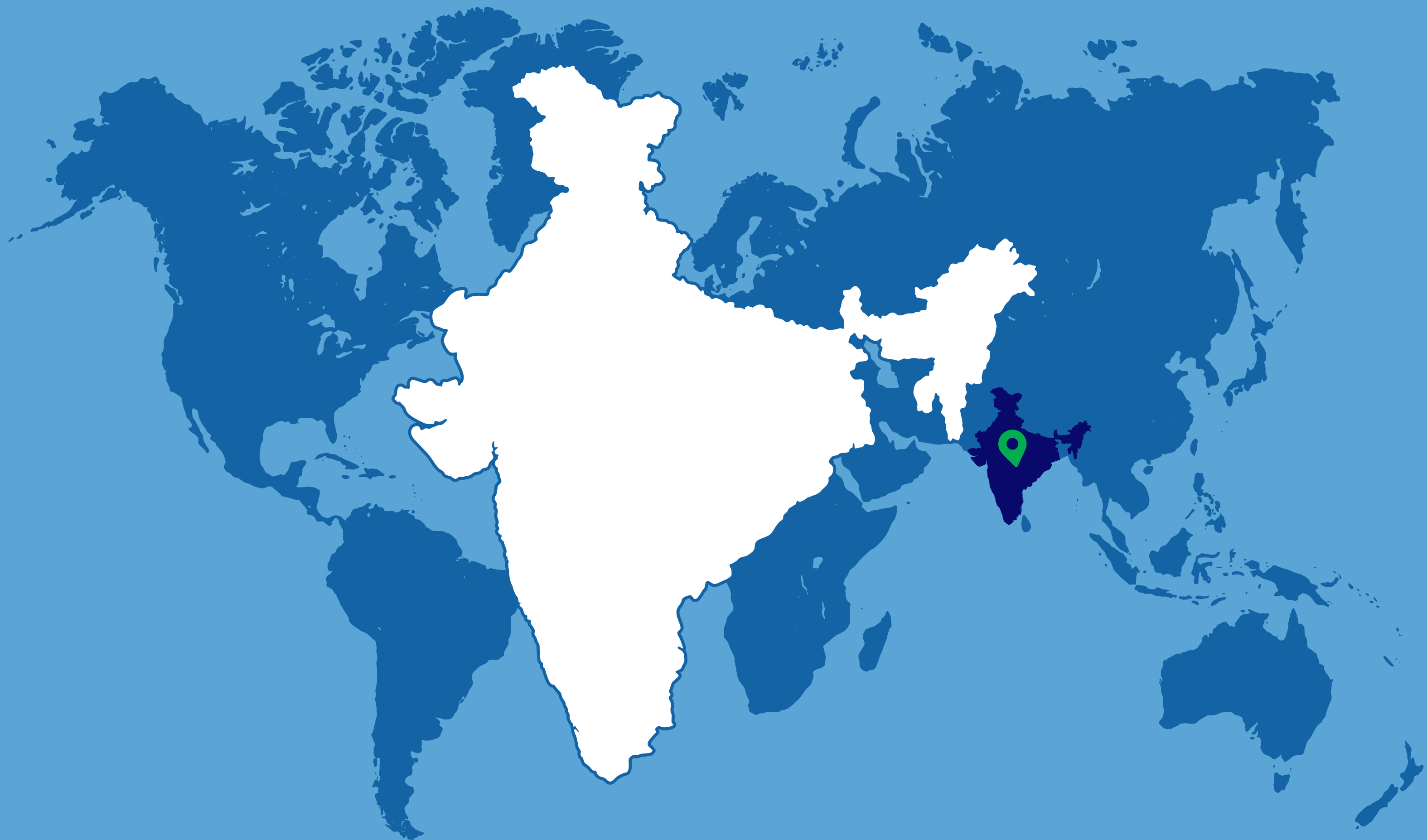
dhruva

YEAR IN REVIEW 2022



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Foreword

On the global front, 2022 saw the world recover from the aftermath of Covid. While Covid has certainly faded as a top headline, the hybrid work model / work-from-home seems to have become a way of life. Plausibly as an outcome of it,'moonlighting' became a much-debated buzzword. Prompted by that amongst other factors, the IT industry especially saw sizeable layoffs.

The layoffs also seem to be a synecdoche to the recession that has seemed to grip the world. The IMF has warned of a worsening outlook for the global economy and all economists across the world have become doomsday prophets. Central banks around the world are quickly raising interest rates in an attempt to tame inflation. Several counties are defaulting or are on the verge of default on payment of debt. A scary situation indeed as calls of recession are, to an extent, self-fulfilling prophesies! In the midst of this, the Russia-Ukraine war also added fuel to the fire and led to further volatility and uncertainty. As with every year, this year saw both highs and lows, and towards the end of the year, the world looked at Qatar with bated breath as it hosted the football world cup. The controversies surrounding the lead-up to the World Cup took somewhat of a backseat as the games kicked off, and the world rejoiced in the Joga Bonito (Portuguese for 'beautiful game').

As we close the doors on 2022, the world is looking at 2023 with renewed energies, enthusiasm, expectations albeit with a fair share of circumspection. With the heightened senses of reflection that usually seem to peak towards the end of the year, we are taking the time to stand and stare at the year that went by.

Amidst the negative global cues, India seems to be in a bit of an oasis. We are looking at a nearly 7 per cent GDP growth, have a stable government and have managed our economy quite well. The GST collections are approaching the ₹ 1.50 lac crores monthly mark, the direct taxes collections are robust and far above the budget numbers. While the capital markets are rocky, transactions continue to happen (albeit at a much slower pace). The NPAs in the banking sector seem to be under better control. The year also saw the launch of 5G in India, which our Hon'ble Prime Minister has called *a knock on the doors of a new era*. Clearly, the global factors will have an impact on the Indian economy; while we may be a bit resilient, we cannot be completely decoupled from the challenges of a connected world. Echoing the global optimism surrounding India's prospects, Bob Sternfels the

global MD of McKinsey and Company, recently said that *it is not just India's decade but it's India's century!*

On the global tax front, following UAE's introduction of Corporate Tax (CT) earlier this year, the formal text of the law was released in December. The CT regime therefore is set to kickstart in the UAE from financial years commencing on or after 1 June 2023. During the year, we also saw significant traction from OECD and the members of the Inclusive Framework towards ironing out several technical issues in the Pillar One and Pillar Two proposals. The OECD released a detailed technical guidance on BEPS Pillar Two (global minimum tax), and the focus on its implementation is expected to increase in 2023 as countries look to enact legislation surrounding it. Interestingly, on 12 December 2022, the Council of EU member states announced that it has reached unanimity which is required to adopt the directive implementing the minimum tax proposals (Pillar Two) at EU level. It is expected that the directive should be transposed into member states' national law before 31 December 2023 and some member states have already presented concrete implementation plans – interesting space to watch out for! The Singapore Budget too continues with its motto of a stable economic policy by ushering in a slew of measures to address the issue of income inequality and also by extending the sunset dates of various exemptions applicable to the financial services and infrastructure sectors.

Closer home, the Union Budget 2022 brought about a plethora of changes on the direct tax front including provisions enabling furnishing of updated tax returns, taxation of virtual digital assets, restriction of surcharge rate to 15% for long term capital gain on all assets, widening the definition of 'information' for reopening of assessments amongst others. Furthermore, the new framework on Overseas Investments served as a step in the direction of rationalizing and simplifying the prevailing regulations. Even as the government took steps to enhance certainty in tax laws, some of the recent Supreme Court rulings have had the effect of unsettling decade old positions. There is also the hint of social jurisprudence in the decisions and certainty in tax remains a work-in-progress at best. We look to 2023 with a hope for progressing towards a more efficient, trust-based taxation system.

This year also marks the completion of eight years of the Dhruva journey. Through this journey of eight years, we are beyond grateful to have been trusted advisors for a repertoire of prominent clients, Indians and MNCs. We have been indeed fortunate that our clients have trusted us with several marquee assignments; we have helped companies restructure, handled litigation, advised on a range of corporate tax intricacies, helped with succession planning, worked on advisory matters and so on. It will always be our endeavor to provide consistent high-quality services which would lead to client satisfaction and enhancement of client engagement.

This publication should be useful especially if you have missed on the key happenings on the tax and regulatory front in 2022, as it provides a comprehensive overview of the events that took place during the year. We have attempted to compile some of the key tax and regulatory issues that had a bearing on businesses in 2022 and their future impact. We hope you will find it an interesting read. Do reach out to us with your feedback and/or suggestions.

Dinesh Kanabar
CEO, Dhruva Advisors LLP

Roadmap of key events in 2022

TAKEOVER OF AIR INDIA BY THE TATA GROUP

JANUARY 2022

The acquisition of Air India by the Tata group from the Government of India was India's first major privatization in nearly two decades. The group was selected as the winning bidder in an auction in October. Tata group also holds majority interest in Air Asia and Vistara, a joint venture with Singapore Airlines. Air India is Tata group's third acquisition in the aviation sector, and it is expected that the acquisition will help in reviving Air India entities and creating a world class airline. The proposed merger of Air India with Vistara should also help in synergizing the operations of these airlines.

KEY STRUCTURAL ASPECTS OF THE UNION BUDGET, 2022

FEBRUARY 2022

India's GDP has witnessed robust recovery amidst severe waves of the pandemic, a testimony to the nation's economic resilience. While presenting the Union Budget for FY 2022-23, the finance minister mentioned that India's economic growth in FY 2022-23 is estimated to be 9.2 per cent, highest among all large economies. The Fiscal Deficit in FY 2022-23 is estimated at 6.4 per cent of GDP, which is consistent with the broad path of fiscal consolidation announced last year to reach a fiscal deficit level below 4.5 per cent by 2025-26. It was also mentioned that capital expenditure outlay would be stepped up by 35.4% from INR 5.54 lakh crore to INR 7.50 lakh crore in 2022-23. Effective Capital Expenditure of the Central Government is estimated at INR 10.68 lakh crore in 2022-23 equivalent to 4.1% of GDP.

TAXATION OF VIRTUAL DIGITAL ASSETS (VDAs)

FEBRUARY 2022

With the increasing popularity of VDAs and in order to bring certainty in its tax treatment, the Finance Act 2022 ('FA 2022') introduced new provisions for taxation of VDAs such as crypto currencies, non-fungible tokens, etc. The new provisions provide for a tax rate and the computation mechanism for determining gains/losses on transfer of VDAs. As per the new provisions, transfer of VDAs (cryptocurrencies, non-fungible token or such other notified digital asset) is taxed at 30% without any deduction (except for cost of acquisition) and set-off of losses. Loss from transfer of such assets is not allowed to be carried forward nor allowed to be set-off against any income (including income from VDAs). Further, in order to establish a trail of transactions in VDA, it is now provided that any payment made to an Indian resident in relation to transfer of VDA shall be subject to withholding tax at 1%. The Guidelines in this regard have also been issued by the CBDT in June 2022.

SUPREME COURT DENIES TAX DEDUCTION FOR FREEBIES TO MEDICAL PRACTITIONERS

FEBRUARY 2022

Allowability of expenditure incurred by the pharma companies in providing freebies to medical practitioners has been a vexed issue with conflicting jurisprudence on both the sides. The Supreme Court in case of *Apex Laboratories (P.) Ltd. v. DCIT*[1] has put the controversy to rest by deciding the issue in favour of the Revenue. The Supreme Court dismissed the taxpayer's appeal and held that when acceptance of freebies is prohibited by law for the recipient, providing such freebies is also impliedly prohibited by law for the payer. The Finance Act, 2022 has also brought in a clarificatory amendment in section 37 of

1. [2022] 442 ITR 1 (SC)

the Act which disentitles a taxpayer to claim any expenditure if such expenditure violates any law or regulation by which the recipient is governed.

WITHHOLDING TAX ON BENEFIT/ PERQUISITE

FEBRUARY 2022

A new provision has been introduced by FA 2022 providing for deduction of tax at source ('TDS') on provision of 'benefit' or 'perquisite' to a resident. Tax is to be deducted @10% by any person responsible for providing 'benefit' or 'perquisite' (whether convertible into money or not) to a resident provided such benefit or perquisite arises from business or exercise of profession of the recipient. This amendment is expected to impact a wide range of industries (FMCG, retail, automobiles, pharma, etc.) and business models. The CBDT has also issued couple of Circulars providing examples on the scope and coverage of section 194R. Refer our article titled ***'Section 194R - Taxation of benefits and perquisites – Removal or Amplification of difficulties?'*** for a detailed discussion on this subject.

UPDATED TAX RETURNS

FEBRUARY 2022

With an objective to promote voluntary compliance, new provisions have been introduced to enable the taxpayer to file an updated tax return subject to certain conditions. The updated tax return can be filed irrespective of whether the original tax return has been furnished or not. This opportunity is available only once for a particular year. If the updated returns are filed within 1 year, the taxpayer needs to pay 25% additional tax on the total tax and interest payable. The additional tax doubles to 50% if the tax returns are sought to be updated thereafter but before end of 2 years. The facility of filing updated return would help taxpayers who might have missed out on filing returns or disclosing certain income in their return. It also gives a window of opportunity to taxpayers to protect themselves from penalty and prosecution implications.

DISALLOWANCE OF CLAIM FOR DEDUCTION OF EDUCATION CESS

FEBRUARY 2022

Deduction of education cess has been a matter of contention between taxpayers and the Revenue in the recent years. To settle the controversy, the Finance Act, 2022 has brought in a retrospective amendment to clarify that the term 'tax' includes 'cess' for the purposes of disallowance. The CBDT has also introduced a new rule prescribing the manner for making an application requesting for a recomputation of total income without allowing the claim for deduction of cess. In doing so, it safeguards the taxpayers from any penal consequences.

CBDT CIRCULAR ON MOST FAVORED NATION ('MFN') CLAUSE

FEBRUARY 2022

MFN status refers to a situation where non-residents are given a favored tax treatment by the Source State (say, India) if India has subsequently offered a favorable tax treatment to another country. This is of course subject to the tax treaty having an enabling clause to this effect. Though each MFN clause has a different formulation/ structure, the underlying principle is that if India subsequently accords a favorable treatment to another OECD member country, the same favorable treatment will apply for tax treaties having an MFN clause. The crux of the controversy was whether another country should be an OECD member at the time of signature of tax treaty or will it suffice if it becomes an OECD member later on? While the matter is

subjudice before the Supreme Court, a Circular[2] issued by the CBDT has raised many concerns. The Circular appears to go beyond what is permissible in the tax treaty and stipulates stringent conditions for an MFN clause to apply.

COMPREHENSIVE ECONOMIC PARTNERSHIP AGREEMENT ('CEPA') SIGNED BETWEEN INDIA AND UAE

FEBRUARY 2022

The UAE-India CEPA has entered into force on 1 May 2022. CEPA is a comprehensive agreement, which inter-alia covers trade in goods, trade in services, dispute settlement, movement of natural persons, telecom, customs procedures, government procurement, digital trade and cooperation in other areas. It is expected that the India-UAE CEPA will further strengthen the already deep, close and strategic relations between the two countries and will create new employment opportunities, raise living standards, and improve the general welfare of the people of the two countries.

INDIA AND AUSTRALIA SIGN ECONOMIC CO-OPERATION AND TRADE AGREEMENT

APRIL 2022

India and Australia signed an interim Economic Cooperation and Trade Agreement (ECTA) on 2 April 2022. The Agreement is set to provide zero-duty access to 96 per cent of India's exports to Australia including shipments from key sectors such as engineering goods, gems and jewellery, textiles, apparel and leather. The pact is expected to boost bilateral trade in goods and services to USD 45-50 billion over five years, up from around USD 27 billion, and generate over one million jobs in India. The Agreement will deliver new market access opportunities for both countries. The Government of Australia has also agreed to amend the Australian domestic law to stop taxation of offshore income of Indian firms providing technical services to Australia. Both the countries have reaffirmed their commitment to conclude a Comprehensive Economic Cooperation Agreement (CECA) by the end of 2022.

NEW CATEGORIES OF TAXPAYERS NOTIFIED FOR FILING INCOME-TAX RETURNS

APRIL 2022

The income-tax provisions require a person to file tax returns if the total income exceeds the basic exemption limit. The provisions are widened, and the following categories of persons are also now mandated to file tax returns even though their total income may not exceed the basic exemption limit:

1. Person having total sales, turnover or gross receipts in the business exceeds INR 6 million; or total gross receipts in profession exceeds INR 1 million; or
2. Person whose aggregate of TDS and TCS is INR 25,000/- or more; or
3. Persons depositing INR 5 million in one or more savings bank accounts in a year.

FUND MANAGEMENT REGULATIONS 2022 FOR SET UP OF FUNDS IN IFSC

APRIL 2022

The International Financial Services Centre Authority (IFSCA) has notified the IFSCA (Fund Management) Regulations, 2022, which have become operative from 19 April 2022. The IFSCA Fund (Management) Regulations, 2022 govern the framework for investment funds in India's

2. Circular 3/2022 dated 3 February 2022

International Financial Services Centre (IFSC). The IFSCA Fund Management Regulations have replaced the various regulatory provisions and circulars issued by Securities and Exchange Board of India (SEBI) with respect to the funds in IFSC. The Regulations inter-alia comprise of framework for various schemes for fund management, regulations for registration of fund management entity, regulatory framework for exchange traded funds, regulatory framework for other fund management activities such as portfolio management services, investment trust, family investment funds etc.

MERGER OF HDFC LTD AND HDFC BANK ANNOUNCED

APRIL 2022

The merger of country's largest housing finance company - HDFC Ltd and biggest private lender - HDFC bank is one of the biggest transactions in India's corporate history, resulting in creation of a financial services behemoth. The deal is valued at about USD 40 billion. The merger is a win-win situation for both the entities and their shareholders. The deal has got in-principle approval from the stock exchanges, Reserve Bank of India (RBI), SEBI, Pension Fund Regulatory and Development Authority (PFRDA) and Competition Commission of India (CCI). The proposed entity will have a combined asset base of around INR 18 lakh crore. The merger is expected to be completed by the first or second quarter of FY24, subject to other pending approvals.

MEASURES ANNOUNCED BY RBI TO BOOST FOREX INFLOWS

JULY 2022

The RBI has announced measures to diversify and expand the sources of forex funding with an aim to mitigate volatility and dampen global spillovers, including letting foreign investors invest in short-term corporate debt and allowing the purchase of more government securities under the fully accessible route. Banks have been exempted from maintenance of cash reserve ratio (CRR) and statutory liquidity ratio (SLR) on incremental foreign currency non-resident deposits. The limit for external commercial borrowings under the automatic route has been raised to $1.5 billion from $750 million or its equivalent per financial year. The all-in cost ceiling under the ECB framework has been raised by 100 bps, subject to the borrower being of investment-grade rating. The measures also include easing norms for FPI investment in the debt market.

DEPARTMENT OF COMMERCE ('DOC') AMENDS SEZ RULES TO LIBERALIZE WORK FROM HOME (WFH) FOR SEZ UNITS

JULY 2022

Hybrid mode of working has become a norm, especially in the IT/ITES sector in the wake of disruptions caused by the pandemic. In order to enable the units in SEZs to adopt hybrid mode of working and provide WFH facility to its employees, DoC has amended the Special Economic Zones (SEZ) rules and issued a Standard operating Procedure (SOP) to this effect. Subsequently, DoC has further relaxed the Rules to provide that WFH can be provided to upto 100% of all employees of the SEZ unit and that the same is permitted until 31 December 2023.

NEW REGIME ON OVERSEAS INVESTMENTS

AUGUST 2022

On 9 August 2021, the RBI had issued draft rules/ regulations regarding Overseas Direct Investment ('ODI')/ Overseas Portfolio Investment and had sought feedback on the same ('Draft ODI Rules'). Pursuant to the Draft ODI Rules and the feedback received, the Central Government and the Reserve Bank of India, on 22 August 2022, released the new

rules/ regulations/ directions on ODI ('New ODI Regime'). The New ODI Regime aims to simplify the existing framework for overseas investment by persons resident in India to cover wider economic activity and significantly reduce the need for seeking approvals. Corresponding changes in light of the amendments vide New ODI Regime have also been made on 23 August 2022 in the Master Directions to Liberalized Remittance Scheme. Refer our articles titled ***'New ODI Guidelines – Issues, opportunities and way forward'*** for a detailed discussion in this regard.

INTRODUCTION OF LEGAL ENTITY IDENTIFIER FOR CROSS-BORDER TRANSACTIONS

OCTOBER 2022

The Legal Entity Identifier (LEI) is a 20-digit number used to uniquely identify parties to financial transactions worldwide to improve the quality and accuracy of financial data systems. LEI has been introduced by the Reserve Bank in a phased manner for participants in the over the counter (OTC) derivative, non-derivative markets, large corporate borrowers and large value transactions in centralized payment systems. In order to further harness the benefits of LEI, the RBI has directed AD Category I banks to obtain LEI number from the resident entities (non-individuals) undertaking capital or current account transactions exceeding INR 50 crores.

DIGITAL PERSONAL DATA PROTECTION BILL 2022 ISSUED BY THE MINISTRY OF ELECTRONICS AND INFORMATION TECHNOLOGY, GOVERNMENT OF INDIA

NOVEMBER 2022

The Ministry of Electronics and Information Technology published the draft Digital Personal Data Protection Bill, 2022 in November 2022. The Bill seeks to replace the previous Personal Data Protection Bill introduced in 2019 and which was later withdrawn in August 2022. The Digital Personal Data Protection Bill is a legislation that frames out the rights and duties of the citizen on one hand and the obligations to use collected data lawfully of the Data Fiduciary on the other hand. The Bill seeks to establish the legal framework for governing protection and processing (which includes collection/recording, storage, alteration, dissemination, removal/deletion) of digital personal data in India.

CORPORATE TAX LAW IN UAE

DECEMBER 2022

UAE had announced the introduction of Corporate Tax (CT) in January 2022. This was followed by a Public Consultation Document (PCD) in April 2022, which laid down the outline of the UAE CT law and invited comments from stakeholders. On December 9, 2022, a formal text of the CT Law was released. The CT Law is supplemented with frequently asked questions (FAQs) which provide further guidance and clarification on the provisions. This will be further supplemented by Cabinet and Ministerial decisions on specific matters. As per the CT law, corporate taxes will be levied at the rate of 9% for taxable income exceeding AED 375,000. Individuals would be in scope of CT Law, if engaged in 'specified' business or business activities. Foreign entities having 'nexus' in UAE are sought to be brought into the net of CT Law. Refer our article titled ***'Emerging tax landscape in the UAE'*** for an insightful discussion on this subject.

EU SET TO IMPLEMENT THE MINIMUM TAXATION (PILLAR TWO) BY END OF 2023

DECEMBER 2022

On 12 December 2022, the Council of EU member states announced it has reached unanimity which is required to adopt the directive implementing the

minimum taxation (Pillar Two) at EU level. A formal approval should follow shortly.

The directive should be transposed into member states' national law before 31 December 2023 and some member states have already presented concrete implementation plans. For groups with a consolidated turnover of at least EUR 750 million, the transitional rules would, however, already have effect as from December 2021.

IMPROVING TAX BUOYANCY – TAX COLLECTIONS FAR EXCEEDING THE TARGETS

The direct tax collections have continued to grow at a robust pace which clearly indicates a revival of businesses post pandemic. Direct Tax collections up to 17 December 2022 shows that the net collections are at INR 11.36 lakh crore, which is 19.81% higher than the net collections for the corresponding period of last year. The net collection includes Corporate Income Tax (CIT) at INR 6.06 lakh crore and Personal Income Tax (PIT) at INR 5.26 lakh crore. The cumulative advance tax collections for the first, second and third quarter of the FY 2022-23 stand at INR 5.21 lakh crore which is a growth of 12.83% from the corresponding period in last year.

PATHBREAKING JUDGEMENTS PRONOUNCED BY THE SUPREME COURT

The year 2022 saw a plethora of landmark rulings by the Hon'ble Supreme Court of India (SC), with more than a fair share of contentions and conclusions bringing about clarity, albeit leading to some confusion and critique at times. The decisions pronounced in 2022 seem to indicate a trend reversal with more than 60%[3] of the concluded matters being held in favor of the Revenue. The setting up of a special bench, which will hear these matters on Wednesdays and Fridays, is a welcome move as it will not only unclog long pending disputes and expedite the matters but will also ensure that matters on the same issues are clubbed and placed in one bench. Refer our article titled "Trends in direct tax Supreme Court jurisprudence" for an incisive analysis on this subject.

INCENTIVES INTRODUCED TO BOOST MANUFACTURING IN INDIA

In order to attain its ambition of becoming a US $5 trillion economy by the year 2025, the Government of India has formulated many initiatives to provide impetus to the manufacturing sector. The Union budget of FY2022-23 announced design-led PLI Scheme for telecom and networking products to build a strong ecosystem for 5G. Consequently, Design-led PLI scheme has been introduced in June 2022 and applications were invited from Design-led manufacturers as well as others, for availing incentive under the PLI Scheme for five years commencing from 1st April 2022. Recently, it has also been announced that 7 new PLI schemes that are not part of the original program have been approved[4]. The Union Budget 2022 also brought along significant changes in the Customs duty structure favoring domestic manufacturing. The Government has sought to further calibrate the Customs duty rates in line with its Atmanirbhar Bharat goals. Accordingly, import duties were raised for finished goods for which domestic manufacturing capacity exists, while duties on industrial inputs have been brought down. The Government is planning a gradual phase out of concessional tariff rates offered for capital goods and project imports, as these concessions deprive the local producers of a level playing field in areas like coal mining projects, power generation, transmission or distribution projects, railway and metro projects. Refer our article titled ***'The Manufacturing Sector in India – A sweet spot'*** for a detailed discussion in this regard.

3. Based on a desktop analysis of direct tax cases barring SLPs on taxmann.com
4. https://pib.gov.in/PressReleasePage.aspx?PRID=1864187

BACK

Trends in Supreme Court jurisprudence[5]

The year 2022 saw a plethora of landmark rulings by the Hon'ble Supreme Court of India (SC), with more than a fair share of contentions and conclusions bringing about ***clarity***, albeit leading to some ***confusion*** and ***critique*** at times. Even as parties locked horns in legal battles, all stakeholders ranging from taxpayers, revenue authorities, professionals to Netizens following the court chatter on Twitter would plausibly agree that the year 2022 was an eventful one. In this article, we attempt to take you through some of the landmark rulings of the Supreme Court and decipher a few of the underlying trends observed from these rulings.

This year saw the appointment of Justice DY Chandrachud as the 50th Chief Justice of India (CJI). He has been a part of benches that have delivered path breaking judgements especially focusing on constitutional rights, including validity of the Aadhar scheme, section 377 of the Indian Penal Code (IPC) and women abortion rights. After his appointment in November 2022 as the CJI, he announced the commencement of a special bench to adjudicate matters relating to direct and indirect taxes. The setting up of a special bench, which will hear these matters on Wednesdays and Fridays, is a welcome move as it will not only unclog long pending disputes and expedite the matters but will also ensure that matters on the same issues are clubbed and placed in one bench.

While our focus in this article will be on taxation matters, considering that it is more often than not the same Bench that rules on all matters, it may be worthwhile noting some of the important judgements on non-tax fronts as well. The Supreme Court decision in ***UOI v. M/s. Ganpati Dealcom (P.) Ltd.***[6] was notable in that regard as it held that the amendments in the law relating to Benami transactions[7] applied prospectively. In 2016, the amended law had the effect of expanding the scope of Benami transactions, as well as enhancing the punishment for them, including confiscation of the Benami property and a fine of up to 25% of the fair market value of the property. In a landmark ruling, the Supreme Court struck down the provisions dealing with criminal prosecution in the unamended law as unconstitutional and held that penal provisions could only be applied prospectively. At a time where retrospectivity has become commonplace, this decision in ***favor of prospective application*** was music to the ears.

On the flip side, the Supreme Court in its ruling in the case of ***Vijay Madanlal Choudhary v. UOI***[8] validated the wide powers of Enforcement Directorate (ED) under the *Prevention of Money Laundering Act (PMLA)*. The PMLA was originally enacted in 2002 to align with India's international commitments to curb the practice of money laundering and it was later made more stringent by way of amendments. The petitioners had, inter-alia, challenged the scope of the law to convert any offence into a money-laundering offence, and the unrestrained powers given to the ED. While dismissing these petitions, the Supreme Court declared that the ED's powers are not arbitrary in nature and upheld the ED's power to arrest and seize properties under the PMLA. Nationwide surveys[9] indicated that the citizens are supportive of this verdict, indicating that they are desirous of concrete action against law breakers.

On the tax front, several notable judgements have been delivered by the Supreme Court in 2022, which are likely to have a far-ranging impact on Indian tax jurisprudence in the coming years. We have analyzed a few key judgements and noted a few key trends that seem to be emerging from the decisions.

Trending towards social jurisprudence

Earlier this year, in February 2022, the Apex Court opened the floodgates to ***morality as a ground*** while delivering its landmark judgement in the case of ***Apex Laboratories (P.) Ltd. v. DCIT***[10]. The Supreme Court settled the long pending debate on the issue of tax deductibility of expenses incurred by

5. This article is contributed by Umesh Gala (Partner, Dhruva Advisors), Saurabh Shah (Principal, Dhruva Advisors) and Jagravi Shah (Senior Associate, Dhruva Advisors)
6. [2022] 141 taxmann.com 389 (SC)
7. The Benami Transactions (Prohibition) Act, 1988
8. [2022] 140 taxmann.com 610 (SC)
9. Conducted by C-Voter on behalf of IANS
10. [2022] 442 ITR 1 (SC)

pharmaceutical companies for providing freebies to medical practitioners. On one hand, the Revenue contended that the regulations issued by Medical Council of India (MCI Regulations) prohibited medical practitioners from accepting such freebies, and hence, these expenses are incurred for a purpose that is an offence prohibited by law and thus ought to be disallowed. On the other hand, the Taxpayer took recourse to the language of the law and argued against the disallowance citing that MCI Regulations applied only to medical practitioners and not to pharmaceutical companies, hence it was not an offence or prohibited by law as far as the pharma companies are concerned. A majority of the High Courts had accepted this contention of the taxpayers. The Supreme Court dismissed the taxpayer's appeal and held that when acceptance of freebies is prohibited by law for the recipient, providing such freebies is also impliedly prohibited by law for the payer. The SC did not accept the taxpayer's legal argument and held that no court will aid a party in an immoral or illegal act. The Court explicated that *patients repose trust in their medical practitioners and granting a deduction for such expenses would undermine public policy*. This ruling has implications not only for the pharma sector but also extends to all other sectors that are regulated. The taxpayers would have to exercise caution in determining if an expense is violating any law, both from the perspective of the payer as well as the recipient.

Fast-forward to September 2022, when morality and trust as a line reasoning were echoed in the Supreme Court ruling in the case of ***Checkmate Services (P.) Ltd. v. CIT***[11] ('the Checkmate case'). The Supreme Court upheld the Revenue's contention that the employees' contribution to the provident fund would be available as a deduction only if it is deposited on or before the due date as per the relevant statues and not the due date of filing the return of income. The Supreme Court expounded that there is a clear distinction in law between the employer's contribution and employees' contribution to EPF, and that the leeway granted to the assessee that the deductions are allowed as long as the deposits are made before the due date of filing the return is available only for the employer's contribution and not for the employees' contribution, which are deducted from their income and thereby ***held in trust*** by the employer.

In recent times, it seems like the Supreme Court is increasingly relying on ***social jurisprudence*** in its rulings. It is well settled as per the positivist theory laid down as early as the 18th century, that law is to be distinguished from morality and religion. Decisions focusing on subjectivity and morality add fuel to the debate as to whether the Courts ought to exercise judicial restraint in dealing with legal issues, and social jurisprudence should be reserved only for exceptional matters and questions really warranting a comment on morality such as the Supreme Court's decision relating to section 377 of the Indian Penal Code or the Hijab ban case. Amidst the speaking orders reading like textbooks on the concerned matters, while there is no denying the fact that the rulings expound the subject matter in abundant detail, these also make one question if there is an overlap of powers with the Legislature at times.

Contrarian judgements in the plenty

The decision in the Checkmate case, settled a long-pending issue subject to differing views by the High Courts. In doing so, it called to question principles cited in a myriad of High Court decisions *("no less than forty High Courts" as quoted by the SC)* and points to possibly an alarming trend of the Supreme Court ***overturning decisions of the High Court***. At a macro level, a desktop analysis[12] conducted on Supreme Court decisions relating to direct taxation matters, indicated that in the year 2022, the Supreme Court overturned almost half of the decisions of the High Court against which an appeal had been filed in the highest Court.

11. [2022] 448 ITR 518 (SC)
12. Based on the direct taxation cases reported on Taxmann.com barring SLPs

Stricter interpretation of the statute

Although the Checkmate case was in the context of a fairly narrow fact pattern, the principles adopted here will have a far-reaching impact. The SC reaffirmed its view in its earlier decision in the case of ***Commissioner of Customs v. Dilip Kumar & Co.***[13] ('the Dilip Kumar case') delivered in 2018 and placed a strong emphasis on the ***principle of strict interpretation of taxing statute.*** Curiously, in the same judgement, while debating whether an amendment brought in by the Finance Act was curative or amendatory and hence, retrospective in nature, the SC duly noted that while the Parliament has explicitly stated that this amendment will operate with effect from the next assessment year, however, the matter before the Court involved the p***rinciple of construction*** to be placed on the provisions of the Finance Act and thereby the amendment was held to be retrospective in nature.

Another decision that will have far-reaching impact when it comes to the perennial debate between strict and liberal interpretation of the statute is that of ***Principal CIT v. Wipro Ltd.***[14] In the said ruling, the Supreme Court denied the option of foregoing the benefit under section 10B by holding that section 10B, being an exemption section, was to be strictly construed and the declaration under section 10B(8) needed to be filed on or before the due date of filing the return of income. Interestingly, while the Supreme Court in the Dilip Kumar case, which is rendered in the context of customs law, has held that an exemption notification should be interpreted strictly, in the 1992 decision of the Supreme Court in the case of ***Bajaj Tempo Ltd. v. CIT***[15] which is in the context of income-tax law, the SC has held that the provision of a taxing statute granting incentive for promoting growth and development should be construed liberally. Not only this, but also the Supreme Court in its earlier ruling in the case of ***CIT v. Yokogawa India Ltd.***[16]***,*** in the context of section 10A of the Act, has held that section 10A is in the nature of a deduction, although the section is placed in Chapter III (exemption provisions) of the Act. Interestingly, the WIPRO ruling does not provide any basis or justification for departing from its earlier decision while holding section 10B to be an exemption provision. Amidst divergent opinions and controversies, one cannot turn a blind eye to the emerging trend of the Hon'ble Court interpreting the taxing statute more strictly and against the taxpayers.

Rewriting the law as we know it

The saga of ***contrarian judgements*** overturning earlier decisions of the Court, continued with the Supreme Court rulings relating to charitable institutions. Two landmark rulings delivered on the same day by the same Bench, has had the effect of virtually turning upside down the law governing charitable institutions as we know it. In the first decision in the case of ***New Noble Educational Society v. the Chief CIT***[17] ('the New Noble decision'), the Supreme Court upheld the Revenue's contention and held that an educational institution will enjoy an exemption under section 10(23C) only if it exists "solely" for educational purposes. The SC interpreted the word "solely" to mean "exclusively" and thereby ***departed from the ratio in its earlier rulings*** in *Surat Art Silk, Queens Educational Society and American Hotel and Lodging Association*[18], which relied liberally on the "predominant" object test. The SC itself, acknowledging the impact of such a deviation from the erstwhile law, held that the ***ruling was to operate prospectively.*** The SC also held that if the objective of the institution is profit-oriented, it would not qualify for the exemption. However, the generation of surplus, per se, would not debar the institution from the exemption, thereby ***stressing on the actual conduct and objects of the institution***. The SC has thrown in a fair bit of subjectivity leaving the field open to newer rounds of litigation.

13. [2018] 69 GST 239 (SC)
14. [2022] 446 ITR 1 (SC)
15. [1992] 196 ITR 188 (SC)
16. [2017] 391 ITR 274 (SC)
17. [2022] 143 taxmann.com 276 (SC)
18. Additional Commissioner of Income Tax v Surat Art Silk Cloth Manufacturers' Association [1978] 121 ITR 1 (SC), Queen's Education Society v Commissioner of Income Tax [2015] 372 ITR 699 (SC) and American Hotel and Lodging Association v Central Board of Direct Taxes [2008] 301 ITR 86 (SC)

The second decision in the case of ***ACIT v. Ahmedabad Urban Development Authority***[19] ('the AUDA decision'), was in the context of charitable institutions engaged in the advancement of the object of General Public Utility (GPU), falling under the meaning of *"charitable purpose"*. The SC held that where fees, cess or consideration represents the cost or a nominal markup, it will not be construed as trade, commerce, or business. However, a substantial markup would have the effect of tainting the activity as commercial in nature and the organization would qualify for a deduction only if receipts are within the prescribed quantitative limits. The Supreme Court's ruling has shifted the focus from mere application of income to charitable purposes to the actual process of earning the income, and the extent of the income earned. However, this ruling also suffers from a lack of clarity in terms of how much markup would qualify as substantial, how costs are determined, what qualifies as incidental activities and so on, and it looks like the chatter around charity is likely to continue in the times to come.

The AUDA decision also brought to the forefront the discussion as to the ***relevance of circulars*** issued by the Board. Taking a cue from the five Bench ruling in ***CCE v. Ratan Melting and Wire Industries***[20], the SC reaffirmed that the well-established principle that circulars are binding on the department applies only if they are in consonance with the plain construct of the law. This serves as a reminder to the taxpayers that circulars are at best an external aid in interpretation and discourages extensive reliance on circulars if they seem to be at odds with the law of the land. This view was also later affirmed in the recent SC decision in ***CCE & ST v. Merino Panel Product Ltd***[21].

One cannot comment on the recent trends without giving due importance to the ***length of the decisions,*** as the New Noble decision runs to 50+ pages, and the AUDA decision runs to almost 150 pages. With the entire legislative history of the provisions, the various amendments and their rationale, the opinions of the Supreme Court from earlier rulings and the observations of the Court in the instant matter packed in one large text, the ***law is practically rewritten*** by the Court. One has to admit that the judgements while delivering a few firm answers, have also led to a myriad of ***unanswered questions*** and the ***confusion*** that has followed invariably. If anything, it forces you to take the old adage – ***nothing is certain in life except death and taxes*** – with a grain of salt, as legal conflicts that we once thought were done, dusted and dead, have found new life and meaning in the recent rulings, and in that light, certainty in tax does remain a question.

More questions than clarifications?

Another decision that has led to both clarifications and questions alike, is the Supreme Court's decision in the case of ***UOI v. Ashish Agarwal***[22]. In a one-of-a-kind case, the Supreme Court had the occasion to deal with an issue that was the subject matter of more than 9,000 writ petitions filed before various High Courts. In the wake of the Covid-19 pandemic, time limits for issuing notices under various provisions were extended, one such extension being issuing notices for re-assessment under the pre-amended section 148 of the Act. The revenue issued reassessment notices post 1 April 2021 under the pre-amended section 148 of the Act (while not following the post amendment reassessment law regime which was effective from 1 April 2021). In several of the cases, the assessees filed writ petitions in the High Courts, and in numerous matters, the HCs ruled in favor of the assessee and held that the notices are invalid and ought to be squashed. The Supreme Court while ruling on this matter, upheld the validity of the reassessment notices and adjudicated that the notices shall be deemed to be issued under the amended section 148A of the Act, so as to not render the revenue remediless. In an attempt to play a balancing act between the interests of the revenue and taxpayers, the SC ruled that the revenue will be obliged to comply with all the procedural requirements laid down in the amended sections. The matter seems to remain largely unconcluded as owing to many

19. [2022] 143 taxmann.com 278 (SC)
20. [2008] 12 STR 416 (SC)
21. [2022] CIVIL APPEAL NO. 6891 OF 2018 (SC)
22. [2022] 444 ITR 1 (SC)

unaddressed issues, further rounds of litigation on various matters not squarely covered by this ruling are being filed and heard at the drop of a hat at all judicial levels currently. This ruling has been discussed in depth in our article ***"Reassessment – The Saga continues"*** forming part of the Year in Review 2022.

Lack of judicial restraint?

It is a well-established principle that ignorance of law cannot be an excuse for its violation. The supreme court however seems to have ***condoned the revenue's ignorance*** which has manifested in the revenue not following the law to the letter while issuing the reassessment notices. By deeming it as a 'genuine mistake' of the revenue, the SC seems to have set a precedent that allows for 'genuine' mistakes so to say, and this could have far-reaching repercussions, if misused. Not only this, but also the Supreme Court ***exercised the extraordinary powers*** vested in it under Article 142 of the Constitution of India in deciding this matter. Article 142 grants powers to the highest court to pass any order or decree as necessary for complete justice. Using this article for taxation matters is quite rare and certainly adds to the debate discussed earlier in this article, as to whether the Courts ought to reserve extraordinary measures only for extraordinary matters and times, while exercising ***judicial restraint*** otherwise.

Substance over form: Conduct over nomenclature

In international taxation, in the case of ***Singapore Airlines Ltd. v. CIT,***[23] the Court dealt with the issue as to whether supplementary commission paid in the form of price difference retained / earned by travel agents from customers on the sale of air tickets would trigger withholding obligations for the taxpayer i.e. the airline. The Court upheld the revenue's contention and ruled that the travel agents only acted on the behalf of the taxpayer and that the principal agent relationship between the taxpayer and the travel agent was undisputed. Accordingly, the supplementary commission income was incidental and such indirect payment of commission to agents was squarely covered in the definition of *"commission"* ***irrespective of the nomenclature*** used by the parties, hence warranting withholding as per the relevant provisions. The only silver lining in the ruling was that the SC held that the taxpayer cannot be penalized since the subject matter was a 'nascent' legal issue which required resolution by the Supreme Court. Although the decision pertained to a narrow fact pattern, the principles adopted here will have a bearing in several cases, most importantly in determining principal – agent relationships based on actual conduct and interpreting the scope of the term 'commission'.

Similarly, the court's decision in *CC, CE & ST v. Northern Operating Systems (P.) Ltd,*[24] although dealing with indirect tax laws, will have an impact on several other areas of tax jurisprudence. The Supreme Court held that secondment of employees between group companies is a taxable service. In deciding the matter, the SC observed that in determining whether an arrangement is a *contract of service or a contract for service*, a close look at the actual terms of the contract is required thereby stressing on the test of ***substance over form.***

Missing logical explanations and contentious connections

As the year was about to come to an end, another decision of the Supreme Court that has opened up a Pandora's box and has witnessed some critique from the professional world, is the recent SC decision in the case of ***CIT v. Mansukh Dyeing and Printing Mills***[25]. The Apex Court in this case, upheld the revenue's contention that revaluation of capital assets of a firm by credit to partners' capital accounts after the admission of partners, followed by partial withdrawal of a part of the revaluation credits by some partners, is a deemed transfer of such capital assets by the firm to the partners falling under the category of 'or otherwise'

23. [2022] 144 taxmann.com 221 (SC)
24. [2022] 61 GSTL 129 (SC)
25. [2022] 145 taxmann.com 151 (SC)

under the old section 45(4) of the Act, as it stood before substitution vide the Finance Act, 2021. The SC has elaborately relied upon the Bombay High Court's ruling in the case of *CIT v. A. N. Naik Associates and Ors.*[26] wherein the distribution of the firm's assets to retiring partner was regarded as transfer of capital asset. The judgement has faced criticism in light of the fact that the Bombay HC ruling involved actual transfer of the firm's assets, while in the present case, the SC has considered mere revaluation of capital asset unaccompanied by actual transfer, as transfer for the purposes of the unamended section 45(4) without giving an adequately logical explanation for this treatment. Tax professionals remain foxed trying to decipher this decision rendered in the context of typical but bad facts

Shifting gears in the favor of the revenue

If the above coverage of judgements has led you to believe that this year saw more decisions in favor of the revenue than the assessee, you might not be amiss with your guess. The above coverage is in fact a synecdoche to the overall trend shifting gears in favor of the revenue; a desktop analysis[27] of Supreme Court decisions of 2022 suggests that more than 60% of the concluded matters are held in favor of the revenue.

THE ROAD AHEAD

All in all, interesting times lie ahead. It will be interesting to see how the year shapes up under the leadership of the newly appointed CJI DY Chandrachud, and one can hope that with the Special Bench up and running, we would see a reduction in prolonged litigation and increased efficiencies in tax litigation. One would also hope for a trust-based taxation system leading to more confidence and certainty in taxation which is certainly the need of the hour. As regards the question as to what do these jurisprudence trends means for taxpayers and tax advisers in general? The emerging proverbial writing on the wall seems to say that now is perhaps not the time to throw caution to the wind while making decisions, but to perhaps adopt a more conservative approach, or at least one that involves a good deal of conviction in contentions. All in all, whether these trends are here to stay or sway, only time (and proceedings) will tell!

26. (2004) 265 ITR 346 (Bom.)
27. Based on the direct taxation cases reported on Taxmann.com barring SLPs

The Manufacturing Sector in India – A sweet spot[28]

In the rapidly evolving post covid geopolitical environment, India is rapidly emerging as a preferred country for foreign investments in the manufacturing sector. FDI equity inflow in manufacturing sector has increased by 76% in FY 2021-22 (USD 21.34 billion), over the previous FY 2020-21 (USD 12.09 billion)[29]. During Q1 of FY 2022-23, India received FDI equity inflow of USD 16.589 billion[30].

Whilst globally countries are facing several economic challenges due to the covid pandemic, the Russia-Ukraine conflict and global recession fears, the Indian economy has fared better in comparison.

India has one of the youngest populations globally, with an average age of 29 years. A young earning population is likely to result in an increase in spending power, resulting in higher consumption. At the same time, many global companies consider India as a preferred manufacturing destination in their China-plus-one strategy. As a result, global companies, and investors regard India as an investment hub due to its superior macro-economic landscape and availability of its young and skilled working population. The "Demographic Dividend" may be coming about.

Cognisant of the opportunities and aiming to achieve its ambition of becoming a US $5 trillion economy by the year 2025, the Government of India has formulated initiatives to provide impetus to the manufacturing sector through several initiatives, such as:

- "Make in India" initiative which aims to make India the global manufacturing hub. It also aims to increase the sector's GDP share to 25%.
- "Skill India" program, which aims to create jobs and promote entrepreneurship within India.
- "Defense Procurement Policy (DPP)", which prioritizes the promotion of indigenous defense technology, with an objective of giving impetus to the manufacturing sector.

The year 2022 saw many tax and fiscal measures from the Government to incentivize and promote the manufacturing sector. The initiatives taken during the year 2022 include:

Extension of the date for the commencement of manufacturing to avail concessional corporate tax rate

To incentivize and promote new manufacturing operations, in October 2019, the Government had introduced a concessional Corporate Tax rate of 15% for new manufacturing companies, with one of the conditions being that the manufacturing operation should commence on or before March 31, 2023. Considering various representations from the industry, the Finance Minister extended the said timeline to March 31, 2024 to accommodate the delays in the setting up of the manufacturing facility owing to pandemic. Accordingly, an eligible new manufacturing company can avail the lower tax rate of 15% if it commences the commercial production on or before March 31, 2024. Given the traction gained by India as a manufacturing destination, this date needs to be further extended by a longer tenure of 5 years rather than making piecemeal incremental changes.

Production Linked Incentive (PLI) schemes

PLI schemes are considered as a cornerstone for achieving "Atmanirbhar Bharat" (self-reliant India). The objective of these schemes is to make domestic manufacturing globally competitive and to create "global champions" in manufacturing. The strategy behind the PLI scheme is to offer companies incentives on incremental sales from products manufactured in India, over the base year. These schemes are specifically designed to boost domestic manufacturing in sunrise and strategic sectors, curb cheaper imports, reduce import bills, improve cost competitiveness of domestically manufactured goods, and enhance domestic capacity and exports, besides offer employment opportunities to Indians.

The Government of India had announced the PLI schemes across 13 sectors, pledging to allocate INR 1.97 lakh over five years starting from FY22. This list and allocation are growing. During 2022, several applications were approved by the Government, including:

28. This article is contributed by Ranjeet Mahtani (Partner, Dhruva Advisors), Ruturaj Bhide and Ankit Gattani (Principals, Dhruva Advisors) and Jainil Shah (Senior Associate, Dhruva Advisors
29. https://pib.gov.in/PressReleasePage.aspx?PRID=1826946
30. https://dpiit.gov.in/sites/default/files/FDI_Factsheet_June_2022.pdf

PLI Scheme	Applications approved
Auto Components	A total 95 applicants have been approved under this PLI scheme – 20 under the Champion OEM and 75 under the Component champion.
Automobile	
Medical Devices	Approvals have been accorded to 9 applicants under the PLI Scheme for the Promotion of Domestic Manufacturing of Medical Devices.
Renewable Energy	Letters of Award have been issued to the eligible successful bidders to the extent of funds allocated (i.e., the present schemes outlay of INR 4,500 crore). An additional outlay of INR 19,500 crore has been announced in the Budget 2022- 23 on 1st February 2022.
Telecom	42 companies including 28 MSMEs have received nod under the PLI Scheme.
Textiles and Apparel	A total of 61 applicants have been approved out of 67 applications received.
White Goods	42 companies selected under the PLI Scheme.

The minimum production in India because of the PLI Schemes is expected to be over US$ 500 billion in 5 years. These schemes stand out due to their approach towards sales-led growth and incentives offered. Given its wide-spread acceptability, the Government has been considering expanding the PLI and similar incentive schemes to other core sectors. Recently, it has been announced that 7 new PLI schemes that are not part of the original program have been approved[31].

Micro Small and Medium Enterprises (MSMEs) are also expected to benefit from the PLI scheme because when a large industrial unit comes up, it creates alongside a whole ecosystem of support manufacturers and service providers. The mainstay of the Indian manufacturing sector is MSMEs.

Manufacturing in warehouses

The Central Board of Indirect Taxes and Customs (CBIC) has introduced program enabling manufacturing and other operations in a bonded warehouse (MOOWR scheme). This scheme allows import goods (both inputs and capital goods) with no interest liability under the Customs Duty deferment.

There are no investment requirements or export obligations under the scheme. If the goods produced by such manufacturing operations in bonded warehouses are exported, the duties are fully remitted.

The import duty is only payable if the finished goods or the imported goods are cleared in the domestic market. This scheme offers huge working capital advantage to encourage domestic manufacturing.

Customs Department have been promoting this flagship program and encouraging manufacturers to avail the benefits under the MOOWR scheme.

Rejigging of Customs duty structure to boost manufacturing

The Union Budget 2022 brought along significant changes in the Customs duty structure favoring domestic manufacturing. The Government has sought to further calibrate the Customs duty rates in line with its Atmanirbhar Bharat goals. Accordingly, import duties were raised for finished goods for which domestic manufacturing capacity exists, while duties on industrial inputs have been brought down.

31. https://pib.gov.in/PressReleasePage.aspx?PRID=1864187

The Government is planning a gradual phase out of concessional tariff rates offered for capital goods and project imports, as these concessions deprive the local producers of a level playing field in areas like coal mining projects, power generation, transmission or distribution projects, railway and metro projects.

Gradual phasing out of customs exemptions on over 350 items is also on the cards. These include exemption on certain agricultural produce, chemicals, fabrics, medical devices and drugs and medicines for which sufficient domestic capacity exists.

On the other hand, exemptions for advanced machineries, intermediates and raw materials that are not manufactured within the country will continue.

This focused rejigging of Customs duty structure will go many a step forward in promoting manufacturing sector in India.

Expansion of RoDTEP scheme

RoDTEP Scheme (Remission of Duties and Taxes on Exported Products scheme) which replaced erstwhile MEIS Scheme, refunds the embedded Central, State, and local duties and taxes (which are non-recoverable in nature) paid on inputs to the exporters. This scheme was introduced with intention to boost exports and manufacturing activity.

Recently, the Ministry of Commerce and Industry has announced that RoDTEP Scheme is being extended to uncovered sectors like Chemicals, Pharmaceuticals and Articles of Iron & Steel. This is likely to enhance the export competitiveness of these sectors.

Inverted duty structure refund

GST law provisions relating to inverted duty structure refund (i.e., cases where the taxes charged on inputs are higher than that payable on the output) have been contentious and subject matter of challenge in various fora.

The lacuna in the GST provisions was noted by Hon'ble Supreme Court in UOI vs VKC Footsteps[32]. The Apex Court urged the GST Council to reconsider and take a policy decision regarding the same. Basis such observation, the formula for inverted duty structure refund was tweaked during year 2022, thereby benefitting manufacturers in several sectors. This example demonstrates the commitment of various Government bodies to streamline procedural aspects with an objective to augment ease of doing business in India.

CONCLUDING REMARKS

With aforesaid initiatives the Government aims to increase the share of manufacturing in the overall economy from 17% to 25% by 2025.

The Government's impetus, coupled with geopolitical reasons around the world, has created a uniquely suited environment for the growth of the manufacturing sector in India. India is emerging as one of the most sought-after manufacturing hubs across the globe. The demand for different manufacturing industries, as well as the FDI into Indian markets, seems to be extremely promising.

Additionally, India being strong in software and information technologies, with apt use of machine learning, artificial intelligence and other forms of technologies, can transform existing manufacturing processes, achieve production efficiency at multiple levels and release new business models.

The manufacturing sector in India is thus in a sweet spot for grabbing growth opportunities, especially considering that the entire ecosystem for components and core raw material are getting developed in India. One could expect the forthcoming Union Budget of 2023-24 to further strengthen, expand and consolidate some of these initiatives.

32. Civil Appeal No 4810 of 2021

BACK

Key direct tax rulings[33] of 2022 and their potential impact on businesses[34]

Equalisation levy not applicable on transactions between two non-residents - *DCIT v. Prakash Chandra Mishra*[35]

In the instant case, the taxpayer, tax resident of India, was engaged in the business of providing support services of online advertisement on the platform of Google Singapore. The role of the taxpayer was to act as a coordinator / agent between Google Singapore and his clients who are residents outside India. During the year, the taxpayer received certain payment from non-resident clients for advertisement services. The taxpayer made onward payment to Google Singapore on behalf of his clients. However, Google Singapore raised the invoice in the name of the taxpayer. The taxpayer had no role in deciding content of the advertisement, target audience, target location, etc. The taxpayer failed to deduct equalization levy on the payment to Google Singapore. The assessing officer denied deduction of amount paid to Google Singapore under section 40(a)(ib) of the Act.

The ITAT observed that the taxpayer was acting merely as an agent of the Google Singapore. The ultimate benefit of the advertisement is desired by advertisers, who are clients of the taxpayer. The advertisement services are provided to non-residents. The intention of equalisation levy is linked with the targeted audience and party paying for the online advertisement has no business nexus with India. Hence, no equalization levy can be levied in the instant case.

Equalisation levy was introduced for the first time on digital / online advertisement services vide Finance Act, 2016. The scope was further extended to cover non-resident e-commerce operators vide Finance Act, 2021. Payment by a resident to non-resident person towards online advertisement or *e-commerce supply* or services can attract equalization levy. However, the ITAT ruling may be relied upon especially in cases where the back office / central team in India places order / makes payment for the goods / services procured purely on behalf of foreign group entities / customers.

Applicability of beneficial ownership test to Capital Gains Article under India-Mauritius Tax Treaty? - *Blackstone FP Capital Partners Mauritius V Ltd v. DCIT*[36]

The taxpayer was a Mauritius resident company registered as foreign venture capital investor (FVCI) with SEBI. The taxpayer had received Tax Residency Certificate from Mauritius tax authorities. During the year, the taxpayer sold shares of Indian company and claimed relief from applicability of capital gains under Article 13 of India-Mauritius treaty.

The assessing officer observed that the taxpayer company is a wholly owned subsidiary of an entity based in Cayman Islands and has no independent existence. He also contended that the entire activity was controlled and directed as per the directions of its affiliates based in Cayman Islands and that it was a fit case to lift the corporate veil. Applying the beneficial ownership test, the assessing officer denied benefit of the treaty and levied tax on capital gain income.

The Mumbai bench of ITAT examined whether the 'beneficial ownership' test is required to be tested for Capital Gains Article under India-Mauritius treaty? The ITAT observed that unlike Article 10 or 11 of India-Mauritius treaty dealing with interest and dividend income, there is no specific reference of 'beneficial ownership' test under Capital Gains Article. Whether in such instance, importing 'beneficial ownership test' in absence of specific provision under the treaty would tantamount to rewriting treaty provisions? The ITAT highlighted lack of clarity of fundamentals of the 'beneficial ownership test' – what constitutes beneficial

33. The analysis of landmark rulings pronounced by Supreme Court is covered in a separate Article titled *'Trends in Supreme Court jurisprudence'*
34. This article is contributed by Umesh Gala (Partner, Dhruva Advisors), Saurabh Shah (Principal, Dhruva Advisors) and Rushi Shah and Bhakti Maru (Senior Associates, Dhruva Advisors)
35. ITA No. 305/JPR/2022
36. ITA Nos. 981 and 1725/Mum/2021

ownership test and how the requirement of beneficial ownership test can be satisfied. Without giving any express conclusion regarding the constituents and applicability of the beneficial ownership test, the ITAT remanded matter back to the assessing officer to pass a speaking order dealing with applicability of beneficial ownership to Article 13 of the treaty along with key factors governing the test. Recently, the ITAT has recalled this order and is now expected to directly adjudicate the matter on merits without making a remand to the assessing officer.

India is well recognized destination for investment opportunities. Global funds are investing in India since decades. Many times, 'exit route' takes a front seat and many times it remains neglected aspect. However, tax on capital gains trims the post-tax returns for an investor. While capital gain controversies associated with non-resident investors are not new to history of Indian tax litigation, adoption of beneficial ownership test in absence of specific provisions can cause uncertainty in availing treaty benefits. The final outcome of the ruling will not only impact the India-Mauritius tax treaty but can potentially impact several treaties where the condition of beneficial ownership is not made explicit.

CBDT Circular on MFN clause is neither binding nor retrospective - *GRI Renewable Industries S.L v. ACIT*[37]

The Central Board of Direct Taxes ('CBDT') vide Circular no. 3/2022 dated 3 February 2022 clarified that the benefit of 'Most Favored Nation' (MFN) clause would be allowed only on fulfilment of certain conditions, *inter-alia,* issuance of a separate notification for importing the benefit of treaty with a third country. Further, it clarified that third treaty country should be an OECD member at the time of signing such treaty. Instead of settling the issue, the Circular has spurted a debate between the taxpayer and the department regarding availability of MFN clause.

In the instant case, the taxpayer, resident of Spain, filed its return of income disclosing royalty and fees for technical services income under Article 13 of India-Spain treaty. Relying upon MFN clause in protocol to the treaty, it claimed lower rate of 10% from India-Portugal treaty. The Revenue denied treaty benefit in absence of any notification importing benefit of India-Portugal treaty into India-Spain treaty.

The Pune bench of ITAT observed that the protocol constitutes integral part of the treaty. It was signed along with the treaty. Once the agreement was notified, along with it, protocol being integral part also stands notified automatically. Hence, no separate notification is required for import of specific treaty under MFN clause. The ITAT further observed that the CBDT circular is neither binding on the taxpayer nor on the ITAT. Without prejudice to above, the ITAT held that the additional restrictions imposed on applicability of circular cannot be applied retrospectively.

The controversy pertaining to availability of MFN benefit with reference to India's tax treaties with Slovenia, Lithuania and Colombia treaties, is sub-judice before the Supreme Court. Until the time the Supreme Court pronounces its wisdom, the ITAT ruling would be available as defense for the taxpayers.

High Court accepts challenge against GAAR panel approval - *EKGE Retail LLP*[38]

General Anti-Avoidance Rules ('GAAR') provisions were made applicable with effect from Finance Act 2017-18 to protect revenue against avoidance practices adopted by the taxpayers. GAAR strengthens armor of the department against tax evasion practices. GAAR provisions allow the taxing authorities to recharacterize impermissible avoidance arrangement. A transaction shall be recognized as impermissible avoidance arrangement, if it meets 'main purpose test' and 'tainted element test'. The legislature has installed checks and balances to prevent misuse of absolute powers of GAAR provisions. GAAR provisions can be invoked after validation by Approving Panel, which was constituted in January 2022. Recently, the GAAR panel approved invocation

37. ITA No.202/Pun/2021
38. Writ Petition no. 21210 of 2022

of GAAR provisions against EKGE Retail LLP. The taxpayer challenged the panel approval under writ jurisdiction before the Telangana High Court.

Since its introduction, GAAR provisions are invoked by the department in very few instances. However, the strength and sharpness of the provisions cannot be disregarded while structuring transactions. While judicial exercise of GAAR provisions can protect interest of the exchequer against malpractices, abuse of the powers can cause genuine hardship to the taxpayer and affect business ecology of the nation. Arbitrary application of GAAR provisions can impair India's shining prospects of becoming global manufacturing and investment hub. Whether the GAAR will turn out to be fairy tale or it will be used as draconian tool for revenue collection tool, upcoming time unveil the curtain.

Premium paid on redemption of convertible debentures allowed as revenue expenditure - *Nitesh Housing Developers (P.) Ltd. v. DCIT*[39]

In the instant case, the taxpayer had issued debentures in September 2009, optionally convertible after 3 years. As per the Debenture Subscription Agreement, the investors had right to exercise the option of converting the debentures to preferential shares. The taxpayer had undertaken to redeem the debenture at a price, which would entitle the investor to post tax IRR of 25%. In case, promoter's IPO was not completed by the debenture redemption date, debentures were redeemable at pre-tax IRR of 18%. The taxpayer claimed deduction in respect of redemption premium in revised return.

The assessing officer denied deduction of redemption premium as the liability had not crystallized. The premium paid or payable on the redemption of Preference shares would be arising out of the reserves and surplus and would constitute capital expenditure out of the accumulated surplus and therefore, not allowable as deduction.

The High Court observed that if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. Applying the ratio laid down by the Supreme Court in case of ***Madras Industrial Investment Corpn. Ltd. v. CIT***[40], the Karnataka High Court granted deduction in respect of quantified amount of proportionate redemption premium as revenue expenditure.

Deduction in respect of convertible instruments has been contentious issue between taxpayer and Revenue. While the Ind AS provisions mandate to classify the instruments partly in debt and equity depending upon terms and fair value, the Act follows the form of the instrument. In general, the deduction is granted in respect of interest paid on convertible debentures, prior to its conversion.

Income already taxed in the hands of the trust cannot be again taxed in the hands of beneficiary on distribution - *Mrs. Sharon Nayak v. DCIT*[41]

'Trust' is a known concept in India; however, taxation of trust involves variety of contentious issues including characterization of trust as a person, residential status and taxability of amount received on distribution. In the instant case, the employer company had formed several trusts in which taxpayer was a beneficiary. The trusts were assessed to tax and have paid taxes on their income. During the year under consideration, the taxpayer received distribution from the trust, which was held as taxable income by the assessing officer. The High Court held that once the income is taxed in the hands of trust, it cannot be taxed again in the hands of beneficiaries.

Private trust is a popular structure for succession planning and wealth distribution. However, the uncertainty in taxation of private trust remains a concern for the settlor and beneficiaries. The instant ruling brings clarity on taxation of distribution received from the trust, where the income is already

39. [2022] 145 taxmann.com 30 (Kar)
40. [1997] 91 Taxman 340/225 ITR 802/139 SCR 555 (SC)
41. [2022] 145 taxmann.com 117 (Kar)

taxed in the hands of the trust. A similar matter pertaining to taxability of corpus distribution by overseas discretionary trust is pending before the special bench of ITAT.

Backoffice sales team of holding company constitutes a fixed place and dependent agent permanent establishment ('PE') - *Redington Distribution Pte. Ltd. v. DCIT*[42]

The Chennai bench of ITAT held that sales team of resident holding company constitutes fixed place and dependent agent PE of the non-resident subsidiary company. In the instant case, the non-resident taxpayer was resident of Singapore. The taxpayer, along with its holding company was engaged in the business of providing end-to-end supply chain solutions for information technology products. The holding company had set up 'Dollar team' acting as a communication channel between the taxpayer and the customer/ vendor / channel partners. During the survey, the department identified that the Dollar team was engaged in various activities like sourcing of customers, supply of equipment and follow-up payments. However, preparation of shipping and export documents were done from Singapore office.

The ITAT held that the Dollar Team constitutes 'fixed place PE' and 'dependent agent PE'. The ITAT observed that:

- Continuous occupation of Indian premises by 'Dollar Team' for business activities constitutes fixed place PE;
- The 'Dollar team' had authority to conclude contracts on behalf of the taxpayer company and such authority has been habitually exercised. Sourcing of customers, supply of equipment and follow-up payments activities conducted by the taxpayer company constitutes dependent agent PE;

The concept of 'PE' has evolved over the years and the instant ruling adds another chapter to the story. The ruling gives rise to a few questions: Whether 'disposal' test stands automatically satisfied on continuous business activities carried out from premises? How to determine 'dependence' of agent while examining independent agent PE? Where 75% of the activities of the non-resident are carried out through 'agent' in source country, but the agent has other revenue sources, whether fall within purview of 'dependent agent PE'?

Section 194LD applicable to interest earned on rupee denominated non-convertible debentures - *Heidelberg Cement AG v. ACIT*[43]

The assessee had invested in rupee denominated non-convertible debentures ('NCD') of Indian companies and earned interest income which was offered to tax @ 5% in accordance with section 194LD read with 115A(1)(a)(iiab). The tax officer took a view that section 194LD is applicable only in case of interest' from rupee denominated bonds ('RDBs') of Indian company and therefore, a concessional rate of 5% as mentioned in section 194LD was not available on NCDs.

The Tribunal relied on the jurisdictional High Court's decision in the case of DIT v. *Shree Visheshwar Nath Memorial Public Ch. Trust* [2011] 333 ITR 248 (Delhi HC) wherein it was held that the term 'debenture' includes 'bond' of a company by referring to the definition of debenture provided in Companies Act 1956 and as understood in common parlance. Following this jurisdictional precedent, the Tribunal decided the issue in favour of the assessee. Thus, in absence of specific definition of bonds in Act, term 'bonds' used in section 194LD should be considered as including NCDs and accordingly concessional rate of 5 per cent would be applicable.

Hitherto, there was no specific precedent on this issue in the context of section 194LD. Now, given that there is a specific precedent, the taxpayer's claim would stand on a stronger footing and if for any reason, the decision is overturned in future, the risk of penalty should be remote. This decision may be relied on by the taxpayers in the context of 194LC too. However, taxpayers need to be mindful that both section 194LC and 194LD use the term 'rupee denominated bonds'. In common parlance, though the expressions 'bonds'

42. IT (TP) A No.14/Chny/2020
43. [2022] 143 taxmann.com 79 (Del)

and 'debentures' are used interchangeably, but as per the Companies Act, 1956 and Companies Act 2013, the term 'debenture' is a broader term which includes bonds and not vice versa. Hence, the Department may seek to distinguish the above decision on this ground.

Revisionary application filed under section 264 for claiming refund of excess DDT is maintainable - *Hapag Lloyd India (P.) Ltd. v. PCIT*[44]

The assessee company had paid dividend to its holding company incorporated under the laws of Kuwait. It had paid DDT @ 16.91%. However, as per India-Kuwait tax treaty, dividend is taxable @ 10%. Hence, the assessee filed a revision application under section 264 before the Principal Commissioner of Income Tax ('PCIT') for claiming refund of the excess DDT paid. The PCIT rejected the application on two grounds - First, the assessee had not claimed refund in the original and revised return and, thus, there was no error in the assessment order passed under section 143(3). Second, the jurisdiction under section 264 was confined to correct the order which is found to be apparently erroneous.

The Tribunal held that the revisionary jurisdiction is different from the review jurisdiction. Section 264 does not limit the power to correct errors committed by the sub-ordinate authorities and could even be exercised where errors are committed by the assessee. There is nothing in Section 264 which places any restriction on the Commissioner's revisional power to give relief to the assessee in a case where assessee detects mistakes after the assessment is completed. Hence, the revision petition filed by the assessee is maintainable and the matter was remitted back to the PCIT.

This is a welcome decision and would help the taxpayers in claiming refund of excess DDT, though such refund was not made in the original return/ revised return/in course of assessment proceedings. In cases which are not picked up for assessment, taxpayers may explore filing a revision application against an intimation as held by the Delhi High Court in *EPCOS Electronic Components S.A v. Union of India.*[45] It may be noted that the order passed under section 264 is not appealable to the CIT(A) or ITAT and a remedy may only lie by way of a writ to the High Court.

Interest income ought to be attributable to the PE to be effectively connected with the PE as per Article 11(6) read with Article 7(1) – *DCIT v. Marubeni Corporation*[46]

The assessee is a company incorporated in Japan and has various sources of income from its Indian operations which includes income from its PE in India. The assessee-company received interest income on loans provided to its Indian customers in the form of supplier's credit. The interest income was offered to tax by the assessee at the rate of 10 per cent as per Article 11(2) of the India-Japan tax treaty. However, the tax officer held that since the assessee had a PE in India, the interest income would be taxable as business income @ 40% as per Article 11(6) read with Article 7 of the India-Japan tax treaty. The CIT(A) held in favour of the assessee and the Department filed an appeal before the Tribunal.

Article 11(6) provides that when the debt claim in respect of which interest is paid is "effectively connected" with the PE, it will result in taxability of the said income under Article 7(1) to the extent it is attributable to the PE. Mere existence of a PE in the source jurisdiction cannot be the reason enough to invoke the taxability of an interest income under Article 7(1) unless such an income is directly or indirectly attributable to such a PE. A connection per se of an income with the PE cannot always and inevitably lead to the attribution of such income in the hands of the PE, as 'attribution of an income to the PE' is a degree higher than mere 'connection of an income with the PE'. There can be incomes which may have some connection with the PE and yet the connection may not be material enough to hold that such an income is attributable to that PE. The connotations of the expression "effectively

44. [2022] 443 ITR 168 (Bom)
45. [2019] 266 Taxman 23 (Del)
46. [2022] 195 ITD 620 (Mum)

connected" are to be seen in this light. Even if the interest income is connected with the assessee company's PE, it can only be brought to tax in India, under Article 7, when the interest income is directly or indirectly attributable to the PE.

In this case, the tax officer has not proved that the PE played any role in the supplier credit, which is the debt claim leading to the impugned interest income. Hence no part of interest income, can be said to be directly or indirectly attributable to the Indian PE of the assessee company.

The ruling lays down an important principle on the interplay of Article 11(6) [effective connection with PE] and Article 7(1) [business profits]. The expression 'effectively connected with such PE' must mean a situation in which the interest income in question can be said to be "directly or indirectly attributable to the PE" and can be brought to tax under Article 7(1). Unless Article 7 comes into play, the jurisdiction of Article 11(2) is not ousted, Article 7 cannot come into play unless the interest income is directly or indirectly attributable to the PE.

Key indirect tax rulings of 2022 and their potential impact on businesses[47]

Supreme Court holds that secondment of employees between group companies is a taxable service – *Comm of CCE & ST v. Northern Operating Systems Pvt Ltd*[48]

In the era of globalization, it is common to have secondment arrangements wherein employees of the parent organization come to India to work in the local entity and vice versa. In the instant case, the taxpayer entered into agreements with its group companies located outside India to provide general back office and operational support. To provide the said services, the group entities provided certain technical personnel selected by them to the taxpayer. The issue before the Supreme Court was whether the group company, with whom the taxpayer had entered into such agreements, provides manpower services to the taxpayer.

The Supreme Court observed that the seconded employee, for the duration of his or her secondment, is under the control of the taxpayer, and works under its direction. Yet, the fact remains that they are on the pay rolls of their overseas employer. What is left unsaid and perhaps crucial, is that this is a legal requirement, since they are entitled to social security benefits in the country of their origin. It is doubtful whether without the comfort of this assurance, they would agree to the secondment. Further, the reality is that the secondment is a part of the global policy of the overseas employer loaning their services, on temporary basis. On the cessation of the secondment period, they have to be repatriated in accordance with a global policy.

Also, the letter of understanding between the taxpayer and the seconded employee nowhere states that the latter would be treated as the former's employees after the seconded period (which is usually 12-18 months. The overall effect of the agreements clearly points to the fact that the overseas company has a pool of highly skilled employees, who are entitled to a certain salary structure as well as social security benefits. These employees, having regard to their expertise and specialization, are seconded to the taxpayer for use of their skills.

Thus, the Supreme Court held that the taxpayer was the service recipient of the overseas company, which can be said to have provided manpower supply service or a taxable service.

Whilst the ratio of each decision is applicable according to the facts before the court, nevertheless this decision has wide ramifications for the industry. Secondment arrangements are a regular feature and the general understanding had been that given the employer and employee relationship, between the Indian entity and the overseas employee seconded to India, it ought not to attract any indirect taxes like service tax or GST. But this decision has necessitated a relook at the existing arrangements to evaluate whether there is any liability to pay any taxes.

Supreme Court holds that IGST is not leviable on inbound ocean freight in case of CIF contracts - *Union of India & ANR vs Mohit Minerals Pvt. Ltd*[49]

The taxpayer imported non-coking coal on Cost, Insurance and Freight (CIF) basis and discharged custom duties on value of imported coal which is inclusive of freight amount. The customs duties include Integrated GST ('IGST') apart from basic customs duty. The contention before the Supreme Court was whether the levy of IGST is again attracted on the ocean freight component. Under the GST law, it had been provided that if a person located in a non-taxable territory (shipping line) is providing transportation of goods by a vessel from a place outside India upto the customs station of clearance in India, then IGST is payable by the Indian importer, under the reverse charge mechanism within the category of services.

The Supreme Court concluded that the import of goods under CIF contract is a contract of composite supply of underlying goods and services such as freight, insurance etc. Thus, on import, IGST is automatically paid on the freight amount in terms

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48. 2022-TIOL-48-SC-ST-LB
49. 2022-TIOL-49-SC-GST-LB

of Section 8 of the CGST Act basis the principal supply and cannot be taxed again in the hands of the importer.

As a way forward, taxpayers should maintain the status quo if GST is not paid on ocean freight on CIF imports made till date. Where GST had been paid and input tax credit was not available, taxpayers can file refund applications. However, where tax was paid under reverse charge and credit was claimed, the department may dispute the eligibility per se.

The Court, while allowing the appeal, also observed that the Parliament, vide amendments in the Constitution of India, 1949, intended that the recommendation of the GST Council could only have a persuasive value. This observation has been a subject matter of debate since uniformity of GST laws is a fundamental pre-requisite to simplify the indirect taxes. If each State acquires the ability to enact independent legislation, then this may lead us back to the old regime where multiple taxes were at play and reduced the attractiveness of India as a business-friendly destination.

High Court holds that provision mandating 1/3rd deduction towards land for valuing construction service is not mandatory - *Munjaal Manishbhai Bhatt v. Union of India*[50]

The taxpayer entered into an agreement for purchase of a plot of land from the developer alongwith construction of bungalow on the said plot by the developer. Separate and distinct consideration was agreed upon between the parties for sale of land and construction of bungalow on the said land. The developer, relying upon entry No. 3(if) of the Notification No. 11/2017-Central Tax (Rate) dated 28 June 2017 read with para 2 of the said notification, charged Goods and Services Tax (GST) @ 18% on the consideration payable for land as well as construction of bungalow as reduced by 1/3rd of the value towards land instead of reducing full consideration paid for land.

The High Court observed that the impugned paragraph which provides for a mandatory fixed rate of deduction of 1/3rd of total consideration towards the value of land is ultra-vires the provisions as well as the scheme of the GST law. While maintaining the mandatory deduction of 1/3rd for value of land is not sustainable in cases where the value of land is clearly ascertainable or where the value of construction service can be derived with the aid of valuation rules, such deduction can be permitted at the option of a taxable person particularly in cases where the value of land or undivided share of land is not ascertainable. Thus, it has been held that the deeming fiction of 1/3rd will not be mandatory in nature.

Going forward, taxpayers (developers) may opt to tread cautiously in view of the documentary aspects and that GST authorities across the States will not readily accept the verdict pronounced by the High Court. Interestingly, the High Court in this case addressed the challenge of vires with a reading down instead of striking down the deeming portion of the Notification. This ruling will be helpful in cases where land was acquired at higher value mainly in urban areas including metro cities. The deduction of actual value of land could reduce property prices due to reduced tax burden on the buyer.

50. 2022-TIOL-663-HC-AHM-GST

BACK

Shades of retrospectivity in tax laws[51]

Retrospective amendment and taxation laws have a history of their own. Whenever we discuss retrospective amendments to taxation laws, our mind goes back to the historic amendment made by the then Finance Minister Late Shri Pranab Mukherjee to section 9(1)(i) of the Income-tax Act, 1961 ('IT Act') to bring to tax the capital gains earned by the likes of Hutchinson (Vodafone being the buyer) and others from indirect transfer of capital assets situated in India. This amendment was introduced with retrospective effect from April 01, 1962 (AY 1962-63) by incorporating the words ***"For the removal of doubts,*** it is hereby clarified that an asset or a capital asset being share or interest in a company or entity registered or incorporated outside India ***shall always be deemed to*** have been situated in India" in Explanation 5 to section 9(1)(i). The retrospective amendment was justified on the ground that it was a ***clarificatory amendment*** and it iterated the intention of the existing provisions. This had generated a lot of furore amongst the business community and the Central Government then had vowed to do away with the ideology of making retrospective amendments. Now, as we discuss the current taxation framework, and more particularly the amendments made by the Finance Act, 2022, we observe similar shades of retrospective amendments being introduced. In this article we shall be discussing some of the amendments that may have a shadow of retrospectivity.

DISALLOWANCE OF BUSINESS EXPENDITURE INCURRED ON PROVISION OF BENEFITS - SECTION 37(1)

Prior to the amendment, certain taxpayers and more particularly the pharmaceutical/ healthcare companies were claiming deductions of expenditure incurred on provision of certain benefits or perquisite to healthcare professionals who were prohibited from accepting such benefits or perquisites under their applicable professional laws. The CBDT had through a Circular[52] clarified that such expenditure was in violation of regulations framed by Indian Medical Council (applicable to medical practitioners and not to pharmaceutical/ healthcare companies) and accordingly was inadmissible under section 37(1) of the Act being an expense prohibited by the law. Despite the CBDT Circular above, the Appellate Authorities in certain cases allowed deduction of the expenditure to taxpayers on the ground that the prohibition / restriction was applicable only to the healthcare professionals and not to the paying entities, while in some cases the deduction has been denied.

The Finance Act, 2022, amended section 37(1) to provide that expenditure incurred on provision of benefits/ perquisites in violation of applicable regulations shall be regarded and shall always be deemed to be regarded as expenditure incurred for a purpose, which is an offence or prohibited by law and hence not allowable as business expenditure. The Memorandum explaining the provisions in the Finance Bill, 2022 ('Memorandum') provides that this amendment will take effect from April 01, 2022 (AY 2022-23). Notably the amendment is titled as clarificatory amendment. The amendment is made by mentioning words such as ***'for removal of doubts'*** and ***'shall be deemed to have always'***. This takes us to the moot question as to whether the amendment is effective prospectively from AY 2022-23 or a retrospective amendment. The tax department would want to argue that the amendment is retrospective and consequently disallow the expenditure for preceding years as well. However, the Supreme Court[53] has held that the mere usage of the phrase 'for removal of doubts' does not make the amendment effective retrospectively and therefore it can reasonably be argued that the amendment is prospective. Unless explicitly mentioned, all amendments are generally applicable prospectively. The parliament has been bestowed with powers to make a retrospective amendment, therefore if an amendment is to be introduced retrospectively, it should be provided specifically.

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52. Circular No. 05/2012 dated August 1, 2012
53. M.M. Aqua Technologies Ltd. v. CIT [2021] 129 taxmann.com 145 (SC)

The story does not end here, after the introduction of the Finance Bill, 2022, the Supreme Court[54] had an occasion to deal with the allowability of such expenditure incurred on the provision of benefit such as gold coins, LCD TVs, fridges, laptops etc., by the pharmaceutical company to medical practitioners under the pre-amended section 37(1). The Supreme Court, based on the facts of the case, disallowed the expenditure, holding it to be incurred for a purpose that is an offence or prohibited by law. Thus, even though the amendment to section 37(1) is regarded as prospective, this Supreme Court ruling paves way for the tax department to disallow expenditure incurred in the preceding year.

The Supreme Court ruling in case of Apex Laboratories (P) Ltd (supra) should apply only in so far as the facts of the taxpayers are similar to the case of Apex Laboratories (P) Ltd. Therefore, in all other cases where it can be demonstrated that there are no benefit/perquisite given or there is no quid pro quo between the taxpayer and the medical practitioners, the expenditure could be claimed as allowable and that neither the Supreme Court ruling nor the amendment should have any adverse impact on the taxpayer.

DISALLOWANCE OF BUSINESS EXPENDITURE INCURRED TOWARDS VIOLATION OF FOREIGN LAWS - SECTION 37(1)

The Finance Act, 2022, as part of the above amendment to section 37(1) also provided that expenditure for a purpose that is an offence or prohibited by any law shall include and deem to have always included the expenses incurred for a purpose that is an offence under ***foreign law*** or for compounding of an offence for violation of foreign law. Again, this amendment is introduced as clarificatory amendment and has shades of it being applicable retrospectively. However, considering that the Appellate Authorities[55] in the past have allowed the deduction in respect of expenditure incurred under foreign law, it may be contended that the amendment shall be effective prospectively and not retrospectively.

Further, it is a common feature across various industries to have out of court settlement arrangements with overseas parties for settling the disputes without admission of guilt or otherwise. The payments made as part of such a settlement arrangement may still be outside the purview of the aforesaid amendment. Only an offence or compounding of an offence, under any law shall be disallowed, accordingly, any payments on account of mutual settlements could still be contended to be outside the purview of disallowance provided under section 37(1).

EDUCATION CESS – NO LONGER AN ADMISSIBLE DEDUCTION – AMENDMENT TO SECTION 40(A)(II)

Another amendment in the Finance Act, 2022 is made to section 40(a)(ii) with the purpose of disallowing the deduction claimed in respect of education cess payable on basic income-tax and surcharge as business expense. Before amendment, the taxpayers had sought deduction of education cess as business expenses under section 37(1) either through return of income or by way of notes to computation during the scrutiny or appellate proceedings. The claim for deduction was based on the judicial precedents[56] which had held education cess as allowable expense on the reasoning that even though cess may be collected as a part of income tax, that does not render such cess, either rate or tax, for the purposes of Section 40(a)(ii) of the Act. Accordingly, the Finance Act, 2022 has now inserted an Explanation 3 to Section 40(a)(ii) to state that the tax shall include and shall be deemed to have always included surcharge and cess, by whatever name called, on such tax.

The amendment is introduced as a clarificatory amendment by submitting that cess is an additional surcharge and tax always included additional

54. Apex Laboratories (P) Ltd vs. DCIT Special Leave Petition (Civil) No. 23207 of 2019
55. Mylan Laboratories Ltd. v. DCIT [2020] 113 taxmann.com 6 (Hyd)
56. Sesa Goa Ltd. v. JCIT [2020] 117 taxmann.com 96 (Bom) and others

surcharge. In this regard reliance is placed on the Supreme Court ruling in the case of CIT v. K Srinivasan[57]. Accordingly, the amendment is brought in with retrospective effect from the time section 40(a)(ii) was introduced and is therefore effective from AY 2005-06. Claim for education cess now is a complete no. Like tax, even surcharge and cess would now be a permanent loss. The glimmer of hope that was provided by the Judiciary is taken away by the retrospective amendment. The CBDT introduced a new rule prescribing the manner for making an application in Form 69 requesting for a recomputation of total income without allowing the claim for deduction of cess. In doing so, it safeguards the taxpayers from any penal consequences.

Consequent to the above retrospective amendment, the following areas may require attention/ action on the part of the taxpayers:

What shall be the way forward in cases where the claim of taxpayer is allowed, and the matter is no longer pending before any authority? Will the tax department initiate rectification proceedings to amend the orders or prefer appeal with condonation of delay? Can the department invoke reassessment provisions?

Considering that there are several options with the tax department, like rectification, reassessment, filing the appeal with condonation of delay application, etc., it is advisable to withdraw the deduction claim by filing the prescribed Form 69 and safeguarding from penalty exposures, if any.

DISALLOWANCE OF EXPENDITURE INCURRED TO EARN EXEMPT INCOME – AMENDMENT TO SECTION 14A

Amongst various amendments made by the Finance Act, 2022 yet another clarificatory amendment has been introduced effective from April 01, 2022. This amendment sets to provide that disallowance under section 14A ought to be made whether or not any exempt income has accrued, arisen or been received during the year.

Section 14A of the Act provides that no deduction shall be allowed in respect of expenditure incurred by the taxpayer in relation to income that does not form part of the total income, as per the provisions of the Act. Over the years, various disputes have arisen in respect of the issue whether disallowance under section 14A of the Act can be made in cases where no exempt income has accrued, arisen or been received by the taxpayer during an assessment year. The provisions of section 14A have been interpreted by High Court in various cases and confirmed by Supreme Court holding that in the absence of exempt income there cannot be disallowance under section 14A of the Act.

However, the Finance Act, 2022 sought to overcome these rulings by inserting an Explanation to section 14A. The Explanation begins with the phrase 'For the removal of doubts' and further it uses the words 'the provisions of this section... shall be deemed to have always applied'. A law interpreted by Supreme Court and High Courts in the above stated manner cannot be overturned by terming the amendment as clarificatory. Merely terming the amendment as clarificatory cannot make an amendment retrospective in absence of specific direction or reference to make it retrospective. Accordingly, it is a strong case to contend that the amendment to section 14A is effective prospectively and need not have any retrospective application.

Impact of the amendment:

1. This amendment would result in application of the section 14A of the Act and also consequently allowing tax department to apply Rule 8D of the Income-tax Rules, 1962, for cases where no exempt income has been earned. As seen in the past, where no disallowance was made by taxpayer under section 14A in absence of exempt income, the tax department mechanically applied Rule 8D and carried out the disallowances. The judicial rulings had curtailed the whimsical approach adopted by the Revenue to make disallowances

57. [1972] 83 ITR 346 (SC)

mechanically, and that there was significant relief to taxpayers on account of the striking down of disallowance under section 14A. However, with this amendment, the tax department may now carry out disallowances under section 14A by mechanically applying Rule 8D even in cases where there is actually no expenditure incurred for earning exempt income. This may result in increased litigation.

2. Further, considering that the dividend income from shares is now taxable, disallowance under section 14A of the Act should trigger only in respect of a few cases where taxpayers have other avenues for earning tax exempt income, such as receiving a share of profits from partnership firms, etc.

ONE STEP FORWARD MANY STEPS BACKWARDS

Successive governments have made unambiguous assertions on the floor of parliament that there will be no retrospective amendments. And yet amendments with shades of retrospectivity find a backdoor entry wearing the cloak of clarificatory amendments. This significantly dilutes the faith of taxpayers especially international investors in the spoken words of the government. More so, when some of these amendments are introduced to negate the rulings handed by the Supreme Court. Given the global aspirations of the Indian economy, the taxation laws also need to evolve in line with the avowed goals of being simple, stable and forward looking. In such an environment one can only hope that successive governments can resist the temptation of bringing in shades of retrospectivity to the amendments

BACK

Reassessment – The saga continues![58]

Typically, whether an act of issuance of a notice is barred by limitation of time is a fairly objective exercise where one just needs to compare the date on which the notice is issued with the due date for issuance of the same. One may not have imagined that such a simplistic exercise can be a matter of huge controversy - which to some extent has been put to rest by the Hon'ble Supreme Court ('SC') in ***Ashish Agarwal's case;***[59] but to a larger extent has ignited several issues and complications.

The controversy has largely emerged due to intermingling of the Relaxation Act[60] and the new reassessment regime (effective from 1 April 2021). Briefly put, the Relaxation Act was introduced by the government in the wake of Covid-19 to ease compliances by way of extending due dates. One such extension was in the context of due date of issuance of reassessment notices till 31 March, 2021. The CBDT subsequently pushed this to 30th June 2021 by way of notifications. On a separate note, the reassessment regime underwent changes vide the Finance Act 2021. The new regime which was effective from 1st April 2021, changed the timelines of issuing reassessment notices and the procedures thereof. Thus, this led to the curious debate as to which regime (pre-amendment or post-amendment reassessment regime) would prevail during the time period from 1st April 2021 to 30 June 2021. To add to the complications of the matter at hand, at the forefront of the debate sat the assessment years 2013-14 and 2014-15, for which the reassessment proceedings were getting time barred by 31 March 2021.

To better understand the entire controversy, we have briefly explained the important features of the Relaxation Act and the new reassessment regime, the judicial journey of the reassessment notices and our analysis in the ensuing paragraphs.

THE RELAXATION ACT

Much before the Finance Act, 2021 was introduced, sometime in March 2020 the country was hit by the COVID-19 pandemic that led to nationwide strict lockdowns putting the lives of citizens and the Government machinery totally out of gear. It became almost impossible for individuals as well as Government authorities to adhere to several statutory time limits which in many cases were not extendable. To overcome these difficulties the Government of India enacted the Relaxation Act extending the due dates of various compliances. One such extension was the extension in due date for issuance of reassessment notices till 31 March 2021. The due dates so extended by the Relaxation Act, 2020 were extended again by the CBDT from 31st March 2021 to 30 June 2021 by issuing notifications[61]. In these notifications, the CBDT also inserted an Explanation clarifying that the old provisions will continue to apply till 30 June 2021 with respect to the reassessment notices issued between 1 April 2021 and 30 June 2021.

NEW REASSESSMENT REGIME

Under the erstwhile reassessment provisions, the base time limit for issuing the reassessment notice was four years (from the end of the relevant assessment year) with a further extension up to six years if the escaped income exceeds INR 0.1 million. The new regime which was introduced by Finance Act 2021 curtailed the time limit to three years from the end of the relevant assessment year. However, in cases where the income escaping assessment exceeds INR 5 million, the tax officer has an extended period of ten years for reopening the assessment, subject to the fulfilment of other conditions.

The new reassessment regime apart from altering the time limits for issuing the reassessment notices, more importantly had the effect of laying down safeguards to protect the interest of the taxpayers. It provided for a procedure to be followed before the issue of reopening notice under section 148. The new provisions require the tax officers to issue a show-cause notice under section 148A, conduct

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59. [2022] 444 ITR 1 (SC)
60. The Taxation and Other Laws (Relaxation and Amendment of Certain Provisions) Act, 2020 ('TOLA')
61. CBDT Notifications No. 20 dated 31 March 2021 and No. 38 dated 27 April 2021

the required enquiries, provide the taxpayer with an opportunity of being heard to the taxpayer, consider the reply of the taxpayer and then pass a speaking order on whether it is a fit case for issuing the notice under section 148. Further, the pre-requisite to issue a reassessment notice changed from 'reason to believe' to 'presence of information' which suggests that income chargeable to tax has escaped assessment.

VALIDITY OF THE REASSESSMENT NOTICES CHALLENGED BEFORE HIGH COURTS

Though the new reassessment regime was applicable from 1 April 2021, the tax officers relied on the above cited Explanation inserted by the CBDT (that the old provisions would continue to apply till 30th June 2021, and continued issuing notices under the old section 148 (without following the procedure laid down under the new regime). These notices were challenged by various taxpayers by filing writ petitions before High Courts. The High Courts[62] in numerous matters quashed such reassessment notices on the following grounds:

- The Explanation in the CBDT Notifications (that allows for the old regime to continue) is ultra vires/ unconstitutional and invalid.
- Any notice under section 148 issued on or after 1 April 2021 must comply with the provisions of the new regime i.e. issuance of notice under section 148A.

Aggrieved by the above, the Revenue preferred an appeal before the Supreme Court.

VERDICT OF THE SC

The crux of the issue before the SC was whether notices issued between April 2021 and June 2021 can said to be time barred as the same were issued under the old regime and without adhering to the procedure as laid down in the new reassessment regime (which was effective from April 2021). In other words, should the provisions of the Relaxation Act be read into the new reassessment regime thereby permitting the Revenue to issue notices as per the old regime even post April 2021?

The SC in the initial part of the judgement seemingly ruled in favor of the taxpayer by observing that the notices ought to have been issued by following the procedure laid down in the new reassessment regime. However, noting that the outcome of the High Courts' views would mean that there would be *"no reassessment proceedings at all"*, the SC changed the course of the tide to modify the conclusion emanating from the High Court decisions. In an attempt to play a balancing act between interest of the Revenue and the taxpayers, the SC noted that the Revenue cannot be made remediless by way of quashing the reassessment proceedings altogether which would only frustrate the objects and purpose of reassessment. It further observed that there was a genuine non-application of amendments due to a bonafide belief on part of the Revenue that the new regime is not in force thereby concluding that some leeway must be shown. The SC therefore in trying to protect the Revenue's interest deemed the notices issued under the old regime as show cause notices under the new reassessment regime. While holding so, the SC also stated that any defences available (including the defence on period of limitation) to the taxpayer and the Revenue under the new reassessment regime shall continue to be available.

The most significant part of this ruling is that the SC invoked its extraordinary power under Article 142 of the Constitution (which is rarely exercised in tax matters) to hold that its directions shall govern, not only the impugned judgments but shall also be made applicable in respect of similar judgments and orders passed by various High Courts across the country and therefore its judgement shall be applicable on a PAN India basis. In addition, the SC extended its order to hold that it shall also govern the writ petitions which are pending before

62. Ashok Kumar Agarwal v. UOI [2021] 131 taxmann.com 22 (All); Mon Mohan Kohli v. ACIT [2021] 133 taxmann.com 166 (Del); Sudesh Taneja v. ITO (Writ Petition No.969 of 2022) (Raj); Vellore Institute of Technology v. CBDT (Writ Petition No.15019 of 2021) (Mad), etc.

various High Courts in which similar notices under Section 148 of the Act issued after April 2021 are under challenge.

It needs to be borne in mind that the SC has been categorical in its assertion that the reassessment notices issued under the old regime after March 2021 are not in accordance with the new reassessment regime. Even after an observation to this effect, these notices nevertheless got a new lease of life albeit subject to fulfillment of requirements of the new reassessment regime.

ANALYSIS

Principle of fairness v. Judicial restraint

The judgement of the SC has raised more questions than answers. Firstly, one wonders as to whether the SC should have exercised judicial restraint and not have been too lenient in allowing the Revenue to proceed with the reassessment which the SC itself observes was not carried out in accordance with the subsisting law. The outcome of the SC judgement therefore appears to be against the cardinal rule of interpretation of taxing statutes that one must have regard to the strict letter of the law and not merely to spirit of the statute or the substance of the law. The oft-quoted words of Rowlett, *J., in Cape Brandy Syndicate*[63] case lay down the correct rule of interpretation in case of a fiscal statute:

"In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to a tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used." It is a rule firmly established that "the words of a taxing Act must never be stretched against a taxpayer". If the legislature has failed to clarify its meaning by use of appropriate language, the benefit must go to the taxpayer. Even if there is any doubt as to interpretation, it must be resolved in favour of the subject".

The reasoning given by the SC also appears to be contrary to the principle of 'fairness' as elucidated by the 5-judge bench of SC in case of ***Vatika Township***[64] wherein the Court had clearly mandated that there cannot be imposition of any tax without the authority of law and that such a law must be unambiguous and should prescribe the liability to pay taxes in clear terms. The SC in that case had reiterated the settled proposition that if the provisions concerning a taxing statute are ambiguous and vague and susceptible to two interpretations, the interpretation which favors the subjects, as against the Revenue, must be preferred.

Applicability to cases where similar notices were issued but the validity of the notices has not been challenged by the taxpayer before any Court

A closer examination of the SC judgement[65] would reveal that the observations of the SC though applicable on a pan-India basis, would apply and modify only those notices which have been challenged before the High Courts. These observations, if read contextually, would imply that the observations of the SC are only confined to matters which were subject matter of appeal before the High Courts and only those cases have been modified suitably.

Contrary to that, the CBDT Instruction[66] clarifies that the SC judgment applies to all cases irrespective of the fact whether such notices have been challenged or not. Undoubtedly, such Instructions are not binding on the taxpayers but will certainly pave way for another round of litigation in this regard. Taxpayers in litigation may nonetheless consider taking this ground in all replies, proceedings etc. in situations where the notices were not subject matter of challenge before the High Court / Supreme Court. This issue is also sub-judice before the Delhi High Court in the case of ***Rajesh Chopra v. ITO***[67].

Instruction issued by the CBDT

Pursuant to the SC judgement, the CBDT had issued an *Instruction*[68] to bring uniformity in the approach

63. [1921] 1 KB 64
64. [2014] 367 ITR 466 (SC)
65. Refer paras 8,9 and 11 of the SC judgement
66. Instruction 1 of 2022 dated 11 May 2022
67. WP(C) 12561 of 2022.
68. Instruction 1 of 2022 dated 11 May 2022

of the Revenue to give effect to the directions of the SC. It is pertinent to note that the SC has not categorically adjudicated on the applicability of Relaxation Act to the new reassessment regime. However, the CBDT Instruction appears to have taken a view that the Relaxation Act supersedes the timelines provided in the new reassessment regime and therefore the extended timelines as per the Relaxation Act applies to notices which are now deemed to be issued under the new reassessment regime.

Consequently, this has resulted in a second round of litigation wherein several writ petitions[69] have been filed, inter-alia, challenging the notices on the ground of period of limitation.

It is arguable that since the old provisions stand repealed and substituted with effect from 1 April 2021 by another legislation i.e. the Finance Act 2021, the notifications will also cease to be effective after 1 April 2021. The old provisions are no longer on the statute book with effect from 1 April 2021. The Relaxation Act could have only extended compliance deadlines for the period and in respect of law as applicable till 31 March 2021. Therefore, the impugned reassessment notices ought to comply with truncated timelines as per the new regime. Taxpayers in litigation may consider taking a separate ground to this effect during the course of reassessment proceedings and subsequent appeals, if any.

69. The SC has recently admitted an SLP in this regard in case of Saroj Chandna v. ITO (Appeal No. 20548/2022) for AY 2013-14. Validity of notices for AY 2016-17 and AY 2017-18 is sub-judice before Delhi High Court in Sunil Nosaria v. ITO [WP(C) 13389 of 2022]. Validity of notices for AY 2013-14 and AY 2014-15 is sub-judice before various High Courts in Kulwant Singh v. Union of India [CWP 18032 of 2022 – P&H HC], SS Commotrade Private Limited v. ITO (WPA 19111 of 2022 – Cal HC), Mamta Surendra Jain v. ACIT (SCA No. 17140 of 2022 – Guj HC)

OTHER KEY AREAS FOR CONSIDERATION

Further, under the new regime, the reassessment notice can be issued only where there is *'information with the assessing officer which suggests that income chargeable to tax has escaped assessment'*[70] ('information'). However, the notices issued under the old regime (which are now deemed to be show cause notices under the new regime) were based on the condition of '*reason to believe*'. This leads to another moot question - would this be a strong enough ground to challenge the notice? Under the old regime, the tax officer was only required to record reasons for reopening the assessment. Since the impugned reassessment notices had been issued under the old regime, one will have to check whether the reasons recorded for reopening comply with the definition of 'information' as per the new regime.

One would also need to be mindful of the fact that the definition of 'information' has been widened prospectively from 1 April 2022. Prior to that, the scope of 'information' was narrower and hence cases which have been reopened based on a revenue audit objection or any other information which does not qualify as 'information' under the pre-amended definition may be challenged on that ground as well.

Depending on the facts of the case, the taxpayer may also challenge the reassessment on the grounds of 'change of opinion' and also on the ground that the alleged escaped income is not represented in form of any asset. For instance, if the tax officer has already applied his mind and examined the issue during the assessment proceedings, he may still not be within his jurisdiction to reopen the case in the new regime despite the change in architecture of the new reassessment provisions. Further, the 10-year time limit under the new regime can be invoked only if the tax officer possesses documents which reveal that escaped income is represented in the form of 'asset' and such income exceeds INR 5 million. Thus while multiple defences may be available to the taxpayers to challenge the validity of reassessment notices, it remains to be seen whether such notices will pass the litmus test of the safeguards (objective and subjective) as are provided in the new reassessment regime.

It may not be out of place to again mention that while the SC has deemed the notices as show cause notices under the new regime, it has also left a window open by providing that all defences available to the taxpayers and the Revenue under the new regime will continue to be available. Therefore, while it may appear to be an initial victory for the Revenue on a glaring procedural lapse, the conduct of the reassessment proceedings and the final outcome in these matters could be subject to further rounds of litigation on various aspects which were not a subject matter of debate before the SC. The intermingling of the Relaxation Act and the new reassessment regime has led to a Domino effect, and it seems like this is not an end to the litigation but rather the beginning of a new era of litigation.

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70. Explanation 1 to section 148 defines the phrase 'information with the assessing officer which suggests that income chargeable to tax has escaped assessment' as follows:

"Explanation 1.—For the purposes of this section and section 148A, the information with the Assessing Officer which suggests that the income chargeable to tax has escaped assessment means,—
i) any information in the case of the assessee for the relevant assessment year in accordance with the risk management strategy formulated by the Board from time to time;
ii) any audit objection to the effect that the assessment in the case of the assessee for the relevant assessment year has not been made in accordance with the provisions of this Act; or
(iii) any information received under an agreement referred to in section 90 or section 90A of the Act; or
(iv) any information made available to the Assessing Officer under the scheme notified under section 135A; or
(v) any information which requires action in consequence of the order of a Tribunal or a Court."

Section 194R – TDS on benefits and perquisites – Removal or amplification of difficulties?[71]

Section 194R – TDS on benefits and perquisites – Removal or Amplification of difficulties?

Every so often, when a new amendment in the tax laws is carried out, one cannot help but recollect the wise words in Chanakya's Arthashastra, *"Governments should collect taxes like a honeybee, which sucks just the right amount of honey from the flower without causing any harm"*.

We have always learnt that as per the doctrine of the separation of powers under the Constitution of India, it is the legislature which legislates, the executive which administers and the Court which interprets. However, recently there have been several instances of a possible overlap/overreach in the functions and powers of these critical organs of Government. The recent Guidelines[72] (hereinafter referred to as 'Circular' or 'Guidelines') issued by the CBDT in the context of section 194R of the Income-Tax Act, 1961 ('the Act')[73] that appears to be one such example.

BACKGROUND & KEY PROVISIONS OF SECTION 194R

It is common for business organisations to undertake various types of sales promotion initiatives, some of which may involve giving incentives to various associates of the business. Some of these incentives be in kind and in the shape of money. Section 28(iv) levies tax on the value of any 'benefit' or 'perquisite', whether convertible into money or not, arising from business or the exercise of a profession. It had been brought to the notice of the legislature that many times, taxpayers do not report the receipt of the taxable benefit or the perquisites under section 28(iv), especially those that are in kind and hence, such income remains out of the radar of taxation.

To catch hold of such transactions and to widen and deepen the tax base[74], the Finance Act, 2022, introduced new withholding provisions in the form of section 194R, which mandates the withholding of taxes at 10 percent of the value or the aggregate of the value of benefit or perquisite, provided to resident.

The key contours of section 194R are tabulated below:

Applicable transactions	Any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession of the recipient.
Withholding tax rate	10%
Deductor	Any person responsible for providing the benefit or perquisite[75].
Deductee	Any resident receiving a benefit or perquisite.
Threshold	INR 20,000 per recipient per annum.
Effective from	1 July 2022
Timing of deduction	Before providing the benefit or perquisite.

The obligation to withhold taxes under section 194R would thus arise on the satisfaction of the following conditions:

- There should be provision of 'benefit' or 'perquisite', whether convertible into money or not;
- The recipient of benefit or perquisite should be a resident in India; and
- The benefit or perquisite should arise from business or the exercise of profession of the recipient.

71. This article is contributed by Umesh Gala (Partner, Dhruva Advisors), Saurabh Shah (Principal, Dhruva Advisors) and Rushi Shah (Senior Associate, Dhruva Advisors)
72. Circular no. 12/2022 dated 16 June 2022 and Circular 18/2022 dated 13 September 2022
73. All references to sections are the sections of the Income-tax Act,1961 unless otherwise stated
74. Explanatory Memorandum to Finance Bill, 2022
75. Exceptions include a person being an individual or a HUF, whose total sales, gross receipts, or turnover does not exceed INR 1 Cr. in case of business or INR 50 Lakhs in case of profession, during immediately preceding financial year

Section 194R(2) and section 194R(3) empower the CBDT to issue guidelines, with the prior approval of the Central Government, for removal of difficulties in giving effect to the provisions of the section. Pursuant thereto, the CBDT has issued the Guidelines, which despite it addressing a few key issues also opens a can of worms, which can have huge ramifications across all types of industries. There is also an ongoing debate on the enforceability of these Guidelines, as they appear to supersede and enlarge the scope of the statutory provisions and impose a higher burden on the taxpayer than the legislature provides.

KEY ISSUES FOR CONSIDERATION

We pick up a few threads which we believe will stir a hornet's nest during the coming few years, further widening the chasm of the certainty and simplicity of tax laws.

'Monetary' benefit or perquisite

The Guidelines provide that *"tax under section 194R of the Act is required to be deducted whether the benefit or perquisite is in cash or in kind."* In this backdrop, the applicability of section 194R on transactions, such as the waiver or settlement of loans, the write-off of bad debts, etc., could cause disputes amongst the taxpayer and the Revenue. In this regard, the Circular has provided that one-time loan settlements or waivers of loans (though income in the hands of the borrower) would not be subjected to TDS under section 194R, so as not to put the extra cost on the lender over and above the haircut borne by it. However, such relaxation is extended only to certain specified institutions like public sector institutions, deposit taking NBFCs, etc. and not to private parties, non-scheduled banks, etc.

The Supreme Court in the case of *Mahindra and Mahindra*[76], held that the term *'whether convertible into money or not'* in the context of 28(iv), where identical language is used, implies that the benefit or perquisite should be in non-monetary form. Based on the above, can the taxpayer take a stand that on whether the monetary perquisite or benefit would not fall within the scope of section 194R despite the Circular stating otherwise? Should the deductor adopt a conservative approach to protect itself from disallowances, interest and penalties? Until some of these questions are settled, taxpayers and advisors will continue to face avoidable anxiety.

Benefit to be taxed only if it arises from business or exercise of profession

One of the important prerequisites for section 194R to trigger is that the benefit or perquisite should *arise from business or exercise of profession* of the recipient. This would be an extremely fact-specific exercise. Arguably, TDS obligation should only trigger if there is a proximate or a direct nexus of the benefit with the business of the recipient. The value of the benefit or perquisite received for personal attributes or out of natural love and affection, may not fall under section 194R / section 28(iv) but could get separately covered under section 56(2)(x).

Thus, for example, cases where there is no regularity of business with the benefit provider or if it is a case of a one-off bargain or concession without any underlying business transaction, may be regarded as being outside the purview of section 194R. Similarly, transactions which are purely on capital account may also be treated as not arising from business, to attract section 194R.

Physician samples to doctors

The Guidelines categorically state that free medical samples provided to medical practitioners are to be regarded as a benefit or perquisite liable for TDS under section 194R. Such a view appears susceptible on multiple counts. Firstly, the doctors may not derive any benefit unless the samples are utilised / consumed by them. In most cases such samples could be given to needy patients to initiate medical treatment which may otherwise get delayed due to financial constraints or to test treatment responses. Benefit needs to be checked from the perspective of the recipient. Since there is

76. [2018] 404 ITR 1 (SC)

no perceivable benefit to the doctor, section 194R should not be applicable. Secondly, there is no way a doctor can monetise the free samples, as such an action is strictly prohibited and is considered an offence under the provisions of the Drugs and Cosmetics Act, 1940 read with Drugs and Cosmetics Rule, 1945. Thirdly, even assuming that a doctor is deriving a benefit, the value of the same should arguably be treated as NIL in absence of his ability to monetise the same.

However, given that the Guidelines have treated them as a benefit and the Guidelines are binding on the taxpayer and taxing authorities, significant litigation in this regard seems almost certain.

Dealer conferences

The Guidelines state that the expenditure pertaining to dealer/business conferences would not be considered as benefit/perquisite provided that such conferences are organised with the prime object being to educate dealers/customers about the product features, sales techniques, etc. The Circular clarifies that it is not necessary that all dealers be invited to the conference for expenses not to be considered as a benefit or perquisite.

The Circular clarifies that the leisure trip or leisure component shall be treated as a benefit or perquisite. However, there will be huge practical difficulties on how one identifies the leisure component of the conference? For instance, to promote networking during the conference the organiser may have arranged for a gala dinner, a 'wine and dine program', or any other entertainment event. Would it be treated as a leisure component and thus qualify as a benefit or perquisite? If yes, would the fair market value of such a benefit or perquisite be determined on the basis of the consumption of each participant?! How would such consumption / utilisation be ever be worked out? There could be a myriad subjective situations which have the potential to catch the tax payers on the wrong foot given the wide encompass of the Guidelines.

In this regard, the Circular states that if the benefit/ perquisite is in a group activity and it is therefore difficult to allocate such benefit/perquisite to each participant using a reasonable allocation key, the benefit/perquisite provider may have an option to not claim the expense, in computation of its total income. In such a case, the benefit / perquisite provider shall not be held in 'assessee-in-default' and the interest and penal consequences shall be avoided. However, the benefit, if any, may still be taxable in the hands of the recipient, even if the taxpayer chooses not to claim the deduction for the expenses incurred by it. Such provisions of the Circular do not have backing under the law and how the courts interpret these aspects is open to question.

Reimbursement of Out-of-Pocket expenses

The Circular clarifies that any expenditure which is a liability of a person carrying out business or a profession, if met by the other person, is in effect a benefit or a perquisite. It further provides that if the invoice is in the name of person granting the reimbursement, then such a payment would not qualify as a benefit or perquisite for the payee. However, in other cases, it would trigger the rigors of section 194R.

The Circular has also linked the liability of the expenditure with the input GST credit and the 'Pure agent' under GST laws. It clarifies that if the service provider qualifies as a "pure agent" as per the GST laws, then the reimbursement received by the service provider would not be subjected to tax deduction under section 194R.

However, the above interpretation again seems lacking in soundness and may also lead to difficulties. For where the service agreement with the consultant (service provider) itself imposes the obligation on the service recipient to provide basic facilities like accommodation, food, travel reimbursement, etc. and is undertaken necessarily in the performance of the services e.g. outstation travel by a lawyer, consultant or a similar service provider, is the fact of mere invoices raised in the name of the consultant entailing a character of benefit or perquisite to a transaction, which is otherwise purely in the nature of reimbursement? If so it seems quite farfetched!

Issue of bonus / rights shares

The Guidelines state that section 194R shall not apply on right / bonus shares by a company in which the public are substantially interested[77], if such bonus / right shares are offered to all the shareholders by such a company. This clarification is likely to cause difficulties for closely held companies[78] in respect of withholding obligation on the issue of bonus / right shares to shareholders. Would the corporate actions by way of issue of bonus/ right shares result into in the benefit / perquisite for the recipient shareholders? Would such corporate action be held to be 'benefit / perquisite' 'arising in the course of business / profession'? Is withholding obligation under section 194R on corporate action is within the scope of legislative intent? While the courts are busy dealing with tax implications of bonus / right shares under section 56(2)(vii)/ (x), the applicability of the withholding provisions shall not allow the Courts to take a breather. There is no reason why the rationale provided in the Circular cannot be made applicable to closely held companies. However, this may only get finally settled after litigation and will therefore add to the bucket of difficulties created by this new provision and the 'clarificatory' circulars issued by the CBDT.

Other common areas which might be prone to litigation

Interest free loans

The word 'benefit' implies an element of advantage, profit, or gain. It would mean 'any advantage, gain or improvement in condition'.[79] Even, cost savings may also qualify as a benefit for the purpose of section 194R. In such a context, it could be argued that the benefit of low interest costs, arising out of a concessional loan also qualifies as 'benefit' and hence, implications of Section 194R may follow.

Without prejudice to the argument that monetary transactions do not fall within the ambit of Section 194R, it can be contested that for the purpose of section 28(iv) and section 194R, the benefit should be real benefit. Mere notional benefit should not be subjected to withholding under section 194R of the Act. Further, in any given case, taxing the notional cost savings can lead to double taxation. Since the borrower subsidiary company is not paying any interest, its profits are already inflated by the amount of interest, which it would have paid on the loan availed from the third party. Now, again taxing the same transaction as income under section 28(iv), would be tantamount to double taxation.

Channel support programmes

Businesses invest great amounts of money in brand building. In order to ensure unique pan-India experiences for the customers, the brand owners design their prototypes, interiors and furniture for all the stores in India, to have a uniform look whilst also providing a few assets like kiosks, POS, computers, etc. Sometimes, the franchise agreement between manufacturers/ businesses and their franchisee, may provide that the franchisor shall, under channel support programmes, renovate / refurbish the franchisee store in accordance with their prototype interior. In such cases, a question may arise as to whether the cost of renovation incurred by the brand owner, to increase its brand value or create unique customer experience, can be treated as a benefit or a perquisite for the franchisee store owner?

Commercially the cost of renovation may be undertaken to strengthen the brand appeal and consequential benefit, if any, to the franchisee store owner is therefore merely incidental. Also, such obligations assumed by the brand owner would be suitably factored commercially in the service charges / margins.

Car facility and other perks to senior advisors.

Companies onboard typically experienced several people as consultants. These consultants are typically provided with the usage of a car solely for official purposes. At times, the car usage can be partly for personal and partly for official purposes. A question would thus arise as to whether the usage

77. Section 2(18) of the Act defines a company in which public are substantially interested
78. The companies in which public are not substantially interested as per section 2(18) of the Act
79. CIT v. Smt. Kamalini Gautam Sarabhai [1994] 208 ITR 139 (Gujarat)/[1993] 114 CTR 244 (Guj)

of a car for personal purposes qualifies as a benefit for section 194R purposes? While this would clearly be a benefit if the company has permitted the advisors to use the car for personal purposes, some difficulties would arise on how one values the benefit arising in the hands of the senior advisors? Should separate logbooks be maintained to demarcate the usage between personal and official purposes? If the car is provided solely for official purposes, any unauthorised usage for personal travel cannot be treated as a benefit, especially for the purposes of section 194R. Companies may want to obtain a declaration in this regard from such consultants. Alternatively, in order to avoid any potential litigation, companies could also consider recovering some percentage of the costs borne from such consultants / advisors which can be attributed to the value of benefit being enjoyed by them.

CONCLUDING REMARKS

The cannon of certainty is one of key principles of an ideal tax system. The provisions which lead to subjectivity run completely contrary to the avowed objective of increasing the ease of doing business and would ultimately only burden the judiciary with huge attendant costs for businesses. While the industry is facing difficulty in the implementation of the guidelines, the views of experts are also divided on the subject matter. Given that Section 194R is a TDS provision, a conservative approach may be preferred by deductors in cases of ambiguity. However, in cases of 'net-of-tax' contracts or higher withholding in the absence of valid PAN or return defaulter, the withholding cost can be substantial. The binding nature of the guidelines further adds to the conundrum.

Most business houses would have or may need to revisit their existing distribution channel models, incentive models, etc. and test the same in light of the guidelines. Only time will tell whether the 'binding' Guidelines will hold water from the lenses of judicial wisdom.

Pillar Two proposals – How should India Inc prepare itself?[80]

Somewhere in the year 2012 a seminar was organised in the Bombay Stock Exchange on the Companies Bill, 2012 and the then Union Minister Mr. Sachin Pilot was one of the main speakers. During the Q&A session I got an opportunity, and I raised a question highlighting difficulties arising from the proposed provisions. I got an interesting answer from the Minister – "what were you doing for last two years? When we requested feedback from the industry, very few studied the draft and responded to us, now the law is finalised".

The story may get repeated for Pillar Two[81] if India Inc does not pay attention to it. The Inclusive Framework, consisting of 141 jurisdictions, led by OECD has been working on two pillar solution for some time now. More than 135 countries agreed on broad contours of two pillar solution by joining October 2021 Statement. Global Anti-Base Erosion Model Rules (GLoBE Rules[82]) were approved by the Inclusive Framework in December 2021. These rules are to be incorporated in the domestic laws of the countries.

OVERVIEW OF PILLAR TWO PROPOSALS

Pillar Two provides for a coordinated system of taxation intended to ensure that large groups pay a *minimum level of tax* on the income arising in each of the jurisdictions where they operate. This result is achieved by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum rate (currently agreed at 15%).

While countries may still choose to not impose a 15 per cent tax, Pillar Two provides that where profits are earned in jurisdictions where the effective rate of tax is less than 15 per cent, the home jurisdiction or the source jurisdiction can tax those profits by way of application of following rules:

IIR[83]	Parent company pays **top-up tax**[84] on its proportionate share of income of its group entity located in low-tax jurisdiction
Switch-Over Rule ('SOR')	Compliments the IIR by providing an enabling mechanism to overturn tax treaty obligations.
UTPR[85]	UTPR seeks to deny deductions or require an equivalent adjustment so that an effective tax rate of 15% is achieved.
Subject to tax Rule ('STTR')	This Rule triggers when the covered payment is subject to nominal rate of tax in payee jurisdiction. For example, if the payment is taxable at 5% in payee jurisdiction, as per STTR, additional withholding tax of 4% will apply in the payer jurisdiction (irrespective of the tax treaty rate).b

HOW PILLAR TWO IS GOING TO IMPACT INDIA INC

Pillar Two is focused on the "remaining BEPS challenges" and proposes a systematic solution designed to ensure that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions, they operate in. Pillar Two also aims to stop "race to bottom" wherein the countries go on reducing rate tax of income to attract MNCs.

80. This article is contributed by Radhakishan Rawal (Senior Advisor, Dhruva Advisors)
81. Pillar Two consists of GloBE Rules and a stand-alone treaty rule Subject to Tax Rule (STTR)
82. IIR and UTPR
83. Previously known as Income Inclusion Rule
84. Amount of tax required to make the Effective Tax Rate ('ETR') at 15%
85. Previously known as Undertaxed Payment Rule

Provisions of Pillar Two are applicable when the consolidated annual revenue of the MNE Group is Euro 750mn or more in two out of the four years preceding the tested year. Several Indian head quartered groups (i.e. the groups where the Ultimate Parent Entity – UPE is situated in India) might satisfy the threshold of Euro 750mn.

Impact of Pillar Two can be divided in two parts:

- Additional tax outflow
- Additional compliance

Additional tax outflow

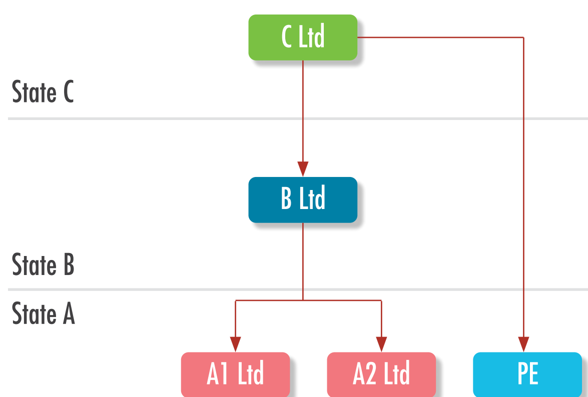
Additional tax outflow under the IIR can be understood on the basis of a simple example.

C Ltd., in State C, is the Ultimate Parent Entity (UPE) of the MNE Group ABC. The group has following presence:

- B Ltd, a subsidiary in State B
- A1 Ltd, a subsidiary in State A
- A2 Ltd, a subsidiary in State A
- PE of C Ltd. in State A

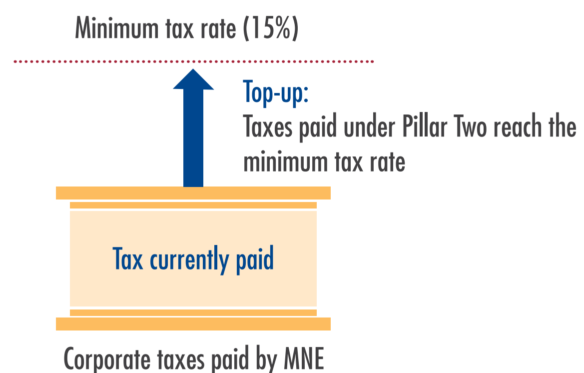
A1 Ltd, A2 Ltd and the PE qualify as Constituent Entity.

ABC Group meets the revenue threshold.



	Total	A1 Ltd	A2 Ltd	PE
Covered Taxes	450	200	100	150
GloBE Income	3,400	1500	900	1000
ETR %	13.23	13.33	11.11	15

It can be observed that the ETR of the group in State A is 13.23% as against the minimum rate of 15%. The shortfall is 60.



The UPE C Ltd. will have to pay top-up tax of 60 in State C. If C Ltd. is an Indian company, it will have to pay the top-up tax of 60 to the Indian tax authorities. Similarly, if the ETR in State B is less than 15% (say 13%) then the Indian company will have to pay additional 2% to the Indian tax authorities.

Further, the Indian company will have to pay top-up tax in certain situations even of it is not a UPE. In the example, if State B is India and State C does not apply IIR, then B Ltd. will have to pay top-up tax with respect to shortfall for A1 Ltd and A2 Ltd to the Indian tax authorities.

Similarly, an Intermediate Parent Entity or a Partially Owned Parent Entity will also have to pay top-up tax in certain situations in India.

When the ETR is less than 15% and IIR cannot be applied, balance top-up tax will be payable under the back stop rule which is UTPR and the Indian company may have UTPR liability.

Additional compliance

India Inc will have obligations to file relevant information with the tax authorities. The ETR will have to be determined for each jurisdiction in which the Indian group has a presence in the form of a branch or a group entity. Computation of ETR involves determination of "Covered Tax" and "GloBE Income".

The group entities may have paid different types of taxes in countries and all the taxes may not qualify as "Covered Tax". Additionally, there would be various adjustments related to deferred tax accounting.

The starting point for computation of amount of GloBE income or loss will be the accounting profits reported in the financial statements of the entity prepared as per the Acceptable Financial Accounting Standards or Authorised Financial Accounting Standards. The amount of book profits will be subject to various adjustments such as net tax expenses, excluded dividends, excluded equity gains, included revaluation method gains or loss, gains or loss from certain excluded assets and liabilities, asymmetric foreign currency gains or loss, policy disallowance expenses, prior period errors, accrued pension expenses, stock-based compensations, arm's length adjustments, fair value or impairment adjustment etc.

ETR for each jurisdiction will be computed for the financial year adopted by the Indian UPE, which will be April to March. Jurisdictional ETR computation will be for the period April to March even when the financial year adopted in a jurisdiction, in which the Indian group has a presence, is not April to March.

HOW CAN INDIA INC BE PILLAR TWO READY?

GloBE Rules are absolutely new, will be applied for the first time and hence several issues arise when these rules are implemented. Even if the Indian UPE does not have to pay top-up tax, it will have to comply with the computation and filing requirements of the GloBE Rules.

Accordingly, India Inc will have to plan well in advance. Although Pillar Two rules are to be applied with prospective effect, the financial results of preceding four years will impact application of the rules. This aspect needs to be considered while planning any mergers acquisitions and corporate restructuring as well.

India Inc will have to dedicate resources for Pillar Two planning and compliance. The MNEs would want to avoid a situation where in one particular jurisdiction it is paying tax at a much higher rate and there is a top-up liability in respect of another

jurisdiction due to ETR lower than 15%. The GloBE rules do not allow credit for higher ETR in one country against lower ETR in another country.

THE CONTINGENCIES AROUND IMPLEMENTATION

As per the initial declaration, Pilar Two rules were to be incorporated in the domestic law in the year 2022 and the implementation was to happen from the year 2023 onwards. However, there has been a delay and now the implementation is expected to be 2024 onwards.

There exists some scepticism about implementation of Pillar Two and one should be surprised if there is no resistance to such a large change in international tax laws. The delay is due to some technical and political reasons. With Hungary withdrawing veto, the major hurdle at EU level for Pillar Two has gone but some contingency at US level continues, some developing countries may be unhappy with the rules and the most recent resolution passed in the General Assembly of the UN for UN to lead international tax developments also creates some confusion.

While these contingencies exist, it is still not possible to ignore Pillar Two. Contingencies existed even when the major new laws such as the Companies Act, 2013 and the GST law were to be introduced in India and India Inc dealt with it. Any large business house prepares itself for various types of contingencies be it foreign exchange rate fluctuation, supply chain issues or uncertain demand for the goods or services supplied by the entity. Contingencies around Pillar Two need to be handed in a similar manner and India Inc needs to be prepared.

Pillar Two is undoubtedly the most serious internationally coordinated tax work in last several decades involving more than 140 countries. In September 2022 certain European countries[86] announced that they will implement Pillar Two even if the 27 EU member states are n ot able to agree due to Hungary's veto. Switzerland proposes to implement Pillar Two rules with effect from January 1, 2024 and this will be done through amendment of Constitution. UK has introduced Pillar Two rules in its recent budget and implementation plan is also progressing in Japan and Canada.

Thus, while contingencies continue, various countries can also be seen as moving fast towards implementation of Pillar Two. India Inc should take advantage of the additional time available due to delay in implementation and prepare itself for Pillar Two.

86. France, Germany, Italy, Netherlands, Spain

Steps towards expediting resolution of tax disputes and encouraging voluntary compliance by taxpayers[87]

The global economic landscape had been quite dynamic in 2022. Amidst the volatility, the Indian economy held firm with the reversal of the impact of COVID-19, accompanied by sound and timely policy decisions. The credit goes to the government for its persistent efforts in making India a promising destination, with focus on the ease of doing business and providing a competitive tax regime.

Over the last few years, taxpayers have seen a sea change in the approach of the government as far as resolution of tax disputes is concerned. Various initiatives introduced such as faceless assessments/ appeals, Vivad Se Vishwas Scheme, etc. have contributed immensely towards amicably concluding longstanding tax matters as well as preventing tax disputes from arising in the first place.

Further, a special scheme was announced by the government to resolve large capital gains tax dispute surrounding 'indirect transfer' pursuant to which close to INR 80 billion has been refunded to the relevant taxpayer(s). Additionally, the government is mulling over the contours of resolving other pending disputes surrounding this issue.

The year also saw the government seeking to plug repetitive litigation by introducing new provisions vide the Finance Act, 2022. It is now provided that where an identical question of law is pending before the High Court or the Supreme Court, the filing of appeal before the Income Tax Appellate Tribunal or High Court (as the case may be), may be kept in abeyance till the receipt of the order pronounced by such higher forum.

While existing policies continue to be reviewed for further improvement, lawmakers have enacted several new initiatives in the year gone by. Some of these measures have been discussed below in detail.

UPDATED RETURN OF INCOME

Traditionally, the Income-tax authorities have followed a 'nudge' approach to enhance tax compliance in the country. With the quantum of information being sourced along with technology at disposal for analysing the same, taxpayers need to be more conscious of disclosing complete and accurate information on all aspects in their income tax return.

Earlier, the Return of Income ('ROI') was required to be filed at the latest by November following the end of the financial year. In the case of failure to file a ROI within the prescribed period, the Income-tax Act, 1961 ('the Act') provided additional time to file a belated ROI/ revise errors in the return already filed.

However, considering the volume of financial transactions undertaken throughout the year, the above timelines were not adequate for taxpayers who subsequently needed to modify the details filed in their ROI. With an aim of promoting voluntary compliance in such cases, the Finance Act, 2022 introduced the provisions for filing an Updated Tax Return.

With effect from 1 April 2022, taxpayers can file an Updated Tax Return for up to 24 months from the end of the relevant assessment year along with proof of payment of tax, additional tax, interest and fee. The Updated Return can be filed irrespective of whether an original ROI has been filed or not. However, the Updated Return cannot be a return of loss or have the effect of reducing the tax liability (as against the earlier ROI) or results in refund/ increases the refund.

The additional tax payable shall be determined as follows:

Where an Updated Return is furnished	Additional Tax [as % of aggregate of tax (including surcharge and cess) and interest payable]
Within 12 months from the end of the assessment year	25%
Between 12-24 months from the end of the assessment year	50%

87. This article is contributed by Sandeep Bhalla (Partner, Dhruva Advisors), Ashish Agrawal (Associate Partner, Dhruva Advisors) and Ritesh Thakkar (Principal, Dhruva Advisors)

The opportunity for filing an Updated Return shall not be available in certain scenarios (such as where a Search has been initiated, assessment/ reassessment proceedings have been initiated or completed, etc.). It is noteworthy that no penalty is leviable on taxpayers merely because additional income is offered by way of filing an Updated Return.

E-DISPUTE RESOLUTION SCHEME, 2022

Navigating tax disputes in India has always been perceived to be an arduous task, as the litigation can be dragged for many years. At times, appeal matters take years to be admitted and decades to be finally adjudicated. The reasons for this range from intricacies involved in the issues to the hierarchy of appellate forums. To add to the above, no mandatory time limits have been prescribed under the tax law for higher appellate authorities to decide matters.

The government is cognizant that small and medium taxpayers need to channel their resources towards their business rather than being embroiled in disputing tax matters. Against this backdrop, an alternative mechanism for dispute resolution has been introduced by inserting section 245MA to the Act. The provisions of section 245MA empower the government to constitute a Dispute Resolution Committee ('DRC') and formulate a scheme for settling tax disputes in case of small and medium taxpayers where:

- income declared in the ROI does not exceed INR 5 million; and
- variation proposed by the income tax authorities to the income does not exceed INR 1 million

The DRC shall consist of three members and the decision of the DRC shall be by majority.

The scheme also specifies certain categories of taxpayers who shall not be eligible to use its benefits (viz. offenders under tax and allied laws, Narcotics Act, etc). Additionally, the benefits of this scheme cannot be resorted to in cases where the variation proposed by the authorities is on account of Search or Survey proceedings or on the basis of information received from the authorities of a foreign jurisdiction under a Tax Treaty.

In April 2022, the Central Board of Direct Taxes ('CBDT') notified the e-Dispute Resolution Scheme, wherein taxpayers can make an application for dispute resolution to the DRC on payment of a nominal fee.

The proceedings before DRC shall be conducted in faceless mode, unless a personal hearing is requested by the taxpayer. Where such a hearing is granted (at the discretion of the DRC), it shall be conducted through video conferencing.

The DRC has the authority to modify the proposed variation and/ or waive the penalty levied on the taxpayer and grant immunity from prosecution proceedings under the Act within six months from the date on which the application was admitted. Subsequently, the income tax authorities shall pass/ modify their original order in conformity with the directions given by the DRC within one month from the receipt of such directions.

It is noteworthy that the DRC cannot make any modifications that are prejudicial to the taxpayer. Further, the order passed by the DRC shall not be appealable before any appellate authority. Hence, the e-Dispute Resolution Scheme provides a window for small and medium taxpayers to resolve their disputes at the initial stage itself and nip potentially prolonged litigation in the bud.

COMPOUNDING GUIDELINES

The Income-tax Act provides for prosecution in cases of non-compliance/ non-adherence with the tax law. Adding to that, authorities have been proactive in bringing defaulters to book by cracking the whip on tax violations and tightening the noose around taxpayers resorting to evasion. While prosecution provisions may be befitting for wilful offenders, the case for bona fide taxpayers needs to be made out.

Thus, compounding of offences becomes important since it provides an opportunity for taxpayers to come forward and suo-motu admit to a genuine

mistake without having to worry about the sword of prosecution hanging over their heads. To address this, CBDT has been regularly issuing guidelines for compounding of offences under the Act.

The guidelines issued in 2019 were aligned with the government's objective of curbing tax evasion. However, there were practical difficulties in applying certain guidelines of compounding on account of certain restrictive provisions in place. Consequently, CBDT issued revised guidelines for compounding of offences in September 2022.

The most notable change in the revised guidelines is scrapping of the collegium system of competent authorities. The earlier guidelines provided that an application involving compounding charges above INR 1 million was to be approved by a committee of three senior tax officials. This collegium system has now been done away with, thereby enabling faster disposal.

The 2019 guidelines provided a period of 12 months from filing of prosecution complaint for filing a compounding application, which could be extended to 24 months at the discretion of compounding authorities. Under the 2022 guidelines, this extended limit (of 24 months) has been made available in all cases. Additionally, a delay of up to 36 months in some cases has also been permitted.

As per the earlier guidelines, the competent authorities could reject an application based on their opinion on the conduct of the taxpayer or the enormity of offence. Such discretion has been done away with and now only repeat offenders are barred from resorting to the compounding mechanism.

Further, under the 2019 guidelines offences under other laws that had a "direct bearing on" the offence under direct tax laws were not to be compounded. This has now been modified to ensure that unless these offences are inextricably linked and the primary offence is "directly related to" the tax violation, the offence shall be compounded subject to other conditions.

With the government's outlook of holding tax defaulters accountable, investigations and consequent actions under tax and allied laws are increasing by the day. From 2017 to 2021 alone, approximately 8,200 proceedings were launched by the government in relation to tax and allied laws. The revised compounding guidelines should bring necessary relief from the harsh repercussions of prosecution to taxpayers who have inadvertently erred in complying with certain provisions of law.

CHARTING THE COURSE

The government's efforts are laudable in proactively laying down the above measures and should go a long way in settling tax controversies. The approach of policy makers is to create a taxpayer-friendly environment and it will have to be ably supported by officials at the ground level.

The Hon'ble Finance Minister recently announced three principles that tax officers should abide by (colloquially referred to as RRR). These are briefly explained below:

a. **Returns** filed should be processed promptly, efficiently and systematically;
b. **Refunds** claimed should be granted speedily, without delay or reasons for withholding them;
c. **Redressal** of grievances should be delivered on time. Matters should not languish on officers' tables.

Further, various schemes initiated by CBDT have gathered momentum in the recent past. Local committees to deal with taxpayers' grievances from High-Pitched Scrutiny Assessments have been set up. While guidelines for the above have been announced, we are yet to see any noticeable practical action on this aspect especially for non-resident taxpayers.

In November 2022, CBDT asked such committees to provide their report on high-pitched assessments within two months. Also, suitable action can now be initiated against the Revenue officers where assessments are found to be high-pitched or on non-observation of principles of natural justice, non-application of mind or due to gross negligence.

Another mechanism for achieving certainty on tax position is by way of obtaining an advance ruling

by the taxpayer. However, the entire process for issuance of advance ruling has been derailed over the past few years. The purpose of having a mechanism for obtaining advance ruling was to bring certainty to taxpayers prior to undertaking a transaction. However, only a handful of rulings have been pronounced in the past few years that too after a lag of several years, making the entire process otiose. While the government has recently overhauled the process and replaced the Authority for Advance Rulings with a new Board for Advance Rulings, the same is yet to be made fully functional.

Further, the Advance Pricing Agreement ('APA') mechanism could be strengthened to have a focused approach at avoiding potential transfer pricing disputes. Practically, even the Mutual Agreement Procedure ('MAP') could be revamped to ensure that pending disputes are brought to their logical conclusion and that too in a shorter timeframe.

Though the government is keen on enacting measures that assist taxpayers in resolving disputes and encourage voluntary compliance, it is the role of Revenue officers to implement it at the ground level by providing the impetus required so that taxpayers can capitalise on the benefits envisaged by legislators.

Overseas Investments in non-financial services – Issues, opportunities, and way forward[88]

INTRODUCTION

There have always been a sophisticated set of rules and regulations governing overseas investments from India, which has seen a transition from erstwhile FERA regime to a relatively liberal FEMA regime over the decades. However, with a constant increase in changes of business dynamics and requirements for Indian business to go global, the Government of India, recognizing the need to enhance ease of doing business and with a view to rationalize/ simplify the prevailing regulations, has in consultation with Reserve Bank of India ('RBI') issued a draft framework on Overseas Investments ('OI') for public consultation on 09 August 2021.

After reviewing the public's comments and conducting a further internal evaluation for more than a year, the Government of India finally notified the revised framework[89] ('New Rules') w.e.f. 22 August 2022 thereby superseding the earlier framework[90] ('Old Rules'). The New Rules are effective from 22 August 2022 and all prospective OIs need to adhere to the New Rules.

While the New Rules have liberalized and provided clarity/ liberalization on various aspects pertaining to OI, they come with their own set of issues, interpretational challenges. Here we discuss some of the provisions of the New Regulations along with their possible impact and the surrounding issues.

GRANDFATHERING EXISTING OVERSEAS INVESTMENTS ('OI')

The New Rules grandfathers all OIs existing before the introduction of these New Rules only if such OI have been fully compliant with the Old Rules (including any compliance with reporting requirements therein).

However, where there is any lapse/ delay /non-compliance with the existing OIs, the same are not grandfathered by the New Rules.

Implications where existing OIs did not comply with the Old Rules or where there has been a delay/lapse in reporting requirements have been provided hereunder in a summarized manner:

- Such OIs are not permitted to be held with the introduction of the New Rules
- Such OIs are not permitted to be transferred with the introduction of the New Rules.
- Indian Parties are not permitted to make any further overseas Financial Commitment ('FC'), either fund or non-fund based

As a result, it becomes imperative for Indian Parties already having any existing OIs as on the date of introduction of New Rules to evaluate as to whether such existing OIs are fully compliant with the Old Rules or not. This is more so relevant as any Indian resident, intending to make OI, needs to give an undertaking that all existing OIs have been compliant with the applicable OI legislation (Old/ New).

In case where any irregularities are observed, the following broad approaches may be considered to be compliant with the New Rules:

- In case of procedural non-compliances under existing OI, one may consider regularizing them by paying prescribed Late Submission Fees ('LSF') before the Authorized Dealer.
- The quantum of LSF differs depending on whether the irregularities are non-fund based (fixed fee prescribed) or fund based (fixed fee + variable element basis the quantum involved)
- In case of any fundamental lapse (e.g., non-permissible OIs under Old Rules, or an OI made under automatic route which required prior approval etc.), one may consider approaching RBI for compounding of offence or seeking their specific approval for the existing OIs on a case-to-case basis.

88. This article is contributed by Abhishek Mundada (Partner, Dhruva Advisors), and Chirag Khetan (Principal, Dhruva Advisors)
89. Foreign Exchange Management (Overseas Investment) Rules, 2022 (ODI Rules); Foreign Exchange Management (Overseas Investment) Regulations, 2022 (ODI Regulations), Foreign Exchange Management (Overseas Investment) Directions, 2022
90. Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 ('FEMA 120') and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property Outside India) Regulations 2015

INVESTMENT ROUTES FOR OI - ODI V/S OPI

The Old Rules lacked clarity/ measurable parameters in terms of identifying which investments should fall within the category of ODI or Portfolio Investments. In a welcome move, the New Rules provide clarity in terms of which OI shall constitute an Overseas Direct Investment ('ODI') and an Overseas Portfolio Investment ('OPI') and also provide for corresponding circumstances, rules, regulations, conditions etc. for making OI under ODI or OPI route.

As per New Rules, an ODI inter alia includes:

- Acquisition of unlisted equity capital of a Foreign Entity ('FE'); or
- Subscription as a part of MoA of FE; or
- Investment in 10% or more of the paid-up equity capital of a listed FE; or
- -Investment with 'control'[91] where investment is less than 10% of paid-up equity capital of the listed FE

Note: Once an investment is treated as ODI, then it will always be treated as an ODI even if control ceases or investment in equity capital reduces to less than 10%.

OPIs are investments other than ODI, in foreign securities, but this does not include investment in any unlisted debt instruments, or any security issued by a person resident in India who is not in an International Financial Services Centre ('IFSC').

It should also be clarified that redeemable or optionally redeemable preference shares shall be considered as debt under the New Rules and, consequently, investment in such instruments under the OPI route will not be permissible[92].

Note: Under the Old Rules, only Indian listed entities were permitted to make OPI, however, under the New Rules, even unlisted Indian entities/ resident individuals are permitted to make an OPI.

OI BY WAY OF DEBT

Under the New Rules Indian Parties can make OI in Debt only when:

- Indian Party has made ODI and
- Indian Party has 'control' in the FE (i.e., borrower).

Further, it shall be noted that under New Rules, OI through Debt is mandatorily required to be backed by a loan agreement and interest is required to be charged at arm's length.

Hence, it may be noted that as compared to Old Rules, the following additional thresholds are required to be met by Indian Parties under the New Rules for the purposes of making ODI:

- Indian Party must have 'control' in FE
- Arm's length interest rate must be charged by Indian Party for overseas debt investment (even where transfer pricing provisions are otherwise not applicable)
- Debt investment to be backed by a loan agreement

OI BY WAY OF GUARANTEE

Similarly, an Indian Party and/or Group Entity of Indian Party can extend Guarantee (performance guarantee, SBLC, etc.) to FE (including SDS) only where an Indian Party has 'control' over the FE/ SDS

91. Control has been defined to mean right to appoint a majority of directors or to control the management or policy decisions individually or jointly with any other person by virtue of their shareholding/ management rights/ shareholders' agreement/ voting agreement that entitles them to 10% or more of the voting rights/ in any other manner.
92. There are certain case specific clarifications provided for investment in certain unlisted securities which shall deemed to be treated as OPI investment (e.g. Contribution in investment fund/vehicle set-up in IFSC, acquisition of shares or interest under ESOPs etc.)

CALCULATION OF TOTAL FINANCIAL COMMITMENT ('TFC LIMIT')

Whilst the TFC Limit has been retained at 400% of net worth, the following aspects are critical to note –

- 'net worth' under New Rules has been defined to mean net worth as defined under Section 2(57) of the Companies Act 2013. In Old Rules, it meant only paid-up capital and free reserve. Thus, securities premium can be considered for reckoning the TFC Limit of 400%
- the Indian Party can no longer utilize the net worth of its subsidiary/ holding company (group companies) for counting its TFC limit.

Thus, the overall framework of making OI by Indian Party under various categories can be summarized as under:

Key Distinction – ODI v/s OPI:

Overseas Investment		
Financial Commitment		
ODI	Unlisted Debt	OPI
Equity Capital of unlisted FE	Only where ODI is made + there is Control	Equity other than ODI
Subscription as part of MOA		Listed Debt Instrument
≥ 10% voting rights or control in listed FE		Deemed OPI4

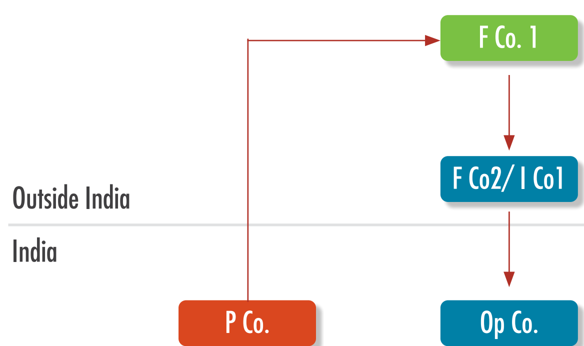
BONAFIDE BUSINESS ACTIVITIES

Like the Old Rules, under the New Rules OI is permitted in FE (directly or through a SPV/ SDS) only if such FE is engaged in a bona fide business activity. The New Rules define the term "bonafide business activities" - a definition not present under the Old Rules.

As per the New Rules, a "bonafide business activity" means any business activity which is permissible under the law in force in India as well as the host country/jurisdiction.

ODI-FDI STRUCTURES

While the Old Rules did not explicitly restrict ODI-FDI (popularly called round trip structures) structure, in practice the RBI was not comfortable with these structures as later clarified in its Frequently Asked Questions ('FAQs') released on ODI (FAQ no- 64). The FAQ clarified that prior RBI approval is a must for ODI-FDI structures. It may also be noted that during applicability of Old Rules, RBI used to consider such structures as non-compliant predominantly for the reason that FE's activity is non-bonafide activity of FE.



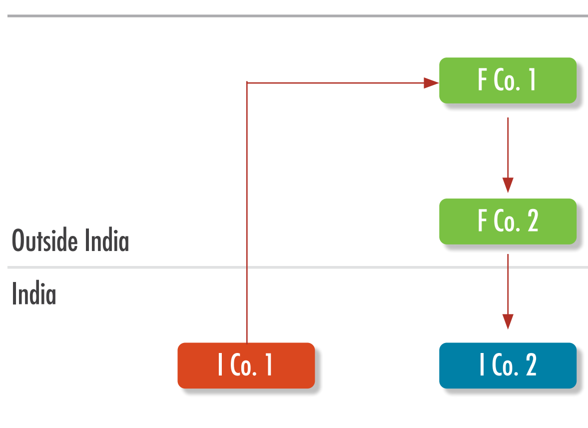
However, it may be noted that under New Rules, OI entailing such ODI-FDI structures are permissible subject to certain restrictive conditions mentioned below:

- ODI-FDI Structure should not result in more than 2 layers of 'subsidiaries' (Layering conditions not applicable to specified entities e.g., Bank, NBFC etc.)
- Subsidiary is defined to mean an entity in which FE has 'control' (e.g., more than 10% of voting rights)

The relaxation mentioned above comes as a relief, as the restrictions were seen as a major barrier in pursuing overseas acquisitions under automatic route which had underlying investment in Indian entity(ies).

However, certain crucial aspects as mentioned hereunder must be evaluated –

- Whether the below is permissible or not?



- The relaxation opens up opportunity for restructuring e.g., to consolidate holding structures which could not be aligned because of restrictions under Old Rules for ODI-FDI structure. Such consolidation could happen in multiple ways e.g., swap, merger, demerger, slump sale depending upon the specific facts of the case
- It shall also be pertinent to evaluate whether an overseas SPV which is created by an Indian Party for the sole purpose of making back investments in India shall be permissible or not? In this regard, one would have to evaluate whether such investments by Indian Party's into overseas SPVs (pure holding company for underlying Indian investments) can be regarded as bonafide business activity or not.

OTHER IMPORTANT ASPECTS

Book write-off/restructuring:

Write-offs consequent to disinvestments in FE:

Under the Old Rules, write-offs arising consequent to transfer or any kind of disinvestments in FE were permitted in specified scenarios. However, under the New Rules, there are no such specified scenarios.

Accordingly, any write off arising in the books of Indian entity pursuant to disinvestment may otherwise be permissible under the New Rules subject to compliance with Pricing Guidelines.

Restructuring not consequent to disinvestments in FE (i.e., Other Restructuring):

Under the New Rules, the entities are permitted to restructure the balance sheet of FE subject to following conditions:

- FE has been incurring losses for the previous 2 years
- Diminution in value of outstanding dues to Indian entity not to exceed their proportionate share of accumulated losses of FE
- Valuation report to be required in cases where:
  - Original investment amount is more than USD 10 Mn OR
  - Diminution exceeds 20% of value of outstanding dues to Indian entity
- Reporting and documentation compliances in respect to FE has been carried out

Under the New Rules, unilateral write-offs (as allowed under the Old Rules subject to prescribed thresholds thereunder) are not permitted.

No-Objection Certificate ('NoC'):

Under Old Rules, an Indian party subjected to investigation by any Government authorities was required to seek prior approval before making any ODI investment.

Under New Rules, this condition has been relaxed and an Indian Party would be required to obtain NoC from concerned parties before making any OI or disinvestment as under:

i. In case of Non-Performing Assets ('NPA') accounts or willful defaulter such NoC to be obtained from AD bank

ii. In case of any ongoing investigation (e.g., ED), such NoC to be obtained from investigating agencies

It may however be noted that in cases where no certificate is issued by the concerned authority within 60 days from the date of application, it would be considered a deemed approval under New Rules.

It is important to evaluate whether a blanket NoC can be received from these authorities or for every tranche of OI proposed to be made, such NoC needs to be sought.

Deferred Payment:

New Rules permit deferred payments provided the period of deferment is defined upfront in sale/ purchase agreement.

Pricing Guidelines:

The pricing for OI should be on an arm's length basis, based on valuation undertaken as per any internationally accepted pricing methodology and AD banks are responsible for such compliance.

Transfer or Liquidation:

Under Old Rules, transfer or liquidation of FE was permissible if such FE was in operation for at-least one (1) year of its incorporation.

However, the lock-in requirement under New Rules has been shifted to the Indian Party wherein Indian investors are required to stay invested for at least 1 year from the date of making ODI before transfer/ liquidation (exception - merger of group entities/ no dilution).

KEY REPORTING RELATED CHANGES

- Annual Performance Reports ('APR') need not be filed in cases where all three conditions are satisfied:
  - Indian Party is holding less than 10% in FE
  - Indian Party do not have control in FE
  - Indian Party do not have any other FC in FE

CONCLUDING THOUGHTS

The New ODI Regime has provided clarity on ODI and OPI. Also, various overseas investment related transactions that were earlier under approval route are now under automatic route (such as non-financial services entity investing in foreign entity engaged in financial services, investments in IFSC, transfer/ disinvestment, restructuring of ODI) thereby significantly enhancing "Ease of Doing Business". The New ODI Regime has also eased provisions relating to ODI-FDI structures.

From an overall perspective, New ODI Regime has sought to ease the erstwhile ODI regime. However, one will have to see the application of the New ODI Regime on actual transactions and where required, the RBI may seek to further liberalize the provisions to overcome the challenges being faced.

BACK

New ODI Guidelines – Impact on resident individuals and investments in financial services[93]

In-keeping with the spirit of liberalisation and to promote the ease of doing business, the Central Government and the Reserve Bank of India ('RBI') have been progressively simplifying the procedures and rationalising the rules and regulations under the Foreign Exchange Management Act, 1999. The Central Government/ RBI duly acknowledges the importance and significance of overseas investments by persons resident in India being important drivers of foreign trade, technology transfer etc. This in turn could potentially boost domestic employment, growth, competitiveness of Indian entities in a significant manner.

In this direction, significant steps have been taken with operationalisation of a new Overseas Investment regime. In this regard, on 9 August 2021, the RBI had issued draft rules/regulations regarding Overseas Direct Investment ('ODI')/ Overseas Portfolio Investment ('OPI') and had sought feedback on the same ('Draft ODI Rules'). Pursuant to the Draft ODI Rules and the feedback received, the Central Government and the RBI on 22 August 2022, released the new rules/ regulations/ direction on ODI[94] ('New ODI Rules').

The New ODI Rules, which are effective from 22 August 2022, aim to simplify the existing framework for overseas investment by persons resident in India to cover wider economic activity and significantly reduce the need for seeking approvals. Corresponding changes in light of the amendments vide New ODI Rules have also been made in the Master Directions to Liberalised Remittance Scheme ('LRS Directions').

The New ODI Rules have made some key changes with respect to permitted overseas investment by resident individuals and investments in the financial services sector (discussed below).

INVESTMENTS BY RESIDENT INDIVIDUALS

The erstwhile ODI Regulations defined direct investment outside India to specifically exclude portfolio investments (i.e. investment of less than 10%[95] without any control or management rights). Also, the erstwhile ODI Regulations provided that investment by resident individuals should be made in an operating entity and no step-down subsidiary was allowed to be acquired by the JV or WOS. Thus, the erstwhile ODI Regulations permitted investment in overseas companies and unlisted funds as portfolio investment[94].

The New ODI Rules permit resident individuals to *inter alia* make ODI[96], subject to LRS limit[97], in an operating foreign entity that is not engaged in financial services activity and does not have a subsidiary or step-down subsidiary where the resident individual has control in the foreign entity.

Accordingly, now (under the New ODI Rules) it may not be possible for resident individuals to invest in an unlisted financial services entity or an overseas fund. This would have a significant impact on future overseas funds that intended to receive investments from Indian individuals, as well as existing structures that have already obtained commitments from Indian individuals, which these individuals may now not be able to fund.

That being said, it is important to note that the New ODI Rules provide that investments (including sponsor commitments) in units of any overseas investment fund (duly regulated by the regulator for the financial sector in the host jurisdiction), shall be considered as OPI. Thus, resident individuals can invest in regulated overseas funds, subject to the LRS limits. However, there is lack of clarity on whether an overseas fund can be considered as regulated where only the fund manager entity is regulated in the host jurisdiction.

93. This article is contributed by Punit Shah (Partner, Dhruva Advisors), Vishal Lohia (Principal, Dhruva Advisors) and Meet Mehta (Senior Associate, Dhruva Advisors)
94. Foreign Exchange Management (Overseas Investment) Rules, 2022, Foreign Exchange Management (Overseas Investment) Regulations, 2022, Foreign Exchange Management (Overseas Investment) Directions, 2022
95. This was not codified in the erstwhile ODI Regulations. The same was a general understanding.
96. The definition of ODI includes investment in unlisted equity capital of a foreign entity or investment in 10% or more of listed equity capital or investment with control in listed equity capital where investment is less than 10%. OPI has been defined to inter-alia mean investments other than ODI.
97. USD 250,000

Resident individuals have also been permitted to make ODI in IFSC Entities, including those that are engaged in financial services activities (other than banking or insurance) provided the IFSC Entity (in which resident individual has control) does not have a subsidiary or a step-down subsidiary outside IFSC (in India or any other jurisdiction). This places the IFSC Entities in a better position as compared to foreign entities in other jurisdictions wherein resident individuals are only permitted to make ODI in operating entities not engaged in financial services activity.

Repatriation/ retention of proceeds remitted under LRS by resident individuals

With respect to ODI in a foreign entity under the LRS route, the resident individuals are required to realise and repatriate to India, all dues receivable from the foreign entity with respect to inter-alia investment in a foreign entity, the amount of consideration received on account of transfer or disinvestment of such ODI within 90 days from the date when such receivables fall due or the date of such transfer or disinvestment.

With respect to remittances under LRS (other than with respect to ODI in a foreign entity), the amended LRS Directions now provide that a resident individual can retain, reinvest the income earned on the investments - however, the received/ realised/unspent/unused foreign exchange, unless reinvested, shall be repatriated and surrendered to an authorised person within a period of 180 days from the date of the receipt/ realisation/ purchase/ acquisition or date of return to India. It is imperative to note that there was no such requirement under the erstwhile LRS Directions. Furthermore, while the amendment is introduced in the LRS Direction on 23 August 2022, the applicability of these new provisions to certain situations such as funds lying in foreign savings/ fixed deposit accounts prior to 23 August 2022 is not clear.

A table summarising the changes vis-à-vis overseas investment by resident individuals is set out below:

Particulars	Erstwhile ODI Regulations	New ODI Rules
Investment in listed entities	Permissible under portfolio investment	Permitted under OPI (i.e. less than 10%)
Investment in unlisted entities	- Permissible under portfolio investment (upto 10/15%) - Permissible under ODI (other than financial services/ real estate/ banking; no step-down subsidiary allowed)	- Permitted under ODI in operating entities (other than financial services) - No step-down allowed in case of control in foreign entity
Investment in overseas funds	Permissible under OPI (upto 10/15%)	OPI only permissible in regulated overseas funds
ODI in IFSC	ODI in foreign entity engaged in financial service activity in IFSC not permissible	Permissible in IFSC (except banking / insurance) if such entity does not have subsidiary or step down subsidiary outside IFSC where the resident individual has control in the foreign entity

INVESTMENT BY INDIAN ENTITY IN FINANCIAL SERVICES ('FS')

The New ODI Rules permit Indian Entity regulated by a financial services regulator to make ODI in foreign entity engaged in financial services activity under the automatic route. Under the erstwhile ODI Regulations only Indian entities registered with the relevant regulatory authority were permitted to make ODI in a foreign entity who has obtained approval from its jurisdictional regulator for engaging in financial services activity.

Another significant change introduced in the New ODI Rules is the ability for Indian Entities not engaged in financial services to invest in a foreign entity engaged in financial services, subject to a three-year profit track record.

A table summarizing the change vis-à-vis overseas investment in financial services is set out below:

Particulars	Erstwhile ODI Regulations	New ODI Rules
FS entity investing in overseas FS entity	Permitted subject to conditions including approval from the concerned regulatory authorities in India and abroad	Permitted subject to conditions including approval from the concerned regulatory authorities in India and abroad, if required
Non-FS entity investing in overseas FS entity	Not permitted	Permitted (other than in banking or insurance), provided the Indian entity has posted net profits during the preceding 3 financial years

Definition of financial services

The New ODI Rules have now defined the term financial services activity thereby providing some guidance in evaluating whether the ODI entity is engaged in financial services activity or not – a foreign entity shall be considered to be engaged in the business of financial services activity if it undertakes an activity, which if carried out by an entity in India, requires registration with or is regulated by a financial sector regulator in India.

On perusal of the definition above, a question may arise whether a foreign entity engaged only in investing activity can be regarded as an entity engaged in financial services activity. Given that an entity that is engaged in investing activity in India and meets the 50:50 test (i.e. company's financial assets constitute more than 50% of the total assets and income from financial assets constitute more than 50% of the gross income) would require to register as an NBFC, such a foreign entity may be considered as engaged in financial services activity.

CONCLUDING REMARKS

The New ODI Rules has its set of positive changes vis-à-vis the erstwhile ODI Regulations such as permitting entities engaged in non-financial services activity to invest in foreign entity engaged in financial services, relaxing the requirement of obtaining approval from the host country regulator, defining the term financial services.

Having said that, as highlighted above, certain concepts including repatriation/ retention of proceeds by resident individuals, regulated overseas fund, business of financial services requires further clarity. It is desired that the RBI releases FAQs to clarify their position on all the contentious issues.

Trends in M&A tax jurisprudence[98]

M&A activities in India has touched a whopping high of USD 148 bn in first nine months of 2022. Despite global M&A activity going through a lull phase due to factors like inflation, supply chain disruption caused by Russia-Ukraine war, rising commodity prices, etc., India's dealmaking ecosystem has witnessed a noteworthy surge. In PE backed M&A deals, India's market share was 28%, more than 4% as compared to China.

While the year witnessed series of mega mergers e.g. HDFC-HDFC bank, LTI-Mindtree, ACC-Ambuja, PVR-Inox etc., it has also witnessed plummet in funding of edtech, new age start-ups followed by layoffs across these sectors. If the year 2021 saw many fintech and e-commerce players going public with handsome valuations, the year 2022 marked a significant value erosion for those fintech and other ecommerce platforms. Majority of this value erosion could be attributed to their financial performance especially the ability to generate cash profits, and this takes all stakeholders back to the basics of sustainability of a business model.

During 2022, we also saw several significant judgments laying down interesting principles from an M&A tax perspective. We have summarized principles from some of the key rulings and regulatory updates below.

PRINCIPLES FROM KEY LANDMARK RULINGS IN M&A TAX

Section 56(2)(viic) of the Act[99] (deemed gift tax provisions) are not applicable to bonus shares

The Delhi Bench of Income-tax Appellate Tribunal in the case of *Joint Commissioner of Income-tax v. Bhanu Chopra*[100] held that section 56(2)(viic) of the Act is not applicable on receipt of bonus shares. The Tribunal ruled in favor of the assessee by relying on favorable jurisprudence on this issue.

This decision reaffirms the position that issue of bonus shares is mere capitalization of profits, which does not have an impact on the wealth of a shareholder, hence, there is no deemed gift tax in the hands of the recipient under section 56(2)(x) of the Act (erstwhile section 56(2)(viic) of the Act).

Carry forward and set-off of accumulated business losses on account of change in ultimate shareholding (Section 79 of the Act)

The Delhi Bench of Income-tax Appellate Tribunal in the case of *Assistant Commissioner of Income-tax v WSP Consultants India Private Limited*[101] held that accumulated business losses shall not lapse where there is change in shareholding of the ultimate holding company, but no change in the immediate shareholding of the company. The Tribunal placed reliance on earlier rulings on the subject, wherein it was held that section 79 of the Act can be invoked only where there is a change in the immediate shareholding of a company, and the registered owner is to be interpreted as the beneficial owner. In the case of a multilayer group structure, the ultimate holding company should not be considered as the shareholder of the company.

In the context of availability of set-off of past losses, there are several contrary rulings on whether one has to give regard to registered (immediate) or ultimate shareholding in cases where there is change in immediate shareholding of a company, but where the ultimate shareholder remains the same. This ruling dealt with a situation when there was a change in the ultimate shareholder, but where the immediate shareholder remained the same. It is a welcome ruling reasserting the position that the registered shareholder is the beneficial owner for the purposes of section 79 of the Act.

Applicability of section 56(2)(viib) of the Act to shares issued pursuant to conversion of convertible instruments

Section 56(2)(viib) of the Act provides for taxability of consideration received for issue of shares by a closely held company that is in excess of the fair market value of such shares. Couple of divergent

98. This article is contributed by Mehul Bheda (Partner, Dhruva Advisors), Nitin Bohra (Principal, Dhruva Advisors) and Ketan Sakhala (Senior Associate, Dhruva Advisors)
99. Unless otherwise stated in this article, Act refers to the Income-Act, 1961
100. [2022] 195 ITD 767 (Del)
101. [2022] 140 taxmann.com 65 (Del)

rulings were issued during the year on the applicability of section 56(2)(viib) of the Act on the issuance of shares pursuant to the conversion of convertible instruments.

In the case of Deputy Commissioner of Income-tax v Rankin Infrastructure Pvt. Ltd[102], the Mumbai Income Tax Appellate Tribunal held that issue of shares at premium on the conversion of optionally convertible debentures ('OCD') shall not trigger the provisions of section 56(2)(viib) of the Act. The key observations were as follows:

- Issuance of shares and receipt of consideration has to be in the same year for applicability of section 56(2)(viib) of the Act.
- Conversion of debentures into shares is a non-taxable transfer. Further, the cost of shares received pursuant to conversion shall be same as the original cost of debentures.
- Section 56(2)(viib) of the Act has been introduced to tax money laundered into the companies through inappropriate means.

The Kolkata Bench of Income-tax Appellate Tribunal in the case of Milk Mantra Dairy Private Limited v. Deputy Commissioner of Income-tax held the other way, ruling that the issue of equity shares on conversion of compulsorily convertible debentures (CCDs) is covered under the ambit of section 56(2)(viib) of the Act. The key observations were as follows:

- Although the CCDs were issued prior to provisions of section 56(2)(viib) of the Act coming into effect, it did not rule out its application thereof to conversion into equity shares, which happened after the provision became effective.
- The term consideration is a term of wider import when compared with words amounts or money. Hence, the phrase receipt of any consideration cannot be limited to the receipt of money only and it encompasses consideration in all forms.
- The consideration involved on conversion of CCDs into equity shares is discharge of company's obligation, release of encumbrance, interest obligation, pari passu ranking of rights with the rights of existing equity shareholders, etc.

A plain reading of the provisions suggest that section 56(2)(viib) of the Act is applicable even to the issuance of shares upon conversion of convertible instruments. The rulings above shall have a significant impact on issuance involving convertible instruments. The contrary rulings could lead to more controversies and the matter is likely to attain finality only once the issue is settled by the ruling of a higher authority.

Waiver of loan neither taxable as business income nor income from other sources

The Mumbai Bench of Income-tax Appellate Tribunal in the case of *ACIT v. Infinite Buildcon Private Limited*[103] held that the waiver of a loan is neither taxable as business income under section 28(iv) of the Act nor taxable under the heading of Income from Other Sources under section 56(2)(x) of the Act.

The Tribunal placed reliance on the decision of Supreme Court in case of *Commissioner v. Mahindra & Mahindra Limited*[104] and held that section 28(iv) of the Act will not apply to the waiver of a loan. Further, the Tribunal distinguished the ruling of Supreme Court in the case of *Commissioner of Income-tax v. TV Sundaram Iyengar and Sons Limited,*[105] wherein deposits received from customers during the business were written back and it was held to be business income. However, the Tribunal noted that in the present case the lenders are not the customers of the assessee. As regards taxability of the waiver of a loan under section 56(2)(x) of the Act, the Tribunal interpreted that this section is attracted only when the person receives any sum of money without consideration during the year. The loan was received in earlier years and during the year there was only the waiver of a loan and no actual receipt of money. Hence, the Tribunal held that the waiver of loan cannot be equated with the actual receipt of money contemplated under section 56(2)(x) of the Act.

102. [2022] 196 ITD 333 (Kol)
103. [2022] 11 TMI 963 (Mum)
104. [2018] 404 ITR 1 (SC)
105. [1996] 222 ITR 344 (SC)

This is an important ruling applicable to all the cases where there is a waiver of loan in the hands of the taxpayers who are in financial distress and undergoing debt restructuring including insolvency and bankruptcy proceedings.

Carry forward and set-off of long-term capital loss and transfer of MAT credit of amalgamating company upon merger

In a recent ruling of Pune Bench of Income Tax Appellate Tribunal, in the case of *Capgemini Technology Services India Limited v DCIT*[106], it was held that the assessee company (i.e. the amalgamated company), is entitled to carry forward and set off long term capital loss brought forward from an erstwhile amalgamating company. Also, it allows the assessee to claim MAT credit of amalgamating company.

The Tribunal observes that the scheme provides that any benefit by way of set off or carry forward of any allowance or loss that is available to the transferor company under the Act shall be available to the transferee company.

The Tribunal relied on the Supreme Court ruling in the case of *CIT v T. Veerabhadra Rao*[107] and held that the law of succession puts the successor in the shoes of the predecessor as a result the successor-in-interest (i.e. amalgamated company) becomes entitled to all the entitlements and deductions that were due to the predecessor subject to the specific provisions contained in the Act. The Tribunal also noted that section 72A of the Act applies exclusively to accumulated business loss and unabsorbed depreciation of the amalgamating company. However, it is not a panacea for all the tax related issues of amalgamation, so as to have an application insofar as the other tax entitlements, privileges or benefits in the hands of the amalgamated company, are concerned. Since the business of the amalgamating company continues uninterruptedly by the amalgamated company, the benefit of carry forward and set off of such loss earned by the business of the amalgamating company has to be allowed to the amalgamated company.

Likewise, it holds that MAT credit of the amalgamating company has to be allowed in the hands of the amalgamated company. Refers to section 115JAA(7) of the Act, which contains a specific prohibition on allowance of MAT credit of predecessor company to successor LLP on conversion. Hence, in the event the intention of the legislature had been not to allow MAT credit to the amalgamated company, then it would have specifically covered the cases of amalgamation in addition to the cases of conversion of a company into LLP.

This ruling takes a contrary stand from the well settled understanding that section 72A of the Act governs the law on transfer of losses on amalgamation. The ratio of this ruling could also be applied to a carried-forward deduction, allowance, loss or exemption / benefits for which no specific provisions are available under the Act to entitle the transferee company to take the same benefit.

Disallowance of set-off of losses despite obtaining HC approval on Demerger

In the case of Deputy Commissioner of Income-tax v Cummins Sales & Service Ltd,[108] the Pune Bench of Income-tax Appellate Tribunal held that merely because the scheme of the demerger was approved by the Hon'ble High Court, ipso facto it would not entitle the assessee resulting company to the benefit of set-off of brought forward losses unless the sole intention of the demerger is for genuine business purposes.

As per the facts, the resulting company had not carried on any business of the demerged undertaking after the date of approval of demerger and had put the assets of the demerged undertaking for sale in the year in which the demerger was effective, showing that the intent was not to continue the business of the demerged undertaking. The Tribunal placed reliance on the decision of Hon'ble

106. ITA No.1857/PUN/2017
107. [1985] 155 ITR 152 (SC)
108. ITA No.2121/PUN/2017

Delhi High Court in the case of *IEL Ltd. vs. Union of India*[109] and of Bombay High Court in *Ballarpur Industries Ltd vs. CIT,*[110] wherein it was discussed that the benefit of section 72A cannot be used if the sole idea of the amalgamation was only to use tax benefit by way of carried forward business losses and unabsorbed depreciation, as it is not for genuine purposes.

Even though section 72A(5) of the Act does not specifically prescribe any condition to determine whether or not the demerger is for a genuine purpose, the conditions are prescribed under section 72A(2) for amalgamation and both the provisions have been enacted with the same objective. Furthermore, section 72A(5) has been enacted to empower the AO to deny benefit of set off of brought forward business losses, and the mere approval of the scheme by the Hon'ble High Court, ipso facto, would not entitle the assessee to carry forward business losses and unabsorbed depreciation if the demerger is not for genuine purpose, but only to utilize a tax benefit.

This judgement reaffirms the view that any business reorganization should be with the intent to fulfill commercial objectives and not just for tax purposes.

Inapplicability of section 56(2)(x) (erstwhile 56(2)(viia)) in the case of buy-back of shares

The Hyderabad Income Tax Appellate Tribunal in the case of *VITP (P.) Ltd v. DCIT*[111] held that section 56(2)(x) of the Income-tax Act, 1961 ('IT Act') would not apply in the event the assessee bought back its own shares at face value. The tribunal placed reliance on the decision passed by the Mumbai tribunal in the case of Vora *Financial Services P. Ltd v. ACIT*[112] and ruled in favor of the assessee by relying on favorable jurisprudence on this issue. It was held that for section 56(2)(x) to be applicable, the property received by the recipient must be shares of any other company and not its own shares. It is a welcome ruling reaffirming the view that section 56(2)(x) shall not apply on the buy-back of shares.

Dividend amount reinvested to subscribe debentures would be considered as cost of acquisition of said debentures

In the matter of *JP Morgan Funds v. Deputy Commissioner of Income-tax*[113], Mumbai Bench of Income Tax Appellate Tribunal held that dividend received by the shareholder, which was reinvested in the company towards debentures issued, shall be considered as a consideration paid for such debentures.

The Tribunal also held that the debentures were not bonus debentures and the nomenclature given by the Revenue is incorrect. Further, it notes that the DDT was duly paid on the deemed dividend in question, and it did constitute income of the assessee.

This ruling is in line with the established principle that the same amount cannot be taxed twice, and hence the dividend that is subject to tax should be available as a cost for debentures purchased.

Current year profits not part of accumulated profits for purposes of deemed dividend

The Bangalore Bench of Income Tax Appellate Tribunal in the case of *Dr. L.S. Ravi Prakash v. Deputy Commissioner of Income-tax*[114] held that current year profits should not be included in accumulated profits for calculating deemed dividend under section 2(22)(e) of the Act.

The Tribunal further held that only the advance made during the current year should be considered for determining the deemed dividend under section 2(22)(e) of the Act and not the opening balance of the loan (even if it is not taxed during the year in which it was advanced).

109. [1992] 195 ITR 232 (Del)
110. [2017] 398 ITR 145 (Bom)
111. [2022] 143 taxmann.com 304 (Hyderabad - Trib.)
112. ITA No. 532/Mum/2018/ [2018] 96 taxmann.com 88 (Mumbai)/ [2018] 171 ITD 646 (Mumbai)
113. [2022] 140 taxmann.com 210 (Mum)
114. ITA No. 30/Bang/2021

There has been plethora of contrary rulings on the issue of whether current year profits are part of accumulated profits or not. In this aspect, this is another ruling holding in favour of the assessee; however, the matter is likely to attain finality only once the issue is settled by a ruling of the higher appellate authorities.

Transfer of financial services business qualifies as a demerger under section 2(19AA) of the Act

The Mumbai Bench of Income-tax Appellate Tribunal in case of *Grasim Industries Limited v. DCIT*[115] held that the demerger of a financial services business ('FSB') is a tax compliant transaction under section 2(19AA) of the Act; as a result, section 2(22)(a) of the Act is not applicable, and accordingly, the assessee is not liable to pay dividend distribution tax ('DDT').

The Tribunal held that considering the assets and liabilities pertaining to the demerged undertaking transferred by the assessee to resulting company, it was capable of being run as a going concern. Further, the income from FSB was shown as business income, hence Revenue was incorrect in holding that Aditya Birla Nova Limited ('ABNL') (the erstwhile company that was amalgamated with the assessee) was not engaged in FSB.

The Tribunal further held that once it is established that the transfer of FSB undertaking qualifies as a demerger, as provided under section 2(19AA) of the Act, then dividend u/s 2(22) cannot arise in view of the specific exclusion of demerger transaction. Additionally, the Tribunal held that the principle laid down in the CBDT circular No. 5-P dated October 9, 1967 (which clarifies that distribution of assets pursuant to merger shall not be regarded as dividend) also applies to demerger transactions.

Transfer of investment division qualifies as a demerger or not has been a vexed issue. The ruling clarifies that as long as the assets (including investments), liabilities, employees, etc transferred can independently undertake the business activity, then it shall qualify as a demerger under the Act.

The ruling also provides insights about the importance of appropriate documentation and disclosures in various documents such as tax audit report, return of income, director's report, management discussions and analysis report, etc. It may be kept in mind that this ruling was delivered by the highest fact finding authority (ITAT) in the specific facts of the case where a FSB together with sizable investment in an entity engaged in FSB was demerged. This ruling cannot be considered as laying down a ratio on whether demerger of a singular investment in an operating business will be meet the requirement of section 2(19AA) of the Act. Overall, this is a welcome ruling as it seeks to remove the clouds around investment business/ financial services business qualifying as a business undertaking for the purposes of a tax neutral demerger.

Transfer of dysfunctional unit on a going concern basis qualifies as a demerger

The High Court of Karnataka in case of *Commissioner of Income-tax v KBD Sugars and Distilleries Ltd*[116] while affirming the tribunal ruling upheld that transfer of dysfunctional unit on a going concern basis should qualify as a demerger under the provisions of section 2(19AA) of the Act. The High Court further held that it would be incongruous to construe sub-clause (vi) of section 2(19AA) of the Act (condition of transfer of undertaking is on a going concern basis) to mean a running unit. Accordingly, the High Court concluded that the assessee should be allowed to set off brought forward losses of a demerged unit even though it was dysfunctional.

This ruling could be helpful in the event of demergers of undertaking that are not functioning for quite some time (due to any commercial/ legal/ genuine reasons) but capable of conducting business activities.

115. [2022] 145 taxmann.com 289 (Mum)
116. [2022] 144 taxmann.com 38 (Kar)

KEY REGULATORY UPDATES

Amendment to the definition of Small Company

The definition of Small Company under the Companies Act, 2013 has been amended to increase the limit of paid-up share capital to INR 4 Crores and turnover to INR 40 Crores.

This will enable more companies to be covered within the ambit of a small company, making them eligible for the benefits of a small company under the Companies Act, 2013, which includes fast track merger process u/s 233 of the Companies Act, lesser number of board meetings, no auditor rotation, etc.

NCLAT approves capital reduction scheme of a negative net-worth company

Recently NCLAT[117] approved capital reduction of a company having negative book net-worth on the grounds that (i) shareholders had approved the scheme through special resolution (ii) no creditors had objected to the scheme (iii) the company had sufficient funds for undertaking the capital reduction and was a going concern.

NCLAT also clarified that reduction of capital is a domestic affair and NCLT cannot sit in the shoes of the shareholders who had approved the scheme based on their commercial wisdom. While this decision paves the way for stressed companies to undertake capital reduction and return capital to its shareholders, it adds to the debate of the degree of intervention that NCLT can have for scheme matters.

NCLAT dispenses with the requirement of convening creditors meeting or obtaining their NOC for merger of two companies that have common promoters

Recently, NCLAT,[118] in the case of merger of two companies that had common promoters, gave relief from obtaining NOC from secured creditors on the grounds that (i) both the companies had positive net worth and they would be able to meet their liabilities (ii) the merger did not involve any compromise with the creditors, since their liability was not proposed to be reduced through the scheme.

In recent times, there have been several judgements dispensing with the requirement of convening creditors meetings or obtaining their NOC in the case of a merger of a wholly-owned subsidiary with its parent company. However, this decision will enable even other companies with positive net-worth to seek such dispensation.

NOC from stock exchange required on Scheme of Arrangement for entities having listed Non-Convertible Debt securities ('NCDs') or listed Non-Convertible Redeemable Preference Shares ('NCRPS')

Entities that have listed their NCDs or NCRPS can file a Scheme of Arrangement under section 230-234 of the Companies Act, 2013 with the National Company Law Tribunal ('NCLT') only after receiving a No-objection letter from the stock exchange(s). The No-objection letter of the stock exchange(s) shall be valid for only six months from the date of its issuance. The stock exchanges(s) shall forward its No-objection letter to SEBI before issuing it to the aforementioned entities.

With this amendment, the entities having listed NCDs or NCRPS will also have to submit all the specified documents to the stock exchange(s) for obtaining a No-objection letter and then proceed to file the Scheme with the NCLT.

In the event that an entity has both listed specified securities and NCDs/ NCRPS, single filing of a draft scheme in terms of both the respective regulations of SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 would suffice. This new regulation shall not apply to a restructuring proposal approved as a part of the resolution plan by the NCLT under the Insolvency and Bankruptcy Code.

117. Precious Energy Services Ltd. v. The Regional Director (NCLAT, Principal Bench, New Delhi – Company Appeal No. 17 of 2021)
118. Lasa Supergenerics Limited v. Harishree Aromatics & Chemicals Private Limited (NCLAT, Principal Bench, New Delhi – Company Appeal No. 82 of 2021)

Reduction in lock-in period for shares issued on preferential basis

The lock-in period for shares issued to promoters or promoter groups via preferential issue or pursuant to exercise of options attached to warrants issued on preferential basis is reduced from three years to 18 months. However, not more than 20% of the total capital of the issuer shall be locked in for 18 months. The lock-in period for equity shares allotted to the promoters in excess of 20% is reduced from one year to six months.

The lock-in period for shares issued to persons other than promoters via preferential issue or pursuant to exercise of options attached to warrants issued on a preferential basis is reduced from one year to six months.

Clarification w.r.t. timing of submission of NOC from lending scheduled commercial banks/ financial institutions/ debenture trustee

With respect to the requirement of submitting NOC from lending scheduled commercial banks/ financial institutions/ debenture trustee to the stock exchange(s) for receipt of No-objection letter, the requirement is amended to include that the NOC shall be obtained from not less than 75% of the secured creditors in value and it is further clarified that the NOC can be submitted to the stock exchange(s) before the receipt of No-objection letter and not necessarily while submitting the application to the stock exchange(s).

This clarification helps in reducing the timeline to submit the application to the stock exchange(s) without waiting for the receipt of NOC to start the process.

Decrypting cryptocurrency and its Taxation[119]

INTRODUCTION TO AND BASICS OF CRYPTO-ASSETS

Crypto-assets is a comprehensive term that encompasses all the digital financial assets based on Distributed Ledger Technology. Crypto-assets can be bucketed into three broad categories:

1. **Payment Tokens or Virtual Currencies:** These are intended to be a surrogate to the traditional form of money or traditional currency.
2. **Security Tokens or Asset and Financial Tokens:** These represent ownership or other rights in an asset and are transferable in nature.
3. **Utility Tokens or Consumer Tokens:** These are a form of digital coupon which can be redeemed against access to a specific product or service.

This article deals only with taxation aspects of cryptocurrencies, which is one of the forms of payment tokens or virtual currencies (though not legally recognized in India).

INTRODUCTION TO AND BASICS OF CRYPTOCURRENCIES

Traditional currency derived its value from its composition or constitution as they were molded in the form of gold coins, silver or any precious metal coins. On the other hand, modern currencies derive value from being backed by gold standards or by government policies, i.e., fiat currency. A cryptocurrency is a category of currency underpinned by cryptographic systems.
"Crypto" refers to the various encryption algorithms and cryptographic algorithms underlying the cryptocurrency.

Cryptocurrency is based on blockchain technology, which is one of the forms of Distributed Ledger Technology. Blockchain is based on a ledger system. It is an open, distributed ledger that records all transactions in codes. In its operation, it works a little like a checkbook that is distributed across countless computers around the world. Transactions are recorded in "blocks" that are then linked together on a "chain" of previous cryptocurrency transactions.

Cryptocurrencies can either be centralised or decentralised i.e., either controlled by a central government or authority such as banks or financial institutions to enforce trust and police the transactions or they can be a decentralised system which facilitates peer-to-peer transfer without at any central and single point of control respectively.

TAXATION OF CRYPTOCURRENCIES

The lifecycle of cryptocurrencies gives rise to the following two taxable events:

1. Creation or generation of the cryptocurrency
2. Disposal of the cryptocurrency

Other events in the lifecycle of cryptocurrencies, such as storage of the cryptocurrency or holding a vested interest in the cryptocurrency, do not give rise to any taxable event.

TAXABILITY ON CREATION OR GENERATION OF CRYPTOCURRENCIES

Mining of cryptocurrencies refers to the exercise by which additional cryptocurrency tokens come into existence and enter the blockchain network. "Mining" is performed using sophisticated hardware and is generated and awarded as a reward or consideration to the miner for solving a set of complicated math problems.

Taxability of creation of cryptocurrencies from an international perspective

Jurisdictions such as Austria, Colombia, Finland, Japan, New Zealand, Slovenia, the United Kingdom and the United States consider the receipt of cryptocurrency on mining to be the first taxable event.

119. This article is contributed by Ajay Rotti (Partner, Dhruva Advisors) and Aditya Raipuria (Principal, Dhruva Advisors)

Whereas certain other jurisdictions such as the Czech Republic, Denmark, France, Latvia, Lithuania, Poland and the Slovak Republic only consider the disposal of cryptocurrency as taxable event and the event of mining of cryptocurrency is not considered as a taxable event.

Taxability on creation of cryptocurrencies under the Income Tax Act, 1961 ('the Act')

It can be argued that no income accrues or arises to the miner upon mining and the mining activity merely leads to creation of an asset of value. The Act does not contain any specific provision for taxation of receipt of cryptocurrencies as a result of mining activities, unlike specific provisions in existence in other jurisdictions such as the United States. For instance, in the United States, a taxpayer who mines cryptocurrencies would be required to include the fair market value of the cryptocurrencies in gross income as at the date of receipt of such cryptocurrency.

The position that the receipt of cryptocurrency on mining would not be liable to income tax in India is further buttressed by the fact that the provisions for taxation of cryptocurrency contained in Section 115BBH only provide for taxation of cryptocurrency on the "transfer" thereof. The term "transfer" as defined in section 2(47) of the Act presupposes the existence of an asset and a change in the ownership or the cessation thereof. In case of receipt of cryptocurrency as a result of mining, there is no asset in existence, rather, there is a creation of an asset.

TAXABILITY OF THE DISPOSAL OF CRYPTOCURRENCIES

The disposal or alienation of cryptocurrencies can be categorised into the following classes of transactions:

a. Exchange of cryptocurrency for fiat currency (i.e., sale or transfer of cryptocurrency for cash consideration)
b. Exchange of cryptocurrency for another cryptocurrency or for other crypto-assets
c. Exchange of cryptocurrency in payment for goods and services or wages

Taxability on transfer of cryptocurrencies from an international perspective

Most jurisdictions across the globe, such as Australia, Austria, Canada, Japan, Spain, Germany, Sweden, etc. consider all the above three categories of transactions of disposal of virtual assets as taxable events.

Taxability on transfer of cryptocurrencies under the Act

The tax implications of the transactions as mentioned in (c) above have not been discussed in this article as this is not prevalent in the Indian economic space. From an Indian income-tax perspective, the transactions mentioned in (a) and (b) above would be chargeable to tax.

The income arising from the transfer of the cryptocurrency is chargeable to tax at a flat rate of 30% (as enhanced by the applicable surcharge and cess) as per Section 115BBH of the Act. The provisions of Section 115BBH would be applicable to the gains arising from the disposal of cryptocurrency irrespective of the head of income under which the same has been assessed to tax. The income arising from transfer of cryptocurrency would be computed without allowing any expenditure (except the cost of the acquisition of the cryptocurrency) or allowance or set-off of any losses against such income. Further, any loss on transfer of cryptocurrency would not be allowed to be set-off against any other income nor would such loss be allowed to be carried forward.

While determining the consideration for transfer of cryptocurrency for fiat currency may not be difficult, determining the value of consideration for exchange of cryptocurrency with another cryptocurrency or other crypto asset may be difficult. The Act currently does not prescribe any specific mechanism to determine the consideration in case of exchange of cryptocurrency.

It is interesting to note that expenses incurred by the miner for mining of cryptocurrency, such as electricity costs, costs of sophisticated machines, etc., may not be regarded as 'cost of acquisition' of cryptocurrency and consequently no deduction would be allowed to the miner for such costs. It may be possible to make an argument that the cost of acquisition in such cases cannot be determined and cannot be quantified. Further, the Act also does not provide for considering the cost of acquisition of cryptocurrency in such cases as 'Nil'.

Based on the above, one may possibly argue that the computation mechanism prescribed for computing income fails, and consequently income from transfer of cryptocurrencies in these cases ought not to be liable to income-tax. One could rely on the principle laid down by the Supreme Court in the case of *B C Srinivasa Setty (1981) 128 ITR 294 (SC)* in support of this contention. It may be noted that this argument is only plausible where the cryptocurrency is held as a 'capital asset' and the consequent income is liable to tax as capital gains. This argument may not be valid where cryptocurrency is held as stock-in-trade and the consequent income is liable to tax as business profits.

WITHHOLDING OF TAXES ON CRYPTOCURRENCIES

Section 194S of the Act mandates deduction of tax at source by any person responsible for paying or crediting to any resident in India consideration for transfer of a virtual digital asset at the rate of 1%. Tax Deducted at Source ('TDS') under section 194S would not be required to be withheld if the consideration payable by a 'specified person' during the financial year does not exceed Indian Rupees ('INR') 50,000 (or INR 10,000 in case of any person other than a specified person).

The requirement to withhold tax under section 194S would also apply where the consideration for the transfer of cryptocurrency is in kind or the transaction of transfer is in the nature of exchange of one cryptocurrency for another cryptocurrency or any other virtual digital asset.

The Central Board of Direct Taxes ('CBDT'), with a view to addressing practical difficulties, has issued Guidelines clarifying the mechanism of deduction of taxes in case of transactions undertaken through a Virtual Digital Asset ('VDA') Exchange. In essence, the CBDT has provided that taxes would have to be deducted by the seller/ broker/Exchange depending on the manner of the transaction. The Guidelines also provide for deduction of tax in case of exchange of VDA through an Exchange. In case of an exchange of a VDA for another VDA, both the parties are regarded as the buyer and seller, and tax would be required to be deducted by both parties. The Guidelines provide that the Exchange, as an alternative for deduction of taxes by both the parties, may deduct taxes on both legs of the transaction.

The CBDT has also subsequently issued a circular clarifying the requirement for deduction of taxes on consideration in cash or kind or exchange of VDA for transactions not covered by the Guidelines.

CONCLUDING REMARKS

With the introduction of provisions relating to VDA, India has begun taxation and, more importantly, tracking of cryptocurrency and other VDA. The taxation of VDA is in a relatively nascent stage not just in India but across the globe and will evolve over a period of time. This is likely to result in continual changes to the income-tax law, which will have to be closely monitored.

Indirect taxes – Trends and outlook[120]

This financial year marks five-year anniversary of Goods and Services Tax ('GST') laws in India. It can be tricky to predict the future, but with the experience of last years, it is a good time to do a crystal ball gazing to understand what lies ahead.

USE OF TECHNOLOGY TOOLS TO PLUG REVENUE LEAKAGE

If one looks at the trend over the last years, the entire thrust of GST implementation has been to use technology for compliance and reporting. The E-invoicing mechanism was introduced in October 2020 so that B2B tax invoices are authenticated electronically over the E-invoice portal. Whilst initially, it was applicable to taxpayers having turnover exceeding Rs. 500 crores, the same has been gradually reduced and brought down to Rs. 10 crores as of today. It is expected that the same would be reduced to Rs 5 crores early next year.

Bringing more taxpayers under e-Invoice reporting has led to the availability of real-time data with the Government which has helped to curb fake invoicing.

Phase one and two of the Goods and Services Tax Network ('GSTN') was focused on building the core functionalities needed by taxpayers and officers. With the core functionalities in place, GSTN's next focus was to leverage the data available to generate actionable insights using a combination of Artificial Intelligence ('AI') / Machine Learning ('ML') based models for detecting tax evasion.

Accordingly, GSTN developed Business Intelligence and Fraud Analytics ('BIFA') tool based on AI / ML capabilities to identify mismatches between returns filed by taxpayers, identify potential frauds, identify entities that were not covered under GST, etc. and consequently, basis the analysis under BIFA tools, the notices have been issued by the revenue authorities seeking clarification from the taxpayers.

Similarly, RFID and Fastag are integrated with the E-way bill system and consequent to the integration, GST officials are now able to track the data related to the movement of commercial vehicles on highways which has proved helpful in preventing revenue leakage by real-time identification of cases of non-generation of E-way bills.

The usage of the aforementioned technology tools to curb tax evasion can be considered to be a big achievement of the Government.

The consequence of efficient use of technology has resulted in robust GST collections. The gross monthly GST collections have improved considerably during this financial year and has averaged upto INR 1.35 lakh crores per month which was around INR 1.1 lakh crore in the last financial year.

BINDING FORCE OF DECISIONS OF THE GST COUNCIL

One of the touchstones of successful GST implementation has been unambiguous pan India implementation of GST Council decisions. Despite some initial doubts about binding nature of GST Council decisions, the same has been uniformly implemented across India without exceptions. There were some anxious moments created with the observations of the Hon'ble Supreme Court in the decision of Mohit Minerals which lead to discussions regarding the role of the GST Council. However, so far we have not seen any departure from the established precedent and the decisions of the GST Council are being implemented uniformly across the country.

Uniformity of the tax laws was one of the basic tenets for introduction of GST. Its attractiveness will be severely dented, if we return to the old regime of each State having its own laws, rate of taxes. Hence, it is imperative to maintain the core attribute of GST laws.

120. This article is contributed by Niraj Bagri (Partner, Dhruva Advisors), Kulraj Ashpnani and Vaibhav Jajoo (Principals, Dhruva Advisors) and Parth Shah (Senior Associate, Dhruva Advisors)

NO EXTENSION FOR COMPENSATION CESS

Before the introduction of GST, various states had expressed apprehensions due to uncertainty of tax revenue collection. To assuage their concerns, the States were guaranteed revenue growth of 14% for a period of five years, and the shortfall if any was compensated by levying compensation cess on specified goods.

The five-year period has expired in June 2022 and the compensation cess levy has been extended upto March 2026 only to cover the shortfall for the compensation to be paid to the States for the earlier periods.

This brings curtains to guaranteed tax revenue growth for the States. One would need to watch this space on the measures States would resort to for predictable growth in tax revenues.

SUBSTANTIAL INCREASE IN GST AUDITS

With the period of limitation for completing the assessment for the FY 2017-2018 approaching, the GST Authorities have increased the pace of departmental audits. Due to Covid-19 restrictions, the departmental audits were stalled but post-pandemic the revenue authorities picked up the audit proceedings to complete the assessments within the prescribed timeline.

WAY FORWARD

Rationalisation of GST rates

The existing GST structure provides four major tax rates i.e., 5%, 12%, 18% and 28% along with exemptions for certain goods and services.

There have been discussions of rate rationalization including a transition from the existing four-tier rate structure to a three-tier rate structure. The idea was to further simplify GST laws, reduce scenarios of inverted duty structure, reduced classification disputes etc.

However, it appears that the rate rationalisation exercise has been put to back burner due to inflationary pressures and uncertain economic environment. It may be taken up later in a conducive environment.

Including Petroleum products in the ambit of GST

Bringing petroleum products, including petrol, natural gas and aviation turbine fuel under GST is a long-standing demand from the industry. Petroleum products are outside GST, but they have extensive use whether in raw materials or logistic costs. These tax costs are not vatable resulting in higher cost of production reducing the competitiveness of Indian industry.

As per the media reports, several states are not yet ready to bring petroleum products in GST citing revenue concerns. Perhaps another round of guaranteed revenue could nudge the reluctant States to fall in line and accept the inclusion of petroleum products within the ambit of GST.

Amnesty scheme in GST

It's been five years since the GST law has been implemented in India. Being a new law, during the initial years, there were several interpretational and procedural issues. There have been also frequent amendments and clarifications issued by the Government.

Therefore, the taxpayers at large may have committed inadvertent errors like payment of tax under the wrong head, incorrect availment of ITC, non-issuance of documents required under the GST law, etc.

Considering the above, introduction of an amnesty scheme to provide one time opportunity to rectify the errors without penal consequences would go a long way in reducing potential litigations and would be welcomed whole heartedly by the industry.

PLI Update

Production Linked Incentive (PLI) Scheme continues a dream run to boost country's manufacturing output. The scheme has been appreciated for its vision and accepted due to fresh air of incentives it offers.

As the name suggests, PLI Scheme provides incentives to companies for enhancing their manufacturing output in India, with a focus on reducing import bills and improving the cost competitiveness of domestically manufactured goods. The objective, clearly being to create global manufacturing champions in India. As compared to the previous incentive schemes, the PLI Schemes stands out due to their approach towards production-cum-sale led growth, which is in wide contrast with earlier schemes which operated on an import substitution model.

Conceptualised originally in Budget 2020, the PLI Scheme got formulated initially for 3 sectors (mobile & specified electronic components, medical devices and pharmaceuticals API) with a budgeted outlay around ₹ 51,311 crore over five years.

Another 11 sectors were added in the second phase with an allocation of ₹ 146 lakh crores over a five-year period. The sectors covered were electronic/ technology products, pharmaceuticals, telecom & networking products, food products, white goods, solar modules, automobiles & auto components, advance chemistry cell battery, textiles, specialty steel and drones. Given the focus on green energy, the Government announced an additional allocation of ₹ 19,500 crores towards PLI on solar modules.

The response to these PLI Schemes has been rather astounding with oversubscription of applications in each of the sector. It is estimated that PLI schemes can generate about ₹ 30 lakh crores of new manufacturing output and over 60 lakhs new jobs in the next 5 years. That apart, this would further stimulate the MSME sector of the country, leading to an all-around manufacturing growth.

The success of PLI is not only attributed to the incentive quantum, but also on the simplicity of its structure and the selection process. Governance by an independent body is also a factor resulting it its widespread acceptability in the investor community.

Seeing the enthusiastic response, the Central Government plans to announce 7-8 new PLI schemes in the upcoming Union Budget 2023. As per the reports, these schemes will cover sectors like textiles, chemicals, furniture, toys and leather.

PLI will surely play a major role in making India 'Atmanirbhar' in essential raw materials, commodities, technology and green initiatives. It is a great bet towards the Government's ambitious plan to make India a US $ 5 trillion economy.

Transfer pricing trends in 2022[121]

The Indian transfer pricing provisions are two decades old and the Government of India has from time to time calibrated the transfer pricing provisions to global best practices to the greatest extent possible. The Government of India is making continuous effort towards providing a stable tax regime and the initiative towards the faceless regime can be considered as a move in the right direction.

Some of the key developments in the field of Transfer Pricing in India during 2022 are as under:

AMENDMENTS BY THE UNION BUDGET 2022-23

Deferment of Faceless Transfer Pricing assessment and appeal proceedings

The timeline for issuing the notification for the faceless assessment scheme, for transfer pricing assessments and proceedings with the Dispute Resolution Panel for the determination of the arm's length price, has been extended by two years i.e., from 31 March 2022 to 31 March 2024.

Power of Revision under section 263 of the Income-tax Act ('the Act') extended to the Orders passed by the Transfer Pricing Officer

Section 263 of the Act contains the provision for revision of the order which is erroneous in so far as it is prejudicial to the interests of the revenue/tax department. The Commissioner[122] has the power to revise the Assessment Order passed by the Assessing Officer (AO), however, they did not have the statutory power to revise the Order passed by the Transfer Pricing Officer (TPO).

The scope of section 263 has been widened to provide that the Commissioner having the jurisdiction of transfer pricing is now empowered to invoke the revisionary powers and direct the revision of the Order of the TPO. Accordingly, the TPO shall pass the revised order giving effect to the Order under section 263 within two years from the end of the relevant financial year. The AO shall then give effect to the revised order of the TPO within two months from the end of the month in which such revised order of the TPO is received.

Since this amendment is an expansion of the scope of the existing revisionary power, the modus operandi presently adopted for revision of the non-transfer pricing order is also applicable for transfer pricing matters as well. Accordingly, any taxpayer who objects to the revision under section 263 for transfer pricing matter would have to file an appeal before the Income-tax Appellate Tribunal against such revisionary orders.

OTHER AMENDMENTS IN THE REGULATIONS

Extension of the existing Safe Harbour Rules to the fiscal year 2021-22

Safe Harbour Rules provide a fixed margin or rate of interest, at which certain transactions like IT/ITeS/KPO, contract R&D services, manufacture of automobile components, financial transactions such as loans and guarantees and intragroup transactions viz. receipt of low value-added intragroup services may be undertaken, subject to the fulfilment of certain conditions. Earlier, these rules were applicable only up to Assessment Year (AY) 2021-22.

The Central Board for Direct Taxes (CBDT) has extended the applicability of the existing Safe Harbour Rules to the fiscal year 2021-22 relevant to the AY 2022-23 *[Notification No. 66/2022 dated 17 June 2022].*

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121. This article is contributed by Sudhir Nayak (Partner, Dhruva Advisors), Sunil Nayak and Sagar Joshi (Principals, Dhruva Advisors) and Maher Doshi (Senior Associate, Dhruva Advisors).
122. Includes Principal Chief Commissioner or the Chief Commissioner or the Principal Commissioner or Commissioner.

The tolerance range for arm's length price extended to the fiscal year 2021-22.

The Central Government has extended the existing arm's length price tolerance range of 1% for wholesale trading and 3% in all other cases to the fiscal year 2021-22 relevant to the AY 2022-23 *[Notification No. 70/2022 dated 28 June 2022].*

Electronic filing facility extended to the Advance Pricing Agreements (APA) annual compliance report

Hitherto the taxpayer who has entered the APA has to furnish the annual compliance report in Form 3CEF physically to the income-tax office to establish that APA terms have been complied with. The CBDT has notified that the annual compliance report in Form 3CEF shall be furnished electronically with effect from 16 July 2022 *[Notification No. 03/2022 dated 16 July 2022].*

STATISTICS ON ALTERNATE DISPUTE RESOLUTION MECHANISMS

Mutual Agreement Procedure (MAP) statistics for India.

In November 2022, the OECD released '2021 MAP statistics' for the jurisdictions that are part of the OECD/G20 BEPS framework. As per the said MAP statistics, India has resolved 167 TP related MAP cases in the year 2021. Out of 167 TP cases resolved, 45% of cases were resolved via domestic remedy; 28% of cases were resolved by fully eliminating double taxation or fully resolving taxation not in accordance with tax treaty; 17% of cases were withdrawn by the taxpayers' and in 1% of cases the objection raised was not justified. There was no instance of denial of MAP access.

The summary of the MAP inventory (TP cases) for India as published by the OECD is as under:

Particulars	2021 Start Inventory	Cases admitted	Cases closed	2021 End Inventory
Cases started before 1 January 2016	286	-	52	234
Cases started from 1 January 2016	422	62	115	369
Total	**708**	**62**	**167**	**603**

The MAP partners of India for the TP cases included Australia, Switzerland, Germany, the United Kingdom, Japan, Sweden, the United States etc.

APA statistics for the year 2021-22

India's APA Programme completed its decade-long journey in June 2022. As per the statement from India's Central Board for Direct Taxes, during the fiscal year 2021-22, India has entered 62 APAs. This includes 13 bilateral APAs between India and its tax treaty partners and 49 unilateral APAs. With this, the total number of APAs signed by India since its inception of the APA program has gone up to 421 *[as per the press release issued by the PIB/ Ministry of Finance on 31 March 2022].*

SOME OF THE KEY JUDICIAL RULINGS OF 2022

The Tribunal scrutinises the expression 'control' referred to in section 92A(2)(j) to hold that the reasons recorded for reopening the assessment were not valid

Deputy CIT v. Reliance Industrial Holdings Pvt. Ltd. [2022] 144 taxmann.com 180 (Mumbai)]

As per the reasons recorded by the Assessing Officer (AO) for the reopening of an assessment for AY 2008-09 and AY 2010-11, late Mr. Sandeep Tandon, who was a Director/Key Managerial Person

(KMP) in the assessee, was a 91% shareholder in Biomatrix Marketing Pvt. Ltd. (Biomatrix, in short), and therefore controlled both the assessee and Biomatrix. The AO formed a view that the assessee and Biomatrix, on whose behalf the assessee has given a guarantee to ICICI Bank Singapore, are Associated Enterprises (AE) under section 92A(2)(j) of the Act. The reassessment was completed and an arm's length adjustment in respect of the said guarantee was made. Although CIT(A) provided relief to the assessee on some grounds, they did not adjudicate on the correctness of the reasons for reopening the assessment.

The Tribunal (Mumbai bench) held that the connotations of 'control' in the scheme of section 92A(2) are far more cogent than visualized by a simplistic notion of a key managerial person. There is no material or substantive indication to the effect that the assessee is controlled by an individual (i.e. Sandeep Tandon), as is the necessary precondition for invoking section 92A(2)(j) of the Act. The Tribunal further held that mere directorship of the assessee or that person being described as a KMP in the annual accounts of the assessee, cannot, by itself, be reason enough to justify that the parties are AEs. Hence, The Tribunal (Mumbai bench) holds that the reasons for reopening the assessment were unsustainable in law.

High Court of Madras holds that AO is empowered to initiate the reassessment sans the final assessment order for the original proceedings

Kone Elevator India Private Limited v. Assistant CIT [2022] 142 taxmann.com 491 (Madras High Court)

In this case, the AO passed a draft assessment order (incorporating the TP order proposing certain adjustments), for AY 2013-14, The assessee neither filed any objections before the Dispute Resolution Panel nor filed any letter to the AO regarding the acceptance or rejection of the additions proposed. The AO did not pass any final order under section 144C(4) of the Act, the time limit for which expired on 31.03.2017. However, the AO issued a re-assessment notice under section 148 on 27.03.2018 based on the TP order passed earlier. The AO passed an order rejecting the assessee's objections, stating that there is no irregularity or illegality in issuing the re-assessment notice. Said AO's order was challenged by the assessee in a writ petition and it was dismissed by the Ld. single judge on the premise that section 147/148 of the Act does not require the passing of a final order under section 144C(4) of the Act, for the initiation of re-opening of an assessment.

In an intra-court appeal against the writ order, High Court of Madras rejected the assessee's argument that AO initiated the re-assessment proceedings by issuing a notice under Section 148 for rectifying the lapses of not passing the final order under section 144C(4) of the Act. High Court of Madras held that the only basic requirement for invocation of section 147 is that the AO has reason to believe that income chargeable to tax had escaped assessment. There is no pre-condition that a final order under section 144C(4) of the Act should have been passed. It further viewed that the reason for re-opening the assessment could be also based on the materials available during the original proceedings, including TP proceedings.

The Tribunal disapproves TPO's re-characterisation of the Equity infusion, in the wholly owned foreign subsidiary, as a loan

Jaypee Capital Services Ltd. [2022] TS-751 (Mumbai)]

The assessee made an equity investment in the wholly owned subsidiaries in USA and Singapore. The TPO re-characterized the said equity investment as a loan to foreign subsidiaries and hence, imputed arm's length interest @ 12.83% p.a. for AY 2014-15. The assessee carried the matter in the appeal before the Tribunal (Delhi bench) on the grounds that both the TPO and CIT(A) erred in re-characterizing the actual transaction of investment in the equity capital of the foreign subsidiaries, as a transaction of loan to the foreign subsidiaries.

The Tribunal (Delhi bench) relying on the assessee's own case for AY 2013-14 held that AO has no authority to re-characterize the equity transaction as a loan and when the AO has not proved a

specific finding that said equity investment is a sham transaction, he cannot treat the said transaction of capital infusion as a loan and charge the interest thereon on a notional basis. Accordingly, the adjustment made was directed to be deleted.

The Tribunal quashes Sec 263 revisionary proceedings against the final assessment order and rules three member DRP superior to single CIT

Barclays Bank PLC v. CIT (International Taxation), Mumbai [2022] 139 taxmann.com 503 (Mumbai)

Barclays Bank PLC had questioned the validity of section 263 proceedings against it when the original assessment order was passed based on the directions of the Dispute Resolution Panel (DRP). The Tribunal (Mumbai bench) observed that an order passed pursuant to DRP directions was excluded from such revisionary proceedings. Referring to the constitution of a DRP, the Tribunal (Mumbai bench) thereby observed 3 member DRP (who were individually equivalent in rank to the CIT) to be superior to CIT. It further held that the assessment orders solely based on the directives of the earlier CITs, could not be revised by the subsequent CIT under section 263.

OUTLOOK

While the Government of India over the years has introduced various measures in the TP regulations, in the recent past, it also introduced specific provisions relating to the Master File documentation, Country-by-Country reporting, MAP procedure, etc in the TP regulations based on the recommendations of OECD BEPS Action Plans.

Given the further developments by OECD on Pillar One which requires application of arm's length principle for certain categories of transactions/businesses and the final report and the implementational guidelines are yet to be issued, it is worthwhile to wait and watch to what extent Government of India adopts/implement the recommendations of the OECD.

The Government of India has achieved decent success in the faceless tax assessment proceedings, and it is expected that the Government will soon implement the faceless scheme for the proceedings relating to TP as well and hope that the litigation process will be smoother in the coming years.

Emerging tax landscape in the UAE[123]

UAE CORPORATE TAX – IT HAS ARRIVED!

A competitive Corporate Tax (CT) regime based on international best practices is expected to cement the UAE's position as a leading global hub for business and investment and accelerate the UAE's development and transformation to achieve its strategic objectives.

UAE announced introduction of CT in January 2022. This was followed by a Public Consultation Document (PCD) in April 2022, which laid down the outline of the UAE CT law and invited comments from stakeholders.

On December 9, 2022, the United Arab Emirates (UAE) Ministry of Finance (MoF) released Federal Decree Law No 47 of 2022 on the Taxation of Corporation and Businesses to enact a new CT law in the UAE. The Law has been supplemented with 158 Frequently Asked Questions (FAQs), and the law is effective for accounting periods beginning on or after 1st June 2023.

An interesting aspect to note is that while the first tax period for the taxpayers will be the accounting year starting on or after June 1, 2023, general anti-abuse rules are applicable within 15 days from the date the Law is published in the Official Gazette. Taxpayers will have to relook at their proposed arrangements and restructuring from an anti-abuse perspective.

CT shall be imposed @ 9% on income exceeding AED 375,000. Tax rate of 9 percent, lowest amongst the GCC countries, makes the UAE one of the most competitive countries with a CT law in the world.

While the resident juridical persons are taxed on global income, non-residents are subject to tax if they have income attributable to permanent establishment in UAE, or a UAE sourced income or a nexus in UAE.

To continue UAE as an attractive business destination, a host of tax measures have been provided in the CT law. UAE has many free zones which provide tax holiday for a period of 15 to 50 years. Free zone entities have been provided with a beneficial 0% CT rate on qualifying income. Exemption from capital gains tax on sale of shares meeting the participation exemption conditions ensure that UAE continues to be an attractive holding company jurisdiction. Dividend earned from UAE entities are exempt. Individuals earning personal income (viz. salary, income from assets held in personal capacity) are not to be taxed.

Accounting Profits shall be considered as the starting point for computing the taxable income. Financial statements can be prepared based on IFRS or any acceptable accounting standards. Audit of financial statements is not mandatory for all taxpayers.

Interest capping rules provide for disallowance of net interest expenses exceeding 30% of EBIDTA. This may impact capital intensive businesses. Other adjustments to accounting profits for determining the taxable income include expenses related to exempt income, donations, grants, or gifts made to non-Qualifying Public Benefit Entity, fines and penalties, transfer pricing adjustments, dividends, corporate tax, 50% of entertainment expenses and adjustments on unrealized gains and losses.

Tax losses can be set off up to 75% of the taxable income of the year in which such losses are set off. Tax losses can be carried forward indefinitely. However, tax losses cannot be carried forward in case of a change in ownership of more than 50 per cent unless the same or similar business is continued by the new owners.

A Group of companies can form a tax group along with its parent company and file a single tax return for the entire group, where the parent company holds at least 95% of share capital of companies proposed to be grouped together.

Withholding tax @ 0% is applicable on UAE sourced income of a non- resident.

All taxable persons are obligated to maintain records and documents for seven years following

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the end of the tax period. Annual CT return is required to be filed by all taxable persons no later than nine months from the end of the relevant tax period.

The UAE is a member of the OECD BEPS Inclusive Framework and is committed to addressing the challenges faced by tax jurisdictions internationally. Large multinational groups covered by Pillar Two rules, would be subjected to tax at a likely rate of 15%.

The UAE CT Law provides for a robust Transfer Pricing (TP) regime in line with the internationally accepted OECD Guidelines and the concept of 'arm's length' principle. The TP rules would be applicable on transactions or arrangements between related parties and connected persons.

Flexibility to adopt any other method apart from the prescribed five methods is also provided to taxpayers to justify the arm's length price.

While the UAE CT Law provides that transactions with related parties and connected persons would be subject to the TP rules, the FAQs clarify that TP rules will apply irrespective of whether the related parties are in the mainland, , Free Zone or in a foreign jurisdiction, which makes the scope of TP extensive. TP rules will have to be complied with even if transactions are tax neutral (between two related or connected mainland persons subject to UAE CT at 9%).

Transactions between members of the same tax group are eliminated on consolidation. Accordingly, transactions between them will not be subject to TP rules.

The Authorities can adjust the Taxable Income if transactions between related parties and connected persons are not within arm's length range. Where such an adjustment is made, the Authority will make a corresponding adjustment to the Taxable Income of the related party.

Detailed compliance requirements have also been prescribed which are aligned with the OECD BEPS Action Plan 13 framework of three-tiered documentation. Also, UAE taxpayers would need to submit a TP disclosure form along with the income tax return detailing the inter-company transactions.

Businesses while welcoming the clarity that the CT Law and the FAQs have provided, will now need to re-align their systems to comply. Further clarity is expected in subsequent Cabinet Decisions in the coming period. Businesses will have to evaluate the readiness for CT implementation. Businesses will have to make sure that internationally accepted method of accounting is followed for preparation of financial statements. Reconciliation of data reported in the financial statements vis-à-vis CT return and VAT return will have to be maintained. ERP systems might need upgradation to ensure readiness for collation and reporting of data.

UAE INDIRECT TAX – YEAR SO FAR

Overview

We are almost half a decade down from the introduction of the Value Added Tax ('VAT') regime in the UAE and it has been a rollercoaster ride ever since. UAE, being one of the first GCC countries to implement VAT, has seen and managed to overcome many challenges on its way to being a country with well-developed VAT legislation and robust tax administration. In its quest to achieve the highest levels of tax compliance and to promote self-compliance among taxpayers, the Federal Tax Authority ('FTA' or 'the Authority') has collected over AED 95.4 billion (USD 26 billion)[124] from VAT between the time of its implementation in 2018 and October 2021 – all despite the Covid-19 outbreak.

As part of constant efforts to maintain the effectiveness and accuracy of the tax system, the Authority has published several guides and clarifications concerning the application and interpretation of the tax rules and processes. Over the years, the Authority has issued 25+ decisions, 30+ public clarifications and 60+ guides about VAT, responding to concerns and inquiries from

124. Source: https://www.arabnews.com/node/2007651/business-economy

taxpayers. All these documents help to simplify and explain specific topics to increase tax awareness, contribute to the development of the tax environment and promote compliance.

Simultaneously with its work on achieving better taxpayer understanding of the tax environment, the Authority has also strived to offer the necessary facilities to enhance its level of services and to provide continuous support and assistance to taxpayers to help them fulfill their tax obligations. For example, in 2020, the FTA has issued 408 private clarifications in response to requests from taxpayers, 73 administrative exception decisions, dealt with 22,081 refund requests and processed 70,839 VAT registration applications (totaling 360,000+ registration to date)[125].

The end of 2022 marks the end of the 5th year of VAT – and the businesses, today, have much more understanding and knowledge on VAT legislations compared to the chaos witnessed in January 2018. Even now, despite the constant efforts of the Authority to increase awareness amongst the taxpayers by arranging workshops, training, guides and clarifications, there are still numerous open issues which require attention. Nonetheless, it will be worthwhile to remind ourselves of some of the amendments issued by the Authority in 2022 in respect of VAT, as well as excise tax, and consider their effect on the UAE's indirect tax landscape.

VAT

Introduction of Statute of Limitation

The most noteworthy amendment has to be the extension of timeframe within which the tax authorities must complete tax audit or issue a tax assessment. Prior to the amendment, the FTA had 5 years from the end of the relevant tax period to complete (not just initiate) the audit or to issue tax assessment. With this amendment, the FTA will have additional time of 4 years to complete the tax audit, provided a notice of tax audit is issued before the expiry of the 5-year period.

Additionally, where a voluntary disclosure is filed by a taxpayer in the 5th year from the end of the relevant tax period, the FTA will have one year to complete tax audit. This will provide a deadline to the FTA to review the disclosure and to issue a tax assessment.

The combined effect of these changes is that it may be prudent for taxpayers to voluntarily disclose any errors rather than wait for the FTA to initiate a tax audit – since such voluntary disclosures will reduce the time available to the FTA to conduct a tax audit, therefore giving more immediate certainty to taxpayers in respect of the accuracy of their adopted tax positions.

Importantly, the legislation now also specifies that voluntary disclosures cannot be filed by taxpayers after the expiry of five years from the end of the relevant tax period. Taxpayers should be mindful of this deadline in case there are any errors or omissions which need to be disclosed to the Authority (including, in respect of any overpayment of tax).

Director services

Effective 1 January 2023, director services provided by a natural person will not to be considered as supply of services and, hence, will be outside the scope of VAT. This has been a welcome move by the FTA since it will simplify tax compliance for natural persons. A public clarification has been issued by the FTA to elaborate more on the application of the new provision in respect of different scenarios concerning director functions. The clarification also provides direction on the tax implications for transitional rules.

With this amendment, the position adopted by UAE is now in lines with Bahrain and KSA. There is still no guidance issued in Oman.

Change in the dispute resolution process

A new layer has been introduced in the dispute resolution process – Tax Assessment Review. This allows any person to submit an application to the FTA to review its tax assessments and related administrative penalties, subject to no reconsideration application being filed for the said assessment.

125. Source: Federal Tax Authority Annual Report 2020

Further, taxpayers have been granted the right to request an extension of the standard timelines of 40 business days subject to meeting certain conditions. If the taxpayer is not granted the extension, the decision issued would be considered final and cannot be further appealed.

Reduced penalties

'Tax penalties' have been in the limelight over the last few years. Since 2021, we saw a series of changes which include reduction in late payment penalty, removal of late payment penalty on the filing of voluntary disclosures if the tax is paid within 20 business days, amnesty scheme with 70% waiver for outstanding penalties as of 28th June 2021 and establishment of a new Committee for taking up cases for payment of penalties in instalments, penalty waivers, and refunds.

Additionally, there is now a new cap on the administrative penalties imposed for a tax assessment – two times of the tax amount (previously, it was three times of the tax amount). Also, there is no longer a minimum value of administrative penalties (previously, it was AED 500).

The overall reduction of the burden of potential administrative penalties, coupled with new detailed provisions for tax evasion offences, further encourage taxpayers to voluntarily correct any errors/ omissions and not wait for them to be discovered during a tax audit.

Penalty waiver

Effective from 1 March 2022, taxpayers can avail of waiver or reduction in tax penalties as per Cabinet Resolution No. 105 of 2021 dated 28 December 2021. The Resolution provides details about the application process, timelines for submission of the application, and transitional provisions.

Requirement of Voluntary Disclosure

Taxpayers will be required to correct their VAT returns even in cases of errors/ omissions which do not result in any additional tax liability. Prior to the amendment, taxpayers could rectify an error (e.g. in disclosing the value of zero-rated or exempt supplies) in the subsequent VAT return.

It becomes important for all taxpayers to conduct a thorough review of the VAT returns vis-à-vis their financial statements and tax positions to rectify issues, if any, relating to mere disclosures before the amendments become effective from 1 March 2023.

Introduction of a whistleblower program

The FTA has launched 'Raqeeb' – a whistle-blower program for reporting suspected cases of tax violations and evasion. The program aims to bring awareness amongst communities to comply with tax legislation and report tax irregularities.

Under this program, the informant has to submit a whistleblowing form on the FTA website with details of suspected offences. Once the form is submitted, the FTA will evaluate the lead based on the information provided and decide to either close or pursue the case. The informant will be rewarded in monetary terms if the conditions specified in the guide are met and fulfilled.

Excise

Wastage of excise goods

The FTA issued a public clarification on tax implications wastage of excise goods and the process to seek excise tax relief for the destruction of excise goods within an excise-designated zone.

The need for the said clarification has arisen due to an increase in non-compliance cases observed by the FTA during excise audits. During the production of goods, it is common for businesses to have a loss due to damages, wastage, moisture loss, deficiency, expiry, other reasons.

The public clarification reiterates what is already specified in the Excise Tax Law on tax implications and the approval process to be followed for deficiency/ wastage of excisable goods within an excise-designated zone. Businesses will have to establish loss quantification to get relief in cases involving normal process loss.

Introduction of Statute of Limitation

In line with the amendment in UAE VAT Law, a new Statute of Limitation provision was also included in Excise Tax Law. The FTA can now issue a notice of tax audit before the expiration of the 5-year period from the relevant tax period, which will grant it another four years to conduct an audit and issue a tax assessment decision

Singapore tax landscape: Key developments[126]

INTRODUCTION

While global growth and inflation dynamics have worsened over recent months, the Singapore economy expanded modestly in Q3 2022, supported in part by industries which continued to benefit from the reopening of borders. Singapore's GDP growth is estimated to be around 3–4% in 2022[127].

Compared to trade-driven growth in 2021, there has been a rebalancing of growth drivers this year with broad-based contributions from the trade-related, modern services, domestic-oriented and travel-related clusters. Recovery in the travel-related and consumer-facing sectors may continue in the near term, but their growth momentum could ease as pent-up demand from economic reopening dissipates.

The near-complete removal of border restrictions in April allowed firms to ramp up hiring of non-resident workers, especially in the construction sector. Meanwhile, resident employment also expanded resulting in a drop of the resident unemployment rate to 2.8% in June 2022. Ongoing recovery in tourism and business-related travel, along with resilient domestic consumption, should support employment growth in the domestic-oriented and travel-related sectors.

On the tax front, the Budget continues the motto of Singapore's stable economic policy by extending the sunset dates of various exemptions applicable to the financial services sector, infrastructure sectors and in general. This publication highlights summaries of the major tax developments over the past year, which may be of interest to businesses and investors operating in Singapore. While the key Budget highlights were captured in our earlier publication[128], the key non-budget changes to the Singapore Income Tax Act ('SITA') are highlighted hereunder:

126. This article is contributed by Mahip Gupta (Partner, Dhruva Advisors), Niti Agarwal (Principal, Dhruva Advisors) and Pallavi Gudka (Manager, Dhruva Advisors)
127. Macroeconomic Review Volume XXI Issue 2, Oct 2022 published by Monetary Authority of Singapore on October 27, 2022. https://www.mas.gov.sg/-/media/mas/epg/mr/2022/oct/mroct22.pdf
128. News-Alert-Singapore-Budget-2022.pdf (dhruvaadvisors.sg)

KEY NON-BUDGET CHANGES TO SITA IN 2022

1. **Tax Incentive Schemes for the Fund (Section 13O/ 13U of SITA)**

   MAS has issued certain clarifications relating to Tax Incentive Schemes for the Funds under Section 13O and Section 13U of SITA including application criteria and process for Family Offices.

   Some of the other significant amendments introduced in the Act are as under:

a. **Clarificatory amendment for Section 13U of SITA**

   In the context of enhanced tier funds approved as a collective structure ("approved structure"), it has been clarified that the requirement for a special purpose vehicle ("SPV") to be wholly owned by the master fund in an approved structure has been waived, insofar as co-investments are via foreign investors or Qualifying Funds. Correspondingly, subject to the other relevant conditions under the enhanced tier fund scheme, qualifying income of the eligible SPV arising from the funds of foreign investors and Qualifying Funds (in addition to the funds of a master fund or any feeder funds) will be exempted from tax.

b. **Specified Income from Designated Investments**

   The Designated Investments list was updated to include physical investment precious metals (with specified condition) and non-publicly traded partnership which invests wholly in designated investments. The Specified Income arising from the updated list of the Designated Investments will now be eligible for tax incentive schemes for the Fund subject to compliance with other conditions as may be applicable.

2. Section 13(12A) of SITA was amended to extend the exemption from tax in respect of foreign sourced income received in Singapore by:

   a. A trustee of **sub-trust** wherein all rights or interest in property of sub-trust are held by trustee of the S-REIT for the benefit of S-REIT beneficiaries; or

b. A Singapore incorporated company the share capital of which is wholly owned **indirectly** by trustees of S-REIT.

3. Section 34A and 34AA of SITA amended to clarify that interest income derived from loans of capital nature should be charged to tax based on contractual interest, **which does not include any capital expenses,** instead of effective interest rates.
4. Amendment made to extend the application of section 37A adjustment factor[129] to a "body of persons" deriving qualifying income from qualifying debt securities ('QDS'). QDS is the only incentive that accords concessionary tax rate to the body of persons.
5. Section 45I of SITA amended to extend the withholding tax ('WHT') Exemption treatment to varied contract where variation takes effect on or after the date the Amendment Act is published in the Gazette to the end of the relevant period for the various WHT exemption.
6. Section 63, 68 and 71 of SITA have been amended to expressly provide powers to Controller of Income Tax ('CIT') to extend due dates for filing of estimate chargeable income, partnership incomes and employee income returns.
7. Definition of "local employee" amended under section 37O of the SITA to recognize central hiring and secondment arrangements under the Mergers and Acquisitions Scheme.
8. Section 105M(2) of SITA amended to grant the CIT the power to compound offences under section 105M(1B) of SITA with those covered under section 105M(1) of SITA to extend the penalties accorded to certain Automatic Exchange of Information offences.
9. Part 18 (Appeals) of SITA amended to streamline provisions on the Board of Review ('BOR') and empower BOR Chairpersons with discretion to convene a one-member coram, instead of the default three-member coram, for greater efficiency in managing BOR cases.

OTHER KEY INCOME TAX DEVELOPMENTS AND UPDATES OF 2022

1. Goods and Service Tax ('GST') Updates

a. Change in GST rates - Singapore's GST will be revised from 7% to 8% w.e.f. 1 January 2023

Considering the change in rate w.e.f 1 January 2023, any unpaid invoices (in full or in part) issued prior to the GST Effective Date, where billed services span across and beyond 1 January 2023, will be subject to the revised GST rate of 8%. Hence, a credit note (at current GST rate of 7%) must be issued for any unpaid balance on services on and from 1 January 2023 along with a fresh invoice for these services with the revised GST rate of 8%.

b. GST on imports of low-value goods and Business-to-Consumer ('B2C') imported non-digital services

With effect from 1 January 2023, GST will be extended to:

(a) Goods imported via air or post that are valued up to (and including) the current GST import relief threshold of S$400; and

(b) B2C imported non-digital services, through Overseas Vendor Registration ('OVR') regime.

Reverse Charge (RC) for Business-to-Business ('B2B') import of low-value goods

For GST-registered business - From 1 January 2023, a GST-registered business which is subject to RC should perform reverse charge on low-value goods. The requirement to perform reverse charge applies to all low-value goods and includes low-value goods purchased from local and overseas suppliers, electronic marketplace operators and redeliverers, regardless of whether they are GST-registered or not.

129. An adjustment factor is applied when a company offsets its unabsorbed capital allowances, losses and donations in respect of income that is subject to tax at one rate against income that are subject to tax at a different rate, whether within the same or across different Years of Assessment.

For non-GST registered business - From 1 January 2023, if the total value of imported services and low-value goods for a 12-month period exceeds S$1 million, and the business would not be entitled to full input tax credit even if the business were GST-registered, it may become liable for GST-registration under the new GST registration rules.

OVR for B2C imported non-digital services

From 1 January 2023, GST will be extended to B2C imported non-digital services, through the Overseas Vendor Registration regime.

c. **GST on Carbon Credits –** Issuance, transfer or sale of any carbon credit (or any digital representation of carbon credit), including those issued by the National Environment Agency, is treated as neither a supply of goods nor a supply of services i.e. an excluded transaction. As such, GST is not chargeable on the consideration received for the issuance, transfer or sale w.e.f. from 23 November 2022. Similarly, carbon credits purchased from overseas exchanges or suppliers fall outside the scope of imported services and are not subject to GST.

Previously, the issuance of carbon credits by the NEA (including the crediting of any carbon credit by the NEA into any registry account under the Carbon Pricing Act 2018) was an excluded transaction for which GST was not chargeable. However, the issuance, transfer or sale of any other carbon credit (or any digital representation of the carbon credit) in return for a consideration was treated as taxable supply of services. The supply was considered standard-rated (i.e. GST of 7% applied) if made to a local person, or zero-rated under section 21(3)(j) of the GST Act if made to an overseas person belonging outside Singapore. Similarly, carbon credits purchased from overseas exchanges or suppliers was considered within the scope of imported digital services, which could be subject to GST under the reverse charge or overseas vendor registration regime.

d. **Enhanced administrative concession for qualifying funds (including standalone VCCs and sub-funds of umbrella VCCs)**

Where a fund cannot meet the conditions of the specific income tax concession at the end of the first year of the grant of income tax concession as it is unable to meet the minimum spending requirement, but the fund is able to meet the conditions at the end of the second year, the fund can claim the GST incurred in the second year. However, the GST remission can only be claimed after the fund has established that it meets the conditions of the income tax concession at the end of the second year. The GST incurred in the first year remains not claimable.

e. **Appeal by the Comptroller of GST with the Singapore High Court against the GST Board of Review's decision in the case of GDY v Comptroller of GST [2021] SGGST 1**

The Hon'ble High Court dismissed the Comptroller's appeal and upheld the Board's decision on 18 March 2022. The decision of the High Court supports the taxpayer's views that zero-rating may still apply to the export of goods in certain situations. This applies even if the taxpayer has not maintained all the documents listed in the e-tax guide on exports.

2. Transfer Pricing Updates - Indicative Margins for Related Party Loans

From 2022, IRAS no longer publishes indicative margins for base reference rates that are Interbank Offered Rates ('IBORs'). With the transition of IBORs to Risk-Free Rates ('RFRs'), IRAS has enhanced the methodology to derive indicative margins for base reference rates that are RFRs, like Singapore Overnight Rate Average ("SORA"), Secured Overnight Financing Rate ("SOFR"), Sterling Overnight Index Average ("SONIA"), etc.

The indicative margin for the related party loans obtained or provided during 2022 is 1.8%. Thus, for e.g. where a taxpayer provides a floating rate loan of S$10 million to its related party on 1 Mar 2022 and decides to adopt 3-Month SORA as the base reference rate for the related party loan, then the interest rate for the related party loan is 1.80% plus the 3-Month SORA rate.

3. Advance rulings

Additional matters on which advance rulings have been issued in 2022 include income tax treatment on sale of investment for approved company, **taxation on digital tokens,** characterization of securities, deferred distributions by unitholders, tax treatment of liquidation proceeds etc.

4. International tax updates

a. Singapore and Greece have entered tax treaty on 14 March 2022 and the treaty would be effective from 1 January 2023.

b. A summary of the effective dates on which the MLI changes to various Double Tax Avoidance Agreements (DTAs) of Singapore come into force are as follows:

Seychelles –1 April 2022

Bahrain –1 June 2022

Spain – 1 July 2022

Thailand – 1 July 2022

China – 1 September 2022

Japan –10 June 2022 (Arbitration Clause)

Crystal gazing – What could 2023 have in store?

UNION BUDGET 2023-24 – ONE STEP FURTHER TOWARDS BECOMING AN ECONOMIC SUPERPOWER

The last full-fledged budget of this Government will be keenly tracked for the macro steps for continuity of structural reforms, the micro aspects as also the signals that this Government may want to give to global and domestic audiences as it prepares to reoccupy its seat in the general elections in 2024. India has surpassed the United Kingdom becoming the 5th largest global economy in 2022. The Union Budget of 2023-24 would now set the stage for providing impetus towards the achievement of a USD 5 trillion economy. Job creation, infrastructure development, the strengthening of India as a manufacturing hub and the cementing of economic growth would be the prime focus of the Budget, whilst keeping fiscal deficit and inflation in check. Reforms in capital gain taxation, uniform income tax returns, the rationalisation of tax rates for individuals and the extension of the deadline for Make in India tax of 15%, will be some of the key areas to watch out for.

PILLAR ONE AND PILLAR TWO – REDEFINING THE INTERNATIONAL TAXATION ARCHITECTURE

BEPS 1.0 was largely focussed on tax avoidance and has achieved deserved success with Multilateral Convention being already in force for some time now. The focus of BEPS 2.0 (Pillar Two proposals in particular) is on achieving a minimum level of tax to end the 'race to the bottom'. The OECD has announced a timeline for 2023 for the implementation of Pillar Two proposals. Whilst a few countries such as the United Kingdom, the Netherlands, Germany and Malaysia have announced an adoption of the Pillar Two rules, several other countries, such as Hungary, are yet to accept the proposed rules. Whilst these rules are yet to take their final shape, the integration of these proposals with domestic tax laws, the signing of yet another multilateral instrument amending the existing treaty network and the withdrawal of unilateral Digital Services Tax by various jurisdictions would remain a prime focus for MNCs in 2023.

ARE WE STARING AT AN UPCOMING GLOBAL RECESSION?

At a time when the world had just left the scars of Covid-19 behind; the Russia-Ukraine war has emerged as a major concern. Developed, as well as emerging economies are facing a risk of recession after the global energy crisis, increasing fuel bills and a record high USD. A series of interest rate hikes across the globe has reduced liquidity in the money market and the flow of credit to industries. The inflation figures and unemployment data in United States and European countries have subdued the GDP projection for upcoming years. With a lot of heavy lifting done by the Government in the recent past, India remains in a sweet spot but nevertheless cannot be entirely decoupled from the happenings in the global markets.

TAX DEVELOPMENTS IN KEY JURISDICTIONS

Implementation of Pillar One and Pillar Two proposals is likely to stop the 'race to the bottom' amongst tax havens. The United Arab Emirates (UAE) introduced VAT in 2018. In continuation of the tax reforms, the UAE is set to welcome corporate income-tax legislation with effect from 1 June 2023. Other GCC countries are also evaluating the introduction of corporate income-taxes, to cater to fiscal deficit targets including on account of a rapid decline in oil revenues.

Interestingly, as a parallel to OECD, the United Nations (UN) is also set to commence developing an international tax cooperation framework through intergovernmental deliberations. It would be interesting to watch whether the UN's new framework will provide alternate taxation rules, or if it will co-exist with the OECD framework?

STRUCTURAL CHANGES IN THE INDIAN ECONOMY

The present Indian government has reiterated its commitment to structural reforms time and again in order to strengthen the economic environment of the nation. Some of the structural reforms to look forward to in 2023 could be:

India introduced the *digital rupee* on a pilot basis in December 2022. The facility is expected to be extended during 2023, which is likely to reduce the cash circulation in the economy.

In compliance with World Trade Organisation's norms, the existing law governing Special Economic Zones is likely to be replaced by the *'Development of Enterprise and Service Hubs' (DESH)*. DESH will augment manufacturing activities by shifting focus from 'exports' to 'manufacturing' for domestic as well as international markets.

Furthermore, addressing the privacy concerns of personal data, the legislature is set to table *The Digital Personal Data Protection Bill, 2022* before the Parliament. The draft Bill, inter-alia, addresses key concerns pertaining to the collection of personal data, data storage and the accountability of the person processing the personal data of individuals.

In another key development, the Ministry of Telecom has prepared a draft *Indian Telecommunication Bill, 2022* to iron out the legal challenges of telecom sectors. Amongst other things, it aims to fix the accountability of communication service providers like the OTT service provider, spectrum allocation and consumer protection concerns. This would be an interesting space to watch.

GIFT City having aimed to promote India as a global financial centre has received increased focus in successive budgets during the last few years. Whilst there has been increased traction during the last few years there are however quite a few expectations of the industry which may still be heeded.

Limited Liability Partnerships (LLPs) have been in vogue for more than a decade. The LLP law provides for various forms of restructuring of the LLPs. However, corresponding tax neutrality provisions are absent comparable to what is available for companies. The restructuring of LLPs has not seen much action. Formulating a commensurate framework for providing tax neutrality to bonafide restructuring of LLPs will supplement this form of entity as a choice for doing business.

SUPREME COURT LIKELY TO PRONOUNCE FREQUENT RULINGS ON TAX MATTERS AFTER THE FORMATION OF TAX BENCHES

Crores of tax revenues stuck in prolonged litigation has always been a cause of concern for the Government and taxpayers alike. Whilst the Government introduces tax settlement schemes at regular intervals, the number of matters which are sub-judice before the Courts are rising at an alarming rate. Recently, the Supreme Court (SC) has announced two tax benches for the regular hearing of tax matters, which are likely to settle many of the key tax disputes in 2023. A few important issues that are pending at the SC level and are likely to be adjudicated by the SC in 2023, include the availability of the Most Favoured Nation ('MFN') benefits in a tax treaty framework, the extinguishment of tax liability of a foreign company if the Indian agent is remunerated on an arm's length basis, the jurisdiction of the High Court to decide matters pertaining to the computation of the arm's length price under transfer pricing, et al. Given the current trend of Supreme Court rulings (Kindly refer to our separate article on this subject titled *"Trends in Supreme Court jurisprudence"*) taxpayers and tax advisers will be keenly hoping for some form of trend reversal.

TAX COLLECTIONS – WILL THE CURRENT BUOYANCY CONTINUE?

With the continuous efforts to widen and deepen the tax base, the Government has achieved robust tax collections in 2022. Whilst monthly

GST revenues achieved the mark of Rs. 1.4 lakh crore for eight months in a row in 2022, direct tax collections for the fiscal year 2022-23 are expected to surpass the budget target by at least Rs 1.5 lakh crore. With the use of technology and artificial intelligence, India is likely to witness increasing collection trends for some time to come. Higher tax collection shall aid the Government in keeping the fiscal deficit under check and increasing the spending for infrastructure development. It can also pave the way for the reduction of tax rates and for simplifying the tax laws! This will enable us to reap the dividends of continued buoyancy.

THE WORLD OF CRYPTOS – WAS ALL OF IT JUST A BUBBLE?

The success of bitcoins and other crypto currencies provided an alternate investment avenue to investors. However, since its peak in 2021, crypto currencies have nose-dived and investors have lost billions of dollars in cryptos. The sudden disappearance of crypto exchanges and the absence of underlying values are major factors for this downfall. With few countries having accepted cryptos as legal tender, they have lost their shine during 2022. Is this the end of a cameo or does it have more to offer? 2023 may possibly unfold the destiny of the cryptos and perhaps by then a real trend could emerge.

About Dhruva Advisors

Dhruva Advisors LLP is a tax and regulatory services firm, working with some of the largest multinational and Indian corporate groups. It brings a unique blend of experience, having worked for the largest investors in India, advising on the largest transactions and on several of the largest litigation cases in the tax space. We also work closely with the Government on policy issues and with our clients on advocacy matters.

Key differentiators:

- Strategic approach to complex problems
- In-depth, specialised and robust advice
- Strong track record of designing and implementing pioneering solutions
- Trailblazers in tax controversy management
- Long history of involvement in policy reform
- Technical depth and quality

We believe in thinking out of the box, handholding our clients in implementing complex solutions and working towards achieving results. We have offices in Mumbai, Ahmedabad, Bengaluru, Delhi, Pune, Kolkata, Dubai and Singapore. We advise clients across multiple sectors including financial services, IT and IT-enabled services (ITES), real estate and infrastructure, telecommunications, oil and gas, pharmaceuticals, chemicals, consumer goods, power, as well as media and entertainment.

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- Dhruva Advisors has been consistently recognised as the "India Tax Firm of the Year" at the ITR Asia Tax Awards in 2017, 2018, 2019, 2020 & 2021.
- Dhruva Advisors has also been recognised as the "India Disputes and Litigation Firm of the Year" at the ITR Asia Tax Awards 2018 and 2020.
- W T S Dhruva Consultants has been recognised as the "Best Newcomer Firm of the Year" at the ITR European Tax Awards 2020.
- Dhruva Advisors has been recognised as the "Best Newcomer Firm of the Year" at the ITR Asia Tax Awards 2016.
- Dhruva Advisors has been consistently recognised as a Tier 1 Firm in India's 'General Corporate Tax' and 'Indirect Tax' ranking tables as a part of ITR's World Tax Guide. The firm is also listed as a Tier 1 firm for India's 'Transfer Pricing' ranking table in ITR's World Transfer Pricing guide.

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