

Katalyst Kaleidoscope

September 2019: Tax and Regulatory Highlights

A. Income-tax Highlights

1. Direct Tax Code:

A Government appointed task force headed by Akhilesh Ranjan, Member (Legislation), CBDT, has submitted its report on the new Direct Tax Code ('DTC') to Finance Minister ('FM') Mrs. Nirmala Sitharaman on August 19, 2019. The report is not yet published in public domain.

Katalyst Comments:

As per press reports, following seem to feature in the DTC:

- i. Abolishing Dividend Distribution Tax, and taxing dividend only in the hands of shareholders, thereby addressing a long-standing demand from various quarters;*
- ii. Lower foreign corporate tax and domestic corporate tax rate;*
- iii. Lower rates for individual assesseees;*
- iv. Introduction of incentives for startups;*
- v. In relation to assessments and litigation, implementation of faceless assessments, delinking of transfer pricing assessments from regular assessments and introduction of concept of Mediation for the settlement of cases, in order to reduce tax litigations.*

2. Withdrawal¹ of enhanced surcharge on capital gains

- CBDT has a press release to withdraw levy of enhanced surcharge on short term as well as long term capital gains (covered u/s 112A and 111A of the ITA) arising to domestic as well as foreign investors from transfer of:
 - i. Equity shares in a company;
 - ii. Units of an equity-oriented fund; and
 - iii. Units of business trust
- It has been further clarified that income arising to Foreign Portfolio Investors ('FPI') from the transfer of derivatives (Future and options) which is subject to tax at a special rate u/s 115AD of the ITA, will also be outside the purview of enhanced surcharge.

¹ Press release dated August 24, 2019

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Katalyst Comments:

Although this is a delayed rectification to the amendment made by the Finance (No.2) Act, 2019, which never intended to apply to FPIs, it's a case of seeking to address a disproportionate damage to credibility / business sentiment.

Separately, it should be noted that, surcharge on capital gains is not leviable only in respect of capital gains covered u/s 111A/112A/115AD of ITA. All other kind of capital gains shall continue to be subject to higher surcharge, e.g. transfer of unlisted equity shares / off-market transfer of listed equity shares will continue to be subject to higher surcharge. Additionally, CBDT should also clarify some open points such as in case of brought forward capital losses, how the set-off would be effected, etc.

3. Revision in monetary limits for filing of appeal by tax department² with retrospective effect

- CBDT has further enhanced the monetary limits and conditions for the tax department to file an appeal before the Tribunals, High Courts and Special Leave Petition ('SLP') before the Supreme Court ('SC').

- Prescribed enhancement in monetary limits are as under:

Appeal with respect to income tax matters before	Revised Monetary Limit (INR)	Existing Monetary Limit (INR)
Tribunal	50,00,000	20,00,000
High Court	1,00,00,000	50,00,000
Supreme Court	2,00,00,000	1,00,00,000

- It has also been clarified³ that the circular for enhanced monetary limits is also applicable to all the pending SLPs / appeals/ cross objections/ references and it is directed to withdraw all such pending appeals on or before October 31, 2019.
- Ahmedabad Tribunal⁴ has already dismissed (as withdrawn) 628 pending cases where tax effect was lower than INR 50 Lakhs. Also, SC⁵ has dismissed 4 pending SLPs where tax effect was lower than INR 2 Crores.

² Circular no. 17/2019 dated August 8, 2019

³ Letter no. 279/Misc/M-93/2018-TJ dated August 20, 2019

⁴ ITO vs Dinesh Madhavlal Patel [ITA No. 1398/Ahd/2004 and 627 others

⁵ DCIT vs MSEB Holding Company Ltd [SLP Diary No. 26373/2019], CIT vs Hongkong and Shanghai Banking Corporation Ltd [SLP Diary no. 25086/ 2019], CIT vs Keshav Power Limited [SLP Diary no. 21497/2019], CIT vs Meenakshi Modi [SLP Dairy No. 25076/.2019]

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- Further circular⁶ has been issued to provide exception to the cases where monetary limits do not exceed Revised Monetary Limits. Such exception includes cases where the Board by way of a special order directs filing of appeal on merit in cases involving organized tax evasion. E.g. bogus capital gains on penny stocks.

Katalyst Comments:

This move of CBDT to further enhance the monetary limits is a welcome move providing much needed relief to tax payers and will also reduce a huge backlog of litigation.

4. Shareholder subject to capital gains upon conversion of company into LLP not complying with conditions prescribed u/s 47(xiiib) of the ITA⁷

- Advance Authority Ruling ('AAR') ruled that on non-fulfilment of all the conditions laid down u/s 47(xiiib) of the ITA, conversion of company into Limited Liability Partnership ('LLP') would be liable to tax in the hands of shareholders as it would tantamount to extinguishment of shareholder's interest in the shares of the company.
- AAR referred to explanation 2 of Section 2(47) of the ITA which provides that transfer includes disposing off of interest in any capital assets against creation of any interest in any assets in any manner directly or indirectly.
- Rejected applicant's contention that computation mechanism fails and hence, capital gains cannot be computed, AAR computes capital gains based on the difference between the value of capital in the LLP and cost of acquisition of shares.

Katalyst Comments:

Last year, Mumbai Tribunal in the case of Celerity Power LLP⁸ held that on failure to comply with the conditions for tax neutral conversion prescribed u/s 47(xiiib) of the ITA, conversion of company into LLP would tantamount to transfer taxable in the hands of company. (summary can be referred in the December, 2018 edition of Katalyst Kaleidoscope). The instant ruling is dealing with shareholder's exposure to taxable capital gains qua value of LLP holding vis-à-vis cost of

⁶ Circular No. 23 of 2019 dated September 6, 2019

⁷ AAR No 1290 of 2012

⁸ ACIT vs Celerity Power LLP [2018] 100 taxmann.com 129 (Mum Tribunal)

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investment in the shares of a company. It should be noted that capital gains exemption compliant conversion should stand on a different footing.

5. Ahmedabad Tribunal⁹: Succession of Partnership Firms by 'Existing' Company treated as exempt transfer

- During AY 2008-09, assessee company acquired assets (including land and intangible assets) and liabilities from 2 partnership firms and as consideration, shares were issued by the assessee company to the partners of the partnership firm in such a way that all the conditions of section 47(xiii) of the ITA in relation to exempt capital gains were satisfied.
- The Tribunal held that transfer of assets and liabilities of partnership firms to existing company upon fulfilling all the conditions of Section 47(xiii) of the ITA should not be regarded as a taxable transfer. Tribunal noted that succession of partnership firm into company need not only be achieved by way of conversion of existing partnership firm into company, but same can be achieved by transfer of assets and liabilities of partnership firm into existing company subject to fulfilment of the conditions of prescribed u/s 47(xiii) of the ITA for capital gains exemption.
- Further, assessee company had claimed depreciation on intangible assets recorded on succession, against which consideration in the form of the issue of shares was discharged by assessee company. Tribunal also allowed claim of assessee company in relation to depreciation on such intangible assets.

Katalyst Comments:

The Tribunal's decision has broad-based the capital gains exemption by widening the scope of succession rather than restricting it only to conversion.

6. Kolkata Tribunal¹⁰: Retrospective applies of 5% safe harbour u/s 50C regarding variation between stamp duty value and sale consideration

- Assessee had realised Long Term Capital Gains ('LTCG') upon sale of immovable property. AO made addition u/s 50C of the ITA by substituting stamp duty value of the property in place of actual sale consideration.

⁹ ACIT vs Neptune Limited [ITA No. 2701/AHD/2011] (Ahd Tribunal)

¹⁰ Chandra Prakash Jhunjhunwala vs DCIT [ITA No. 2351/Kol/2017] (Kolkata Trib)

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- The Tribunal held in favour of the assessee (i.e. safe harbour applied), based on the following:
 - i. The Finance Act, 2018, has provided for no adjustment of deemed consideration where difference between stamp duty value and sales consideration is not more than 5% of the sales consideration;
 - ii. Placing reliance on Hon'ble Supreme Court judgement in case of Alom Extrusions¹¹ and Hon'ble Delhi High Court judgement in case of Ansal Landmark¹² it was held that once a statutory amendment is made to remove any undue hardship to the assessee or to remove an apparent incongruity, such an amendment has to be treated as effective from the date on which law containing undue hardship or incongruity was introduced, even though it may not state so specifically.
7. CBDT¹³ & ¹⁴: clarifies on assessment of Startup Companies involving Angel Tax issue u/s 56(2)(viib)
- In furtherance of circulars¹⁵ issued by Department of Promotion of Industry and Internal Trade ('DPIIT') and CBDT for non-applicability of Angel Tax provisions, clarifications are provided by CBDT with respect to assessment of Startup Companies as under:

Scenarios	Procedure	Time limit for completion of pending scrutiny assessments
1. Startup Company is recognised by DPIIT and case is selected under "Limited Scrutiny" on a single issue of Angel Tax	No verification on such issues will be done by AOs during assessment proceedings	Preferably be completed by September 30, 2019

¹¹ CIT vs. Alom Extrusions Ltd [2009] 185 Taxman 416 (SC)

¹² CIT vs Ansal Landmark Township (P.) Ltd [2015] 377 ITR 635 (Delhi HC)

¹³ Circular no. 16/2019 dated August 7, 2019

¹⁴ Circular No. 22 of 2019 dated August 30, 2019

¹⁵ DPIIT Notification no. G.S.R. 127(E) dated February 19, 2019 and CBDT notification no. 13/2019 dated March 5, 2019

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Scenarios	Procedure	Time limit for completion of pending scrutiny assessments
2. Startup Company is recognised by DPIIT and case is selected under "Limited Scrutiny" with multiple issues or under "Complete Scrutiny" including Angel Tax issue	<u>Angel Tax issue:</u> shall not be pursued; <u>Other Issues:</u> inquiry or verification shall be carried out only after obtaining approval of supervisory officer.	Preferably be completed by October 31, 2019
3. Startup Company has not got DPIIT approval and the case is selected for scrutiny <i>inter-alia</i> on the grounds of applicability of section 56(2)(viib) of the ITA or any other issues	Inquiry or verification in such cases shall be carried out only after obtaining approval of supervisory officer.	Preferably be completed by October 31, 2019

- In relation to pending appeals cases, tax department has been directed as under:
 - i. For cases pending before CIT(A), order shall be passed by CIT(A) before December 31, 2019, if such Startup Company is registered with DPIIT. No further appeal shall be perceived;
 - ii. For cases pending before jurisdictional Tribunal, department is directed not to press issue relating to addition u/s 56(2)(viib).
- Further, it is clarified that outstanding tax - demand in respect of addition made u/s 56(2)(viib) of the ITA shall not be pursued by tax officers. Also, tax demands to Startup Companies in relation to other issues shall not be pursued unless confirmed by jurisdictional Tribunal.
- For redressing the grievances and mitigation of various tax related issues arising to Startup Companies, CBDT has constituted Startup Cell comprising of 5 members team. Any Startup Company having issues related to income tax can approach the cell for quick resolution of the problem.

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Katalyst comments:

Angel tax provisions are clearly in the nature of outlier provisions and have caused significant and needless harassment. Whilst the above mitigates a self-inflicted issue, the key point is that such an outlier provision is totally unwarranted and should be deleted from the statute book.

B. Corporate Law

8. National Company Law Appellate Tribunal ('NCLAT')¹⁶: Allows dispensation of the meeting of shareholders and unsecured creditors in relation to Scheme of Amalgamation of its wholly owned subsidiaries

- NCLAT allows appeal filed by assessee company and its wholly owned subsidiary seeking dispensation from holding of meeting of shareholders and unsecured creditors, respectively where consent from such shareholders and unsecured creditors, for dispensation was not obtained by assessee company and its wholly owned subsidiary.
- NCLAT reviewed and accepted submission made by assessee company along with its wholly owned subsidiary company that both the companies have positive net worth and proposed scheme of arrangement would not dilute any interest of shareholders or its creditors from the respective companies. NCLAT regarded the order of NCLT as 'per incuriam' as the matter was not at a stage where it needed to be considered on merit.
- Referring to various similar matters where co-ordinate bench has granted dispensation from holding of meeting of shareholders and creditors, NCLAT set aside the order of NCLT to the extent it did not grant dispensation from holding meeting of shareholders and unsecured creditors and remanded matter back to NCLT for fresh consideration.

9. MCA¹⁷: Clarification with regard to 'Appointed Date' under a scheme of amalgamation / merger ("Scheme")

MCA has issued clarification with regard to Appointed date as relevant to various situation as under:

- Appointed date can be a specified date which may be prior to filling of application or may be tied to an event that may be taking place in future as part of an arrangement as a pre-condition;

¹⁶ DLF Phase IV Commercial Developers Ltd and Ors [LSI-442-NCLAT-2019(NDEL)]

¹⁷ General Circular No. 09/2019 dated August 21, 2019

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- In case of specified date, beyond one year from the date of filling of application, a justification would need to be bought out in the Scheme itself and should not be against public interest;
- In case where appointed date is prospective and event based, mention of such event should need to be made in the Scheme. Where date of such event is beyond 30 days from the approval of Scheme by jurisdictional NCLT, an intimation would need to be filled with Registrar of Companies within 30 days of occurrence of event;
- Appointed date shall be deemed to be 'Acquisition date' for the purposes of identifying date for change of control under provisions of IND AS 103 – 'Business Combination'.

Katalyst comments:

Clarification provided by MCA facilitates flexibility in deciding appointed date which was till now shrouded in a grey zone.

This clarification would be helpful in a deal scenario especially where one of the step involves Scheme, effectiveness of which depends on any pre-determined future event. Such Scheme can now run parallelly with other arrangements involved in the deal, resulting in curtailing of delays owing to lengthy time frames involved.

10. MCA¹⁸: Amendment in the framework for eligibility to issue shares with Differential Voting Rights ('DVR')

MCA has made amendment to Rule 4 of Companies (Share Capital and Debentures) Rules, 2014 in relation to issue of DVRs instruments by listed and unlisted companies, which are as under:

- i. Enhancement in the cap of voting power in respect of shares with DVR, to 74% of total voting power, including voting power in respect of equity shares with DVR. Earlier such limit was capped at 26% of the total post issue paid up equity share capital.
- ii. Removal of eligibility requirement for the company to have distributable profits for last 3 years for issue of DVR.

¹⁸ MCA notification dated August 16, 2019 made to Rule 4 of the Companies (Share Capital and Debentures) amendment Rules, 2019

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Katalyst comments:

Amendment made for relaxing eligibility requirement for issue of DVRs would facilitate promoters of Indian Companies to retain control of their companies in certain circumstances. It would also benefit Startups, which although may not be profit making, but which have prospects of becoming much larger and for raising funds globally without Promoter(s) losing control.

11. MCA¹⁹: Amendment in the framework for issue of ESOPs by Startup Companies

MCA has made amendment to Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 in relation to eligibility of Startup Companies registered with DPIIT, to issue ESOPs to promoters and/or director holding more than 10% equity stake in such Startup Companies within 10 years, as against 5 years previously.

Katalyst comments:

Above amendment broadens the time limit for DPIIT registered Startup Company to issue ESOPs to its promoters and directors.

C. Securities and Exchange Board of India ('SEBI')

12. SEBI²⁰: Amendment in imposition of fine for Listed Companies not complying with SEBI (Issue of Capital and Disclosure Requirements), Regulations, 2018 ('SEBI ICDR Regulations')

- SEBI notifies fine to be imposed by stock exchange(s) on listed companies not complying with certain provisions of SEBI ICDR Regulations at standard quantum of INR 20,000/- per day till the date of compliance, if delay in compliance is beyond prescribed timeline as under:

Sr. No	Compliance	Prescribed timeline
1	Issue of bonus shares	i. Within 15 days from the date of approval of issue by board of directors, where approval of shareholders for

¹⁹ MCA notification dated August 16, 2019 made to Rule 12 of the Companies (Share Capital and Debentures) amendment Rules, 2019

²⁰ SEBI/HO/CFD/DIL2/CIR/P/2019/94 dated August 19, 2019

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Sr. No	Compliance	Prescribed timeline
.		capitalization of profit or reserves is not required; ii. Within 2 months from the date of meeting of board of directors, where approval of shareholders for capitalization of profit or reserves is required and same is approved by shareholders
2.	Conversion of convertible securities and allotment of shares	Within 18 months from the date of allotment of convertible securities
3	Application for listing of further shares issued to the stock exchange(s)	Within 20 days from the date of allotment of further shares
4	Application for trading approval to the stock exchange(s)	Within 7 working days from the grant of listing approval by stock exchange(s)

Previously, an additional fine equal to 0.01% of the paid-up share capital of the entity, maximum upto INR 1 Crs was also imposed over and above fine of INR 20,000 per day, if non-compliance enlisted in Sr No (1) to (3) above, continued for more than 15 days. Now, SEBI has done away with such additional fine.

13. SEBI²¹: Harmonisation of provisions governing investments made by Alternative Investment Funds ('AIF') operating in International Financial Services Centers ('IFSC') with those applicable to domestic AIFs

- Until now, AIFs operating IFSC were permitted to invest in following:
 - i. Securities which are listed in IFSC;
 - ii. Securities issued by companies incorporated in IFSC;
 - iii. Securities issued by companies incorporated in India or companies belonging to foreign jurisdiction.

²¹ SEBI Circular No. SEBI/HO/IFSC/CIR/P/2019/91 dated August 9, 2019

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- In order to harmonise provisions governing investment by AIFs operating in IFSC with those applicable to domestic AIFs, SEBI has issued circular permitting AIFs operating in IFSC to make investment as per provisions of SEBI (Alternative Investment Fund) Regulations, 2012 ('SEBI AIF Regulations').

Katalyst Comment:

Allowing AIF operating in IFSC to make investment as per SEBI AIF Regulations, would attract more investments as business unit operating from IFSC enjoys various tax incentives such as, 100% tax holiday for 10 years, capital gains exemption to AIF category III from transfer of specified capital assets, tax exemption interest to non-residents on loan provided, etc.

D. Foreign Direct Investment ('FDI')

14. Liberalisation of FDI²²:

- The Union Cabinet has approved proposal for review of FDI in various sectors and this seems aimed at boosting foreign investment in India except in relation to Digital Media. The broad details are as follows:

Sr. No.	Sector	Erstwhile provision/ conditions
1	Coal Mining under 'Mining Sector'- 100% under automatic route: Sale of coal, including coal washery, crushing, coal handling and separation (magnetic or non-magnetic).	No FDI allowed
2.	Contract Manufacturing under 'Manufacturing' sector – 100% under automatic route: Now, manufacturing activities can be undertaken either by the investee entity itself or through contract manufacturing in India under a legally tenable contract, whether on Principal to Principal or Principal to Agent basis.	No specific provision

²² Cabinet Press Release dated August 28, 2019

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Sr. No.	Sector	Erstwhile provision/ conditions
3	<p>Digital Media – 26% under approval route:</p> <p>For uploading / streaming of news and current affairs through digital media, on the lines of print media.</p> <p>Earlier, in the absence of such provision, there was no such restriction on investment in Digital Media, which now is under approval route with limit of 26%.</p>	<p>No specific provision, but the provision now seems restrictive</p>
4.	<p>Single Brand Retail Trading:</p> <p>Currently, 100% FDI under automatic route is permitted for Single Brand Retail Trading ('SBRT') subject to certain conditions. Further, relaxation/clarification are provided as under:</p> <p><u>(i) Permission of E-commerce operations prior to opening physical stores:</u></p> <p>Allowance of online trade by entities engaged in SBRT sector without having physical presence in India for initial 2 years</p> <p>However, within 2 years of online trading, such SBRT entities shall operate brick and mortar stores in India;</p> <p><u>(ii) Incremental sourcing for global operations by non-resident entities to include sourcing done by third party</u></p> <p>Sourcing for goods from India for global operations, now to also include any incremental sourcing done by third party (on behalf of SBRT entity) under a legally tenable agreement. This is in addition to</p>	<p>No specific allowance for permission of online trading prior to opening physical stores;</p> <p>Incremental sourcing by an entity engaged in SBRT either directly or through group companies only counted;</p>

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Sr. No.	Sector	Erstwhile provision/ conditions
	<p>sourcing by SBRT entity directly or indirectly through its group companies;</p> <p><u>(iii) Local sourcing requirement for global operations (where SBRT entity has received FDI of more than 51%, 30% of the local sourcing requirement needs to be met):</u></p> <ul style="list-style-type: none"> Entire sourcing done in India by SBRT entity to be counted towards local sourcing requirement; Further, clarification provided that end use of goods procured from India to meet such local sourcing requirement, can be sold in India or outside India; Cap of considering exports for 5 years has been removed. 	<p>No such end use flexibility;</p> <p>Average of 5 years of total value of goods purchased to be counted towards local sourcing, and thereafter annually towards India operations</p>
5	<p>Insurance Intermediaries²³ – 100% under automatic route</p> <p>The department of financial services has issued Indian Insurance Companies (Foreign Investment) Amendment Rules, 2019 ('IIC Rules'), permitting 100% FDI in insurance intermediaries, subject to verification from Insurance Regulatory and Development Authority of India ('IRDAI').</p> <p>Key provisions of IIC Rules for intermediaries with majority FDI (i.e. > 50%), are as under:</p> <ul style="list-style-type: none"> Intermediaries to be incorporated as limited companies under the Companies Act, 2013; 	<p>49% under automatic route for intermediaries appointed under the provisions of IRDAI</p>

²³ Ministry of Finance – Notification no. G.S.R. 619 (E) dated September 2, 2019

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Sr. No.	Sector	Erstwhile provision/ conditions
	<ul style="list-style-type: none"> • Intermediaries are required to bring in the latest technological, managerial or other skills; • At least one amongst the Chairman of the board of directors or Chief Executive Officer or Principal Officer or Managing Director, mandatorily to be resident Indian citizen; • IRDAI approval mandatory prior to repatriating dividend; • Any payments to promoter(s) or any group entity including foreign group entity shall be subject to limits prescribed by IRDAI and disclosure requirements in relation to same; • Composition of board of directors and key managerial personnel shall be as specified by concerned regulators 	

Katalyst comments:

Except for the Digital Media, which is restrictive, the other changes are welcome move. However, in relation to Insurance Intermediaries, the conditions for approval of IRDAI regarding payment of dividend or other payments to promoters seems unduly restrictive.

E. Goods and Services Tax ('GST')

15. Clarifications – Sabka Vishwas (Legacy Dispute Resolution) Scheme²⁴, 2019

- The scheme is open from September 1, 2019 to December 31, 2019;
- Voluntary disclosures are eligible under the scheme except certain exclusions mentioned under the scheme;

²⁴ Circular no. 1071/4/2019-CX 9 dated August 27, 2019

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- Applicant cannot be selective about the issues/disputes covered in a SCN which he wishes to cover under the scheme;
- If the adjudication order has been passed and received prior to June 30, 2019, but the appeal is filed on or after July 1, 2019, the benefit under the scheme is not available;
- The scheme provides for total waiver of interest, penalty and fine for the all the cases;
- If the amount of pre-deposit or other deposit already paid exceeds the amount payable under the Scheme, the difference would not be refunded.

16. Advance Ruling on applicability of GST on Royalty Payments:

The Rajasthan Appellate Authority of Advance Rulings (AAAR)²⁵ has upheld the order issued by the AAR and held that GST is payable @18% on royalty paid to Government for assigning of mining lease.

17. Advance Ruling on applicability of GST on Liquidated Damages:

The Gujarat AAR²⁶ has held that GST is payable on liquidated damages received by the Government entity from the contractors due to non-achieving the milestone and also on interest received for deferring the liquidated damages recovered.

18. Advance Ruling on disallowance of ITC on Medicines provided by employer to employees / dependents for personal use:

The Tamil Nadu AAR²⁷ has held that no ITC of medicines services or medicines provided by the applicant to its employees or dependents is available as the same has been used by the employees for personal consumption and hence, it falls under the provisions of 'blocked credit' u/s 17(5) (g) of the CGST Act, 2017.

²⁵ In the matter of M/s Aravali Polyart (P.) Ltd. [TS-642-AAAR-2019-NT]

²⁶ In the matter of Dholera Industrial City Development Project Ltd. [TS-661-AAR-2019-NT]

²⁷ In the matter of Chennai Port Trust [TS-660-AAR-2019-NT]

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