

Regulatory Hotline

November 18, 2015

TAX DEMAND ON E-COMMERCE COMPANIES QUASHED – AUTHORITIES DIRECTED TO RE-EXAMINE TRANSACTIONS

- Kerala High Court quashed demand notices under Kerala VAT law to Flipkart and Myntra on the ground that tax authorities did not satisfactorily deal with objections of Petitioners.
- High Court holds that notices were issued arbitrarily without concluding on whether transaction was an inter-state sale or intra-state or that one of petitioners was not engaged in sale of goods and that sellers on its portal were responsible for the same.
- High Court also cautioned tax department from making aggressive claims in show cause notice

BACKGROUND

The Kerala High Court (“**Court**”) in *Flipkart Internet Private Limited vs State of Kerala*¹ quashed demand notices issued against Flipkart and Myntra (“**Petitioners**”) under Kerala Value Added Tax Act, 2003 (“**Kerala VAT Act**”). The Court ruled that the tax authorities did not consider the objections of Petitioners that the transactions were made in the course of inter-state commerce and hence, were not liable to tax under Kerala VAT Act.

There have been a lot of aggressive claims against e-commerce sites in the past² and the Court’s ruling lays down an important principle – tax authorities will have to satisfactorily conclude whether the transactions sought to be taxed are those which were made in the course of inter-state trade or within a particular state, i.e., intra-state and also, whether the party is the seller at all. Further, the onus is clearly on tax authorities demonstrate that a transaction sought to be taxed fell within the ambit of the state VAT law. The ruling should provide some relief to companies that have been dissuaded from providing services in some states in India due to such tax claims.³

FACTS

The Authorities under the Kerala VAT (“**Tax Authorities**”) issued show cause notices (“**Notices**”) to Flipkart and Myntra (“**Petitioners**”) on the ground that they were liable to make payments under the Kerala VAT Act. Tax Authorities reasoned that since sales were effected within the state of Kerala and Petitioners’ websites were accessible in Kerala, Petitioners were liable to tax under the Kerala VAT Act .

The Notices set out figures disclosed by Petitioners as amounting to sales effected in the state of Kerala and on this basis, Tax Authorities concluded that Petitioners had failed to fulfil the registration requirements under the Kerala Vat Act. Petitioners filed responses to Notices, objecting to the jurisdiction of the Tax Authorities and also contended that transactions were conducted in the course of inter-state sales. The Tax Authorities by an order under the Kerala VAT Act confirmed the demand in the Notices against Petitioners (“**VAT Demand**”). Therefore, Petitioners challenged the Notices and VAT Demand in a writ petition before the Court.

CONTENTIONS OF PARTIES AND ISSUE BEFORE THE COURT

Flipkart contended that it was an online marketplace that facilitated transactions of sale and purchase through its online portal. Its role was limited to providing a list and description of goods on its website. When a customer indicated interest in purchasing certain goods, Flipkart would notify the seller of the goods (“**Seller**”) regarding the choice made by the customer. Thus, Flipkart was not even a seller for the purpose of the Kerala VAT Act. The Seller would then in turn raise an invoice on the customer and make arrangements for the delivery of the goods to the customer.

Myntra on the other hand agreed that it was a seller, however, it contended that sales were made in the course of inter-state trade. It had registered as a dealer under the Karnataka Value Added Tax Act and was paying tax in respect of local and inter-state sales effected by it.

Both parties had taken the defence that these transactions were not liable to tax under the Kerala VAT Act as they were sales made in the course of inter-state trade.

Tax Authorities argued that an agreement for sale came into existence when a customer chose a product on the Petitioners’ website. The transaction was concluded within the state of Kerala since the product was delivered to a customer in Kerala and the *situs* of the transaction was located within Kerala. The Petitioners were, therefore liable to pay tax under the Act. Further, by not registering as a dealer and by not filing returns under Sections 20 and 40 of the Kerala VAT Act, Petitioners were liable to pay a penalty equal to the value of the transactions conducted.

JUDGMENT

Research Papers

M&A In The Indian Technology Sector

February 19, 2025

Unlocking Capital

February 11, 2025

Fintech

January 28, 2025

Research Articles

Re-Evaluating Press Note 3 Of 2020: Should India’s Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

Key changes to Model Concession Agreements in the Road Sector

January 03, 2025

Audio

Securities Market Regulator’s Continued Quest Against “Unfiltered” Financial Advice

December 18, 2024

Digital Lending - Part 1 - What’s New with NBFC P2Ps

November 19, 2024

Renewable Roadmap: Budget 2024 and Beyond - Part I

August 26, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Arbitration Amendment Bill 2024: A Few Suggestions | Legally Speaking With Tarun Nangia | NewsX

February 12, 2025

The Court quashed the Notices and VAT Demand concluding that Tax Authorities had failed to establish the fact of intra-state sale. The Court noted that in the absence of a clear finding on whether sales were made in the course of intra-state trade, it was not permissible for Tax Authorities to levy tax on sales disclosed. Relying on various Supreme Court judgments⁴, the Court held that *situs* of a sale was not relevant for determining whether the sale was an inter-state sale or intra-state sale. Tax Authorities also failed to consider the objection that Flipkart was not engaged in sale of goods and that sellers on its portal were responsible for the same.

The Court noted that Flipkart's contention that sellers registered on its websites had disclosed sales and made payment under Central Sales Tax Act, 1956 ("**CST Act**") was not dealt with at all by Tax Authorities.

The Court concluded that the failure of Tax Authorities to satisfactorily deal with objections of Petitioners was an arbitrary action and reflected 'patent non-application of mind'. The Court went on to observe that when show cause notices are issued, allegations in the show cause notice should not pre-judge facts and should not make presumptions and conclusions. Show cause notices should be used to elicit the facts and hence, it should not draw conclusions. The judgment also reiterates the importance of 'reasons' in quasi-judicial orders – a principle that has been reiterated since the ruling of the Supreme Court of India in *Maneka Gandhi v. Union of India*.⁵

ANALYSIS

This judgment would come as a measure of respite for websites operating as online marketplaces and also those effecting sales in the course of inter-state trade. News reports suggest that tax authorities in various states are contemplating some action against e-commerce websites. The observations of the Court in the present case are of significant importance and will aid e-commerce companies.

Tax Authorities would also do well to consider the ruling of the Supreme Court of India in *Ashok Leyland* case where the court considered action under CST Act and a state tax law – the court in that case observed that taxability under a statute would be subject to determination of the nature of the transaction. Specifically, the court held that once situs of sale was determined by a statute, State Legislature would be denuded of its powers.⁶ While balancing legislative powers of Central and State Legislatures, it is also important to bear in mind the constitutional scheme of legislative powers, as was enunciated by the court in *State of Madras v. Gannon Dunkerley & Co.*⁷

Non-taxation of e-commerce sites has been a bone of contention⁸, however, it can only be levied and collected with the authority of law. The proposal of the Karnataka government to levy value added tax at 1% as tax deducted at source has also been a cause for concern for e-commerce websites operating on marketplace model.⁹ It is therefore important for tax authorities throughout India to consider the legal principles regarding taxation of e-commerce transactions before making aggressive demands.

News reports that suggest government is likely to evolve a policy for taxation of e-commerce transactions are therefore a welcome development.¹⁰ Till such time, the observations of the Court with regard to the tenor and observations of show cause notices and penalty demands are welcome and extremely relevant. When states are seeking to promote themselves as destinations for doing business in India, it is hoped that tax authorities across India will keep these observations in mind, to truly ease doing business in India.

– Mithun Verghis, M.S. Ananth & Pratibha Jain

You can direct your queries or comments to the authors

¹ Writ Petition (C) 5348 & 6916 of 2015, Decided on October 13, 2015

² See for instance, *Amazon's Karnataka tax issues likely to escalate*, Business Standard, December 5, 2014, available at http://www.business-standard.com/article/companies/amazon-s-tax-problems-in-karnataka-may-escalate-114120400259_1.html, *E-Commerce Portals Face The Heat*, The Pioneer, October 31, 2015, available at <http://www.dailypioneer.com/city/e-commerce-portals-face-the-heat.html>.

³ *Top e-commerce firms Flipkart, Amazon, Snapdeal shun UP, Uttarakhand post tax hassles*, Economic Times, October 23, 2015, available at <http://economictimes.indiatimes.com/industry/services/retail/top-e-commerce-firms-flipkart-amazon-snapdeal-shun-up-uttarakhand-post-tax-hassles/articleshow/49497979.cms>.

⁴ *Union of India v. KG Khosla* (1979) 2 SCC 242. However, this principle was reiterated in *Ashok Leyland Ltd. v. State of Tamil Nadu & Anr.* (2004) 3 SCC 1.

⁵ (1978) 1 SCC 278.

⁶ *Ashok Leyland* at p. 36.

⁷ AIR 1958 SC 560

⁸ Non-imposition of tax is a beneficial treatment, M.S. Ananth, Business Standard, August 10, 2014, available at http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Articles/Non-imposition_of_tax_is_a_beneficial_treatment.pdf.

⁹ http://articles.economictimes.indiatimes.com/2015-10-08/news/67999208_1_amazon-india-levy-tax-net last accessed on November 05, 2015

¹⁰ Government likely to clarify confusion over tax norms for e-commerce companies, Economic Times, November 9, 2015, available at http://economictimes.indiatimes.com/news/economy/policy/government-likely-to-clarify-confusion-over-tax-norms-for-e-commerce-companies/articleshow/49717471.cms?utm_source=contentofinterest&utm_medium=text&utm_campaign=cppst.

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.