
TAX JURISPRUDENCE

# N. A. SHAH BULLETIN

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## JUDGEMENTS UNDER DIRECT AND INDIRECT TAXES

We are pleased to draw your attention to following important decisions which might be useful for you to take call on tax position.

## EXECUTIVE SUMMARY

| CASE & CITATION | ISSUE INVOLVED | DECISION |
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| **DIRECT TAX** | | |
| Apex Laboratories (P.) Ltd. [Special Leave Petition (Civil) No. 23207 of 2019] | Whether freebies (gifts, foreign travel, attending conferences etc.) given by pharma companies to doctors are allowable as deduction under section 37(1) of the Income Tax Act ("Act")? | Hon'ble Supreme Court ("SC") held that acceptance of freebies by medical practitioners is punishable by the Medical Council of India ("MCI").<br>Pharmaceutical companies cannot be granted tax benefit for providing such freebies as it tantamount to enabling the commission of an act which attracts such opprobrium. |
| M/s I.G. Petrochemicals Limited [ITA No. 1954/ Bang/ 2016] | Whether duties, taxes, interest & penalty on assets taken on lease, can be claimed as deduction u/s 43B on payment basis? | Tribunal dismissed taxpayer's appeal on the ground that for claiming deduction u/s 43B it is imperative that the amount should be 'otherwise allowable' as deduction.<br>Since it is a case of import of capital asset and that too not by the taxpayer, such expenditure cannot be claimed as revenue expenditure. |

| INDIRECT TAX | | |
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| IPCA Laboratories Limited [2022-TIOL-270-HC-AHM-GST] | Whether an SEZ unit can claim refund of unutilized IGST balance available in its credit ledger on account of ISD credit and ITC on inward supply? | High Court held that SEZ unit is eligible to claim refund of IGST balance as there is no other specific supplier who can claim the refund as the credit is distributed by ISD. |
| Rajesh Kumar Gupta [2022-TIOL-23-AAR-GST] | Whether ITC can be claimed in full or proportionate reversal of ITC is required in respect of commercial credit note issued on account of cash discount for early payment or any incentive / schemes?<br>Whether GST is leviable on above cash discount / incentive / scheme as output supply of services from applicant to vendor? | Applicant can avail ITC of full GST charged on invoice and proportionate reversal of ITC is not required in respect of such commercial credit note.<br>GST is not leviable for said cash discount / incentive / schemes offered by vendor. |

The brief analysis of above referred decisions and rulings are given below.

## A. DIRECT TAX

**CASE 1 – APEX LABORATORIES (P.) LTD V. DCIT [SPECIAL LEAVE PETITION (CIVIL) NO. 23207 OF 2019) (SC)]**

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| **Facts in brief & Issue Involved** | • In A.Y 2010-11, the appellant has claimed deduction in respect of sales promotion expenditure incurred by way of gifts/freebies to doctors/ medical practitioners.<br>• CBDT issued a circular no. 5/2012 dated 01.08.2012 which clarified that freebies to medical practitioners are ineligible for deduction by virtue of Explanation 1 to Section 37(1) of the Act as the said expenses are incurred for any purpose which is an 'offence under law' or is 'prohibited by law'.<br>• Based on the above Circular, the appellant was denied deduction in respect of sales promotion expenditure incurred by way of gifts/freebies to doctors and medical practitioners.<br>• High court confirmed the view of the AO, CIT(A) and ITAT.<br>• Aggrieved by above orders, appellant filed an appeal before the SC. |
| **Contentions of Appellant** | • Medical practitioners were expressly prohibited from accepting freebies. However, no corresponding prohibition in the form of any binding norm was imposed on the pharmaceutical companies gifting them. In the absence of any express prohibition by law, Appellant could not be denied the benefit of seeking exclusion of the expenditure incurred on supply of such freebies under Section 37(1).<br>• While introducing Explanation 1 to Section 37(1) in Finance (No. 2) Bill, 1998 the intention was to deny deduction for expenditure which is illegal in nature, and which are considered as an 'offences' under the relevant statutes.<br>• Act needs to be interpreted strictly and not in a wide manner to include in its scope an act by a pharmaceutical company not recognized as 'illegal' by any statute<br>• Even if the CBDT circular had to be brought into effect it could be done so only 'prospectively', and not 'retrospectively', i.e., from the date of publication of the CBDT circular on 01.08.2012, and not the date of publication of the 2002 Regulations on 14.12.2009.<br>• Reliance was placed on the decision of Supreme Court in the case of Director of Income-tax v. S.R.M.B Dairy Farming (P.) Ltd., (2018) |

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| | 13 SCC 239, wherein it was held that beneficial circulars are to be applied retrospectively, however, only oppressive circulars are to be applied prospectively. |
| **Observations & Decision of Supreme Court** | • Narrow interpretation of Explanation 1 to Section 37(1) would defeat the purpose for which it was inserted, i.e., to disallow an assessee, from claiming a tax benefit for its participation in an illegal activity.<br>• It is logical that when acceptance of freebies is punishable by the MCI (the range of penalties and sanction extending to ban imposed on the medical practitioner), pharmaceutical companies cannot be granted the tax benefit for providing such freebies, and thereby (actively and with full knowledge) enabling the commission of the act which attracts such opprobrium.<br>• Incentives or freebies given to the doctors directly results in exposing them to the prohibition on their medical profession and held that granting deduction would wholly undermine public policy.<br>• Doctors and pharmacists are "complementary and supplementary" to each other in the medical profession. Adopting a comprehensive view to regulate their conduct in view of the contemporary statutory regimes and regulations, SC held that denial of the tax benefit "cannot be construed as penalizing the pharmaceutical company".<br>• CBDT circular being clarificatory in nature, would apply retrospectively from the date on which the Regulations were amended. |
| **NASA Comments** | • The present ruling settles a contentious debate on tax deductibility of expenses for provision of freebies by pharma companies to medical practitioners in violation of MCI Regulations by rejecting the argument that giving of such freebies is not prohibited for taxpayer.<br>• The ratio of this ruling and the proposed amendment by Finance Bill 2022 is applicable not only to pharma sector, but to all other sectors governed by similar regulations.<br>• Onus will be on the taxpayers to demonstrate that expense incurred is not in violation of any law from the perspective of both payer and recipient. |

**CASE 2 – I. G. PETROCHEMICALS LIMITED VS DCIT, BENGALURU [ITA NO.1954/BANG/2016]**

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| **Facts in brief & Issue Involved** | • Taxpayer, promoted by Mysore Petro Chemicals Ltd (MPCL), had taken turbine generator set (imported by MPCL) on lease from 22.3.1996.<br>• Taxpayer claimed exemption of customs duty which was subsequently held to be wrong and demand aggregating to INR 6.65 crores was raised towards custom duty, excise duty, interest and penalty which was paid by taxpayer under protest and accounted as an asset in its Balance Sheet.<br>• During assessment, taxpayer made a claim of INR 6.65 crores as an allowable deduction u/s 43B which was not accepted by AO.<br>• In appeal before CIT(A), appeal was decided against the taxpayer inter alia on the following grounds:<br>o Section 43B refers to allowability of expenses which are "otherwise allowable" under the Act, subject to other conditions. In case of Taxpayer, turbine generator set was imported by MPCL, hence MPCL is liable to pay import duty & other ancillaries.<br>o Expense directly relates to import of capital asset, hence, cannot be claimed as revenue expense & thus section 43B cannot be applied to claim deduction.<br>o Expense includes amount of penalty for specific infraction of Customs & Central Excise law which is not allowable.<br>o Amount has been paid by Taxpayer under protest, thus it is certainly a disputed liability & it cannot be said that liability has crystallized/accrued during the year under consideration.<br>• Aggrieved by above order, appellant preferred an appeal with ITAT. |
| **Contentions of Appellant** | • Appellant contended that captioned payment of INR 6.65 crores is an allowable deduction being revenue in nature by relying on Jurisdictional High Court in case of CIT vs M/s NCR Corporation Pvt Ltd 2020 (taxcorp DT 83007 dated 16th June, 2020) wherein taxpayer had taken premises on lease for a period of 3 years & incurred expense on leasehold premises and it was held that expenses were incurred for conducting the business more profitably |

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| | and successfully, hence, expenditure is of revenue nature and allowable. |
| **Observations & Decision of ITAT** | • Tribunal upheld the Order of CIT(A).<br>• W.r.t. High Court judgement, Tribunal held that the impugned payments cannot be equated with expenses incurred towards improvement in leasehold property and hence the said decision cannot be applied in the case of taxpayer. |
| **NASA Comments** | • This decision confirms the principle that deduction u/s 43B is allowable only if the same is otherwise allowable and that the section cannot be considered alone for deciding allowability. |

## B. INDIRECT TAX

### CASE 1 – IPCA LABORATORIES LTD [2022-TIOL-270-HC-AHM-GST]

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| **Facts in brief & Issue Involved** | • Petitioner's one of the manufacturing facilities is located in Special Economic Zone ["SEZ"] at Kandla in Gujarat. Petitioner is engaged in export of goods under LUT from said SEZ unit.<br>• Petitioner has received Input Tax Credit ["ITC"] in respect of ISD credit and other inward supply received for export of goods. Since, petitioner is an SEZ unit making zero rated supplies, the said ITC is lying unutilized in its Electronic Credit Ledger.<br>• Petitioner filed refund application to claim refund of such accumulated ITC.<br>• Petitioner's refund claim was rejected by the GST Authorities on following grounds:<br>  ○ Supplies made to SEZ is zero rated and hence the petitioner is not eligible for refund u/s 54.<br>  ○ Refund filed by the petitioner cannot be processed under any category of manual refund.<br>  ○ SEZ unit is not supposed to pay any tax whether on forward charge or reverse charge and therefore there would be no question of ITC.<br>  ○ This office is unable to process the refund application in absence of any circular / notification / relevant guidelines issued by CBIC.<br>• Aggrieved by the decision of appellate authority, petitioner has filed a writ petition before the Honorable Gujarat High court. |

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| **Observations & Decision of High Court** | • Honorable Gujarat High Court held that the issue raised by the petitioner is no longer res integra in view of order passed by it in following cases:<br>o M/s. Britannia Industries Limited vs. Union of India [2020-TIOL-1495-HC-AHM-GST] wherein refund claim by SEZ unit of ITC distributed by ISD was allowed; and<br>o M/s Amit Cotton Industries vs. Principal Commissioner of Customs [2019-TIOL-1443-HC-AHM-GST] wherein refund claim of IGST concerning an export unit was allowed.<br>• Honorable High court quashed the impugned order and directed the GST Authorities to process the refund claim within a period of three weeks from date of receipt of their order. |
| **NASA Comments** | • This decision will serve as a good precedent for SEZ units facing rejection of their refund applications on above referred grounds.<br>• This is a welcome decision and should be cited by SEZ units in their refund applications or written submissions at the time of adjudication of refund processing. |

**CASE 2 – RAJESH KUMAR GUPTA [2022-TIOL-23-AAR-GST]**

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| **Facts in brief & Issue Involved** | • Applicant is carrying on the business of whole sale trading of rice and pulses.<br>• Rice vendors offer various schemes such as–<br>o Cash discount if payment against invoice is made before the due date or within certain days from date of invoice;<br>o Yearly target incentive.<br>• Vendor issues commercial credit note for above schemes to applicant without considering the GST. Vendor does not reverse its output liability of GST and likewise applicant does not reverse its ITC on such commercial credit notes issued by vendor.<br>• Applicant has sought advance ruling on following questions:<br>o Whether it can avail ITC of full GST charged on invoice or proportionate reversal is required on account of cash discount / incentives / scheme?<br>o Whether GST is leviable on applicant as output supply on cash discount / incentives / schemes offered by the vendor? |

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| **Contentions of Applicant** | • Quantum of cash discount and incentives are determined and settled post sales. Discount arrangement is not part of the purchase contracts and the rate / quantum of purchases made by applicant is also not known.<br>Hence credit note cannot be issued u/s 34 and also the conditions of section 15(3)(b) are not satisfied.<br>• Applicant drew attention to Circular No 92/11/2019-GST dated 7th March, 2019 prescribing that where the credit notes in terms of section 34(1) are not satisfied, credit note in form of financial / commercial credit notes can be issued and the value of supply will not be reduced under Sec 15(3).<br>• Applicant also placed reliance on the ruling pronounced by Kerala AAR in the decision of **Santosh Distributors [2019-TIOL-433-AAR-GST]** where it was observed that commercial credit notes issued by supplier does not satisfy the conditions prescribed in Section 15(3) and supplier is not eligible to reduce original tax liability. As supplier of goods is not reducing original tax liability, the applicant will be eligible to avail the credit of the tax paid as per the invoice of the supplier subject to payment of value of supply as reduced by commercial credit notes plus the amount of original tax charged by the supplier.<br>• Amount of the credit note on account of cash discount / incentive will be treated as payment / discharge of dues of the original invoice and hence applicant will not have to reverse GST under third proviso to Section 16(2).<br>• Applicant referred to handbook on **"Practical FAQ's under GST"** December 2020 edition **issued by ICAI** wherein they have opined that:<br>○ Failure to pay should ideally arise in a situation where there is a requirement to pay in the first place. On issuance of an accounting / financial / commercial credit note by the supplier, there is an acknowledgement by the supplier himself that there is no further requirement of payment. Where no payment is required, there cannot be a failure to pay. |

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| | ○ 'Failure to pay' is due to inaction by the recipient where they are unable to perform the positive activity of having made the payment within the specified time limit. However, when the credit note is received which dispenses with the requirement of having to make further payment, no further action is required by the recipient to the extent of the value of credit note. When no action is required, there cannot be any inaction on the part of the recipient. The recipient should not be penalized when there is no failure or inaction. Therefore, there should not be any reversal of ITC.<br>• Applicant placed reliance on ruling pronounced by West Bengal AAR in the decision of **Senco Gold Ltd. [2019-TIOL-140-AAR-GST]**.<br>• Indirectly, incentive has an effect on the sale price of the goods purchased by applicant from the vendor and is actually in the form of discount.<br>• Applicant has drawn attention to the ruling pronounced by Karnataka AAR in the decision of **M/s Kwality Mobikers Private Limited [2019-TIOL-391-AAR-GST].** |
| **Observations & Decision of AAR** | • Applicant can avail ITC of full GST charged by vendor and no proportionate reversal of ITC is required in respect of commercial credit note issued by vendor for cash discount and incentive / schemes provided without adjustment of GST, if the said discount is not covered under Section 15(3)(b) of CGST Act, 2017 and the said discounts is not in terms of prior agreement.<br>This ruling is subject to the conditions that the GST paid for the said goods / service is not reversed or reimbursed or re-credited by the vendor to the applicant in any manner.<br>• Since the amount received in the form of credit note is actually a discount and not a supply of service by the applicant to the vendor, GST is not leviable on receiver on cash discount/incentive/schemes offered by the vendor to applicant through credit note. |
| **NASA Comments** | • This is a well-reasoned and unbiased ruling and provides clear guidance as to treatment of discount or incentives granted through commercial credit notes wherein vendor does not give credit for GST. |

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| | This ruling clarifies that discount or incentive is re-quantifying the consideration agreed for the supply of goods and/or service as per original contract. It is not a consideration received by recipient for providing any services to the vendor and hence not liable to GST in hands of recipient.<br>• As ruling of AAR does not have binding precedence, one has to take a considered call looking at the facts of the case, agreement with suppliers and legal provisions. |

We will be glad to provide any elaboration or elucidation you may need in this regard.

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