

Katalyst Kaleidoscope

September 2023: Tax and Regulatory Insights

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A. Income tax highlights

1. **Chennai ITAT: Buyback through Court approved scheme held liable to dividend distribution tax (DDT)¹**

The facts of the case were that the assessee Cognizant Technology Solutions Pvt Ltd ('CTS') is a private limited company engaged in the business of software development and related services. It is operating in India since 1994. It was originally a subsidiary of CTS USA and, as a result of restructuring, its shareholding was approximately 24% through USA and 76% through Cognizant Mauritius. In the financial year 2017, the assessee purchased the 24% shares of the US shareholders and a substantial junk of the shares of the Mauritius shareholders such that Mauritius became almost 100% shareholders of CTS India. The purchase of shares was in terms of a scheme of arrangement u/s 391-393 of the Companies Act.

CTS India deducted tax at source in relation to capital gain vis-à-vis the US shareholders, but not vis-à-vis the Mauritius shareholder, the latter as a result of the capital gains clause of the India Mauritius treaty. The tax department as of the view that the buyback under the scheme was not a capital gains trigger event, but is liable to be taxed as dividend and in that year and sought to contend that DDT should be leviable.

Assessee argued that the scheme of arrangement was for the purchase of its own shares and for the tax department to treat it as reduction of capital would amount to re-writing the scheme of arrangement. On the other hand, the tax department argued that Section 46A which is the capital gains provision relevant to buyback applies only to a buyback u/s 68 of the Companies Act, 2013 (Section 77A of the earlier Act) and not to a situation of purchase of shares is under a scheme of arrangement, and that only buy back under 77A is excluded from the definition of deemed dividend u/s 2(22).

The Tribunal held that the buyback was liable to DDT, because it was a colourable device intended to avoid legitimate tax dues.

Katalyst comments:

This is a significant order and very adverse from the point of view of the assessee; without going into the merits in detail, it is important to recognise that the Tribunal has laid down that approval by regulatory authorities cannot be used as the base for taking tax shelter, but the reality is that it will unfortunately open up a window for tax authorities to seek to rewrite schemes of arrangement.

There is no reference to General Anti Avoidance Rules ('GAAR'), except a general reference to "colourable device"; this reiterates the aggressive stand of tax authorities and also highlights

¹Cognizant Technology Solutions Pvt Ltd Vs Assistant Commissioner of Income Tax(ITAT Chennai) [2023] dated September 13, 2023

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the need for caution in terms of undertaking restructuring transactions. One key aspect is the need to demonstrate commercial rationale in every transaction.

It is important to note that capital gains taxes have been paid by the US shareholder entities and it will now become extremely complicated, in the sense that one cannot imagine a situation of there being a dividend and capital gains for the same amount, but the entities are different; therefore, the assessee group will be in a very difficult position. This aspect will possibly be strongly agitated also by the assessee group at different forums.

Please note subsequently, section 115QA has been introduced to levy Buyback Tax (BBT) on income distributed to shareholders by listed as well as unlisted companies upon Buyback and the said income is exempt in the hands of shareholders u/s 10(34A).

2. CBDT notifies Angel Tax rules and amends Rule 11UA new valuation methods²

CBDT has issued a circular notifying changes to Rule 11UA with respect to angel tax and valuation methods. The draft rules issued by CBDT were mentioned in our earlier newsletter for May 2023. Pursuant to the same, the key changes notified by CBDT in the Circular are as follows:

- Introduction of five more valuation methods in addition to the Discounted Cash Flow (DCF) and Net Asset Value (NAV) method for calculating the FMV of unquoted shares, as determined by the merchant banker on issue of shares to non-resident investors
- On receipt of consideration on issue of shares to non-resident entity, the share price of Equity shares for other investors can be taken as FMV, if it is received within 90 days before or after issuing shares. There are similar provisions with reference to investment by Venture Capital Funds or Specified Funds
- Further, Valuation methods for calculating the FMV of Compulsorily Convertible Preference Shares have been provided and a safe harbour of 10% variation in value has been provided to determine FMV of equity and preference shares issued

3. Advance Pricing Agreement – 4th and 5th Annual Report by CBDT³

This Annual report highlights the progress made in the respective financial year. CBDT has recorded the highest ever APA signings of a total of 95 APAs financial year 2022-23. It has also signed the maximum Bilateral Advance Pricing Agreements (BAPAs) in any financial year till date, with the signing of 32 BAPAs. Out of the 1,659 APA applications filed till 31 March 2023, a total of 831 applications have been disposed of, and 828 applications are still under processing. Majority of the applications pertain to the Service sector, predominantly the IT industry. However, Manufacturing and trading based companies have recorded an increase in

²CBDT Notification No. 81 /2023/F. No. 370142/9/2023-TPL Part (1) dated September 25, 2023

³The Advance Pricing Agreement (APA) programme of the CBDT – 4th and 5th Annual Report

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the APAs signed. The maximum UAPAs have been signed with USA followed by China, UK and Singapore. The maximum BAPAS have been signed with USA followed by UK and Japan.

4. **Delhi ITAT: Revenue duty-bound to rework valuation after rejecting Assessee's method in the context of premium on issue of shares⁴**

The assessee had received a certain amount from investors on account of share premium. The Revenue did not accept the valuation of shares as it considered the share premium was excessive. On appeal, ITAT opined that the Revenue rejected the Discounted Cash Flow (DCF) method adopted by the assessee; however, the lower authorities ought to have reworked the fair market value based on their conclusions or adopt the other method available.

5. **Madras HC: Amalgamation with Sun Pharma 'smoke screen' for tax-evasion; Directs denovo assessment⁵**

Tamil Nadu Dadha Pharmaceuticals Ltd (TNDPL) was acquired by Sun Pharma Industries Limited (SPIL) pursuant to which the Dadha Group (DG) was paid Rs.290 per share by SPIL for consolidated shares held by the DG after acquisition, prior to and pursuant to the amalgamation scheme being approved. The issue under consideration is whether the consideration received by DG was a result of transfer of shares on amalgamation or sale/ transfer of shares independent of the amalgamation

The Madras High Court set aside the ITAT order and gave directions to conduct a new assessment to determine taxability of the amount received by Dadha Group members on amalgamation of TNPL with SPIL. The High Court observed that the transaction was of sale/transfer of shares and not an amalgamation, and therefore fell outside the purview of 'transfer' by virtue of Section 47.

It held that vehicle of amalgamation was used as a smoke screen to evade income tax as transfer of shares arising out of amalgamation are not liable to tax under Section 47(vi). The High Court found that payment of cash was independent of the amalgamation and prior to the amalgamation.

6. **Delhi ITAT: BVI Co.'s Singapore subsidiary eligible for treaty benefits; Revenue's 'pre-conceived mind behind denial⁶**

The assessee was incorporated in Singapore as an investment company and made investments in earlier years in two Indian companies. These shares were duly reflected in its Balance Sheet and were subjected to verification by the Singapore Tax Authorities.

⁴Movefast Automobiles Pvt. Ltd vs Income Tax Officer (ITAT Delhi) [2023] dated August 18, 2023

⁵Commissioner of Income Tax vs Dadha Pharma Pvt. Ltd (Madras High Court) [2023] dated April 5, 2023

⁶The Golden State Capital pte Ltd vs DCIT (ITAT Delhi) [2023] dated August 23, 2023

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The AO denied the assessee treaty benefit under India-Singapore Double Taxation Avoidance Agreement (DTAA) on capital gains arising from the sale of shares of the Indian Company. The AO stated that the entire affairs of the assessee were controlled outside Singapore.

The ITAT observed that the assessee had furnished relevant evidences to prove that its entire affairs were not controlled from outside Singapore. Moreover, it held that the Treaty benefits could not be denied when the assessee had submitted documents such as the Tax Residency Certificate, audited financial statements and return of income filed along with tax assessment orders by Singapore Tax Authority.

7. Delhi HC: 'Brand Name' akin to trademarks, qualifies for depreciation as intangible asset⁷

The assessee claimed depreciation on the brand names used for its paper manufacturing business, considering them as intangible assets for the purpose of depreciation. The Revenue disallowed depreciation on brand names since brand name is not referred to in Section 32(1)(ii) of the Income Tax Act, 1961. The High Court, referring to the Trademarks Act observed that brand names are a specie of trademarks and concluded that the expression “trademark” under Section 32(1)(ii) and Explanation 3(b) would clearly include brand names and thus, be amenable to depreciation.

8. Mumbai ITAT: Compensation for waiving off 'right to sue' capital receipt not chargeable to tax⁸

The assessee is an individual, who had entered into an MOU with the intention to book commercial space to be developed and constructed in a proposed project by the same entity. Later the project did not materialize and was cancelled. Since the specific performance was not possible, the right to sue was the only remedy. The same was waived off by the assessee and damages were received towards the waiver. The assessee, claimed that amount received for waiving the 'right to sue' was a capital receipt not liable to be taxed and the same was accepted by the AO.

On an appeal, it was noted by the ITAT that the specific performance was not possible since the project was itself aborted. Thus, right to sue was the only remedy under Section 6 of Transfer of Property Act and the reliance on a previous Bombay High Court judgement⁹ was not applicable in this case. Hence, the damages received were not liable to tax.

⁷Pr. Commissioner Of Income Tax Vs Kuantum Papers Ltd (Delhi High Court) [2023] dated August 16, 2023

⁸Virendra Bhavanji Gala Vs Pr. Commissioner of Income Tax (ITAT Mumbai) [2023] dated August 30, 2023

⁹Commissioner of Income Tax Vs Vijay Flexible Containers (Bombay High Court) [1989] dated September 13, 1989

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9. Gujarat HC: Section with respect to taxability of property received without adequate consideration not applicable to fresh issuance or allotments of shares by a company¹⁰

The assessee was allocated right shares in proportion to the shareholding of the assessee in the company. The issue under consideration was whether the allotment of new shares by the company particularly through right shares, fell under the purview of section 56(2)(vii)(c).

The court on reference of the explanatory note to the Finance Bill 2010 clarified that section 56(2)(vii)(c) should be applied only in cases involving the transfer of shares. It emphasized that the shares came into existence only upon allotment and are not transferred from one party to another. Moreover, it stated that when shares are allotted strictly on a proportionate basis based on existing shareholding, Section 56(2)(vii)(c) does not apply.

Based on this, the court held that section 56(2)(vii)(c) should not be applied to fresh issuances or allotments of shares by a company.

B. Corporate Law Highlights

1. NCLT: Extends resolution plan implementation term to complete proposed merger with corporate debtor¹¹

A Resolution application was submitted by SLD Steels Pvt. Ltd in case of the insolvency resolution process of Noble Ispat & Energies Ltd. with a proposed scheme of merger, and a waiver from compliances under the provisions of the Companies Act, 2013 was claimed for the same. The approval of the Resolution Plan was granted; However, the specific approval regarding the merger had not been given, and accordingly, the ROC did not pursue any action with respect to RP order filed with the ROC for the implementation of the merger.

An order cited¹² by the petitioner clearly stated that the requirements under the applicable Laws, that is the Company Law for the Merger u/s 230-232 should be deemed to have been complied with in case of the approval of Resolution Plan. However, in the present case, it is clearly stipulated that this approval was subject to the provisions of the Companies Act, 2013; it is therefore clear that the procedural requirements provided in the Companies Act, 2013 had not been waived on this order, and therefore had to be complied with by the assessee.

2. NCLT: Mandatory Pre-requisite for filing matters in NCLT¹³

NCLT has issued an order dated August 29, 2023 relating to pre-requisite for filing matters pertaining to the NCLT. It consists of directions on the required formatting, book marking of documents, using electronic signature etc, at the time of e-filing on the NCLT Portal and contains various annexures with detailed instructions for the same.

¹⁰Pr. Commissioner Of Income Tax Vs Jigar Jashwantlal Shah (Gujarat High Court) [2023] dated August 28, 2023

¹¹SLD Steels Pvt. Ltd (NCLT) [2023] dated September 8, 2023

¹²Vasan Health Care Private Ltd (NCLT) [2023] dated February 3, 2023

¹³ National Company Law Tribunal Order- File No. 25/02/2023-NCLT dated August 29, 2023

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Key aspects include Optical Character Recognition searchable, PDF/A versions of documents are mandatory for filing along with electronic signature using a Digital Signature Certificate (DSC) and provisioning of e-sign based on Aadhar Authentication as an alternate to DSC to be made available.

C. SEBI/RBI/Other Legal highlights

1. **SEBI: Tightens disclosure norms for Foreign Portfolio Investors¹⁴**

SEBI has issued circular mandating additional disclosures by Foreign Portfolio Investors (FPIs) w.e.f. November 1, 2023, with observations that certain FPIs hold concentrated portions of their equity portfolio in a single investee company, raising the concern and possibility that promoters of such companies could be using the FPI route for circumventing regulatory requirements

To mitigate the same, SEBI requires disclosures of granular details of all entities holding any ownership, economic interest or control in the FPI on a full look through basis, without any threshold, by FPIs that fulfill the following criteria –

- FPIs holding more than 50% of their Indian equity assets under management (AUM) in a single corporate group
- FPIs that individually or along with their investor group hold more than Rs. 25,000 cr. of equity AUM in the Indian markets

It has also listed seven exemptions fulfilling the conditions of which would make the additional disclosures inapplicable for the concerned FPIs. The disclosures would also not apply to FPIs in case their investments are realigned with the prescribed thresholds within the conditions mentioned in the circular.

2. **SEBI: Informal guidance on gifting of shares to spouse¹⁵**

SEBI has issued an Informal Guidance to Vidli Restaurants Ltd. (Applicant / Target Company) with respect to a proposed transaction of gifting certain equity shares by a shareholder to their spouse. SEBI explains that on acquiring mentioned equity shares in VITS Hotels, the spouse would be able to indirectly exercise 53.98% of the voting rights and control over the Target Company, thereby triggering the open offer requirements in the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 (Takeover Regulations), unless such an obligation is expressly exempted under Reg. 10. of the Takeover Regulations.

¹⁴Sebi Circular No. SEBI/ HO/ AFD/ AFD – PoD – 2/ CIR/ P/ 2023/ 148 dated August 24, 2023

¹⁵Informal Guidance Letter No. SEBI/HO/CFD/PoD-2/OW/P/2023/25677/1 dated June 23, 2023

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Further, the Takeover Regulations specify that ‘promoters and members of the promoter group’ and ‘immediate relatives’ are persons acting in concert, unless the contrary is established. SEBI concludes that, hence, the spouse would be a person acting in concert with the others in promoter group of the Target Company

Katalyst Comments:

While the shares are being transferred, it is by way of gift and the transaction should be considered as an instance of substance over form. Considering regulations such as GAAR also work on the principle of substance over form, transfers such as this, even on the promoter level should not fall under to takeover regulations and should be considered as a transfer in the form of gift to a spouse.

3. SEBI eases norms for large corporates tapping the debt market¹⁶

SEBI had issued a circular¹⁷, as mentioned in our earlier newsletter for April 2023, stating that the compliance period for Large Corporates (LC’s) to meet their financing needs through issue of debt securities to the extent of 25% of their incremental borrowings was extended from contiguous block of 2 years to 3 years. Further, a Consultation paper¹⁸ reviewing the framework for borrowings by Large Corporates was issued by SEBI on August 10, 2023.

Subsequently, in the SEBI Board meeting held on September 21, 2023 it is proposed to provide flexibility in the framework for LC’s meeting their financing needs from the debt market. The proposed measures include raising the monetary threshold for defining LC’s, removing penalty on LC’s which are not able to raise a certain percentage of incremental borrowing from the debt market, etc

4. CCI draft Combination Regulations 2023¹⁹

In view of the changes introduced by the Competition (Amendment) Act, 2023, Competition Commission of India (CCI) has proposed draft Combination Regulations. A summary of the key features is as under:

- The draft regulations have set out a methodology for the calculation of the value of a transaction. This is in line with the threshold of INR 20 billion introduced by the amendments in the Deal Value Thresholds
- With respect to on-market transactions, the regulations clarify that certain rights are permitted prior to the CCI’s approval for the transaction. The acquirer however, must not directly or indirectly influence the target entity in any manner.

¹⁶ SEBI Board Meeting Press Release PR No.21/2023

¹⁷SEBI Circular No. SEBI/HO/DDHS/DDHSRACPOD1/P/CIR/2023/049 dated March 31, 2023

¹⁸SEBI Consultation Paper DDHS-POD 1 dated August 10, 2023

¹⁹The Competition Commission of India (Combinations) Regulations, 2023

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5. Regulatory Panel: Further incentives suggested for GIFT IFSC/city²⁰

An expert committee constituted by the International Financial Services Centres Authority (IFSCA), the GIFT City regulator and chaired by Mr. G. Padmanabhan (Former Executive Director, RBI), has suggested tax and regulatory measures to encourage new fintechs and startups to set up shop in the IFSC.

The recommendations by the committee are as under:

Sr.	Issue	Recommendation
A	Company Law and Regulatory issues	
1.	Holding Company Structure	Holding Company structures with simplified incorporation processes and procedures to be permitted in GIFT IFSC.
2.	Liberalised Remittance Scheme	LRS limit for the purpose of investment in IFSC should not be clubbed with other investments / activities
3.	Overseas Investment Restrictions on Indian AIFs and Mutual Funds	Investments made by Indian AIFs and Mutual Funds into entities domiciled in GIFT IFSC to be excluded from the aggregate limit set by RBI for making overseas investments
B	Tax related issues and proposals	
1.	Participation exemption for GIFT IFSC holding company on levy of capital gains tax	To incentivise the movement of holding / parent companies to GIFT IFSC, it is recommended to have a “participation exemption” mechanism to provide for exemption on capital gain tax on transfer of shares, subject to meeting prescribed conditions.
2.	Concessional tax regime for dividend in the hands of GIFT IFSC Company/ dividend distributed by GIFT IFSC Company	Dividends received by an IFSC holding company from investment in overseas subsidiaries or Indian subsidiaries should be tax exempt, subject to meeting prescribed conditions
3.	Angel Tax Exemption	Angel taxation provisions should not apply to GIFT IFSC holding companies to encourage flipping of offshore holding company into GIFT IFSC and for greenfield investments in holding companies setup directly into GIFT IFSC
4.	Stamp duty exemption	Stamp duty exemption to encourage startups to consider GIFT IFSC for set-up of holding company
C	Listing of startups on IFSC exchanges	
1.	Listing of start-ups on IFSC stock exchanges	To relax or provide exemptions from the applicable conditions for the listing of startup in GIFT IFSC
D	Other Regulatory issues	
1.	Expanding ODI for GIFT IFSC entities	To allow ODIs in entities in GIFT IFSC which have Indian Subsidiaries
E	Dispute Resolution	

²⁰Report of the Expert Committee on ‘Onshoring the Indian Innovation to GIFT IFSC’ (IFSCA) August 2023

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1.	Special courts and arbitration	Establishment of special courts in GIFT IFSC that can provide a faster, simpler and efficient dispute resolution mechanism
2.	Advance Ruling Authority	Establishment of an advance ruling authority to address any regulatory questions that the investors/entrepreneurs may have with respect to any transaction

6. RBI Releases a list of upper layer NBFCs for 2023-24²¹

The Scale based regulation framework issued by RBI categorizes NBFCs in base layer, middle layer, upper layer and top layer. It gives the methodology to identify the NBFCs in the upper layer as per their asset size and scoring methodology. Once it is classified as a NBFC-UL, it is subject to enhanced regulatory requirement for a period of five years.

The RBI has listed 15 companies that are as under:

Sr.	NBFC	Category of NBFC
1.	LIC Housing Finance Limited	Deposit taking HFC
2.	Bajaj Finance Limited	Deposit taking NBFC-ICC
3.	Shriram Finance Limited	Deposit taking NBFC-ICC
4.	Tata Sons Private Limited	Core Investment Company
5.	L & T Finance Limited	Non-deposit taking NBFC-ICC
6.	Piramal Capital & Housing Finance Limited	Non-deposit taking HFC
7.	Cholamandalam Investment and Finance Company Limited	Non-deposit taking NBFC-ICC
8.	Indiabulls Housing Finance Limited	Non-deposit taking HFC
9.	Mahindra & Mahindra Financial Services Limited	Deposit taking NBFC-ICC
10.	Tata Capital Financial Services Limited	Non-deposit taking NBFC-ICC
11.	PNB Housing Finance Limited	Deposit taking HFC
12.	HDB Financial Services Limited	Non-deposit taking NBFC-ICC
13.	Aditya Birla Finance Limited	Non-deposit taking NBFC-ICC
14.	Muthoot Finance Limited	Non-deposit taking NBFC-ICC
15.	Bajaj Housing Finance Ltd.	Non-deposit taking HFC

A. Goods and Service Tax Highlights

1. ITC cannot be denied on the ground of non-disclosure of tax amount in GSTR-2A²²

Kerala HC quashed the assessment order which denied the partial ITC of the assessee on the ground of non-disclosure of tax amount in GSTR-2A. The HC opined that if the supplier/seller

²¹RBI Press Release 2023-2024/923 dated September 14, 2023

²²Diya Agencies vs The State Tax Officer [TS-461-HC(KER)-2023-GST] dated September 20, 2023

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has not remitted the tax amount, the assessee/purchaser should not be held responsible. The HC also clarified that the petitioner/assessee should provide the burden of proof regarding the remittance of tax to the seller dealer by giving evidence as mentioned in the Judgment of the Supreme Court in *The State of Karnataka v. M/s. Ecom Gill Coffee Trading Private Limited*.

Katalyst comments:

Very reasoned decision by the Kerala HC. If purchaser has paid tax and proof of payment of tax is available with him, then in such case, he is entitled for ITC even though the tax amount if not reflected in GSTR-2A.

2. Refund of export of service as “Principal” to its affiliated entity, is allowed²³

The assessee rendered services of “Bookkeeping, Payroll, and accounts, through the use of cloud technology” to the foreign affiliated entity. The refund of services used to provide export of services was rejected on the ground that the assessee is an ‘intermediary’ and hence, place of supply of said services is in India and hence, these services are not classified as export of services. In this regard, the Delhi HC has held that the assessee has provided services as a ‘Principal’ and he is neither facilitating the provision of services by a third entity nor acting as a middleman and hence, services provided by assessee should be classified as export of services and he is entitled for refund of ITC used to provide export of services.

Katalyst comments:

Welcome decision by the Delhi HC. If services are provided as a principal to the group entity, GST refund of zero-rated supply is available.

3. Section 16(4) of the CGST Act is not violative of the Articles 19(1)(g) and Article 300A of the Constitution of India²⁴

The Patna High court has dismissed the writs and held that ITC is a concession granted by the statute and not a vested right and hence, the conditions granted vide section 16(4) of the CGST Act should be strictly followed. Also, the HC clarified that the section 16(4) of the CGST Act is constitutionally valid and it is not violative of Articles 19(1)(g) and Article 300A of the Constitution of India.

Katalyst comments:

ITC availed by the assessee was disallowed for belated filing of return in Form GSTR-3B and a demand notice was issued seeking refund along with interest and penalty. The HC in this regard, explains that “right of a registered person to take ITC” becomes a vested right only if the conditions to take it are fulfilled and hence, section 16(4) of the CGST Act is not violative of the Articles 19(1)(g) and Article 300A of the Constitution of India. The HC relied on the Apex Court’s

²³Boks Business Services Pvt Ltd [TS-446-HC(DEL)-2023-GST] dated September 11, 2023

²⁴Gobinda Construction & ors vs UOI & ors [TS-455-HC(PAT)-2023-GST] dated September 15, 2023

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*decision in the case of **Jayam and Company vs. Assistant Commissioner & Anr [2016 (9) TMI 408]** wherein it was held that whenever concession is granted by the statute, the conditions thereof are to be strictly followed.*

4. The Government constitutes State Benches of GST Appellate Tribunal with effect from September 14 2023²⁵

The Ministry of Finance, Department of Revenue, issued a notification on September 14, 2023, regarding the constitution of State Benches of Goods and Services Tax (ST) Appellate Tribunal whereby 31 benches of GST Appellate Tribunal for 28 states and 8 union territories constituted. It is pertinent to note that 3 benches are allotted to the State of Maharashtra and Goa at the Mumbai, Thane, Pune, Nagpur, Aurangabad and Panaji.

Katalyst comments:

The Ministry of Finance's notification regarding the constitution of State Benches of the GST Appellate Tribunal in various states of India for 2023 marks a crucial step in streamlining the appeals process for GST-related matters. These State Benches are strategically located to facilitate easier access to justice for taxpayers and suppliers across the country.

²⁵Notification by Ministry of Finance (Department of Revenue) dated September 14, 2023