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Newsletter - March 2024

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Judgments

Karnataka High Court holds against levy of service tax on expenses incurred by Venture Capital Funds

India Advantage Fund c/o ICICI Venture Funds Management Co. Ltd. vs The Commissioner of Central Tax [C.E.A No.20/2021]

The Karnataka High Court has overruled the judgement of Customs, Excise and Service Tax Appellate Tribunal (CESTAT), Bangalore, to hold that service tax is not leviable on the expenses borne by Venture Capital Funds (Funds).

Typically, the investors/contributors make investments in Funds, which then appoints an Asset Management Company (AMC) to manage the funds contributed. The Fund retains a portion of the payouts to be made to its investors/contributors and payments are made therefrom to the AMC and to the special class of investors in the form of carried interest (CI).

In this backdrop, the CESTAT had ruled that any retention of money from the contributors' forms 'consideration' for service rendered by the Fund to its contributors, which is leviable to service tax under the taxable category of 'banking and other financial services'.

In appeal, the High Court held the following:

(a) Funds are not juridical person: The Funds, structured as Trusts, are not 'juridical persons' for the purpose of Finance Act, 1994 (Finance Act). The Court held that the definition clause of each statute must be read with the object and purpose of that statute only. Therefore, even though various other statutes such as SEBI recognize "Trust" as a person, 'Trust' is not recognized as a juridical person under the Finance Act.

(b) Fund was merely a pass through: The Fund does not make any profit and merely acts as a 'pass through' whereby the funds from the contributors are consolidated and invested by the Fund Manager. In other words, the Fund has not rendered any service to its contributors but has acted as a trustee holding the money belonging to contributors which was invested as per the advice of the Fund Manager.

(c) If at all, the Fund provided service to self: The 'doctrine of mutuality' was held to be applicable to the facts of case as the contributors' investment was held in trust by the Fund and it is invested as per the advice of the Fund Manager. Therefore, the Fund and its contributors could not be dissected as two different entities.

The judgement passed by the CESTAT had created a furore in the Funds Industry, since carried interest had traditionally been treated as return on capital and not consideration for any service. While the ruling by the Karnataka High Court comes as a major relief to the Funds Industry, it will be interesting to see how the issue unfolds under the GST regime, particularly since the definition of 'person' is very wide and the doctrine of mutuality has been diluted by way of statutory amendment to the Central Goods and Services Tax Act, 2017 (CGST Act) itself.

GST leviable on transfer of development rights in Joint Development Agreement

Prahitha Construction vs. Union of India [Writ Petition No. 5493 of 2020]

The Petitioner-developers, by way of a writ petition before the Telangana High Court, sought for declaration of the transfer of development rights (TDR) of land by way of Joint Development Agreement (JDA) to be treated as a sale of land and consequently, challenged Notification No. 4/2018- Central Tax (Rate) dated 30.09.2019 (TDR Notification) vide which GST on TDR was imposed.

The High Court, after examining the terms of the JDA, noted that there was no sale of land being effectuated under the JDA. The JDA per se could not be considered as a medium adopted by the landowner to sell his land since the JDA did not result in sale of land by itself. The Court held that unless the land stands transferred in the name of the Petitioner, the same cannot be brought within the ambit of 'sale of land' and that transferring of the development rights does not result in transfer of ownership rights.

Consequently, the Court held that the TDR cannot be termed as a sale of land under Entry 5 of Schedule III of the CGST Act.

The Court rejecting the challenge to TDR Notification further held that it did not create any charge on the transfer of development rights and instead only provided for the time of supply of services of TDR.

The taxability of TDR was subject matter of dispute in the pre- GST era as well. Since immovable property includes land and benefits arising out of land and 'sale of land' has been kept outside the purview of GST, the controversy around leviability of GST on TDR continued even under the GST regime. While the above decision holds that GST is leviable on TDR, the same was passed in the peculiar facts and terms of the JDA. Thus, the issue may undergo further judicial scrutiny in the backdrop of distinct terms of development agreements.

No service tax is payable on royalty payments made to State Government for grant of mining lease

M/s. Oil and Natural Gas Corporation Ltd. Vs. The Commissioner of GST& Central Excise [Service Tax Appeal No.41666 of 2018]

CESTAT, Chennai has held against the levy of service tax under reverse charge, on the royalty amount paid to the Government of Tamil Nadu for grant of mining lease and the right to use natural resources.

On the issue of whether royalty is in the nature of tax or a consideration for services, the CESTAT noted that while a seven- judge bench of the Supreme Court, in the *India Cement Ltd vs. State of Tamil Nadu 1990 AIR 85*, had held royalty to be a tax, the ratio of the said judgement was later doubted by five-judge bench of the Supreme Court in the case of *State of West Bengal vs Kesoram Industries Ltd & Ors. AIR 2005 S.C. 1646*. Though the issue was referred to a nine-judge bench in *Mineral Area Development Etc. vs Steel Authority of India and Ors (2011) 4 SCC 450* for further clarification, in the absence of any outcome of the reference made to a larger bench, the CESTAT held that in accordance with judicial discipline, the decision in *India Cements Ltd.* ought to be followed.

The CESTAT further opined that the royalty was predominantly in the nature of regulatory fee and did not fall within the definition of 'consideration' for services under the Finance Act.

The CESTAT observed that the activity impugned in the Show Cause Notice issued by the Department was the 'assignment of right to use'. However, the activity in essence was the grant of mining lease. The transition of the from 'lease' to 'assignment' acquires significance. If the activity was to be construed as lease, the activity was likely to fall under 'Renting of Immovable Property Services' and in case of renting of immovable property services, the liability to pay service tax is on forward charges basis, even if the services are provided by Government to business entities.

The CESTAT further held that any demand based on an Exemption Notification rather than charging provision is unsustainable in the eyes of law.

While the CESTAT by way of the above decision has ruled that service tax is not leviable on royalty payments made to the State Government, similar demands have also been raised under GST. Further, the 9 - judge bench of Court is currently seized of the issue of power of the States to impose tax on royalty and the same is likely to get a new dimension after the Supreme Court's ruling.

Madras High Court allows receipt of payment by an Intermediary in case of export of services

Afortune Trading Research Lab LLP vs. Additional Commissioner & Others [W.P. No. 2849 of 2021]

The Assessee was engaged in the business of providing advisory services to its customers located outside India. The payments, in lieu of the services, were received by an Intermediary appointed by the Assessee (in convertible foreign exchange), who, after deducting its service charges, remitted the amounts to the Assessee. Since the Assessee was exporting services, it filed refund claims for unutilized ITC as well tax paid on such exports, which were rejected. The rejection of refund claims was subsequently challenged by the Assessee before the Madras High Court.

The High Court noted that routing of payment by the Intermediary from its own account to the Assessee's account was in accordance with the Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016. Accordingly, the High Court held that mere receipt of payment through an Intermediary ipso facto does not imply that the Assessee had not exported services. Accordingly, the Assessee was held to be entitled to the refund of tax paid on export of goods and the unutilized ITC where exports were made without payment of tax.

Many cross-border financial transactions are channelized through financial intermediaries. Therefore, this is an important decision for exporters in India who may also be receiving payment from customers located outside India via financial intermediaries. In such cases, by virtue of the above decision, the refund claim of the exporters ought to be allowed by the Department.

GST officers do not have power to seize cash under Section 67 of the CGST Act

K.M. Food Infrastructure Pvt Ltd vs. The Director General DGGI Headquarters [W.P.(C). 328/2024 & 363/2024]

The Delhi High Court, on challenge by the Assessee to seizure of cash by Revenue Officers, has held that the power under Section 67(2) of the CGST Act to conduct search and seize goods, does not include the power to confiscate cash or currency.

The High Court noted that 'cash' is clearly excluded from the definition of 'goods' under Section 2(52) of the CGST Act and that it falls within the definition of 'money' as defined in Section 2(75) of the CGST Act. The Court further observed that the word 'things' appearing in Section 67 of the CGST Act does not include 'money'.

Accordingly, the action on the part of the Revenue Officers in seizing the cash was held to be illegal and arbitrary.

The decision of the Delhi High Court provides clarity on the scope of power of the Revenue Officers in respect of search and seizure under GST, reaffirming the position that seizure must be confined only to items relevant to the search proceedings.

Allahabad High Court holds against discretionary condonation of delayed by the First Appellate Authority

Garg Enterprises vs. State of U.P. And 2 Others [Writ Tax No. - 291 of 2022]

In this case, the Assessee challenged the dismissal of appeal by the First Appellate Authority before the Allahabad High Court. The First Appellate Authority had dismissed the appeal, filed under Section 107 of the CGST Act, on the ground of being preferred beyond the prescribed period of limitation under the CGST Act.

The High Court opined that Section 5 of the Limitation Act (which gives discretion to the court/ authority to admit appeals filed beyond the prescribed period of limitation) is applicable to a special statute only when specifically extended to such a statute. The Court accordingly held that since Section 107 of the CGST Act specifically provides for the limitation period and the power to condone delay by showing sufficient cause after the prescribed period is patently absent thereunder, there is complete exclusion of Section 5 of the Limitation Act.

Accordingly, the Court held that the First Appellate Authority cannot condone delay in filing of the appeal beyond the prescribed period and power provided under Section 107 of the CGST Act.

The question of applicability of Section 5 of Limitation Act to appeals before the First Appellate Authority under GST has been subject to matter of litigation previously as well. The Calcutta Hight Court in this respect held that 107 of the CGST Act does not exclude, expressly or impliedly, the applicability of the Limitation Act and thus, the period of limitation, along with discretionary condonation of delay, for filing of the appeal under Section 107 can be extended by the First Appellate Authority. With divergent views of different High Courts, the issue is far from being settled.

KEY PEOPLE

Shashank Shekhar
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Shashank Shekhar is a Partner in the Indirect Tax Practice at DMD Advocates, bringing over two decades of experience to the role. He has extensive court-room experience while representing clients at various fora including Supreme Court of India, High Courts and Tribunals and has obtained favourable judgments and orders for the clients from Courts and Tribunals.

Tushar Joshi
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Tushar Joshi is a Principal Associate with 10 years of experience in indirect tax litigation and advisory. He handles a wide range of matters related to GST, Customs, Service Tax, SEZ, Foreign Trade Policy, etc., and has represented clients at the adjudication and appellate stages, as well as before Tribunals, High Courts, and the Supreme Court.

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