N. A. SHAH ASSOCIATES LLP
Chartered Accountants

TAX JURISPRUDENCE

CASE LAW ALERT – SEP 2024 VOL.1

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 useful for you to take call on tax position.

Case & Citation	Issue Involved	Decision
Direct Tax		
General Motors Company USA vs. ACIT, International Taxation [ITA No. 2359/Del./2022]	Whether a limited liability company ("LLC"), assessed as a fiscally transparent entity under US tax laws is eligible for benefits of India – USA DTAA?	The Hon'ble Delhi Bench of Income Tax Appellate Tribunal held that LLCs, which are disregarded as separate from its owner and whose incomes are taxed in the hands of the owners are, by virtue of their option to elect their tax classification. Thus, such LLCs are liable to tax in USA for the purpose of India – USA DTAA and hence, are eligible for beneficial rate of taxation prescribed under such DTAA
Indirect Tax		
M/s.Shobikaa Impex Private Limited vs Union of India, (Madras High Court W.P.(MD) No.13263 of 2022)	Whether refund incorrectly claimed under Rule 96(10) be denied on the grounds of procedural irregularity when the refund should have been claimed under Rule 89?	The Madras High Court took a view that legitimate export incentives ought to be granted as an exporter competes in the international market. The Court confirmed that the procedural irregularity committed by the Assessee shouldn't come in the legitimate way of grant of export

		incentives as admittedly exports were made, and the refund claims were itself based on the shipping bills.
Reserve Bank of India [TS-461-AAR(MAH)-2024-GST], decided on 31-07-2024.	Whether A) the penalties, late fees/penal interest, fine of the nature, levied and collected for contravention or violation of provisions of law; B) penalty of the nature of non-performance or under-performance as per contractual agreement with third party vendors; by RBI are taxable under GST?	Maharashtra Authority of advance ruling has ruled that these activities are not in nature of a consideration for an activity and hence would not constitute a supply of service. Therefore, not taxable under GST.

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

DIRECT TAX

General Motors Company USA vs. ACIT, International Taxation [ITA No. 2359/Del./2022]

Facts in brief & issues involved:

- General Motors Company USA ("the assessee") was a company incorporated under the laws of USA and claimed to be a tax resident of USA.
- It had earned income in the nature of fees for technical services from two Indian entities viz. General Motors India Pvt. Ltd. and Chevrolet Sales India Pvt. Ltd. during the FY 2013-14.
- The rate of tax for such receipt, as prescribed u/s 115A of the Income Tax Act, 1961 ("the Act") was 25% plus applicable surcharge and cess whereas, para 12 of India – USA DTAA prescribed a concessional rate of 15%. The assessee claimed benefit of India – USA DTAA and offered the receipt to tax @ 15%.
- The case of the assessee was reopened and the assessee was show caused as to why the said income should not be taxed at the rate of 25% instead of 15%.
- The assessee made detailed submission which was disregarded by the Assessing Officer ("AO"), who charged the impugned receipt at the rate of 25%, plus applicable surcharge and cess. This action was confirmed by the Dispute Resolution Panel ("DRP").

Contention of the Assessee:

- The Assessee argued that under the US tax laws, an LLC is given an option to either be taxed as a corporation or be taxed as a disregarded entity, wherein the income of the LLC is clubbed in the hands of its owner who merely discharges the tax, that is otherwise assessable in its hands.
- The term "liable to tax" ought not be equated with actual paying of tax. The said term connotes that a person is subject to one of the taxes covered by the DTAA and it is immaterial whether the person actually pays the tax or not.
- Reliance for this purpose was placed by the assessee on the decision of Hon'ble Apex Court in the case of UOI vs. Azadi Bachao Andolan [2013] 263 ITR 706 (SC) wherein it was held that

liability to taxation is a legal situation: payment of tax is a fiscal fact. The Court held that for the purpose of Article 4, what is relevant is legal situation and not the fiscal fact.

- Reliance was further placed on the decision of Mumbai Bench of the Income Tax Appellate Tribunal in the case of Linklaters LLP vs. ITO [2010] 40 SOT 51 (Mumbai) wherein the Tribunal held that while the modalities or mechanism of taxation may vary from jurisdiction to jurisdiction, what really matters is whether the income, in respect of which treaty protection is being sought, is taxed in the treaty partner country or not and thus held that even when a partnership firm's income is taxable in the hands of the partners, as long as the entire income of the partnership firm is taxed in the residence country, treaty benefits cannot be declined.

Contentions of the Respondent:

- The AO, unsatisfied with the contentions of the assessee, denied the benefit of India – USA DTAA on the grounds that being a fiscally transparent entity, income of the assessee was not subject to tax in their own hands, thereby not clearing the rigours of Article 4 of India – USA DTAA.
- The AO further observed that LLCs do not fall under the special clause laid down in Para 1(b) of Article 4, which applies only to partnerships and trusts.
- The above conclusions were confirmed by DRP which further observed that commentary to the OECD Model Convention on Article 4, in para 8.4 specifically states that where a particular country disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not 'liable to tax, and may not, therefore, be considered to be a resident of that country.

Observation and Decision of the Tribunal:

- The Delhi Bench of the Income Tax Appellate Tribunal observed that under the US tax law, an LLC with a single owner is disregarded as separate from its owner unless the LLC elects to be treated as a corporation for US federal income tax purposes. This ability of an LLC to elect its tax classification supports the legal situation or aspect of the LLC being liable to tax.

- Further, where an LLC elects such a tax classification, the tax owner of the LLC pays tax on the tax owner's share of the taxable income attributable from the LLC. This further supports the legal situation of an LLC being liable to tax.
- Accordingly, the Tribunal considered the assessee to be a resident under Article 4 of the India – USA DTAA and consequently, held the impugned receipts to be taxable at the rate of 15%.

NASA Comments:

- The above decision would throw light on the settled position of law that liable to tax may not be equated with the actual payment of tax and would cover a scenario where a person is subsequently exempted from paying tax under the laws of that country. In fact, the said situation is also factored in a subsequent amendment to the Indian tax law by insertion of section of 2(29A).
- The decision would specifically come as a respite for LLCs which were acting as a fiscally transparent entity under US tax laws since LLCs are not specifically covered under para 1(b) of Article 4, which deals with cases of fiscal transparency.

INDIRECT TAX

M/s. Shobikaa Impex Private Limited vs Union of India, (Madras High Court W.P.(MD) No.13263 of 2022)

Facts in brief & issues involved:

- M/s. Shobikaa Impex Private Limited (herein after referred as petitioner), is a 100% Export Oriented Unit [EOU], and had exported goods out of the country on payment of IGST. The department issued a show cause notice for wrongly availing the benefit of refund under Rule 96(10) of CGST Rules, 2017 on the IGST paid on capital goods and inputs utilized for the export of goods instead of claiming refund under Rule 89 of the CGST Rules, 2017.
- Subsequently, a Show Cause Notice (SCN) was issued, and Order-in-Original confirming the IGST demand on account of ineligible IGST refund for Rs.22.50 crores plus interest and penalty was issued. The petitioner has challenged the O-I-O.

Contention of the Respondent:

- The Respondents argued that Rule 96(10) of the CGST Rules, 2017 barred the petitioner from paying IGST on exports and claiming a refund of the same, as they had availed the benefits under specific notifications for duty-free/concessional procurement of inputs.
- The Respondent stated that the petitioner was aware of their ineligibility for IGST refunds on export goods under Rule 96, yet consciously opted to pay IGST and claim the refund.
- The Respondent maintained that the petitioner was not eligible for the refund claimed and should repay the erroneously refunded amount along with applicable interest and penalty.

Contention of the Petitioner:

- The Petitioner argued that they had mistakenly claimed a refund under Rule 96 of the CGST Rules for IGST paid on capital goods and inputs utilized for export, instead of Rule 89.

- They contended that such procedural error should not impede their entitlement to export incentives as they had genuinely exported goods and claimed refunds based on shipping bills.

Observation and Decision of High Court:

- The High Court of Madras took a view that legitimate export incentives ought to be granted as an exporter competes in the international market and relying on the decision of Apex Court in the case of Commissioner of Sales Tax, Uttar Pradesh v. Auriaya Chamber of Commerce, Allahabad, 1986 (3) SCC 50 : (1986) 25 ELT 867, wherein it has been held that the rules or procedures are hand-maids of justice, not its mistress, the Court confirmed that the procedural irregularity committed by the Assessee shouldn't come in the legitimate way of grant of export incentives as admittedly exports were made and the refund claims were itself based on the shipping bills.

NASA Comments:

- Considering the difficulty being faced by the exporters due to restriction in respect of refund on exports, imposed vide rule 96(10), rule 89(4A) & rule 89(4B) of CGST Rules, 2017, in cases where benefit of the specified concessional/ exemption notifications is availed on the inputs, the GST Council in its 54th Council meeting recommended to prospectively omit rule 96(10), rule 89(4A) & rule 89(4B) from CGST Rules, 2017. This will simplify and expedite the procedure for refunds in respect of such exports.
- Till the time the amendments are made effective, this favourable ruling brings a sigh of relief for the Exporters who have been burdened with show cause notices demanding payment of tax along with interest and penalty.

Case 2: Reserve Bank of India [TS-461-AAR(MAH)-2024-GST]

Facts in brief & issues involved:

- RBI ("The applicant"), being the central bank of the country, provides currency management services to the public. It also acts as a regulator of the banking and financial system and performs the role of monetary policy authority. RBI is the manager of foreign exchange and issuer of currency & plays a developmental role.
- In the course of its operations, the applicant occasionally encounters situations where the involved parties may breach laws or contractual agreements or fail to meet performance expectations. In such cases, the RBI imposes penalties, interest charges, late fees, or fines.
- The Applicant has approached the Maharashtra AAR concerning the taxability under GST on charges such as penalties, penal interest, late fees, or fines imposed for contravention of laws as well as liquidated damages for non-performance of contracts by third parties.

Contention of the Applicant:

- The applicant submits that RBI is a statutory body, set up under the Act of the parliament i.e. the Reserve Bank of India Act, 1934. As a part of its functions, RBI administers various acts.
- The applicant contends under two parts: **A) "Regarding to non-levy of GST on the penalties, late fees/penal interest, fine of the nature levied and collected by RBI for contravention or violation of provisions of law**" – Referring to Circular no. 178/10/2022-GST dated 03 August 2022 issued by CBIC wherein, clarification has been provided in respect of non-applicability of GST on penalties imposed for violation of laws and collected for breach of contract; whereby clarifying that penalties imposed for violation of laws cannot be regarded as consideration charged by the authority for tolerating violation of laws. Laws are not framed for tolerating their violation. Authority/Government stipulate penalty not for tolerating violation but for not tolerating, penalizing and deterring such violations.
- The applicant further contends for **B) "Regarding to non-levy of GST on the penalty on account of non-performance or under-performance as per contractual agreement with vendors"** – Referring to Circular no. 178/10/2022- GST dated 03 August 2022 issued by CBIC

wherein, clarification has been provided in respect of non-applicability of GST that breach of non-performance of contract by one party results in loss and damages to the other party. Therefore, the law provides in section 73 of the Contract Act, 1972 that when a contract has been broken, the party which suffers by such breach is entitled to receive from the other party compensation for any loss or damage caused to him by such breach.

- The applicant placed reliance on the judicial pronouncement of CESTAT, Principal Bench New Delhi in case of M/s South Eastern coalfields Ltd. [2021(55) GSTL 549 (Tri.- Del.)].

Observation and Ruling by AAR MH:

- RBI administrate various Acts, Rules & Regulations. Being a statutory body, it levies penalties, late fees/penal interest, fine arising out of such legal statutes. The intention behind the levy of penal interest/penalty is to inculcate discipline among banks and other institutions so as to ensure prompt/correct reporting and compliance. That penalty imposed for violation of laws, or for violation of public norms or other laws are not consideration for any supply received as no service is received in lieu of payment of such fines and penalties and are not taxable.
- Also, the applicant is levying penalties on violations or of the nature of non/under-performance for the purpose of compensating any injury, loss or damage suffered by the RBI due to such breach. As the AAR is bound by the circular, it is of the opinion that these activities are not in the nature of a consideration for an activity and hence, would not constitute a supply of service and not taxable.

NASA Comments:

- This favourable AAR ruling is a welcome judgment which helps in substantiating non-taxability of fines/penalties levied by Statutory authorities for non-compliance with laws/ breach of contract. However, it is not binding on taxpayers other than the applicant. It does not have a binding precedence except for persuasive value.

The contents provided in this newsletter are for information purpose only and are intended, but not promised or guaranteed, to be correct, complete and up-to-date. The firm hereby disclaims any and all liability to any person for any loss or damage caused by errors or omissions, whether such errors or omissions result from negligence, accident or any other cause.

B 21-25, Paragon Centre,
Pandurang Budhkar Marg, Mumbai – 400013
Tel: 91-022-4073 3000, Fax: 91-022-4073 3090
E-mail Id: info@nashah.com