, still retained the levy of IGST on such imports at 12%. When this was challenged in the Delhi High Court, by Mr. Gurcharan Singh, the levy was held as unconstitutional for several reasons, including unjustifiable differential treatment for different classes of persons. The Court also held that when the Union Government chose to issue an exemption notification such exemption notifications are subject to judicial review (2021-TIOL-1168-HC-DEL-CUS) -.

Firing on all cylinders *(not oxygen, obviously)* the Union Government moved the Supreme Court against this judgment and obtained a stay on the High Court order; now the matter is before the highest court of the land. (2021-TIOL-185-SC-CUS)

Thus, the issue will be decided by the Supreme Court with regard to levy of IGST for oxygen concentrators when imported by an individual as gift for his/her use.

Leave alone, oxygen concentrators, for most of the medical supplies for handling the current COVID pandemic, the import duty waiver, including waiver of IGST is conditional. Medicines and equipment imported as donations from abroad and supplied to a State Government and other authorised relief agencies

for free distribution are eligible for total customs duty exemption, including the IGST component. Additionally, on May 31, 2021, Union of India has issued another notification **32/2021-Cus**. providing total customs duty exemption even when such goods are imported from abroad involving payment to the suppliers. These exemptions are available up to the end of August 2021. The Government could have issued these notifications with a longer validity period, thereby eliminating additional paperwork for issue of further notifications for extension beyond August 2021. There is no confirmation by medical experts that after August 2021 the COVID pandemic will fade away or that there may not be any necessity for these medical supplies.

Another perplexing issue is involving the Goods and Services Tax (GST) Council for providing customs duty exemption for imports.

Alice, in her 'Adventures in Wonderland', after going down the rabbit hole and after undergoing transformation and assuming different sizes by growing taller and shrinking smaller, within a span of a single day comes face-to-face with Caterpillar. Caterpillar demands to know who she is. Alice starts saying that she hardly knows who she is and adds "*I'm not myself, you see*". She goes on to state that being changed into so many different sizes in a day is very confusing.

Imposition of IGST, leviable in terms of section 5 of IGST, as a duty of Customs for imported goods in terms of sections 3(7) and 3(12) of CTA read with section 12 of CA appears to have caused a similar identity crisis here. On imported goods, is it customs duty or IGST?

Section 5(1) of IGST authorises levying of tax on interstate supplies and the proviso to section 5(1) stipulates that on imported goods, IGST shall be levied and collected in accordance with the provisions of section 3 of CTA. Section 3(7) stipulates that the goods imported into India shall, in addition, will be liable to IGST as is leviable on a like article on its supply in India.

Thus, the authority to levy IGST on imported goods is to be traced to section 3(7) and section 3(12) of CTA, in terms of which, the provisions of CA and the relevant rules relating to exemptions were equally made applicable to this levy. As such, a notification issued in terms of section 25 of CA will take care of any exemption from levy of basic customs duty as well as IGST in terms of the above provisions. Hence, GST Council does not have a role with regard to grant of exemption under section 25 of CA for imported goods.

On the contrary, the press release issued by the Union of India after the conclusion of the 43rd meeting of the GST Council held on May 28, 2021, refers to the Council's decision regarding full exemption from IGST for COVID relief items when imported on payment basis subject to certain conditions and also extension of these exemption notifications up to the end of August 2021.

Any exemption from payment of basic customs duty leviable in terms of section 12 of CA and IGST leviable in terms of section 3(7) of CTA can be only with reference to section 25 of CA for which the Union of India is competent to issue notifications. As a matter of fact, these notifications providing conditional exemption from payment of IGST leviable in terms of CTA, all have been issued by the Government by exercising powers in terms of section 25 of CA; these notifications are without any reference to any approval by the GST council.

The real bottleneck will be when COVID relief materials imported free of any duty are supplied and distributed locally for a 'consideration'. As per section 2(25) of CA, imported goods lose their identity, legally, as 'imported' goods once they are cleared out of customs control. They merge with the local mass of goods within the country and will attract CGST/SGST/UGST/IGST, as applicable, depending upon the fact whether they are supplied within a State or from one State to another State or a Union Territory. The unique GST structure we follow provides different identities, as Alice experienced.

Thus, today, if one firm imports medical supplies free of all duties, still when it sells them to a hospital, it has to pay GST. In this context, the recommendations by the GST Council for providing exemption become relevant and important.

If tax waiver for local supplies is provided, apart from free distribution to the State Governments and other authorised relief agencies, the traders and other importers can also avail exemption benefit and take upon the distribution themselves. Most of the supplies are such that they are not amenable for misuse. One need not worry about the goods going into the wrong hands. Secondly, wide publicity can be given that for all these goods, customs duty as well as local taxes are waived. This will ensure that the medicines reach the needy at affordable prices; keep Charlatans and hoarders at bay; will enable fast and expeditious distribution by more persons; eliminate bottlenecks; reduce paperwork for certifications and finally avoid artificial shortages.

We only hope that the Group of Ministers constituted in this connection for considering tax relief comes up with novel ideas for grant of exemption for such essential supplies from payment of taxes under the GST statutes involved. Laws are not an end to themselves; they are to serve the interests and welfare of its subjects and are to be dynamic. Therefore, the provisions can be amended, tweaked, modified and made amenable to result in justice and thus subserve the welfare of the people. In the ultimate analysis the citizens taking treatment for COVID virus, in such a calamitous and pandemic situation, should be able to first get relief from tax burden for the medicines before they get relief from the infection.

The principles of the right to health and the right to a life with dignity to all citizens should permeate and temper taxation measures by a Sovereign power during these extraordinary times of such a ghastly and horrific pandemic that has thrown millions of people, temporarily out of work and out of any earnings to meet even their daily needs, not to speak of their ability to afford a reasonable medical treatment.

In Arthashastra, Kautilya stated - "*It is the duty of the ruler to ensure ' yogakshema', that is, the welfare of the people and that in the happiness of the subjects, lies the happiness of the ruler"*.

Yogakshemam Vahamyaham [Sanskrit for - your welfare is our responsibility] also be the government's philosophy just like that of the country's largest insurance company!

April 19, 2021

CAROTAR - Protecting the Soul of "Atmanirbhar Bharat"

Debasish Bandyopadhyay
Manager-Taxation, Khadim India Ltd.

Indian customs has undergone a sea-change in the recent past. While in one hand simplification of processes have been the key area of focus whereas on the other hand, plugging loopholes in protecting revenue and abuse of concessional provisions have also been taken care of. As part of such regulatory watch or preventive measure, Government has notified Customs (Administration of Rules of Origin under Trade Agreements) Rules, 2020 (CAROTAR) which came into effect on September 21, 2020 in order to check the undue claims of concessional duty benefit under free trade agreements and to put in place the requirement for stringent monitoring on imports of goods. Certain guidelines have been put in place for the enforcement of the 'Rules of Origin' for allowing preferential rate of duty on such imports.

CAROTA Rules and import controls

It is observed that the Free Trade Agreements (FTA) or Preferential Tariff Agreement (PTA) are being grossly misused by certain unscrupulous entities in order to claim the undue benefits of concessional rate of customs duty. The Finance Minister in her Union Budget-2020 speech had touched upon the said issue by voicing concern that such undue claims of FTA/PTA benefits had posed considerable threat to the domestic industry. Therefore, such imports required stringent checks. Accordingly, the Government of India has implemented the said rules effective from September 21, 2020. In terms of the said rules, the importer is obligated to comply with regulatory compliances in addition to producing the Certificate of Origin (CoO) at the time of imports. It is very significant to highlight that the proper implementation of the said rule is utmost important for the trade since any mess up in implementation may harm the domestic industry profusely. It is also significant to understand that in these pandemic times, it seems that not only the compliance burden of the CAROTAR but also the availability of major raw materials for certain sectors such as pharmaceutical, footwear, electronics etc. may be at stake causing huge disruption in domestic production and looming disaster for the domestic as well as export sectors.

Protect exports to protect the growth momentum

It is pertinent to note that the protection of revenue is rightly prioritized by the Government, however, the impact on our weakened economy is also required to be assessed before putting any restrictive or harsh

compliance obligation on the trade and industry in such pandemic times. Thus, "Atmanirbhar Bharat" is no doubt a noble idea to turn India into a global manufacturing hub, however, a sense of danger is always circling around the edges of the economy in respect of damaging impact on the country's exports. Indian exports have consistently been declining from April 2020 in terms of growth in comparison to the same period of last year. It is also required to be kept in mind while formulating restrictive policies in cross-border trade that production for exports should not be disrupted for want of raw materials due to such restrictive import policy. India needs to balance its EXIM policy in order to compete and outrun the over-growing influence of Bangladesh and Vietnam, even during such difficult economic times, they have registered robust growth in their exports as well as domestic economic parameters.

Adverse impact on trade facilitation

Whereas necessary arrangements have been made by the Government to ensure judicious application of CAROTAR, 2020, however, significant number of issues have been raised for delay in verification process leading to adverse impact on trade facilitation. In order to address the aforesaid issues, Central Board of Indirect Taxes and Customs (CBIC) has issued Instruction No. 20/2020-Customs dated December 17, 2020, and deliberated upon the issue of ground for verification. It is instructed that proposals for verifications should be duly vetted to ensure valid ground for verification. The field formation is also instructed to ensure that enquiry on origin of imported goods is initiated only where there are sufficient grounds to suspect origin of goods. It is also directed that unnecessary queries are not to be raised on account of goods origin as advised via Circular No. 45/2020-Customs October 12,2020.

Reforms, restrain and reward

India owns one of the largest market and consumption base in the world. In order to become a self-reliant economy, the country not only needs to focus on domestic manufacturing but is also required to formulate strategies to remove the inefficiency in the import related regulatory and bureaucratic processes. Many a times, it has been observed that the regulatory and administrative arrogance resulted into defeat of the intent and purpose of the reform policies. The Government has implemented many reforms in the recent past in order to improve the business climate in the country. However, reforms without reasonable restrain may not reap the targeted reward from the market. As discussed supra, if not properly supervised, CAROTAR may turn out to be counter-productive in the days to come. Alternatively, where digitization is fast catching up with the Indian Tax Administration, CBIC should emphasise on framing a mechanism to identify risk relating to sensitive import of goods through technology-based process. Therefore, India needs to balance its reforming or restrictive policies to protect the soul of Atmanirbhar Bharat.

October 20, 2020

Rules Transgress Section 30 of the Special Economic Zones (SEZ) Act and also Misread Customs Act

R K Singh

Former Member CESTAT and Senior Partner, TLC Legal Advocates

It is trite to say that the rules made under an Act are subordinate to that Act and cannot transgress the boundaries of the Act itself. However, rules 47 and 48 of the SEZ Rules, 2006 provide a hard-to-believe example of the transgression of the parent SEZ Act besides misreading the Customs Act, 1962 (CA).

For the ease of reference, rules 47 and 48 of the SEZ Rules and section 30 of the SEZ Act are reproduced below:

Section 30. Domestic clearance by Units-

Subject to the conditions specified in the rules made by the Central Government in this behalf-

a. *any goods removed from a Special Economic Zone to the Domestic Tariff Area shall be chargeable to duties of customs including anti-dumping, countervailing and safeguard duties under the Customs Tariff Act, 1975 (51 of 1975), where applicable, as leviable on such goods when imported; and*

b. *the rate of duty and tariff valuation, if any, applicable to goods removed from a Special Economic Zone shall be at the rate and tariff valuation in force as on the date of such removal, and where such date is not ascertainable, on the date of payment of duty.*

Rule 47. Sales in Domestic Tariff Area-

(1) *A Unit may sell goods and services including rejects or wastes or scraps or remnants or broken diamonds or by-products arising during the manufacturing process or in connection therewith, in the Domestic Tariff Area on payment of customs duties under section 30, subject to the following conditions, namely:*

(4) *Valuation and assessment of the goods cleared into Domestic Tariff Area shall be made in accordance with Customs Act and rules made thereunder.*

Rule 48. Procedure for Sale in Domestic Tariff Area-

(1) *Domestic Tariff Area buyer shall file Bill of Entry for home consumption giving therein complete*

description of the goods and/or service namely, make and model number and serial number and specification along with invoice and packing list with the Authorised Officers: Provided that the Bill of Entry for home consumption may also be filed by a Unit on the basis of authorization from a Domestic Tariff Area buyer.

(2) Valuation of the goods and/or services cleared into Domestic Tariff Area shall be determined in accordance with provisions of Customs Act and rules made thereunder as applicable to goods when imported into India.

It is evident that section 30 of the SEZ Act only deals with removal of goods by SEZ unit into the domestic tariff area. This section does not even mention services. But the said rules state that the assessment and valuation of the goods and services cleared by SEZ Unit into the domestic tariff area shall be in accordance with the provisions of the CA. Thus, the said rules transgress the boundaries of the parent section/Act inasmuch as they cover services also which are beyond the scope of the parent section (section 30 of the SEZ Act). Also, the CA (or even the Customs Tariff Act for that matter) does not deal with the services at all and has no provision for charging Customs duty or determining value of the services imported.

In the wake of this major illegality, the internal inconsistency of the wordings of these rules is not being discussed as that is of relatively minor consequence, but just as an illustration of such inconsistency, suffice to point out that sub-rule (2) of rule 48 inter alia speaks of valuation of services cleared into the Domestic Tariff Area (DTA) to be determined in accordance with the provisions of CA as applicable to goods imported.

In the light of the foregoing, it is imperative that the said illegality is forthwith removed by deleting all references to services in rules 47 and 48 of the SEZ Rules.

With Best Wishes:

MOON BEVERAGES LIMITED

AUTHORISED BOTTLER OF THE COCA-COLA COMPANY

A-32, SITE-4, SAHIBABAD INDUSTRIAL AREA, DIST. GHAZIABAD

May 05, 2020

Special Valuation Branch & Valuation of Goods Imported from Related Party

Jeevesh Mehta
Advocate and Lead Partner, Maven Legal LLP

It is common for a commercial establishment, whether manufacturer or a trading concern to import raw materials, semi-finished goods or finished goods from other countries. Import plays an important role in terms of availability of new technology, better quality goods, rate of goods etc.

Importing goods from various countries can be a part of corporate strategy which is mostly cost effective for a company having its branches / subsidiaries in various countries. The cost effectiveness and ease in dealing with a sister concern/ subsidiary often leads to special treatments given to each other.

Example: Ram and Shyam are brothers. Ram has a car which he wants to sell. Shyam showed his desire to purchase that car for his use. Ram offered Shyam a price of Rs 1 Lakh for the car, being totally aware that he can sell the car in the open market for Rs 150,000/-. But because Shyam is his brother he wants to give him a special discount.

The discount given by Ram to Shyam is quite natural and is a human phenomenon. The same behaviour is often seen between the corporates who are related to each other, may be as a Holding - Subsidiary, Sister Concern having one or more holding regulators etc. Therefore, whenever these companies buy and sell goods amongst each other, the sale is done without adding any profit margin or not at normal market value. This is called an influence on the price of goods due to the relation between the companies/parties.

As far as pricing between the related companies is concerned, it can be a part of corporate strategy, obligations or through an agreement. But from the perspective of Revenue department, this kind of business behaviour leads to evasion of taxes / duties.

Example: Indian Company (importer) who is importing a particular product from its parent company in JAPAN at an invoice value of USD 8000 and pays customs duty on the said value. But if that Indian concern or any other importer imports the same product from an unrelated supplier, then the invoice value would be USD 8000 and applicable customs duty is to be paid on USD 8000.

In the afore-mentioned scenario, the customs, is losing customs duty on USD 3000 since the parties are related. To curb the loss of revenue and to deal with such kind of

scenarios, the authorities developed a specialized investigation branch of customs. This branch of customs is called S V B.

As per rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007 (Customs Valuation rules), persons shall be deemed to be "related" only if:-

i) they are officers or directors of one another's businesses

ii) they are legally recognized partners in business;

iii) they are employer and employee;

iv) any person directly or indirectly owns, controls or holds 5 per cent or more of the outstanding voting stock or shares of both of them;

v) one of them directly or indirectly controls the other;

vi) both of them are directly or indirectly controlled by a third person;

vii) together they directly or indirectly control a third person;

viii) they are members of the same family.

Apart from the above categories and as per the facts and circumstances of each case, those who are having Collaboration Agreement, Technical Assistance Agreement or any other agreement / contract with the foreign supplier have to prove genuineness of their declared value before the Jurisdictional Commissioner or SVB.

Procedure & Mechanism for Finalization of Provisional Assessment of imports from related party:

Circular No.5 / 2016-Cus dated 09/02/02016

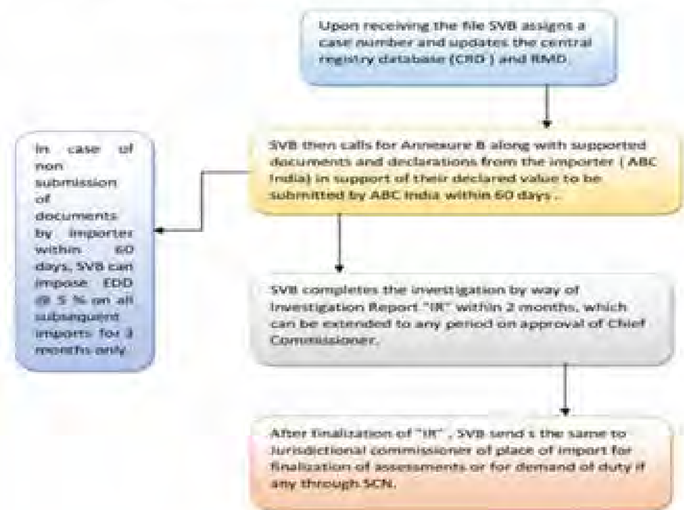
(This circular is issued in supersession of Circular No. 1/98 - Cus dated 1-1-98 and11/2001-Cus dated 23rd February 2001 and comes into immediate effect.)

TABLE - 1 **SVB Branches in India**

TABLE 2-**Determining Place of SVB for Investigation**

TABLE 3 - **Procedure**

TABLE 4: **Reference to SVB for further Investigation**



The SVBs are presently functioning at the Customs Houses at Bengaluru, Chennai, Kolkata, Delhi and Mumbai. In cases where the import takes place through Customs Houses of Mumbai / Delhi / Chennai / Kolkata / Bangalore, the importer is free to select the SVB of the Customs House of import or the Customs House most proximate to the corporate office, as convenient to him.

Whether the case requires SVB investigation or not?

It is imperative on the part of the importer to declare while filing Bill of Entry that the goods are being imported from a related

party as it would be necessary for the Customs to examine whether or not the circumstances surrounding the sale of the imported goods indicate that the relationship has influenced the price. In such situation, importers are advised that if their transaction falls in such a category they should, insofar as possible, file a prior Bill of Entry as provided under the second proviso to subsection (3) of section 46 of the CA, preferably 15 days prior to the import. The clearing custom house may ask for Provisional Duty (PD) Bond for such imports as it is generally presumed that such imports will be cleared on provisional assessment of the assessable value of the goods. If the prior PD Bond is not filed, the importer may face difficulties once the consignment has arrived at the port and end up in paying demurrages.

Submission of Annexure A before the Jurisdictional Commissionerate of Custom at the place of import.

After the importer declares the relation or while filing the bill of entry, he has to also file prescribed Annexure A before the Commissioner of Customs or the concerned officer of the Customs House of place of import so as to enable such officer to determine whether, prima facie, **there is a need for investigation by the SVB or not**.

Decision of Jurisdictional Commissioner of place of import to refer or not to refer the case to SVB.

After taking and analysing the relevant information/ declarations submitted by the importer under the related party import transaction, the Commissioner of the place of import can decide as to whether the case needs to be investigated by SVB or the assessment of such imports can be finalized by himself under rule 3 or 4 to 9 of Customs Valuation Rules, 2007.

Categories of cases where SVB investigation not required

The following cases are not to be taken up for inquiries by SVBs:

(i) Import of **samples and prototypes** from related sellers

(ii) Imports from related sellers where **duty chargeable (including additional duty** of Customs etc.) is unconditionally **fully exempted or nil**.

(iii) Any transaction where the value of imported goods is less than Rs 1 lac but cumulatively these transactions do not exceed **Rs 25 lacs** in any financial year

Procedure followed in SVB

Upon receipt of all related records from the referring customs formation, the SVB shall forthwith assign a case number and update the Central Registry Database (CRD) maintained by (Directorate General of Valuation (DGoV). The SVB shall also inform the Risk Management Division (RMD) of the details of the importer, his Importer- Exporter Code (IEC) , and details of seller for inserting suitable instructions for assessing officers at all Customs Houses so as to ensure provisional assessments during the currency of SVB inquiries.

Submission of Annexure B with relevant documents

SVB after receiving the reference from Commissionerate of place of import, then call for other information, documents and declarations including prescribed Annexure B from the importer and shall commence inquiries. The importer is also given suitable opportunity to submit all documents, declarations and evidence in support of the declared value.

Levy of Extra Duty Deposit (EDD) during pendency of SVB investigation

The procedure and mandate of levying of EDD upon the importer while the case is pending before SVB investigation has been amended via Circular no 05/2016 Customs, wherein it is provided that no EDD shall be obtained from the importers in case the importer provides the documents and information required for SVB inquiries within 60 days of such requisition. But, in case the importer fails to provide such documents and information within such stipulated time then EDD @ 5% of the declared assessable value shall be imposed by the Commissioner for a period not exceeding the **next three months**. As the EDD is in the nature of security deposit, the Importer has an option to pay EDD by way of **cash deposit or a Bank Guarantee**.

It is important to note here that via the Circular 05/2016 it has been very clearly specified that the **EDD @5% cannot be imposed for a period of more than 3 months.** But it is seen and observed many a times while dealing with various SVB branches across the country that the SVB investigations are kept pending even after providing all the information/ documents and EDD @5% is being levied for period of more than 3 months till the time Investigation Report (IR) is finalized by SVB. Importers are advised to be cautious over this aspect and must try to provide all the required documents within stipulated time of 60 days to avoid

payment of EDD @5% for 3 months or even for more than 3 months. Importer must insist SVB to finalize the IR at the earliest because the burden of EDD is often overseen by the importers, which consequently reduces margin in the product and increases financial burden.

Key Circumstances / Factors to be examined during investigation

The proper officer or SVB as the case may be, shall carefully examine the "circumstances surrounding the sale" and evaluate the case on the following parameters:

i.	Has the importer declared the price of the goods imported is a "transfer price"?
ii.	What is the basis on which the price has been settled between the buyer & seller?
iii.	Has the price been settled in a manner consistent with the way the seller settles prices for sales to buyer who are not related to the seller?
iv.	Does the nature of relationship between the buyer and seller appear to influence the price?
v.	Is the information provided by the importer in terms of rule 3 (3) (b) able to demonstrate that the transaction is at arm's length?
vi.	Are there any payments, such as royalty, licence fee etc., actually made or to be made, as a condition of sale of the imported goods, by the buyer to the seller, or by the buyer to a third party to satisfy an obligation cast by the seller? Are such payments included in the price actually paid or payable?
vii.	Whether any part of the proceeds of subsequent re-sale, disposal or use of the imported goods accrues, directly or indirectly, to the seller?
viii.	What is the nature of other payments, if any, made or to be made by the buyer as a condition of sale of the imported goods?
ix.	Has the importer entered into an Advance Pricing Agreement with the Income Tax Authorities or obtained an Advance Ruling?
x.	Will the prices paid or payable by the importer be settled with the seller at the end of a defined period by means of a debit note / credit note?
xi.	Is there any royalty and licence fee paid by the importer to the supplier or related party?
xii.	Whether the value of any part of proceeds of any subsequent resale, disposal or use of imported goods accrues to the seller?
xiii.	Whether any other payments are made or are contemplated to be made in future by buyer to seller as a condition of sale of imported goods etc.?

There can be other determination factors to be examined by the officer on case-to-case bases such as nature of the imported goods, the nature of the industry itself, the season in which the goods are imported, and whether the difference in values is commercially significant.

Note: During the investigation by SVB, the transfer pricing reports of the importer company plays an important role because to determine the genuineness of import value, the declarations made by importer before transfer pricing authorities for declaring the values as arrived at arm's length bases becomes the bases of submissions before SVB.

Time frame to complete the investigation

As per the Circular 05/2016 it is prescribed that the SVBs shall **as far as possible**, complete the investigations and issue its findings within **two months** from the date of receipt of information in Annexure B. But in most of cases there is always a need to extend the time period due to detailed information sought by SVB and time taken by the importers to submit the same. Therefore, where the enquiry is not complete in 2 months, the SVB seeks the approval of the Jurisdictional Commissioner for such extended time period as is deemed necessary to complete investigations.

Completion of investigation and submission of IR

Upon completing investigations, the SVB prepares an IR") with due approval of the Principal Commissioner/ Commissioner, by incorporating all relevant facts, submissions made by the importer, investigative findings, grounds for acceptance or rejection of transaction value, and the extent of influence on declared transaction value, if any. The IR also includes all relied upon documents and is communicated to the referring customs station/appraising group and such other stations where imports have been provisionally assessed. A copy of the IR shall also be sent to the DGoV and concerned customs stations where imports of the importer are being finalized provisionally.

Finalisation of assessments

- Where under the findings in IR, the declared value is found to be uninfluenced (Rule 3 CVR 2007)

The customs stations where provisional assessments have been undertaken immediately proceeds to finalize the same. There will be no issuance of a speaking order for finalising the provisional assessments in such cases.

- Whereas per findings in IR, the declared value is found to be influenced.

The Commissionerate at the custom station of the place of import shall issue a show cause notice creating demand of duty to the importer within 15 days of the receipt of the IR, under intimation to the concerned SVB. After the adjudication of such show cause notice, the order so passed by the adjudicating authority is order in original and appeal lies under section XV of the Customs Act against such order.

Validity of IR or Final assessment and change in circumstances surrounding the sale post finalization of assessment. (Annexure C)

In the erstwhile regime of SVB investigations, the SVB order so passed was valid for 3 years and importers were required to renew the said order by declaring if there is any change in circumstances or even no change in circumstances.

At present via Circular 05/2016 Customs, the SVB no longer passes an order in original or an appealable order on its own, rather it finalizes an IR, on the bases of which the Jurisdictional Commissionerate at place of import finalizes the provisional assessments or passes adjudication order as the case may be. Such IR or Final Assessment or Adjudication Order is valid indefinitely unless there is change in circumstance of sale or terms and conditions of agreement between importer and his related party supplier. In such a case the importers are required to declare the same at the place of import in the prescribed format under **Annexure C**.

In all such cases, the proper officer at the place of import shall examine the transactions as per procedures laid out above and the Jurisdictional Commissioner shall refer the matter to SVB, where required.

Closing notes: SVB investigations are being handled differently across the country and by different kind of professionals such as Chartered Accountants, Lawyers and even by teams of Customs House Agent (CHAs). It has been observed that SVB investigation requires specialized knowledge of Valuation Rules, relevant provisions of Customs Laws, import transactions and understanding of the importance of the documents submitted before SVB. The basic documents which are required to be submitted are as under:

a. Copy of the Audited Financial Statements of at least 3 preceding financial years.

b. Transfer pricing declarations made by the importer Form 3CEB and Transfer Pricing (TP) Reports for last few years.

c. All agreements with related parties.

d. Price list of products.

e. Back-to-back invoices of the imported products or cost certificates from supplier.

f. Advance Pricing agreements with Central Board of Direct Taxes (CBDT).

Importer must be very careful in submitting the above documents along with other certificates and declarations asked for by SVB during investigations. Any wrong declaration or mistake on part of importer can be fatal leading to loading of the declared value of the imported goods in many folds. Such loading may lead to increased cost of import, reduced profits along with penalties and interest imposed upon the importer by the customs authorities.

Parliamentarian
PEOPLE I POWER I POLITICS
UNDERSTANDING THE UNION BUDGET 2022
Exclusive Interview
Dr. Arvind Panagariya
Photo Feature by
Pritam Bandyopadhya
nti Media Limited
PUBLICATIONS
There is a little bit of Parliamentarian in Every Leader
Parliamentarian
PEOPLE I POWER I POLITICS
www.parliamentarian.in

A better tomorrow is not just something we're hoping for,

but something we're working towards, together.

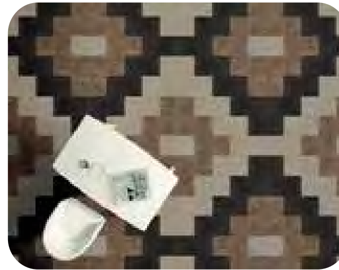
—

"A tomorrow that will be filled with all the little joys,
And all the big reunions.
And for this shared tomorrow,
We need to come together today,
Now, even if it's tough,
Even if we can't take it anymore.
Because sometimes for the greater good,
We have to make slight adjustments.

Like settling for the quarter plate when the guest list's too long.
And letting go of the good chair for somebody that wants it more.
Adjustments we've always made,
That we need to make once more.
And wear a mask and become the face of hope,
For you, for them, for us.
And so even if our smiles are hidden,
We're okay with that.
Because our hidden smiles today,
Will be the reason for a billion smiles tomorrow.
And so every time you think that you're alone,
Know that you're not,
That we too are doing our bit,
Covering our faces, masking our faces,
And becoming the face of hope."

Refer pack for details

An initiative *from* Nestlé



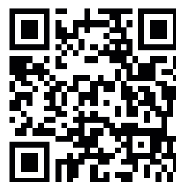
Creating Possibilities Transforming Lives

Welspun Group is one of India's fastest growing conglomerates with presence in Home Textiles, Line Pipes, Infrastructure, Warehousing, Steel, Oil & Gas, Advance Textiles and Flooring Solutions.

With state-of-the art manufacturing facilities in India, USA and Saudi Arabia, we cater to the global needs of our partners with solutions backed by innovation and cutting-edge technology, keeping customers as the key focus.

Scan the QR code to watch our **Corporate ad film**

Many Reasons To Smile!



HOME TEXTILES | LINE PIPES | INFRASTRUCTURE | FLOORING | ADVANCED TEXTILES | WAREHOUSING

/TheWelspunGroup | /WelspunGroup | /welspungroup | /company/welspun-group

WELSPUN GROUP
Leading Tomorrow Together

ENJOY THE TASTE OF COKE ZERO SUGAR

Coca-Cola®

ZERO SUGAR

Tried it yet?

COCA-COLA ZERO SUGAR. CARBONATED WATER. CONTAINS NON-CALORIC SWEETENER. THIS CARBONATED WATER CONTAINS AN ADMIXTURE OF SUCRALOSE AND ACESULFAME POTASSIUM. NOT RECOMMENDED FOR CHILDREN; PREGNANT AND LACTATING MOTHERS. TRADEMARK OWNER: THE COCA-COLA COMPANY. IMAGES ARE FOR REPRESENTATIVE PURPOSES ONLY.

EMPOWERING PROFESSIONALS to ACHIEVE THEIR GOALS

with Efficiency & Speed

www.oakbridge.in

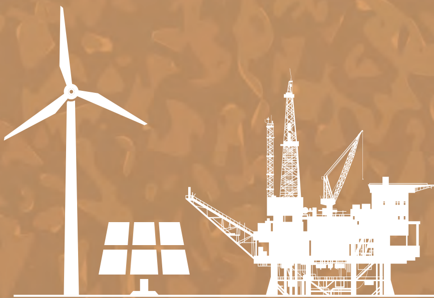
आज़ादी का अमृत महोत्सव

ओएनजीसी
ONGC

The Planet

पर्यावरण के प्रति प्रतिबद्ध ओएनजीसी

We have been consciously working on a plan to save the only known home to life- Planet Earth. That is the reason you will find multiple initiatives by ONGC for a sustainable future.



ONGOING PROGRAMS

Clean Development Mechanism Projects • Global Methane Initiative • Reduction in Gas Flaring • Renewable Energy • LED Program • Rain Water Harvesting • Green Buildings • Paperless Offices

स्वच्छ विकास तंत्र परियोजना • वैश्विक मीथेन पहल • गैस फ्लेयरिंग में कमी • नवीकरणीय ऊर्जा • एलईडी कार्यक्रम • बारिश के पानी का संग्रहण • ग्रीन बिल्डिंग • कागज रहित कार्यालय

UPCOMING PROGRAMS

Carbon Neutrality • Water Neutrality • Carbon Capture, Utilization and Storage

कार्बन तटस्थता • जल तटस्थता • कार्बन कैप्चर, उपयोग और भंडारण

Oil and Natural Gas Corporation Limited

To know more about how we are leaving a greener footprint behind, please visit ongcindia.com