March 2015

# TAX UPDATES

(containing recent case laws, notifications, circulars)

Prepared in association with

# Foreword

I am pleased to enclose the March 2015 issue of FICCI's Tax Updates. This contains recent case laws, circulars and notifications pertaining to direct and indirect taxes.

FICCI's Post-Budget National Executive Committee Meeting was held on March 4, 2015, wherein the Union Budget 2015-2016 was discussed in separate sessions with the Chief Economic Adviser, Revenue Secretary and other senior officials of the Finance Ministry, and with Mr. Jayant Sinha, Minister of State for Finance.

An Interactive Session on Union Budget 2015-16 was held on March 5, 2015, at Federation House. The session entailed discussions on the key provisions of the Finance Bill, 2015 and the relevant notifications to help the participants in understanding the implications of the changes in the Income Tax, Customs, Central Excise and Service Tax laws and procedures. Joint Secretaries from Tax Research Unit (TRU), Central Board of Excise & Customs and Tax Policy and Legislation (TPL), Central Board of Direct Taxes, in the Ministry of Finance clarified the doubts of the participants.

FICCI would be submitting its inputs / suggestions on the tax proposals in the Union Budget 2015-16, in the form of a Memorandum by March 24, 2015. You may send your suggestions to Mr J K Batra at jitendra.batra@ficci.com at the earliest. FICCI's analysis of the Union Budget can be accessed at http://www.ficci.com/SEdocument/20323/Union-Budget-Analysis-2015-16.pdf

On the Taxation regime, in the case of DIT v. GE Packaged Power Inc. the Delhi High Court held that Interest under Section 234B for non-payment of advance tax is not leviable on the payees since the primary liability of deducting tax was on the payer. The payers were obliged to determine whether the taxpayers were liable to tax under Section 195(1) the Act, and to what extent, by taking recourse to the mechanism provided in Section 195(2) of the Act

In an important decision the Customs, Excise and Service Tax Appellate Tribunal has observed that CENVAT credit is available on acquired technical knowhow despite delays in initializing production activity. It observed that technical knowhow once obtained, begins to be utilized right from the time of necessary setting up required for manufacturing the product and held that CENVAT credit was eligible on technical knowhow in such cases.

We do hope that this newsletter keeps you updated on the latest tax developments.

We would welcome any suggestions to improve the content and the presentation of this publication.

A. Didar Singh

# Recent Case laws

## I. Direct Tax

## High Court Decision

### The Uttarakhand High Court quashed writ petition challenging declaration of Cyprus as notified jurisdictional Area

The government had specified 'Cyprus' as notified jurisdictional area' for the purposes of the Section 94A of the Income-tax Act, 1961 (the Act) by issuing a Notification 86/2013, as it was not providing information sought for by Indian tax authorities. The writ petition was filed seeking the quashing of notification on the grounds that 'Cyprus' ought not to have been declared as notified jurisdictional area as they had never denied any information and they had been ready and willing to supply the information sought for by the Indian government. The High Court denied quashing of the said notification and observed as follows:

- Bare perusal of the Notification would reveal that Cyprus has not been providing the information as requested by the Indian Authorities under the provisions of Exchange of Information Agreement, therefore, the Government of India has decided to notify Cyprus as notified jurisdictional area under Section 94A of the Act.

- While exercising the writ jurisdiction under Article 226 of the Constitution of India, this Court ordinarily should not proceed to look into to whether information sought by the Indian Authorities were ever declined by the Government of Cyprus or if the Government of Cyprus is ready and willing to supply the information sought by the Indian Authorities.

- Moreover, there seems to be no valid reason to disbelieve the satisfaction so recorded by the Indian Authorities.

- Accordingly, said petition was quashed.

*Expro Gulf Limited v. Union of India and others [Writ Petition No. 2871 of 2014 (M/S]*

### Interest under Section 234B is not leviable on the payees since the primary liability of deducting tax was on the payer

General Electric group was manufacturing equipment relating to oil and gas, etc. for supply to customers in India. After a survey under Section 133A of the Act at the premises of General Electric International Operations Company Inc. (GEIOC), the liaison office, reassessment proceedings were initiated against several entities of the GE group. Eight entities of the GE group (taxpayers), had filed nil return of income during the relevant years. The Assessing Officer (AO) held that the taxpayers had Permanent Establishment (PE) in India. The taxable income of the taxpayers was computed by attributing some percentage of the consideration received as profits to the PE and interest under Sections 234A and 234B of the Act was also levied.

The tax department relied on the decision in the case of DIT v. Alcatel Lucent USA Inc. [2014] 45 taxmann.com 422 (Delhi), where it was held that interest could be imposed on an foreign company which denies tax



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liability, for non-payment of advance tax, because there exists a presumption that the taxpayer had represented to the Indian payer that tax should not be deducted from the remittances made to it.

The High Court held that the view taken in Alcatel Lucent cannot be applied to this case because if the payer deducts tax at source only when the taxpayer admits tax liability, then deductions would not be made in cases where the taxpayer either falsely or under a bona fide mistake denies tax liability. Tax obligations cannot be founded on assertions of interested parties. The High Court followed the judgment in the case of Director of Income-tax v. Jacabs Civil Incorporated/Mitsubishi Corporation [2010] 194 TAXMAN 495 (Delhi) and held that the obligation of the payer to deduct tax is absolute.

Accordingly, the primary liability of deducting tax (for the period concerned, since the law has undergone a change after the Finance Act, 2012) is that of the payer. The anomaly of a taxpayer denying tax liability (whether under a bona fide mistake or by deceit), thereby not suffering TDS, and still being permitted a tax credit for the tax deductible, is remedied after the Finance Act, 2012. In the present case, the payer would be an assessee in default, on failure to discharge the obligation to deduct tax, under Section 201 of the Act. The High Court held that no interest is leviable on the taxpayers under Section 234B, even though they had filed returns declaring nil income at the stage of reassessment. The payers were obliged to determine whether the taxpayers were liable to tax under Section 195(1) the Act, and to what extent, by taking recourse to the mechanism provided in Section 195(2) of the Act. The failure of the payer to do so does not leave the tax department without remedy; the payer may be regarded an 'assessee-in default' under Section 201 of the Act, and the consequences delineated in that provision will visit the payer.

*DIT v. GE Packaged Power Inc. [ITA 352-391/2014, ITA 402/2014, dated 12 January 2015]*

## Engineering specifications, inspection of the final product, etc. of the plant in the 100 per cent EOU qualify as manufacture or production of goods and therefore, the taxpayer is entitled to benefit under Section 10B of the Act

The taxpayer is a company engaged in the business of manufacture, trading and export of engineering goods, etc. and also has a 100 per cent Export Oriented Unit (EOU) located in an Export Processing Zone. In the relevant year, the taxpayer claimed exemption/deduction under Section 10B on profit from the Unit. The AO, however, held the taxpayer himself did not manufacture any goods but had removed various parts after testing and disassemble them for the purpose of export. Testing, painting or prepackaging for export cannot be construed as manufacture or assembling activity. Accordingly, the AO did not allow deduction under Section 10B of the Act.

The Delhi High Court observed that a reading of the Section 10B of the Act indicates that it is a beneficial provision and has been enacted to give tax concession to 100 per cent export oriented units engaged in production of articles, things or computer software. Further, the taxpayer had carried out detailed engineering analysis of system design, equipment specifications and

development and preparation of engineering drawings and thereafter, approval was taken from the client. At the next stage, the taxpayer issued technical specification and drawings for production, which was outsourced to vendors. During the course of production by the third parties vendors, process inspection and final inspection was undertaken and after approval, the goods were dispatched from the vendor's factory to the taxpayer. The goods were then examined at the Unit and approved, and the taxpayer had also undertaken in-house fabrication. Subsequently, the goods were exported from India and erected at the site, tested and then commissioned.

The High Court observed that it is apparent that the taxpayer did not self-manufacture most of the articles which were exported and used for setting up the plant. However, in Section 10B of the Act, the word 'production' has been used in addition to the word 'manufacture', and also an expanded scope and ambit is envisaged for the said term in the context in Explanation 4 of Section 10B of the Act. The tax department had also accepted that in case the plants installed outside India have been completely assembled in the Unit and exported as such, the taxpayer would qualify and would be a manufacturer or a person engaged in production of articles or things. However, the benefit under Section 10B of the Act, as asserted by the tax department, should be denied for what was exported were separated or disassembled parts of the plant. The said fabrication and assembly had to be undertaken in view of size and logistics at the location where the plants had to be upgraded or set up. The reasoning of the tax department is not acceptable since it deflates the object and purpose of Section 10B of the Act. Export of goods and things can take various forms and Section 10B accepts and admits such interpretation.

Accordingly, the aforesaid activities qualify as manufacture or production of goods by the taxpayer himself and therefore, the taxpayer is entitled to benefit under Section 10B of the Act.

*CIT v. AAR ESS EXIM PVT. LTD. (ITA No. 551/2013 and 553/2013, dated 5 February 2015)*

# Tribunal Decisions

## The consideration for the grant of permission to use or right to use intellectual property rights is taxable as royalty

HCL Infosystems Limited (HCL), made certain lump sum payments to M/s Apollo Domain Computers, West Germany (ADC), under 'Technology Transfer and Technical Assistance Agreement' (the agreement). The Assessing Officer (AO) was of opinion that this payment constituted Royalty under the India-Germany tax treaty. The Tribunal accepted the AO order.

The Delhi High Court held that the term 'royalty' under the India-Germany tax treaty represents consideration received by a person, who is the owner of the intangible intellectual property rights or know-how for permitting a third person to use or the right to use, the said rights or know-how. In case payment is made for acquisition of a partial right in the intangible property or know-how without the transferor fully alienating as the ownership rights, the payment received would be treated as 'royalty'. Where, however, full ownership rights are

alienated as intellectual property of the transferee, the payment made is not royalty, but sale consideration paid for acquisition of the intangible rights.

As per the agreement, ADC was to provide, on mutually agreeable terms, marketing, sales and technical support, and training to HCL to develop local system builders and software programmes and equipment i.e. the hardware. HCL was granted and conveyed, non-exclusive right to manufacture, maintain, use and sell the licensed products in India in accordance with and pursuant to use of the technology. The rights granted to HCL by ADC were restricted to specified and listed licensed property. ADC had the absolute rights in its own discretion to discontinue and eliminate manufacture, use of, sale or otherwise stop business in respect of licensed products at any time during the term of the agreement.

Under the agreement, there was no full transfer of ownership of technology. The proprietorship or ownership rights continued to vest with ADC, but right to use the trade name, technology, etc. was granted by ADC to HCL. There was no transfer of the ownership of intellectual property rights. Mode and manner is not determinative, but nature and character of the right acquired are definitive and decisive criteria.

The agreement in the present case is of the tenure of five years unless it is terminated earlier, but the confidentiality obligation subsists and would be applicable even subsequently. The period of five years would necessarily have reference to the commercial life of the intellectual property rights for which permission or right was granted. It has been held in various decisions that intellectual property rights in scientific processes, technology, etc. have limited time scale benefit and have invariably a short life span, due to rapid progress and advancement in such fields.

Accordingly, it was held that there was a grant of permission to use or right to use intellectual property rights or knowhow and it is not a case of outright sale and therefore, the consideration is taxable as royalty under the tax treaty.

*HCL Limited v. CIT (ITA No. 93/2002 and 120/2008, dated 3 February 2015)*

## Section 50C of the Act is not applicable to transfer of leasehold rights in land

During the Assessment Year (AY) 2006-07, the taxpayer transferred factory land, building and a shed in the Pimpri industrial area in favour of Rishap Industries Pvt. Ltd. In terms of the said transfer, the taxpayer received consideration of INR31.20 million for land and building, and INR4.80 million for other fixed assets. Out of the consideration of INR31.20 million for land and building, the taxpayer had adopted the value of consideration for building at INR7.7 million and for the transfer of land at INR23.50 million in its computation of income.

The AO invoked Section 50C of the Act. The taxpayer contended that it was only holding leasehold rights in the land and that it was not the owner of the land so as to attract the provisions of Section 50C of the Act.

The Pune Tribunal held that Section 50C of the Act would apply only to ‘a capital asset, being land or building or both’. There was no dispute about the fact that the expression land by itself cannot include

leasehold right in land. Leasehold right in land is also a capital asset. However, every kind of 'capital asset' is not covered within the scope of Section 50C of the Act for the purposes of ascertaining the full value of consideration.

The heading of the Section itself provides that it is a 'special provision for full value of consideration in certain cases'. Therefore, there is significance to the expression 'a capital asset, being land or building or both' contained in Section 50C of the Act. The significance is that only capital asset being land or building or both are covered within the scope of Section 50C of the Act and not all kinds of capital assets.

The meaning of the term 'immovable property' provided in Section 269UA(d) of the Act has been referred to in Section 2(47) of the Act only in relation to sub-clause (v) and (vi) thereof. On a perusal of the term 'immovable property' provided in Section 269UA(d) of the Act, it can be inferred that even leasehold rights in land is a capital asset. However, the said inference does not justify the inclusion of a transaction involving transfer of leasehold rights in land within the purview of Section 50C of the Act.

Accordingly, the Pune Tribunal held that Section 50C of the Act applies only to capital assets being land or building or both. It does not apply to leasehold rights in the land or building.

*Kancast Pvt. Ltd. v. ITO (ITA No.1265/ PN/2011) (Pune)*

## The Kolkata Tribunal confirms that functional, asset and risk analysis should be given due importance over the business models agreed between the taxpayer and its AEs

The taxpayer is engaged in the business of Information Technology services and avails marketing support services from its Associated Enterprises (AEs), namely ITC Infotech Inc. (USA) (ITC U.S.) and ITC Infotech Limited, U.K. (ITC U.K.) to render such services to the customers.

The AEs of the taxpayer perform only marketing activities and undertake administrative functions i.e. accounting management services for which they share 25 per cent of the total revenue from the customers under an integrated 'Global Delivery Model'. This model stands true for both the arrangements, i.e.:

- Arrangement 1 – when the customer contracts directly with the taxpayer and the taxpayer subcontracts administrative functions to the AEs;

- Arrangement 2 – when the customer contracts with the AEs and the AEs subcontracts work to the taxpayer.

The Transfer Pricing Officer (TPO) proposed adjustments for AY 2005-06 and AY 2006-07 in respect of the contracts directly entered into by the taxpayer with the customers, by altering the revenue sharing model without fully appreciating the functional and risk profile of the taxpayer and its AEs and the global business model followed by them.

Considering that the economic substance underlying the taxpayer's global business model including the functional and risk profile of the taxpayer vis-à-vis its AEs remain the same under both the above arrangements, the Commissioner of Income-tax (Appeals) [CIT(A)] deleted the

adjustments made by the TPO for both the years in relation to payment of accounting management charges.

The Kolkata Tribunal observed that the taxpayer performed non-administrative i.e. IT services under both the business models, and thus entire risks with regard to non-administrative services were being borne by the taxpayer irrespective of the business model and that the activities/ services in connection with development of the assignment/project would be essentially driven by the taxpayer in adherence with various commercial and technical qualification parameters.

Further, the Tribunal observed that under both the business models, the essential factor for awarding a service contract by the customer would always be technical and commercial expertise and experience of the taxpayer in handling such projects. The taxpayer relied on the United Nations Practical Manual on Transfer Pricing for Developing Countries (UN TP Manual) wherein the concepts of allocation of risks and conduct of parties are explained where it provides that it is not only necessary to identify the risks but also to identify who bears such risks; also an analysis of the conduct of parties is critical in order to determine actual allocation of risk. Further, the taxpayer also relied on the Organisation for Economic Co-operation and Development TP Guidelines 2010 (OECD Guidelines) where the same concepts of risk allocation and control are reiterated which provides that there should be consistency between the risks allocated to the party in a controlled transaction and the control exercised by that party to manage those risks.

Relying on the aforesaid OECD Guidelines and UN TP Manual, the Tribunal observed that the conduct of the taxpayer and its AEs should be given due cognizance which is same in both the business models. Whether the agreement was directly executed with the taxpayer or the AE would not create any substantial difference in the sharing of functions or risks between the parties and hence, it would not change the functional characteristic of the parties. Based on the above the Tribunal deleted the adjustment made on payment of accounting management charges.

*DCIT v. ITC Infotech India Limited (ITA No. 2222 & 2223/Kol/2010)*

## The Hyderabad Tribunal deletes royalty adjustment stating that the benefit test approach of the TPO is flawed and the necessity to pay royalty was not challenged by the TPO

The taxpayer is a wholly owned subsidiary of RAK Ceramics PSC, United Arab Emirates and is engaged in the manufacture of vitrified tiles and sanitary ware products which are sold in domestic and export markets. During the AY 2010-11, the taxpayer received technical know-how and assistance for manufacturing products from its AE, for which royalty was paid at 3 per cent on net sales.

The taxpayer aggregated its international transactions (i.e. purchase and resale of raw material, sale of finished goods and payment of royalty) and benchmarked using Transactional Net Margin Method (TNMM) as Most Appropriate Method. The taxpayer had earned a margin of 11.69 per cent, as against the average margin of 4.32 per cent


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earned by comparable companies and considered the transactions to be at arm's length.

Further, as far as payment of royalty is concerned, the taxpayer undertook an alternative analysis adopting the Comparable Uncontrolled Price (CUP) method. The taxpayer selected three comparable companies with an average royalty payment of 3.65 per cent against the taxpayer's royalty rate at 3 per cent to justify the arm's length price (ALP) of royalty paid.

During the course of the assessment, the TPO rejected the analysis towards royalty paid under TNMM on the premise that the taxpayer had used three year data. Further, the alternate analysis under the CUP method was rejected as the comparable companies selected were based out of the United States of America (U.S.) and applied benefit test for royalty payment. The TPO concluded that the taxpayer was unable to establish the benefit test towards receipt of technology and allowed royalty payment of 2 per cent as against 3 per cent claimed by the taxpayer. The Dispute Resolution Panel (DRP) upheld the finding of the TPO.

The Tribunal held that it is an accepted principle of law that the TPO has to determine the ALP by adopting one of the methods prescribed under Section 92C of the Act. Further, the TPO did not provide a single comparable company to justify the ALP of royalty at 2 per cent either under CUP or TNMM. While rejecting the approach of the TPO, the Tribunal relied on the finding of the Mumbai Tribunal in case of Castrol India Ltd. v. ACIT [ITA No. 1292/Mum/2007] on an identical issue of determination of ALP as nil by applying benefit test wherein it was held that the TPO has not dismissed the method adopted by the taxpayer or followed any of the identified method to benchmark the royalty paid from an arm's length perspective, and thereby deleted the TP adjustment.

The Tribunal observed that the adoption of royalty at 2 per cent is neither on the basis of any approved method nor on any reasonable basis. The approach of the TPO in estimating royalty at 2 per cent by applying the benefit test is in complete violation of TP provisions and against the principles of law.

Further, the Tribunal observed that the DRP has approached the entire issue in a rather mechanical manner without examining whether the approach of the TPO is in accordance with the statutory mandate. The Tribunal held that determination of ALP of royalty at 2 per cent cannot be sustained and also dismissed the theory of the benefit test, since the TPO did not question the necessity of paying royalty but only objected to the quantum. The Tribunal held that the increase in sale with no apparent increase in production, minimal product recalls and low after sales maintenance cost, certainly proved that these were possible due to utilization of advanced technical know-how transferred by the AE.

Thus, based on the above the Tribunal deleted the adjustment made on royalty payment.

*DCIT vs. R.A.K. Ceramics India Pvt. Ltd. (ITA No. 1492/Hyd/2014)*

# Notification & Circulars

## Standard Operating Procedure for prosecution in cases of TDS/TCS default

All cases where tax is deducted at source (TDS)/tax is collected at source (TCS) but not deposited within the due date, as prescribed, are punishable under Section 276B, 276BB or 278A of the Act. The selection of cases and their processing is governed by Instruction F.No. 285/90/2008, dated 24 April 2008 which has been modified by the CBDT vide F.No.285/90/2013, dated 7 February 2013. Presently, the monetary limit specified for cases to be considered for prosecution is as under:

- Cases, where amount of tax deducted is INR100,000 or more and the same is not deposited by the due date, shall mandatorily be processed for prosecution in addition to the recovery.

- Cases, where the tax deducted is between INR25,000 and INR 100,000 and the same is not deposited by the due date, may be processed for prosecution depending upon the facts and circumstances of the case, like where there are instances of repeated defaults and/or tax has not been deposited till detection.

In this relation, the Central Board of Direct Taxes (CBDT) has issued the 'Standard Operating Procedure' (SOP), whose highlights are listed below:

- Identification of cases

    - Centralised Processing Cell – TDS/ TDS Reconciliation Analysis and Correction Enabling System (CPC-TDS/TRACES) will generate a list of prosecutable cases for mandatory processing for prosecution (List-A) in accordance with the criteria laid down by the CBDT vide its instruction dated 7 February 2013 or any other modified criteria. Such identification shall be done within one month of filing the quarterly TDS statement.

- Procedure for launching prosecution

    - After identification of potential cases for prosecution by the CPC – TDS in case of mandatory processing or otherwise, it should be entered in the 'Prosecution register' and to be reported to the CIT(TDS).

    - The AO(TDS) after collecting the above information/documents shall issue show cause notices to the person responsible for deduction within 45 days of receipt of the list of prosecutable cases from CPC-TDS.

    - It may be ensured that the reply is furnished within 30 days of the issue of the show cause notice.

    - The assessee deductor can at any stage of the proceedings, file a compounding application before the Pr. Chief Commissioner of Income-tax/Chief Commissioner of Income-tax. If a person who has committed an offence(s) under Section 276B/276BB of the Act files an application for compounding of the said offence(s), the application should be processed on priority basis and mandatorily be disposed-off within the time frame as prescribed by the Central Action Plan guidelines. During the pendency of the compounding application, the CIT(TDS) shall keep the prosecution proposal pending.


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- If any such prosecutable offence comes to light during the proceedings before the appellate authorities, revision authorities or any other proceedings, same shall also be treated at par with other prosecutable cases as enumerated under Chapter-XVII of the Act (i.e. collection and recovery of taxes) and action shall be initiated in accordance with procedure vide this SOP.

- Time Frame

  - The time period for the entire process from identification to passing of order under Section 279(1)/279(2) of the Act has been prescribed.

- SOPs defining the roles of different TDS authorities in addressing the issue of prosecution and compounding of TDS cases have been specified.

*Source: www.taxsutra.com*

## BEPS Action Plan 13 – Guidance on implementation of Transfer Pricing Documentation and country-by-country reporting

The OECD had issued guidance in September 2014 recommending three-tier documentation structure i.e. Master file, Local file and Country-by-Country (CbC) Report for the group's inter-company transactions of Multinational Enterprises (MNEs).

The OECD has now issued Guidance relating to implementation of CbC Report (the Guidance). It has been recommended that the master file and local file documentation standards will be implemented by all countries in their local country legislations and will be required to be filed directly with the tax-authorities by group entities of each countries jurisdiction.

The Guidance issued by the OECD only covers the following important aspects of CbC Reporting.

**Key recommendations:**

- **First CbC Report:** The MNEs shall be required to file the first CbC reports for fiscal years beginning on or after 1 January 2016, within a deadline of one year from the end of the fiscal year for which the CbC report relates to i.e. by 31 December 2017.

- **Which companies shall be required to file CbC report:** The Guidance recommends that all MNE group parent entities would be required to file the CbC Report each year except the companies with annual consolidated group revenue of less than Euro 750 million in the immediately preceding fiscal year.

**Necessary conditions for obtaining and using the CbC Report:**

***Confidentiality***

The Guidance recommends that each jurisdiction should incorporate and enforce legal protections for the confidentiality of the reported information.

***Consistency***

It is proposed in the Guidance that, no jurisdiction shall exempt the MNE Group's parent entity which is a resident from CbC reporting except as recommended in this Guidance. Further, the Guidance insists that, there should be no modifications in the information requested as per the standard template i.e. Annexure III of the

OECDs September Report on TP documentation.

***Appropriate use***

The Guidance advocates the commitment from jurisdictions to appropriately use the CbC Report only for the limited 8 purpose of assessing high-level transfer pricing risk and other BEPS related risk and not to propose Transfer Pricing adjustments on the basis of income allocation formula. However, the Guidance does not restrict or limit the Revenue Authorities from making further enquiries based on information in the CbC Report.

**Framework for government-to-government mechanisms to exchange CbC Reports and implementation package**

***Framework***

The Guidance requires each jurisdiction, to ensure CbC reporting by the resident's ultimate parent entity of the MNE Group and exchange this information with the jurisdictions in which the MNE Groups operate. In case a country fails to provide information to another country on the CbC reporting, a secondary mechanism would be considered as appropriate, through local filing or by moving the obligation of CbC reporting and automatically exchanging these reports to the next tier parent country.

***Implementation package***

Countries participating in the OECD/G20 BEPS Project have agreed to develop a work-plan for exchange mechanisms of CbC Reports between governments which focus primarily on the following:

- To develop the key elements of domestic legislation requiring the ultimate parent entity of an MNE group to file the CbC Report in its country of residence and the key elements of secondary mechanisms.

- To implement arrangements for the automatic exchange of the CbC Reports under international agreements (both bilateral and multilateral) incorporating the conditions set out above.

- To develop a comprehensive implementation package for CbC reporting by April 2015.

*Guidance on implementation of Transfer Pricing Documentation and country-by-country reporting issued by the OECD on 6 February 2015*

# II. SERVICE TAX

## Tribunal Decisions

### CENVAT Credit available on acquired technical knowhow despite delays in initializing production activity

The taxpayer acquired technical know-how for the purpose of manufacturing pharmaceuticals. The payment for acquiring such technical knowhow was discharged in entirety and CENVAT Credit on the same was availed, however the production activity was not started by the taxpayer. The Revenue Authorities ("RA") disputed the availment of CENVAT Credit on such technical know-how on the ground that know-how was a 'ready to use' service and non-initialization of the production activity within a reasonable period of time (4 years in the present case) would render such credit inadmissible. The Commissioner (Appeals) also denied such credit on this ground and held that the same may be available when the production process is started and know-how is utilized.

The Customs, Excise and Service Tax Appellate Tribunal ("CESTAT") observed that technical know-how once obtained, begins to be utilized right from the time of necessary setting-up required for manufacturing the product. The CESTAT drew an analogy with a factory and observed that the time lag in setting up of a factory and actual production can be quite long, and the Commissioner (Appeals) has failed to lay down the yardstick for determining what should be a reasonable period for starting production. The CESTAT placed reliance on the CESTAT ruling in the case of Cadila Health Care Ltd. vs CCE [2010 (17) STR (Tribunal)], and held that CENVAT Credit was eligible on technical know-how.

*Indswift Laboratories Ltd vs Commissioner of Central Excise & Service Tax, Chandigarh – II [Appeal No.ST/52950/2014-CU[DB], CESTAT New Delhi]*

### When proportionate credit is already reversed but without intimation, enforcing Rule 6(3A) of the Credit Rules is not warranted

The taxpayer availed credit on input services used for providing both taxable and exempt services and reversed proportionate credit in terms of Rule 6(3)(ii) of the Credit Rules at the end of the year. However, the taxpayer neither filed any intimation before adopting the said method as required in terms of Rule 6(3A) of the Credit Rules, nor the duty was reversed provisionally every month. The RA denied the benefit of proportionate reversal of credit to the taxpayer since the conditions prescribed under Rule 6(3A) were not met and demanded service tax, based on an amount equivalent to 8%/ 6% of the value of exempt service.

The CESTAT held that the amount reversed by the taxpayer has not been disputed by the RA and therefore it would be too harsh to raise an additional demand on the taxpayer only on account of non-compliance of procedural requirement as per Rule 6(3A). Further, it was held that since the taxpayer has reversed the proportionate credit, the intent to evade payment is not established and no penalty can be imposed.

*M/s Rathi Daga vs Commissioner of Central Excise, Nashik [Appeal No. ST/03/12, CESTAT Mumbai]*

## Service tax is not applicable on free service of cars provided by dealerships to car buyers

The taxpayer operated an authorized service station for cars manufactured by Maruti Udyog Limited ("MUL"). The taxpayer provided free services to its customers i.e. car buyers that purchased cars manufactured by MUL. The taxpayer engaged drivers for providing servicing to its customers through mobile-vans. The salaries payable to such drivers was reimbursed to the taxpayer by MUL. The RA sought to levy service tax on such salary reimbursements on the ground that the amount constituted consideration for free services provided by the taxpayer to the car buyers.

The CESTAT observed that provision of free service to customers was part of the function and duties of the taxpayer, who are entitled to dealership commission and that the recipient of such free services was the customer of the taxpayer and not MUL. The CESTAT held that the amount reimbursed to the taxpayer for salary of drivers is not liable to service tax for provision of authorized service station services.

*Commissioner of Central Excise, Indore vs Jabalpur Motors Limited [Final Order No. ST/A/52771/2014-CU(DB), CESTAT New Delhi)*

## Service tax paid on services wholly consumed within Special Economic Zone ("SEZ") can be claimed as refund; claim of upfront exemption not mandatory

The taxpayer, an SEZ unit, received certain services from a service provider situated outside the SEZ and paid service tax thereon. The taxpayer claimed refund of the service tax paid which was also granted by the adjudicating authorities. The RA contended that the services received by the taxpayer were wholly consumed within SEZ and were eligible for upfront exemption and therefore, the grant of refund by the adjudicating authorities was erroneous.

The CESTAT observed that the SEZ Act, 2005 provides that all services imported into an SEZ to carry on authorized operations shall be exempt from service tax and that SEZ Act has an overriding effect as prescribed under section 51 of the SEZ Act. The CESTAT referred to the ruling in the case of Intas Pharma Ltd vs Commissioner of Service Tax Ahmedabad [2012 (32) STR 543 (Tri-Ahmd.) and held that refund cannot be denied for procedural infraction of having paid the Service Tax which ought not to have been paid by the Service provider.

*Eon Kharadi Infrastructure Private Limited vs Commissioner of Central Excise, Pune – III [Appeal No. ST/20012012-Mum, CESTAT Mumbai]*

## Provision of technical knowhow is not taxable under the category of 'consulting engineer services'; service tax cannot be demanded from the overseas service provider who does not have an establishment in India

The taxpayer is a company incorporated and operating from USA. During the Financial Year ("FY") 2003-04, the taxpayer provided technical know-how to an Indian company for manufacturing bearings and also for up-gradation of technology for better quality of products. As consideration, the taxpayer received royalty from the Indian company. The RA demanded service tax from the taxpayer, in response to which the taxpayer submitted that the liability to pay service tax falls on the service recipient located in India and not on the taxpayer (which is a company located abroad not having any branch or establishment in India and which had provided the services from abroad). However, the plea of the taxpayer was not accepted by the RA.

The CESTAT held that the service provided by the taxpayer was in the nature of transfer of technology for manufacture of products, that such services are in the nature of 'Intellectual property services' and not 'consulting engineering services' and that intellectual property services were not taxable during the period in dispute. Further, relying on the decisions of Mumbai CESTAT in the cases of Philcorp Pte Ltd v CCE, Goa [2007 (7) STR 266 (Tribunal-Mumbai)] and Relax Safety Industries & Others v CC, Mumbai [2002 (53) RLT 1100 (CEGAT-Mumbai)] the CESTAT held that service tax, if any, could be demanded only from the service recipient on a reverse charge basis and not from the taxpayer who did not have any branch / establishment in India,.

*Commissioner of Central Excise, Jaipur - I vs Brenco Incorporated [Final Order No ST/A/52765/2014-CU(DB), CESTAT New Delhi)*

# III. VAT/ CST/Entry Tax

## Supreme Court Decisions

### Supreme Court ("SC") upholds imposition of sales tax on the goods involved in processing and supplying of photographs, photo prints and photonegatives

The taxpayer challenged the constitutional validity of Entry 25 of Schedule VI of Karnataka Sales Tax Act, 1957 ("KST Act"), which was introduced to levy of VAT on works contract in nature of processing and supplying of photographs, photo prints and photo negatives, with retrospective effect from July 01, 1989. The taxpayer also sought to challenge retrospective application of said entry as being violative of Article 265 of the Constitution of India.

After delving into the legislative history of works contract amendments and plethora of landmark judicial decisions on the issue, the SC observed that post insertion of clause 29A in Article 366 of the Constitution of India, works contract (which was indivisible) could be bifurcated into two contracts, one for sale of goods and other for provision of service. Thus sales tax could be levied on the goods component of a works contract. Further, it was also observed that in case of transactions covered under Article 366(29A) of Constitution of India, the dominant nature test cannot be applied to determine the nature of the transaction.

In view of these observations, the SC held that entry 25 of Schedule VI of the KST Act imposing VAT on processing and supplying of photographs, photo prints and photonegatives is constitutionally valid. With respect to retrospective application of aforesaid entry, the SC held that the legislature has powers to introduce a retrospective amendment and that the same cannot be challenged.

*State of Karnataka vs M/s Pro Lab & Others [Civil Appeal No. 1145 OF 2006, SC)*

# High Court Decisions

### 'Work Station' for a software developer is an accessory for manufacturing/ processing of goods and not a 'furniture'; ITC is not restricted under Karnataka VAT

The taxpayer was engaged in the business of development and sale of computer software, and provision of technical consultancy services. The taxpayer purchased work stations and availed input tax credit ("ITC") on the same. The RA sought to disallow such ITC on the ground that work stations qualified as 'furniture' on which ITC was specifically restricted under Schedule 5 of the Karnataka Value Added Tax, 2003 ("KVAT Act"). As per the KVAT Act, the only exception to the aforesaid rule was when the restricted goods were used for resale or further manufacturing process.

The High Court ("HC") observed that in the absence of a definition of 'furniture' under the KVAT Act, the term has to be interpreted in the common parlance, without imposing a scientific or technical meaning. The HC further observed that a 'work station' designed for scientific or engineering applications and used to sit and operate a computer with all accessories cannot be interpreted to be a generic piece of furniture like chairs, table, etc, Thus the HC held that a 'workstation' is an accessory for use in the manufacture or processing of goods for sale on which ITC was available without restriction.

*State of Karnataka vs M/s Infosys Technologies Limited [STRP NOS.7/2011 & 64-69/2011 & 113-121/11 & STRP 103/11 & 217-236/2011, Karnataka HC)*

### In case of turnkey contracts, the State where the contract is executed is not competent to levy tax on inter-state procurements and imports

The taxpayer was awarded a contract under International Competitive Bidding for supply and installation of a turnkey project by its client. The taxpayer entered into three different contracts with its client wherein the first contract was for import of plant and machinery, second was inter-state / intra-state procurement of plant and machinery and third was for provision of service in the turnkey contract. The taxpayer paid applicable taxes on import, inter-state and intra-state procurements of plant and machinery and service tax on services rendered during the execution of contract.

The RA sought to levy VAT on supplies made under the contract by way of import and inter-state procurement on the basis that the taxpayer executed a composite contract in the State of West Bengal.

The Calcutta HC observed that after forty-sixth amendment in the Constitution, works contract is capable of being bifurcated into a supply contract and a service contract. It was also observed that it is not a universal rule that if the works contract is on the turn key basis, it cannot be segregated and taxed separately. The HC held that whether a turnkey contract can be segregated or not would depend on language of contracts and the intention of the parties entering into such contract.

The HC observed that the RA had not examined the true nature of the transaction and simply proceeded on the fact that the contracts are on a turnkey basis and partakes the character of invisible and inseparable works contract exigible to the sales tax. The HC remanded the matter back to the RA to re-consider the issue in light of the observations of HC.

*Reliance Infrastructure Ltd & Anr vs Deputy Commissioner, Sales Tax & Anr [Writ Petition No. 24939 (W) of 2012 with CAN 10009 of 2014, Calcutta HC]*

## Permitting subsidiaries to use the brand name of the parent amounts to transfer of right to use goods

The taxpayer is the principal or holding company in the group of companies mainly referred to as TATA companies and collectively belonging to House of 'TATA'. With a view to systematically enhance the brand equity and legally protect the word TATA, the taxpayer entered into TATA Brand Equity and Business Promotion Agreement ("Brand Agreement") with the subsidiary companies. The said agreement provided for guidelines for use of the 'TATA' name in the course of business by the subsidiary companies.

The RA alleged that allowing the subsidiary companies to use the brand name is liable to tax under the Maharashtra Sales Tax on the Transfer of Right to use any Goods for any Purpose Act, 1985 ("TRUG Act) and accordingly demand was raised on the taxpayer. The demand raised was further upheld by the first and second level appellate authorities.

In the appeal before the HC, the taxpayer contended that the Brand Agreement has been executed to protect the brand / equity by disallowing abuse or misuse, by placing certain constraints on the use of the same. Thus, no transfer of right to use trademark and name was involved. Also, tax under the TRUG Act is leviable on exclusive transfer of right to use any goods and not on conditional transfer.

The HC held that the transaction between the taxpayer and the subscribers of the Brand Agreement envisage that there is a transfer of right to use goods and observed as follows:

- The TRUG Act nowhere restricts the levy of tax on exclusive transfer of right to use goods only. Even conditional transfer of right to use goods would come under the ambit of the said act; and

- The decision in the case of BSNL is not applicable to the facts and circumstances in the case of the taxpayer. Further, the decision in the case of Duke Sons Private Limited is not bad in law since it has been



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consistently applied subsequent to the BSNL decision.

*Tata Sons Limited vs State of Maharashtra [Writ Petition No.2818 OF 2012, Bombay HC)*

### Multifunction network printers qualify as computer peripherals

The taxpayer claimed that image runner i.e. multifunctional printers ("MFP") sold by them fall under the entry covering *'computers… and its peripherals…'*, thereby attracting VAT at rate of 4 percent. The taxpayer contended that the predominant function of the Image Runner printer is printing documents. The RA contended that there was no specific entry which covered MFP and thus the VAT rate applicable is 12 percent. The contention of the RA was upheld by the CESTAT stating that hold that the functions of Image Runner, such as xerox and photo copying, fax machine are clearly mentioned in Part D Entry 14(iv).

The Madras HC referred to the decision of the SC in the case of Xerox India Limited [2010 (260) ELT 161 (SC)], wherein it was held that MLP serves as input and output of computer and would be covered under tariff heading 8471 60 which covers *'Printers in Automatic Inter Processing Machine (ADD)'* instead of classifying it under others category. Further, while deciding the matter the SC laid emphasis on the predominant use of the instrument. The HC observed that MFP is an input output device that works in conjunction with the computer and also has got scanning facility for the very same function of input and output device and therefore, it is clearly a "peripheral" of computers.

*M/s Canon India (P) Ltd vs State of Tamil Nadu [Tax Case (Revision) Nos.94 to 96 of 2014, Madras HC]*

## Tribunal Decisions

### Stock transfer to depots outside the State for further sale to sole distributor is an interstate sale

The taxpayer is a joint venture company engaged in the manufacture and sale of products. The products were sold through a sole distributor, who was also one of the partners to the joint venture company. The taxpayer transferred majority of the manufactured goods to its various branches and depots outside the State for further sale to the sole distributor. The branches / depots of the manufacturer were located adjacent to the depot of the sole distributor. The taxpayer claimed that the movement of goods to its branch / depots were stock transfers and did not pay any tax on such movement. The taxpayer discharged the local VAT on the sale made to its sole distributor from its branch / depot in each State

The RA contended that the movement of goods from factory of taxpayer to its branches / depots is not a stock transfer but inter-state sale of goods to its sole distributor. In order to support its contention, the RA relied on the distributor agreement wherein it was agreed that the sole distributor would periodically place an order on the taxpayer for selling of taxpayer's products throughout India. Accordingly, the



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taxpayer transferred requisite quantity of goods to its branches / depots in each State for further sale to its sole distributor.

The CESTAT observed that although the respective branch of taxpayer had issued the Form F for each movement of goods from factory to its braches/depots, however, the lorry receipts of the goods transported were signed by the sole distributor. Accordingly, the CESTAT held that the movement of pre-identified goods from the taxpayer's factory to various depots / branches was pursuant to the distribution agreement between the taxpayer and the sole distributor and that such transfer was an interstate sale of goods liable to CST.

*M/s Kimberly Clark Lever (P) Ltd vs The State of Maharashtra [VAT Appeal No 59 OF 2011 & VAT APPEAL No 423 of 2013, MSTT Mumbai]*

# IV. CUSTOMS

## High Court Decisions

### Refund of Terminal Excise Duty available in case of supplies made by a Domestic Tariff Area ("DTA") unit to a 100 percent Export Oriented Unit ("EOU")

The taxpayer cleared goods to a 100 percent Export Oriented Unit ("EOU") on payment of central excise duty. The taxpayer sought refund of the excise duty paid, on the ground that the supplies to an EOU qualified as a 'deemed exports' in terms of Para 8.2(b) of the Foreign Trade Policy, 2009-2014 ("FTP") and such supplies to EOU are entitled to terminal excise duty refund. The claim of refund was rejected by the Director General of Foreign Trade ("DGFT") on the ground that supplies to an EOU are eligible for exemption from payment of terminal excise duty, subject to CT3 procedures. Subsequently the taxpayer filed a representation before the Policy Interpretation Committee of the DGFT for an interpretation, where also the taxpayer did not get relief as it was ruled that a policy interpretation was not required.

The HC allowed the writ petition filed by the taxpayer against the order of the DGFT. The HC relied on the decision of the Delhi HC in the case of Kandoi Metal Powders Manufacturing Company Private Limited vs Union of India (2014-VIL-41-DEL-CE), wherein it was held that supplies made to EOUs are to be regarded as deemed exports and where the supplies are not made against ICB, the supplies would be eligible for refund of terminal excise duty.

*M/s Raja Crowns And Cans Pvt Ltd vs Union of India and Others [Writ Petition No. 1468 of 2013, Delhi HC]*

## Tribunal Decisions

### Exemption unavailable when imported equipment is diverted in violation of the actual-user condition

The taxpayer imported certain road construction machinery from outside India and claimed exemption under Notification 21/ 2002 – Cus dated March 1, 2002. The taxpayer furnished work orders from Mumbai Metropolitan Regional

Development Authority ("MMRDA") and a contract entered into with the State Government of Gujarat for construction of the Surat-Dhulia road. The taxpayer executed a bond with the Custom authorities to use the imported machinery exclusively for construction of roads and declared not to sell/ dispose-off the machinery in any manner within a period of 5 years. However, the imported machinery was used by the taxpayer only for one and a half years, and thereafter the machinery was given on hire on a monthly hire charge. The RA contended that the taxpayer had violated conditions of the aforesaid notification and demanded duty.

Basis the findings in the case of Shreeji Constructions [2013-TIOL-441-CESTAT-MUM], the CESTAT held that MMRDA would not qualify as a road construction company as required under the notification and thus the taxpayer was not entitled for exemption under the notification ab-initio. The CESTAT also held that the taxpayer violated the actual user condition prescribed for the period of five years from the date of importation.

*Rajhoo Barot, Atlanta Limited vs Commissioner of Customs (Import), Mumbai [Appeal Nos C/967 & 968/2009, CESTAT Mumbai]*

# V. CENTRAL EXCISE

## High Court Decisions

### An order in appeal merges with the adjudication order appealed against; no other right of appeal can lie against the adjudication order on the same issue

The taxpayer cleared certain pipes manufactured at its factory to the work site, for execution of a turnkey contract and discharged excise duty liability with respect to the manufactured pipes on cost plus basis, as applicable to captive consumption. The adjudicating authority passed an order including the freight cost of the manufactured pipes from factory gate to the work site in the assessable value of the goods since that the pipes were captively consumed at the work site and not at the factory gate.

The taxpayer preferred an appeal against this order before the Commissioner (Appeals), who ruled in favour of taxpayer. The RA did not appeal against this appellate order but preferred another appeal against the original order of adjudicating authority before the Commissioner (Appeals), contending that excise duty should be discharged by the taxpayer on the sale price of the pipes. The taxpayer objected to this appeal filed by the RA on the ground that the appellate order had merged with the adjudication order. However, the Commissioner (Appeals) held that the issue raised by the RA was independent and the 'doctrine of merger' would not apply. The Chennai Bench of the CESTAT was of the view that the doctrine of merger would apply.

The HC observed that the core issue raised by the RA and the taxpayer was the same i.e. levy of excise duty on the cost of production and thus the order of the Commissioner (Appeals) should be treated as merged with the original order, thereby


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extinguishing any other right to appeal against the original order.

*Commissioner of Central Excise, Chennai vs The Indian Humes & Pipe Co Ltd [Civil Miscellaneous Appeal No.2749 of 2008, Madras HC]*

# Tribunal Decisions

## Banding single soap packs into combo packs amounts to 'manufacture'; job work exemption is not available if principal manufacturer claims area based exemption

The taxpayer was engaged in the activity of banding single unit soaps into multi-piece combo packs for Hindustan Unilever Ltd (”HUL”). The banding tapes used by the taxpayer were pre-printed with the brand name and the MRP of the combo pack. The taxpayer paid service tax on the banding activity. Separately, HUL had obtained an area based exemption for the manufacturing activities carried out by it under Notification No. 50/2003-CE dated June 10, 2003. The RA contended that the activity carried out by the taxpayer is a ‘deemed manufacture’ and thus is liable to excise duty. The CESTAT observed as follows:

- The activities of the taxpayer would amount to ‘manufacture’ as a job worker and not as a service provider; however, it would not be entitled to the benefit of exemption from excise duty (as a job worker) as the principal manufacturer was claiming area based exemption;
- Since the taxpayer was under the bona fide belief that it was not a manufacturer, and considering the fact that it obtained registration under the Finance Act, 1994 and that it made requisite declaration under notification 50/2003, *albeit incomplete*, there was no suppression of information.

The question of eligibility of the taxpayer to the area-based excise exemption was remanded to the adjudicating authority and it was ordered that the service tax paid by the taxpayer should be refunded on application by the taxpayer.

*M/s Vasantham Enterprises vs Commissioner of Central Excise, Chandigarh [Appeal No. E/3130/2009-EX[DB], CESTAT New Delhi]*

## Issue of separate debit notes is sufficient proof that freight charges do not form part of the assessable value

The taxpayer is a manufacturer and sold goods from the factory gate. The taxpayer made arrangement for transportation of the goods to its customers’ premises and collected the amounts charged by the transporter by separately issuing debit notes to the customers. The RA contended that since the transportation charges were not separately disclosed on the original invoices raised to customers, the same would amount to a violation under Rule 5 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 (“Excise Valuation Rules”) and therefore the exclusion of such charges from assessable value would not be allowable. The CESTAT relied on the decision in the case of CCE vs.


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Garware Enterprises Ltd [2014 (301) ELT 349 (Tri. Mum)] and held as under:

- Rule 5 of the Excise Valuation Rules mandates separate disclosure of transportation charges on the invoice with the intent to exclude such amount from the assessable value;

- The taxpayer had issued separate debit notes for the amount of freight paid by them to the transporters and thus the freight charges do not form part of the assessable value.

*CCE, Mumbai-III vs Emerson Network Power (I) Ltd [Appeal No.E/936, 937/05 –Mum, CESTAT Mumbai]*

# Notification & Circulars

## Adjudication of cases by Principal Director General of Central Excise Intelligence

Vide this Notification it was specified that principal director general of central excise intelligence shall have jurisdiction over the principal commissioners / commissioners of service tax or the principal commissioners / commissioner of central excise, for assigning show cause notices issued by the directorate general of central excise intelligence for adjudication. A circular explaining the changes introduced by the Notification has also being issued

*Notification No 02/2015-ST dated February 10, 2015, Notification No. 02/2015- Central Excise (NT) dated February 10, 2015 and Circular No 994/01/2015-CX dated February 10, 2015*

## Drawback rates amended for various products

Drawback rates of products ranging from articles of leather, paper products, footwear, articles of iron and steel nuclear reactors etc have been amended. A circular has also been issued to clarify the amendments in entries and drawback rates

*Notification No. 20/2015-Customs (N.T.) dated February 10, 2015, Notification No. 21/2015-Customs (N.T.) dated February 10, 2015 and Circular no 6/2015- Customs dated February 11, 2015*

## Amnesty Scheme notified under Rajasthan Value Added Tax Act, 2003

Amnesty scheme notified in Rajasthan which would apply to demands created upto 5 crores prior to March 31, 2011 under:

- The Rajasthan Sales Tax Act, 1954
- The Rajasthan Sales Tax Act, 1994
- The Rajasthan Value Added Tax Act, 2003 Act
- The Central Sales Tax Act, 1956

or demands which are under dispute and cases have been filed by the applicant or by the Department on or before December 31, 2013.

The main benefit under the scheme is waiver of interest and penalty subject to payment of whole amount of tax due and fulfilment of certain conditions.

*Notification No. F.12(16)FD/Tax/2009-188 dated February 09, 2015*

## Finance Ministry issues policy framework to set up Finance SEZ

Ministry of Finance issues policy framework to set up Finance Special Economic Zones (SEZs) to make India a global hub of Financial Services

*Policy Framework for Finance SEZs dated February 6, 2015*

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