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TAX JURISPRUDENCE

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EXECUTIVE SUMMARY OF JUDGEMENTS / ADVANCE RULINGS UNDER DIRECT AND INDIRECT TAXES

We are pleased to draw your attention to following important decisions which might be

Case & Citation	Issue Involved	Decision
Direct Tax		
Microsoft Regional Sales Pte. Ltd. vs. DCIT(IT) [ITA No. 1553/Del/2016) (Delhi Tribunal)]	Whether retail sale of Microsoft Products and access to cloud-based services for process and storage of data or run the applications shall be taxable as Royalty?	Following the rationale of decisions pronounced by Honourable Supreme Court in the case of Engineering Analysis Centre of Excellence P. Ltd. (supra) and by Honourable Delhi High Court in the case of Infrasoft Ltd, the Honourable ITAT that Retail sale of Software's which are "Copyrighted article" and not "Copyrights", the same does not give rise to royalty income. Further, as the access to cloud-based service do not involve any transfer of rights to the customers or does not provide any copy of the said software to the subscriber for reproducing the same, hence, subscription fees paid is not to be treated as royalty.
Indirect Tax		
Munjaal Manishbhai Bhatt [2022-TIOL-663-HC-AHM-GST]	Whether Notification No. 11/2017-Central Tax (Rate) dated 28th June 2017 providing for 1/3rd deduction with respect to	Honourable High Court held that paragraph 2 of the notification is to be read down to the effect that the deeming fiction of 1/3rd will not be mandatory in nature. It will

	land or undivided share of land in cases of construction contracts involving element of land is ultra-vires the provisions of the GST Acts and/or violative Article 14 of the Constitution of India?	only be available at the option of the taxable person in cases where the actual value of land or undivided share in land is not ascertainable.
Numinous Impex India Pvt Ltd [2022-TIOL-549-HC-MAD-GST]	Whether exporter can avail duty drawback under Customs Act and claim refund of ITC under GST Act on exports made without payment of IGST under bond?	Honourable High Court directed the respondents to scrutinize the refund claims filed by the petitioner and refund the same together with applicable interest, within a period of three months from date of receipt of order.

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

DIRECT TAX

Case 1 – Microsoft Regional Sales Pte. Ltd. vs. DCIT(IT) (ITA No. 1553/Del/2016) (Delhi Tribunal)

Facts in brief & Issue Involved

- Microsoft Regional Sales Pte. Ltd ('Taxpayer') was incorporated in USA and is a wholly owned subsidiary company of Microsoft Corporation, U.S.A. ('MS Corp.'). The Taxpayer has a branch office in Singapore.

- MS Corp also has wholly owned subsidiary in Singapore being Microsoft Operation Pte Ltd ('MO') and in USA being MOL Corporation ('MOLC').

- MOLC has exclusive license to manufacture and distribute Microsoft Retail Software Products. It granted to MO non-exclusive rights to manufacture and distribute Microsoft Retail Software Products in Asia (with restriction in China, Korea and Taiwan), Japan, Southeast Asia.

- MOLC entered into exclusive agreement with Taxpayer to distribute software manufactured by MO in Asia specific region. The said software's were further delivered by the Taxpayer to the distributors "ex warehouse" and in turn were ultimately sold to consumers.

- The Taxpayer has also received consideration towards user-based access to Cloud services.

- Assessing Officer ('AO') taxed both the above transaction as Royalty U/s 9(1)(vi) and also under Article 12(3) of the India US DTAA. The addition made in the hands of Taxpayer on protective basis and substantive basis in the hands of MOLC.

- Dispute Resolution Panned ('DRP') upheld the order of AO. Being aggrieved by the order of DRP the Taxpayer filed an appeal before the Hon'ble Tribunal.

Contentions of Taxpayer

- The Taxpayer contended that the tax authorities have failed to follow the ratio laid down and principles of law with respect to sale of software products not giving rise to royalty income as held by Hon'ble Delhi High Court in DIT vs. Infrasoft Ltd. and in case of Hon'ble Supreme Court of India in its judgment dated 02.03.2021 in Engineering Analysis Centre of Excellence (P) Ltd. whereby the judgement of the Hon'ble Delhi High Court has been upheld.

- As regarding taxability of access to Could-based services as Royalty, the Taxpayer relied upon ruling of co-ordinate bench judgment in case of M/s. Salesforce.com Singapore Pte. Vs. Dy. D.I.T. Circle- 2(2) ITA No. 4915/DEL/2016 [A.Y 2010-11] wherein it was held that subscription to the cloud computing services do not give rise royalty income.

Observations & Decision of the Hon' Tribunal

- Hon'ble Tribunal gave a thoughtful consideration to the matter and found no reasons in diverting from the views as laid down in the landmark ruling of Supreme Court in case of Engineering Analysis Centre of Excellence (P) Ltd and also by Hon'ble Delhi High Court in DIT vs. Infrasoft Ltd where there were no distinguishing facts and hence it was held that "Sale of Software Product" could not be treated as Royalty.

- Further, as regarding taxability of consideration for "access to could-based software", following key attributes of Could-based services are worthwhile to be noted: -
    - The grant of right to install and use the software included with the subscription does not include providing any copy of the said software to the customer.
    - Although the said cloud base services are based on patents / copyright, but the subscriber does not get any right of reproduction.
    - The services are provided online via data centre located outside India.
    - The Cloud services merely facilitate the flow of user data from the front-end users through internet to the provider's system and back.
    - Subscription Fees paid is merely for online access of the cloud services for process and storage of data or run the applications online.

- Further, the Hon'ble ITAT also relied upon ruling in case of DDIT v Savvis Communication Corporation [2016] 69 taxmann.com 106 and M/s. Salesforce.com Singapore Pte. (supra) wherein it was held that comprehensive customer relationship management servicing and web hosting services cannot be treated as 'consideration for use of, or right to use of, scientific equipment' and hence, it cannot be considered as royalty.

NASA Comments

- After landmark ruling in the case of Supreme Court in case of Engineering Analysis Centre of Excellence (P) Ltd there is very little room left for the Revenue authorities for creating any controversy as regarding Sale of Software Products which are held as not taxable as Royalty.

- Further, important attributes are also encompassed by the said ruling in relation to consideration received for access to Could-based services which clearly establishes that the said services are not to be treated as Royalty will help taxpayer at large for ending litigation on the said ground.

- Further, how far the Judgement of Apex Court will hold good by amendment carried out in Finance Act, 2020 applicable w.e.f. 1st April 2022 in Section 9(1)(i) as regarding applicability of "Significant Economic Presence" for provision of download of data or software in India will also have to be examined on case-to-case basis.

INDIRECT TAX

Case 1 – Munjaal Manishbhai Bhatt [2022-TIOL-663-HC-AHM-GST]

Facts in brief & Issue Involved

- Petitioner entered into an agreement with Navratna Organisers & Developers Pvt. Ltd. (hereinafter referred to as "landowner / developer") for purchase of a plot of land.

- The agreement also encompassed construction of bungalow on the said plot of land by the landowner / developer.

- Separate and distinct consideration was agreed upon between petitioner and landowner / developer for sale of land and construction of a bungalow on the land.

- The landowner / developer raised invoice on petitioner by relying upon the entry no. 3(if) of Notification No. 11/2017-Central Tax (Rate) dated 28th June 2017 read with para 2 of the said notification.

- Accordingly, petitioner was charged GST at the rate of 9% CGST + 9% SGST on the entire consideration payable for land as well as construction of bungalow after deducting 1/3rd of the value towards the land.

- Petitioner has filed a writ petition challenging the validity of entry 3(if) of Notification No. 11/2017-Central Tax (Rate) dated 28th June 2017 read with para 2 of the said notification.

Contentions of Petitioner

- Petitioner submitted that the consideration towards land is separately agreed and was clearly indicated in the agreement. Also, the agreement was entered after the land was fully developed and that no further activity was required to be done by the landowner / developer in respect of the land after entering of the booking agreement with the petitioner.

By virtue of Section 7(2) of the GST Act, transactions as specified in the Schedule III are excluded from the purview of supply. Sale of land is included in the Entry No. 5 of the Schedule III to the GST Act.

- Petitioner also relied on the minutes of the 14th GST Council meeting wherein it was discussed that for all intent and purpose, the abatement of 1/3rd value towards the land was thought of only in respect of sale of Flats / Apartments and not in respect of the transactions where land was separately sold, and separate value of land was specifically so available.

- Petitioner contended that the legislative history of tax on construction contracts which has culminated into incorporation of the GST Acts is required to be looked into closely for understanding the true scope and purport of the statutory provisions of the GST Acts.

- The legislative history clearly indicates that the intention is to only impose tax on construction undertaken for a buyer from the stage when the contract is executed between the developer and buyer. Moreover, it is clearly held that when the actual value can be ascertained then fictional value cannot be taken into consideration.

- The notification leads to a consequence whereby tax is imposed on land which is never sought to be taxed by the statute. Therefore, petitioner contended that the impugned notification is ultra-vires the provisions of the GST Acts as well as arbitrary and violating Article 14 of the Constitution of India.

Observations & Decision of High Court

- Supply u/s 7 of the CGST Act includes supply of goods or services made or agreed to be made for a consideration. Thus, the factum of supply would be initiated only once the agreement is entered into between the supplier and recipient and such agreement is for consideration.

- The legislative intent is to impose tax on construction activity undertaken by a supplier pursuant to contract with the recipient. There is no intention to impose tax

on supply of land in any form and it is for this reason that it is provided in the Schedule III.

- It is not as if deduction is not granted if land is not developed. Deduction is granted for any transfer of land. Thus "sale of land" under Schedule III to the GST Acts covers sale of developed land.

- Ordinarily the value of supply of goods or services or both should be the value which is the price actually paid or payable for the said supply of goods. When the statutory provision requires valuation in accordance with the actual price paid and payable for the service and where such actual price is available, then tax must be imposed on such actual value. Deeming fiction can be applied only where actual value is not ascertainable.

- Thus, mandatory application of deeming fiction of 1/3rd of total agreement value towards land even though the actual value of land is ascertainable is clearly contrary to the provisions and scheme of the CGST Act and, therefore, ultra-vires the statutory provisions. Such deeming fiction which leads to arbitrary and discriminatory consequences could be clearly said to be violative of Article 14 of the Constitution of India.

- Honorable High Court held that paragraph 2 of the impugned notification is to be read down to the effect that the deeming fiction of 1/3rd will not be mandatory in nature. It will only be available at the option of the taxable person in cases where the actual value of land or undivided share in land is not ascertainable.

NASA Comments

- This is well reasoned and fair decision.

- In urban area or metro cities actual value of land is much higher than 1/3rd value of flat. Application of 1/3rd deduction is arbitrary in nature as it is applied uniformly irrespective of the area, size, and location of land.

- The decision of Gujarat High Court has persuasive value. However, it may not be binding on other High Courts.

- There are all chances that government may challenge this judgement in higher forum. In case government files a SLP, one cannot say that law laid down by Gujarat High Court is law of land till Honorable Supreme Court upholds the decision of Gujarat High Court.

Case 2 – Numinous Impex India Pvt Ltd [2022-TIOL-549-HC-MAD-GST]

Facts in brief & Issue Involved

- Petitioner has exported consignments of goods classifiable under Customs Heading No. 8483 40 00 and claimed duty drawback u/s 75 of the Customs Act, 1962.

- Petitioner also claimed refund of input tax credit ('ITC') availed on the input and input services used in the export goods u/s 54 of CGST Act read with section 16(3)(a) of the IGST Act.

- Authorities denied the ITC refund under GST law since duty drawback was claimed on the same export.

- Petitioner has filed a writ petition challenging the same.

Observations & Decision of Honorable High Court

- Notification No. 131/2016-Cus (N.T) dated 31st October 2016 as amended by Notification No. 73/2017-Cus (N.T), dated 26th July 2017 prescribes the quantum of drawback eligible to the exporter.

- There are two rates of All Industry Duty Drawback (AIR) under the Schedule to Notification No. 131/2016-Cus (N.T) dated 31st October 2016 namely:
    - where no input tax credit is availed; and
    - where input tax credit is availed.

- Where ITC has not been availed, drawback rates mentioned in columns (4) and (5) of the schedule are applicable. The said drawback rates refer to the total drawback, i.e., Customs, Central Excise and Service Tax component put together.

- Where ITC has been availed, drawback rates mentioned in columns (6) and (7) of the schedule are applicable. The said drawback refers to the drawback allowable for the Customs component only.

- Paragraph No. 7 to Notification No. 131/2016-Cus (N.T) dated 31st October 2016 reads as under:
  The difference in rates between the columns (4) and (6) refers to the Central Excise and Service Tax component of drawback. If the rate indicated is the same in the columns (4) and (6), it shall mean that the same pertains to only Customs component and is available irrespective of whether the exporter has availed of Cenvat facility or not.

- In the present case, the drawback rate against Customs Heading No. 8483 40 00 is the same at 2% irrespective of availment of ITC. Therefore, there is no merit in the stand of the respondents that the petitioner is not entitled for the refund of ITC.

- Court also placed its reliance upon decision of Gujarat High Court in case of **Awadkrupa Plastomech Pvt. Ltd Vs. Union of India [2020-TIOL-2238-HC-AHM-GST]**

- Honorable High Court directed the respondents to scrutinize the refund claims filed by the petitioner and refund the same together with applicable interest, within a period of three months from the date of receipt of a copy of this order.

NASA Comments

- It is in consonance with the Gujrat High Court decision in the case of Awadkrupa Plastomech Pvt. Ltd Vs. Union of India. The SLP against this ruling has also been dismissed by the Supreme Court.

- Thus, it is a very fair and sound judgment providing relief to the exporters who are claiming drawback only for the customs portion without claiming any double benefit.

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

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