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Newsletter

Sharp View

January 2025

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In a recent ruling (Sanjay Bhandari v Income-tax Office), the Honourable Delhi High Court upheld that the assessee needs to disclose the foreign assets in the return of income accurately. Also it held that the prosecution under the Black Money (Undisclosed Foreign Income and Assets and Imposition of Tax) Act, 2015 can be initiated even before completion of assessment proceedings under the Income-tax Act, 1961.

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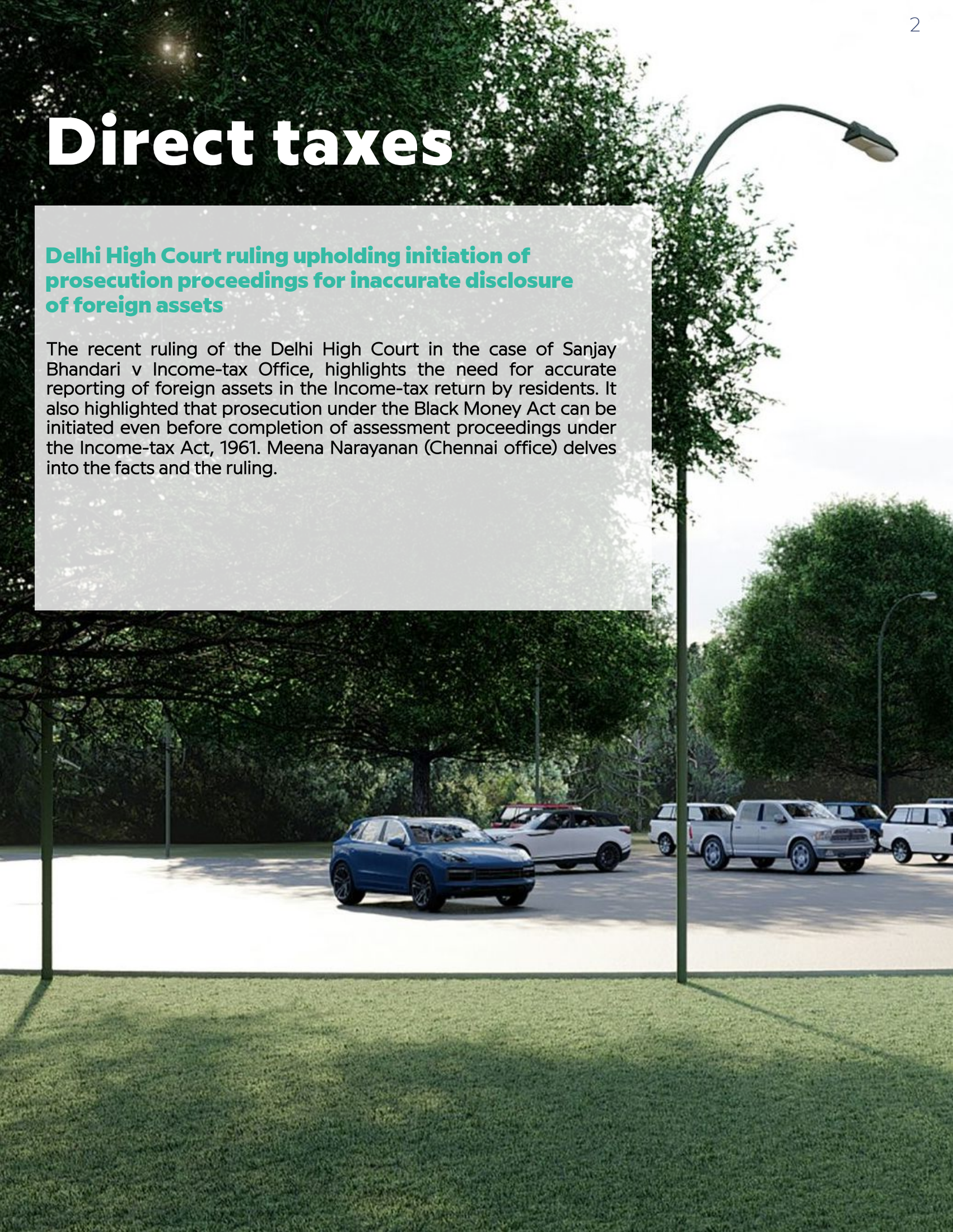
As per section 17(5)(d) of the Central GST Act, 2017, no input tax credit on goods/services/both received by a taxable person is allowed on construction of an immovable property (other than plant or machinery) either on his own account including when such goods or services or both are used in the course or furtherance of business.

In a recent decision, the Supreme Court of India held that if the construction of a building is essential for supplying services such as renting out, it could fall into the category of 'plant.' It emphasised on the words Plant OR Machinery used in section 17(5)(d). As a result, the assesses may now be eligible to claim the ITC on the goods/services used in the construction of immovable property, on case to case basis, where the said functionality test is satisfied.

However, the GST Council has decided to amend the GST Act to nullify the effect of this decision.

Direct taxes



Delhi High Court ruling upholding initiation of prosecution proceedings for inaccurate disclosure of foreign assets

The recent ruling of the Delhi High Court in the case of Sanjay Bhandari v Income-tax Office, highlights the need for accurate reporting of foreign assets in the Income-tax return by residents. It also highlighted that prosecution under the Black Money Act can be initiated even before completion of assessment proceedings under the Income-tax Act, 1961. Meena Narayanan (Chennai office) delves into the facts and the ruling.

Direct taxes

Delhi High Court ruling upholding initiation of prosecution proceedings for inaccurate disclosure of foreign assets

Summary

The recent ruling of the Delhi High Court in the case of Sanjay Bhandari v Income-tax Office, highlights the following:

- Need for accurate reporting of foreign assets in the Income-tax return by residents.
- Prosecution under the Black Money (Undisclosed Foreign Income and Assets and Imposition of Tax) Act, 2015 ('the Black Money Act') can be initiated even before completion of assessment proceedings under the Income-tax Act, 1961 ('the IT Act').

Background

- The petitioner sought the quashing of criminal complaint filed by the Additional Commissioner of Income-tax (Central) ('the complainant) under the Black Money Act alleging that the petitioner failed to disclose his foreign bank accounts and properties.
- As per the complainant, information was received though Foreign Tax and Tax Research that the petitioner held foreign assets in the form of foreign bank accounts, immovable properties and interests in foreign entities and failed to disclose these in his return of income filed for assessment year ('AY') 2012-13. Further, the petitioner was planning to alienate his foreign assets and offshore entities by backdating documents to evade taxes.
- Incriminating documentary evidence and information were discovered during search and seizure operations against the petitioner, his Chartered Accountants and advocates.

Contention of the petitioner

The petitioner sought the quashing of the complaint on the following grounds.

- The Income-tax department has not produced any evidence in the complaint to connect the petitioner with the alleged assets or showing ownership/ beneficial ownership of the assets by the petitioner.
- For an offence under Section 51 of the Black Money Act, the assessee must not only be the owner/ beneficial owner of the alleged foreign asset, but the ownership must have occurred after the commencement of the Black Money Act, i.e. after 1 July 2015. The complainant failed to provide evidence that the petitioner owns any alleged foreign assets or that such ownership existed after the commencement of the Black Money Act's commencement.
- Documents indicate that the petitioner does not own any of the alleged foreign assets.

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- Criminal prosecution should not commence without first completing the petitioner's assessment proceedings to determine any tax evasion. The Income-tax department cannot proceed with a case under Section 51 of the Black Money Act, unless the petitioner is first assessed to tax and declared to be in default.

- An assessment order cannot be made more than 2 years after the end of the financial year in which notice under Section 10 of the Black Money Act is issued. This 2-year period has expired, and no assessment can now be conducted. Without an assessment, there can be no finding of tax evasion and no grounds for prosecution.

- Without conceding the allegations in the complaint, even if true, they would constitute preparation rather than an attempt. An attempt would only arise if a backdated document were submitted as defense to the Income-tax department. Consequently, no willful attempt to evade tax under Section 51 of the Black Money Act is made out.

- The assessment order issued by the complainant during the pendency of proceedings is time barred.

- Since a complaint under Section 50 of the Black Money Act, which provides punishment for failure to furnish information about foreign assets in the return of income has already been filed, there was no occasion of filing complaint under Section 51 which provides for willful attempt to evade tax.

Contention of the complainant

The complainant argued the following:

- Section 51(1) of the Black Money Act operates independently under Section 48(2) of the Black Money Act and is not dependent on any assessment order. Therefore, any order not made due to time limitations or other reasons cannot be used as a defense. Assessment proceedings and orders are entirely separate from the prosecution initiated against the petitioner.

- If the petitioner is aggrieved by the assessment order, he has an effective alternative remedy, by way of filing an appeal. The assessment order is a separate matter from the initiation of prosecution and has no bearing on it.

- The assessment was completed within time limits as detailed in the assessment order.

- Evidence regarding the petitioner's ownership of foreign assets has been discussed in detail in the assessment order for the year 2017-18. Some evidence was obtained during the search and seizure operations at the petitioner's premises and further corroborated through inquiries from Foreign Tax Authorities.

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High Court's ruling

The High Court observed the following:

- Section 48 of the Black Money Act provides that the provisions in the Chapter on Offences and Prosecution shall be independent of any order made or not made under the Black Money Act and it shall be no defense that the order has not been made on account of time limitation or for any other reason. The initiation of prosecution is not dependent on the completion of assessment.

- The Black Money Act provided for a one-time opportunity to declare any undisclosed asset located outside India and acquired from income chargeable to tax under the IT Act. The assessees who desired to take the benefit of one-time opportunity could have made declaration and paid tax and penalty within the due dates specified.

- Section 50 of the Black Money Act provides punishment for failure to furnish in return of income, any information about an asset (including financial interest in any entity) located outside India, whereas Section 51 provides punishment for willful attempt to evade tax. Both the provisions function in different realms.

- At this stage, the complainant is not required to bring material on record to prove the guilt of the petitioner. This is very initial stage where the Magistrate has to form an opinion on that there are sufficient grounds for issuing the process. The objections of the petitioner regarding the assessment are not relevant.

- The complainant has mentioned that the petitioner stated that the foreign assets were held by him in the capacity of a trustee. It has been contended that this statement could be substantiated only by means of the fabricated/ back dated documents.

- It has been pointed out that the petitioner's affidavit has not been properly attested and he has not disclosed his address at United Kingdom.

In view of the afore-mentioned discussions, the High Court dismissed the petition.

Indirect taxes

Supreme Court Decision: Building can be classified as a plant if it is constructed for supplying services such as letting out.

In a recent ruling, the Honourable Supreme Court of India interpreted that if construction of a building is essential for supplying services such as renting out, it could fall into the category of 'plant.' As a result, the assesses may become eligible to claim the input tax credit on the goods/services used in the construction of immovable property. Shouvik Roy (Mumbai office) brings out the detailed facts and the ruling of the apex court along with a short discussion of how the GST council has decided to rectify the drafting of the law (which would again reverse the effect of the Supreme Court decision).

Supreme Court Decision: Building can be classified as a plant if it is constructed for supplying services such as letting out

Union of India vs Safari Retreats

The Supreme Court of India in the above ruling held:

If the construction of a building was essential for carrying out activity of supplying services such as renting or giving on lease or other transactions in respect of the buildings or part thereof which are covered by clauses 2 and 5 of schedule 2 of the Central Goods and Services Tax Act ('the CGST Act'), the building could be held as a 'plant'. The Court the ruled that functionality test will have to be applied to decide whether building is a 'plant', thereby widening the scope of the exception provided in section 17(5) (d) and allowing hope to many assessees who had lost the input tax credit ('ITC') on input taxes paid on input goods/services used in the construction activity of immovable property , due to the mischief of section 17(5)(d).

Facts of the case

- The petitioners, M/s. Safari Retreats Pvt. Ltd. and another, constructed a shopping mall in Bhubaneswar for the purpose of letting it out to tenants.
- In the business activity of constructing the mall, the petitioners incurred expenses in purchasing goods and services such as cement, steel, lifts, air-conditioning plants, transformers, electrical equipment and architectural services, consultancy, legal and professional services. They paid GST on these purchases under the CGST and Orissa GST Act (OGST).
- The petitioners claimed ITC of INR. 34,40,18,028 (approx INR 34 crores)for the GST paid on these purchases to offset the GST liability arising from the rental income they earned by letting out the mall.
- However, the petitioners were denied this ITC by the tax authorities, citing section 17(5)(d) of the CGST and OGST Acts, which restricts ITC for goods and services used in the construction of immovable property on the taxpayer's own account.
- Aggrieved by this decision of the Department, Safari Retreats moved the Orissa HC ('HC') by way of a writ petition , challenging, inter alia, the vires of section 17(5)(d).
- The primary issue before the court was whether the petitioners were entitled to claim ITC on the GST paid for goods and services used in the construction of a shopping mall, which was intended to be let out on rent, under the provisions of Section 17(5)(d) of the CGST Act .

Supreme Court Decision: Building can be classified as a plant if it is constructed for supplying services such as letting out

- To appreciate this better, section 17(5) (d) (also referred to as the section of 'blocked credits', is reproduced below:

17(5) Notwithstanding anything contained in sub-section (1) of section 16 and sub-section (1) of section 18, input tax credit shall not be available in respect of the following, namely;.....
(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of business.

Eplanation.- For the purposes of clauses (c) and (d), the expression 'construction' includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalisation, to the said immovable property;

- The Orissa HC noted that the CGST Act aims to eliminate the cascading effect of various indirect taxes by allowing input tax credit on inputs, services, and capital goods. It is based on the VAT concept, enabling taxpayers to offset input taxes against output taxes, thereby reducing multiple levies at each stage . Section 16 of the CGST and Orissa GST ('OGST') Acts allows registered persons to claim input tax credit on goods or services used or intended to be used in the course or furtherance of their business, subject to conditions and as specified under Section 49.

- The HC opined that the denial of ITC in this case would lead to double taxation. The HC noted that the GST was paid on both the inputs used for the construction of the mall and the rental income derived from the mall. Since the construction was not for sale but for letting out, there was no break in the tax chain.

- The HC held that the purpose of the GST regime was to avoid the cascading effect of taxes by allowing ITC. It held that denying ITC in cases where the immovable property is constructed for the purpose of letting out, and not for sale, would be against the basic philosophy and objectives of the GST system.

- The HC held that section 17(5)(d) should be interpreted in a way that aligns with the purpose of the GST laws. The blocking and restricting portion of the provision, in its plain reading, was meant to apply to cases where the immovable property was constructed for sale, and not for letting out, as GST is not applicable to sale after completion certificate. The HC observed that applying the provision of blocked credit per section 17(5)(d) to situations and transactions where the property is let out would lead to unfair consequences for the assessee, and was contrary to the spirit of the law. The HC also noted that the denial of ITC would render properties constructed for letting out uncompetitive compared to older properties, which would adversely affect the business of such developers.

Supreme Court Decision: Building can be classified as a plant if it is constructed for supplying services such as letting out

- The HC said that denying ITC to the petitioners violated their fundamental right under Article 14 of the Constitution.

- Consequentially, The HC read down Section 17(5)(d) of the CGST and OGST Acts and stated that it does not apply to cases where immovable property is constructed for the purpose of letting out on rent. The HC held that the petitioners were entitled to claim ITC for the GST paid on goods and services used in the construction of the shopping mall, which was let out on rent.

Aggrieved by the HC decision, the Revenue Dept filed a Special Leave Petition before the Supreme Court.

Ratio decidendi and conclusions of Supreme Court judgment

- The expression 'plant or machinery' used in section 17(5)(d) cannot be given the same meaning as the expression 'plant and machinery' defined by the explanation to Section 17;

- Thereby , by laying emphasis on the words Plant OR machinery and using a liberal interpretation of the term, the Supreme Court ('SC') widened the scope of the exception to S 17(5)(d), as, in order so as to fall within this exception and escape the rigors of blocked credit (and thus be eligible for the ITC) the concerned immovable property would have to qualify as either plant Or machinery, but not both together cumulatively.)

- Section 17(5)(d) uses the word 'Plant OR machinery'. Other sections of the word use Plant AND Machinery . The phrase plant OR signifies that either a plant or machinery could qualify for ITC under certain conditions.

- The question whether a mall, warehouse or any building other than a hotel or a cinema theatre can be classified as a plant within the meaning of the expression 'plant or machinery' used in section 17(5)(d) is a factual question which has to be determined keeping in mind the business of the registered person and the role that building plays in the said business.

- If the construction of a building was essential for carrying out the activity of supplying services, such as renting or giving on lease or other transactions in respect of the building or a part thereof, which are covered by clauses (2) and (5) of Schedule II of the CGST Act, the building could be held to be a plant.

- Functionality test will have to be applied on a case to case basis, to decide whether a building is a plant. Therefore, by using the functionality test, in each case, on facts, in the light of what we have held earlier, it will have to be decided whether the construction of an immovable property is a “plant” for the purposes of clause (d) of Section 17(5).

However, the SC otherwise upheld the constitutional validity of section 17(5)(d). Hence, the challenge to the constitutional validity of clauses (c) and (d) of section 17(5) and section 16(4) of the CGST Act fails.

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