May 2016

# TAX UPDATES

(containing recent case laws, notifications, circulars)

Prepared in association with

# Foreword

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

FICCI was invited to a meeting convened by the Ministry of Finance to discuss the recommendations in the Second Report of Special Investigation Team (SIT) on Black money regarding limitation on cash holdings and cash transactions. It was represented on behalf of FICCI that there should not be any limit on the legally acquired and duly accounted for cash amount that a person in India can hold.

Bombay High Court has given an important ruling in a case filed by a taxpayer apprehending that the Revenue Authorities may initiate coercive action against the Company (i.e. arrest of its Directors, employees) for recovery of tax, without issuance of show cause notice to the Company. [Cleartrip Private Limited vs Union of India (Writ Petition No.1088 of 2016)]

The High Court in this case held that service tax cannot be recovered by coercive means unless the investigation results into issuance of a show cause notice, an opportunity has been provided to resist the demand, adjudication order has been passed and protective remedies as appeal are provided to the taxpayer. Coercive measures including arrest can be resorted to only when investigation has been completed and prosecution has been launched. Thus, recovery of service tax by coercive means is not permissible without issuance of show cause notice.

It has been decided by the Central Board of Excise and Customs to observe Wednesday as the Taxpayers' Day wherein heads of all offices of Central Excise / Service Tax / Customs will meet the taxpayers / other stakeholders between 9:00 A.M. to 1:00 P.M. without any prior appointment in order to address their grievances expeditiously.

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 TAXES

## High Court Decision

### Section 94A of the Act notifying Cyprus as a notified jurisdiction is constitutionally valid

On 16 October 2014, a tripartite agreement was entered into between an Indian company (New Kovai Real Estate Private Limited), a Cyprus company (Skyngelor Limited) and the taxpayers. By the said agreement, the Cyprus company sold equity shares and compulsorily convertible debentures of an Indian company to the taxpayers. The taxpayers did not deduct tax at source while remitting the amount to the Cyprus company.

After three months of execution of the aforesaid agreement, the taxpayers received show cause notices inviting their attention to Section 94A(1) of the Act and Notification No.86/2013, dated 1 November 2013. Before the Assessing Officer (AO), the taxpayers contended that they would have an obligation to deduct tax at source, only if there was chargeability of a payment under Section 195 of the Act. The taxpayers claimed that they had purchased securities at a rate below their face value and that the Cyprus company had, in fact, suffered a loss. However, the AO passed orders under Section 201(1)/201(1A) of the Act, directing the taxpayers to pay tax and interest, as determined. A notice of demand under Section 156 of the Act was also issued. The taxpayers filed appeals under Section 246A of the Act before the Commissioner of Income-tax (Appeals) [CIT(A)]. The taxpayers also filed writ petitions with the Madras High Court challenging the validity of Section 94A(1) of the Act, Notification No. 86 and the press release (dated 1 November 2013), in view of the fact that so long as these are in force, their claim on the merits may prove to be very weak.

The High Court while dismissing the writ petitions of the taxpayers observed that the challenge to the constitutional validity of Section 94A(1) of the Act is without any merit. It is not correct that once a tax treaty is entered into, the Parliament loses the power conferred by the constitution, to make a law. If one of the parties to the tax treaty fails to provide necessary information, then such a party is in breach of the obligation under Article 26 of the Vienna Convention. The beneficiary of such a breach of obligation cannot invoke the Vienna Convention to prevent the other contracting party from taking recourse to internal law, to address the issue.

*T.Rajkumar, K.Dhanakumar and T.K.Dhanashekar vs UOI, CBDT, ITO (Intl Taxation) [W.P.Nos.17241 to 17243 & 17407 to 7412 of 2015] – Taxsutra.com*

### Services rendered by non-resident sub-arrangers are not FTS under the Act

During the Assessment Year (AY) 2001-02, the taxpayer was appointed by the State Bank of India (SBI) as an arranger for mobilizing deposits in its India Millennium Deposits Scheme (IMDS). The taxpayer was entitled to appoint sub-arrangers for mobilizing IMDS both inside and outside India. During the year under consideration, the taxpayer received payment from SBI as arranger fees and commission. Subsequently, the taxpayer paid the sums to the sub-arrangers by way of sub-arranger fees and



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commission. However, the taxpayer had failed to deduct tax at source paid to non-residents as sub-arranger fees and commission. The AO invoked provisions of Section 40(a)(i) of the Act for failure to withhold tax under Section 195 of the Act since the payment to a non-resident sub-arranger was in the nature of FTS under Section 9(1)(vii) of the Act. The CIT(A) held that the amount paid to the non-resident sub-arranger was in the nature of commission/brokerage and not FTS under Section 9(1)(vii) of the Act. The Tribunal upheld the order of the CIT(A).

The High Court held that payment of sub-arranger fees is not a technical service as defined under Section 9(1)(vii) of the Act. The services are rendered by the non-resident sub-arrangers outside India and hence there is no occasion for any income accruing or arising to the non-resident in India. The services of the non-resident sub-arrangers of attracting deposit to IMDS scheme are carried out entirely outside India. The High Court relied on the decision of the Supreme Court in the case of CIT vs Toshoku Ltd. [1980] 125 ITR 525 (SC). Further, the CBDT vide Circular No.786, dated 7 February 2000 reiterated the view of the Supreme Court in Toshoku Ltd.'s case. Further, there is no change in law which would warrant taking a view different from the view taken by the Supreme Court in Toshoku Ltd. The High Court held that the services rendered by non-resident sub-arrangers to the taxpayer would not fall within the category of managerial, technical or consultancy services in terms of the Explanation (2) to Section 9(1)(vii) of the Act so as to be deemed to accrue or arise in India. Accordingly, withholding of tax under Section 195 of the Act will not arise.

*DIT vs Credit Lyonnais (ITA No. 2120 of 2013) – Taxsutra.com*

## The taxpayer is eligible to claim income tax refund even though all the contract work was done by the sub-contractor

The taxpayer was a joint venture (JV) executing civil contract works. The taxpayer was awarded contracts by the irrigation department of the government of Andhra Pradesh. Later, these contracts were sub-contracted by the taxpayer to one of its constituents, on a back to back basis without any margin. During the year under consideration, the taxpayer had declared gross receipts and the same were passed on to the sub-contractor. In the return of income, the taxpayer claimed a refund. The AO disallowed the taxpayer's claim for the tax refund and held that the JV was just a procedural device used for submitting the bid and all the contract works were to be executed only by the constituent member. Since no real work was carried on by the taxpayer, no income had accrued to it and, therefore, tax deducted at source (TDS) credit was not allowable in the hands of the taxpayer. The taxpayer filed a writ petition before the High Court.

The High Court observed that the deduction of tax at source by the Government of Andhra Pradesh was on behalf of the taxpayer JV and it is from their income, tax was deducted at source. The tax deductions were made by the government from the amounts paid to the taxpayer, and no amount was paid by the government directly to the sub-contractor. The information, relating to deduction of tax at source, has been furnished by the deductor to the income tax authority. There are two distinct and independent contracts. While it does appear that the JV was constituted only for it to enter into a contract with the government, and for one of its constituents to execute the work, the

fact remains that there is no privity of contract between the government and the constituent of the JV i.e. the sub-contractor. The contractual obligation, to execute the work for the government, is that of the joint venture alone, and not that of the constituent member of the JV. The sub-contractor is assessable to tax on their income earned out of the amounts received by them from the taxpayer in terms of the second contract, and not in terms of the first contract between the government of Andhra Pradesh and the taxpayer JV. Not only did the Government of Andhra Pradesh deduct tax at source from the taxpayer's bills, the taxpayer, in turn, while making payment to the sub-contractor, also deducted tax at source from the bills of the sub-contractor. Credit for the TDS, by the taxpayer from the bills of the sub-contractor, was given to the sub-contractor as such income was assessable in their hands. Likewise credit for the tax deducted at source, from the bills of the taxpayer, was required to be given to the taxpayer alone as the income, from the contract entered into between them and the Government of Andhra Pradesh, was assessable only in their hands, and not in the hands of the sub-contractor. As per Rule 37BA(2)(i) of the Income-tax Rules, 1962 (the Rules) where the income is assessable in the hands of a person, other than the deductee, the deductee is required to file a declaration with the deductor. On such a declaration being made, the deductor is required to report the tax deducted at source, not in the name of the deductee but in the name of the other person, in the information which they are required to furnish to the income tax department. In the present case the deductee had not made any such declaration to the deductor, nor had deductor reported, the tax deducted at source, in the name of the other person (the sub-contractor) to the income tax department. Accordingly, the AO shall be directed to determine the quantum of TDS credit and refund the amount so computed to the taxpayer.

*IVRCL-KBL (JV) vs ACIT (Writ Petition Nos. 31680, 31681, 31740, 31741, 31748, 31763, 42408, 42489, 42657, 42666, 42667, 42678, 43038, 43069 & 43078 of 2015) – Taxsutra.com*

# Tribunal Decisions

## A foreign company engaged in outsourcing services constitutes a business connection under the Act but does not have a PE in India under the India-U.K. tax treaty

The taxpayer, a U.K. based company, is engaged in outsourcing services for its clients in finance, utility and the public sector. The main services provided by the taxpayer are customer management outsourcing business, service outsourcing and transfer of technology. Vertex Customer Service India Pvt. Ltd (Vertex India) is an Indian entity in the group, which also carries out outsourced work from the taxpayer. This outsource work is in relation to contracts of the taxpayer with PowerGen Retial Ltd. and Last Minute Networks Ltd. The taxpayer allowed Vertex India, the right to use certain equipment located outside India and claimed reimbursement of expenses incurred on behalf of Vertex India. The taxpayer offered the payment received from Vertex India for the right to use equipment outside India as royalty under Article 13(3)(b) of the India-U.K. tax treaty. Regarding the reimbursement, it was claimed that the same was not taxable as it was on a cost to cost basis.

The AO held that the taxpayer has a Permanent Establishment (PE) in India under the tax treaty as well as a business connection under the Act and hence computed the profit attributable to such a PE. Regarding reimbursement as it has the effect of reducing the service fee payable to the Indian company was also considered as business profits of the PE in India. Further, royalty was also taxed as a business profit of the PE in India.

The Delhi Tribunal held that the taxpayer has a business connection in India under Section 9(1)(i) of the Act. However, the taxpayer does not have a fixed place PE, service PE or Dependent Agent PE in India under Article 5(1) of the India-U.K. tax treaty. The Tribunal also held that since there is no PE of the taxpayer in India, the business income is not chargeable to tax in India. Even if it is assumed that there is a PE of the taxpayer in India, no profit can be attributed since the PE was compensated at an arm's length price in accordance with FAR analysis.

*DCIT vs Vertex Customer Management Ltd. (ITA No. 3759/Del/2013) – Taxsutra.com*

## Payment of inter-connection usage charges by an Indian telecom service provider to a foreign telecom operator is neither FTS nor royalty under the Act or the relevant tax treaties

The taxpayer is a global telecommunication company having operations in several countries including India. The taxpayer, as part of its international long distance (ILD) telecom services business, is responsible for providing services to its subscribers in respect of calls originated/terminated outside India. Thus, for providing ILD services, the taxpayer is required to obtain services of the Foreign Telecom Operator (FTO) for the provision of connectivity services over the last leg by the communication channel. The taxpayer entered into an agreement with an overseas network corporate to connect the call over the network. The taxpayer provides seamless end-to-end connectivity to the subscribers and the entire revenue from services is paid by the subscribers to the taxpayer. The taxpayer is in turn billed by the FTO in the form of interconnection usage charges (IUC).

The AO held that IUC paid by the taxpayer to the FTO, in the course of carrying out its business as an ILD service provider are in the nature of FTS under Section 9(1)(vii) of the Act, or in the alternative, in the nature of royalty under Section 9(1)(vi) of the Act. Accordingly, the income from IUC is deemed to accrue or arise in India in the case of an FTO. The AO levied a tax at a higher rate of 20 per cent on the gross amount of payment made to the FTO for all the years under consideration by applying the provisions of Section 206AA of the Act.

The Delhi Tribunal held that the interconnection facility and the service of the foreign telecom operator (FTO) in picking-up, carrying and successful terminating a call over their respective network is a standard facility, and the FTO does not render any technical services to the taxpayer under the interconnect agreement. Therefore, the payment in the form of IUC is not in the nature of fee for technical services (FTS) under Section 9(1)(vii) of the Act. The process of running the network in the cases of all the telecom operators is essentially the same and they do not have any exclusive right over such process to characterise it as royalty. When a process is widely available in the public domain, it cannot consti-

tute a part of the intellectual property (IP) for the purpose of charge of ‘royalty’ under Section 9(1)(vi) of the Act. There is no ‘use' of or ‘right to use' of any process in the present case and hence, even under relevant tax treaties, the payment cannot be termed as royalty.

*Bharti Airtel Limited vs ITO (TDS) [ITA Nos. 3593 TO 3596/Del/2012] – Taxsutra.com*

## The non-resident taxpayer is eligible to set-off of business losses under the Act, despite operations being discontinued in the Indian branch

During the year under consideration the taxpayer had filed its return of income as Lloyds Register-India Office (LRIO). The U.K. parent company had several subsidiaries all over the world, including two subsidiaries in the U.K., having their branch office in India namely Lloyds Register Asia (LRA) and Lloyds Register Quality Assurance Ltd. (LRQA). During the year under consideration, the taxpayer discontinued its India operation as branch office. All the assets and liabilities were under the process of transfer to LRA-India Branch office (LRA-IBO) and LRAQ India Branch Office (LRAQ-IBO). The taxpayer does not have a Permanent Establishment (PE) in India. Therefore, the taxpayer claimed that the business profit could not be taxed in India under Article 7 of the India-U.K. tax treaty. The AO held that the profit included loss and once the taxpayer had taken the benefit of the tax treaty, the loss arising under the head business income could not be set off against any other head of income. Since no business activity was carried out by the taxpayer, the business loss cannot be adjusted against the taxable royalty income. The CIT(A) upheld the order of the AO.

The Tribunal observed that the provisions of Section 90 of the Act provide an option to the taxpayer to opt for the provisions of the tax treaty or the Act whichever is beneficial to it. The taxpayer had claimed that set off of losses should be dealt with as per the provisions of Section 71(2) of the Act. The issue of opting for a tax treaty and provisions of the Act has been discussed by the Special Bench in the case of Sumitomo Mitsui Banking Corporation [2012] 136 ITD 66 (Mum)(SB). Respectfully following the decision of Sumitomo Mitsui Banking Corporation, it has been held that the CIT(A) was not justified in denying the setting off of losses that the taxpayer could avail the benefit of provisions of the Act over the provisions of the tax treaty for setting off of losses.

*ADIT vs Lloyds Register U.K. (ITA No. 3138/Mum/2011) – Taxsutra.com*

## Assessment in the hands of an Indian company as an agent of a foreign company is valid since it was done prior to the assessment of the foreign company

The taxpayer is a public sector undertaking engaged in the business of civil aviation. It had entered into a wet lease agreement, with Carbijet Inc. based in West Indies. Subsequently, the taxpayer also entered into a fresh agreement, for wet lease of three aircrafts. However, the said agreement was terminated by the taxpayer, and this termination of lease was subjected to litigation seeking compensation for Carbijet Inc, before the International Arbitral Tribunal London, (IATL). The IATL decided the matter in favour of Carbijet Inc. The AO held that receipt arising from the termination of the wet lease contract was revenue receipt in

nature and it was liable to be taxed simultaneously in the hands of the Carbijet Inc as also taxpayer, as a representative assessee of Carbijet Inc. The CIT(A) held that the same income cannot be assessed first in the hands of the non-resident and simultaneously through its agent, representative of the taxpayer.

The Tribunal relied on the decision of the Supreme Court in the case of Claggett Brachi & Co Ltd [1989] 177 ITR 409 (SC). It was held that the AO can only assess one of the persons, either the principal or the agent, and once he does so, he is functus officio so far as assessment of that income is concerned. When the AO taxes the income in the hands of the taxpayer directly, he loses his right to tax the same income in the hands of the agent, and vice versa. When he taxes the same income in the hands of both of them, the assessment, which is done at a later point of time ceases to be valid in the eyes of law.

When the AO exercised his/her option to bring the income to tax in the hands of the taxpayer, as a representative assessee, he/she was perhaps legally functus officio so far as assessment of the same income in the hands of Carbijet Inc. directly was concerned. In the present case, the assessment is on two different dates, and the date of assessment on the taxpayer in a representative capacity is a day earlier than the assessment on the Carbijet Inc. directly. Therefore, the assessment in the hands of the taxpayer, in the representative capacity, cannot be said to be legally unsustainable. Accordingly, it is concluded that the impugned income has been rightly assessed to tax in the hands of the taxpayer, as an agent under Section 163 of the Act.

*DDIT vs Air India Limited- as an agent of Carbijet Inc. [ITA No.6630/Mum/06 Assessment Year: 2000-01] – Taxsutra.com*

## Compensation paid to the tenants towards alternative accommodation is not in the nature of rent under Section 194-I of the Act

The taxpayer is engaged in the business as a builder/developer of real estate. It is also engaged in carrying out SRA projects (Slum rehabilitation), wherein it has to provide flats at free of cost to hut dwellers. The taxpayer had made a payment on account of compensation without deduction of tax at source. The AO held that the compensation is rent, and hence, provisions of Section 194-I of the Act are applicable. As the payment made to each individual was more than INR1,20,000, the AO disallowed the payment under Section 40(a)(ia) of the Act on account of non-deduction of tax at source. The CIT(A) upheld the order of the AO.

The Tribunal on a perusal of the agreement entered into between the taxpayer and the society formed by the tenants, observed that the taxpayer was not able to provide alternative accommodation to the tenants and therefore, the taxpayer would be liable to pay compensation for alternative accommodation. The concerned persons to whom the payment made are neither tenants of the taxpayer nor the taxpayer has in reality paid rent on behalf of them. On a plain reading of the definition of rent, it becomes clear that the payment made by the taxpayer does not fall within the purview of rent as the taxpayer is not making such payment for use of any land, building, etc. Accordingly, it was held that the compensation paid by the taxpayer to the tenants towards alternative accommodation not be-

ing in the nature of rent as defined in Section 194-I of the Act and there is no requirement for deduction of tax under the said provisions. Therefore, disallowance made under Section 40(a)(ia) of the Act was deleted.

*Sahara Dwellers Pvt. Ltd. vs ITO (ITA No. 5963/Mum/2013) – Taxsutra.com*

## Turnover filter considered at 10 times; comparables with RPTs up to 15 per cent accepted; standard deduction of +/- 5 per cent benefit under the erstwhile provisions of the Act confirmed

The taxpayer rendered software development services to its Associated Enterprise (AE) and was remunerated on a cost +15 per cent on the basis for the services rendered. The taxpayer selected Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM) and selected nine comparable companies to justify the arm's length. The Transfer Pricing Officer (TPO) rejected the TP study, used various filters, selected 17 comparables and made an adjustment. The Commissioner Income Tax (Appeals) [CIT(A)] partly allowed the appeal by excluding 10 comparables selected by the TPO, by applying a zero per cent related party transaction (RPT) filter, and four more comparables for functional dissimilarity, resulting in a final selection of three comparables.

### Tribunal's ruling

- Various filters are required to be adopted in selecting a company as a comparable as part of the FAR analysis and companies having RPTs upto 15 per cent of total revenues could be considered as comparables.

- The turnover filter is adopted to avoid selection of high-end companies (big companies) with that of 'minnows' in a similar line of business. The range cannot be fixed and how to adopt the filter depends on the facts of each case. Simply because the turnover of a comparable exceeds the upper limit, it cannot be rejected given that in a number of cases, no objections were raised on inclusion of companies with very small turnovers. Based on broad parameters, what one has to consider is, the turnover/receipts of the taxpayer and the range of the upper limit at ten times as well as the lower limit at ten times i.e. one-tenth with a margin of variation.

- Drawing references from various pronouncements, the Bangalore Tribunal ruled on the comparability of companies selected by the TPO.

- Relying on the Coordinate Bench decision in the case of SAP Labs India Pvt. Ltd. vs ACIT [2010] 6 ITR (Trib) 81 (Bang) and reference to the CBDT Circular 5/2010, dated 3 June 2010, the Tribunal held that the standard deduction of 5 per cent permitted by the CIT(A) was in accordance with the provisions, since the amendment to the proviso is applicable from Assessment Year (AY) 2009-10 onwards and hence the pre-amended proviso shall apply.
- The Tribunal additionally observed that, the explanation brought in by the Finance Act, 2014 also specifies that the provisions of the second proviso shall also be applicable to all assessments or reassessment proceedings,


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pending before the Assessing Officer as on the first day of October 2009. Considering that the present proceedings were concluded before that day, the Tribunal held that the second proviso did not apply, and granted the standard deduction of +/-5 per cent.

*McAfee Software (India) Pvt Ltd. [IT(TP)A No.1388/Bang/2011 and IT(TP)A No. 04/Bang/2012 – AY 2005-06]*

### Tested party shall be selected with reference to the entity which has undertaken the transaction. Market determined interest rate applicable to currency in which loan has to be repaid shall be considered at arm's length

The taxpayer is engaged in the business of identifying investment opportunities in financially distressed companies which otherwise have an inherently viable business proposition and had a low credit rating of BBB(-). These investments were funded through intra-group financing, wherein taxpayer raises money through debt instruments i.e. Compulsory Convertible Debentures (CCDs) from group companies. The average interest rate on the CCDs issued by the taxpayer to its AE was determined at the rate of 11.30 per cent. In order to benchmark the Arm's Length Price (ALP) of interest rate on the CCDs, the taxpayer adopted Comparable Uncontrolled Price (CUP) method as MAM and the taxpayer analyzed the External Market Data using Thomson Reuters' Deal Scan and Bloomberg Database in order to find external CUP. Alternatively, the taxpayer also conducted corroborative search using Bombay Stock Exchange (BSE) data on INR denominated debt issuances. Based on this, the taxpayer contended that its average interest rate of 11.30 per cent is at arm's length. TPO rejected the entire methodology adopted by the taxpayer, on the ground that it did not point out anywhere in its TP study, whether it has taken the taxpayer or the AE as a 'tested party'. The Dispute Resolution Panel (DRP) upheld the TP adjustment made by the TPO. The taxpayer preferred an appeal before the Tribunal. Before the Tribunal, the taxpayer filed a copy of public issue of secured and non-secured debentures issued in the year 2009, wherein for AA and AA+ credit rating, the range of average yield of interest was from 11 per cent to 12 per cent and contended that, it being BBB(-), the average interest rate of 11.30 per cent is within the arm's length range and hence, no TP adjustment shall be made.

#### Tribunal's ruling

- The foremost issue under consideration was the necessity to identify 'tested party', while applying the CUP method. Although, Indian TP regulations do not lay down any specific procedure or guidelines for choice of 'tested party', however, OECD guidelines provide that, as a general rule, tested party should be the one to which TP method can be applied in most reliable manner and for which most reliable comparables can be found. Therefore, the tested party ought to be the enterprise that offers high degree of comparability and requires least amount of adjustment i.e. the one that has least complex functional analysis.

- Product comparability is the 'key factor' under CUP method unlike the other methods like Cost Plus Method (CPM), Resale Price Method (RPM) or TNMM wherein financial indicators like

markup on costs, gross margin or net profit is tested with an appropriate base. Hence, the Mumbai Tribunal observed that under these other methods, the choice of the 'tested party' becomes far more imperative which is envisaged by para 5.3.3 of the UN TP Manual and para 3.18 of the OECD guidelines, with no such reference of tested party under CUP method.

- The transaction to be benchmarked is interest payment by the taxpayer to its AE i.e. transaction undertaken by the taxpayer and not vice-versa. It observed that if the transaction was undertaken by the AE, then similar transaction by the AE with the third party or independent similar transaction in the place of AE could have been analysed to arrive at an ALP. There is no premise for the conclusion arrived by the TPO as well as by the DRP in holding that the entire benchmarking analysis done by the taxpayer is vitiated, simply because the taxpayer has not identified the 'tested party'.

- The Tribunal, relying on the decision of the Delhi High Court in the case of Cotton Naturals India (P) Ltd, wherein it was held that arm's length interest rate should be computed based on market determined interest rate applicable to currency in which loan has to be repaid, held that the arm's length interest rate should be based on INR in which CCDs has been issued and the currency in which interest is being paid and not on any foreign currency lending rate.

- The Tribunal accepted the two comparable transactions for the year 2009, wherein for credit rating of AA or AA(+) Enterprises, the interest rate per annum is between 11 per cent to 12 per cent for a tenor of 60 months, as against the taxpayer's BBB(-) credit rating, and observed that 11.30 per cent interest paid to its AE is much within the arm's length rate.

- Based on the above, the Tribunal held that 11.30 per cent interest rate is at ALP and thus, deleted the TP adjustment.

*India Debt Management Pvt Ltd vs DCIT [IT(TP)A No. 7518/Mum/2014]*

# Notifications/Circulars/ Press Releases

## CBDT notifies a rule to clarify that pre-conversion period is includible in the period of holding of shares acquired on conversion of debentures/bonds into shares

The CBDT vide Notification No. 18/2016 notifies a new Rule 8AA to prescribe method for determination of period of holding of capital assets, being shares or debentures acquired by the taxpayer on conversion of bonds, debenture, debenture-stock or deposit certificates in any form.

As per the new rule, the period for which a bond, debenture, debenture-stock or deposit certificate, as the case may be, was held by the taxpayer prior to conversion shall be considered for determining the period of holding of such shares or debentures acquired upon conversion.

The above rule will be effective from 1 April 2016.

Notification No. 18/2016, dated 17 March 2016

# II. SERVICE TAX

## Advance Rulings

### Mere payment of customs duty does not exempt the transaction from service tax

The importer appointed a foreign C&F agent for material handling, arranging shipping lines, ocean freight, material clearance etc both at origin and destination port and other related local transportation. The foreign C&F agent was to issue a composite invoice to the taxpayer for such services. The importer stated that on such charges all customs duties would be paid by the importer. The question raised by the taxpayer before the Authority for Advance Ruling ("AAR") was with respect to the portion of the C&F agent's invoice on which service tax was payable under the reverse charge mechanism.

The AAR observed that there was no statutory provision to indicate that if customs duty was paid on a particular import transaction, service tax would not be levied on the same component. Further, the Notification 34/2012-ST dated June 20, 2012 and Notification No 31/2010-Cus dated Feb 27, 2010, are specific to exemption provided to packaged and canned software and the same would not be applicable in the instant case.

The AAR held that the taxpayer shall be liable to pay service tax under the reverse charge mechanism on the gross amount charged by the foreign C&F agent, excluding the value of expenditure incurred as a 'pure agent' under Rule 5(2) of the Service Tax (Determination of Value) Rules, 2006 ("Valuation Rules") such as freight, insurance,



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loading and unloading charges, handling charges, etc.

*M/s Berco Undercarriages (India) Pvt Ltd, Authority for Advance Rulings, New Delhi (AAR/ST/10/2016) (AAR)*

# High Court Decisions

### Service tax cannot be collected by Revenue until issuance of a SCN and an opportunity is being granted to the taxpayer to resist the demand

The taxpayer filed a writ petition before High Court ("HC") apprehending that the Revenue Authorities ("RA") may initiate coercive action against the Company (ie arrest of its Directors, employees) for recovery of tax, without issuance of show cause notice to the Company.

The HC in this case held that service tax cannot be recovered by coercive means unless the investigation results into issuance of a show cause notice, an opportunity has been provided to resist the demand, adjudication order has been passed and protective remedies as appeal are provided to the taxpayer. Coercive measures including arrest can be resorted to only when investigation has been completed and prosecution has been launched. Thus, recovery of service tax by coercive means is not permissible without issuance of show cause notice.

*Cleartrip Private Limited vs Union of India (Writ Petition No.1088 of 2016) (Bombay HC)*

# Tribunal Decisions

### Passenger service fee collected by airlines on behalf of Airport Authority of India ("AAI") would not be liable to service tax at the hands of airlines

The taxpayer was engaged in providing services of transportation of passengers by air. The taxpayer collected passenger service fee from its passengers on behalf of AAI, and remitted the same to AAI. The RA relying on the Board's Circular No. 85/3/2006 – ST dated October 17, 2006 demanded service tax on such passenger service fee collected by the taxpayer. The said Circular had clarified that fuel surcharge and administrative surcharge were in the nature of administrative fees and were therefore liable to service tax, however it was silent on the issue of applicability of service tax on passenger service fee.

The CESTAT observed that the same issue was considered in the case of *M/s Continental Airlines Inc [2015–TIOL–148 –CESTAT (Del.)]*, where it was held that airport taxes (equivalent to passenger service fee) collected by airlines and remitted to airport authorities were to be excluded from the assessable value of services. Thus it was held that as passenger service fee was collected by the taxpayer from the customers on behalf of AAI, and thereafter remitted to AAI, the same could not be added to the gross value of services provided by the airline. Accordingly the demand of service tax and penalty was set aside.

*M/s Lufthansa German Airlines vs Commissioner of Service Tax (Adjudication), New Delhi (ST Appeal No 929 of 2009) (CESTAT, New Delhi)*

## Export of services – subsequent usage of the services by recipient located outside India should not be relevant to determine the export status

Export of services – subsequent usage of the services by recipient located outside India should not be relevant to determine the export status

The taxpayer is engaged in producing programmes for its customer located outside India. The programmes were uplinked and disseminated by the offshore customer to distributors located in India for the purpose of broadcasting to Indian viewers. As per the contract between the taxpayer and its customer, consideration was to be paid in Indian currency to the taxpayer.

The RA contended that the service provided by the taxpayer did not fulfil the condition of 'delivered outside India'/ 'used outside India', under Rule 3(2) of the Export of Service Rules, 2005, as the programmes are disseminated to Indian distributors for broadcasting to Indian viewers. Further, since the contract specifically provided for consideration to be paid in Indian currency, the condition of 'receipt of consideration in convertible foreign exchange' was not fulfilled.

On the above two grounds the observations on the CESTAT are as under:

- Placing reliance on the decision in the case of *M/s Paul Merchants Ltd [2012-VIL-09-CESTAT-DEL-ST]*, it was observed that subsequent dissemination of the programme was a distinct activity from the programme production activity carried out by the taxpayer. Thus, usage of the programmes after delivery to offshore customer is irrelevant to determine the liability of the taxpayer as programmes producer
- On the issue receiving consideration in Indian currency, it was stated that Indian Rupee is not a freely convertible currency and therefore cannot be received as inward remittance through the banking channel. Further, the taxpayer had produced a bank certificate certifying receipt of foreign currency in its bank account, to satisfy the condition of receipt of convertible foreign exchange

Thus the benefit of export of service was upheld by the CESTAT.

*Commissioner of Service Tax-VI, Mumbai vs Balaji Telefilms Ltd (Appeal No ST/651/2010) (CESTAT, Mumbai)*

## Employee insurance - CENVAT Credit allowed on insurance obtained to overcome difficulties under the Workmen's Compensation Act

On the issue of eligibility of CENVAT Credit on the employee insurance taken by the taxpayer after April 1, 2011, the CESTAT held that the exclusion of employee insurance from the definition of input services under the Credit Rules is only in respect of insurance coverage given to employees during journeys availing leave travel concession. However, if the insurance service is availed to overcome difficulties under Workmen Compensation Act, ie in case of hazard, will be in the nature of welfare of workmen under the Factories Act and

hence would not be covered under the exclusion of insurance services from the definition of input service. The taxpayer was accordingly allowed CENVAT Credit on input services.

*M/s FIEM Industries Ltd vs CCE, Chennai III (Appeal No E/40018/2015) (CESTAT, Chennai)*

# III. CENTRAL EXCISE

## Supreme Court Decisions

### Excise valuation – value of returnables cannot be excluded from the assessable value unless there is an upfront formal arrangement between the parties and the seller is obligated refund the value of returnables

The taxpayer was engaged in manufacturing soda ash (referred as 'goods'), which was supplied to the buyer in gunny bags. As per the arrangement, the buyer can return the gunny bags, upon which the value of such bags will be refunded to the buyer. The taxpayer deducted the value of gunny bags from the assessable value of goods for the purpose of payment of excise duty. The question before the Supreme Court ("SC") was whether the value of such gunny bags was required to be included in the assessable value of goods cleared by the taxpayer.

The SC placed reliance on the decision in the case of *Mahalakshmi Glass Works (P) Ltd. [1988 (Supp) SCC (601)]* and *Triveni Glass Ltd [2005 (3) SCC (484)]* and observed that the deduction shall be available only if an arrangement exists between the seller and the buyer of the excisable goods for return of the packing materials by the buyer to the seller, carrying an obligation on the seller to return the value of such materials to the buyer. It was further observed that where such an arrangement existed, actual return of packing material was not relevant.

In the instant case, since the taxpayer failed to present proof of existence of such an arrangement with its buyer, it was held that the value of gunny bags was includable in the assessable value of the goods.

*M/s Tata Chemicals Ltd vs Collector of Central Excise (Civil Appeal No 7251-7302 of 2000) (SC)*

# IV. VAT/CST

## Supreme Court Decisions

### Supply of goods under turnkey contracts - sale involving inter-state movement of goods in pursuance of and incidental to a contract qualify as inter-state sale

The taxpayer was appointed by Delhi Metro Railway Corporation Ltd ("DMRC") for supply of equipment like transformers, switchgears, high voltage cables, etc (collectively referred as 'goods'). The specifications of the goods were clearly laid down in the bid document, including approved sources of such equipment and detailed terms and conditions. The taxpayer supplied the goods imported from outside India as well as brought from its approved location outside the State of Delhi and claimed exemption from levy of VAT under the Delhi Value Added Tax Act, 2004 ("DVAT Act") on the ground that the same were made in the


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course of import and in the course of inter-state trade, hence covered under Central Sales Tax Act, 1956 ("CST Act").

The RA sought to levy VAT on such supplies on account of lack of privity of contract between the taxpayer, DMRC and supplier of goods and denying the status of inter-state sales and sale in the course of import.

The SC observed that terms of the contract between taxpayer and DMRC clearly provide that the goods are imported/ procured as per the specification of DMRC and DMRC was aware of the movement of goods from outside the State. Further, the goods could not be diverted by the taxpayer for any other purpose considering the same were specific to the contractual arrangement. Thus, relying on the decision of SC in the case of *K G Khosla vs Deputy Commissioner of Commercial Taxes, Madras [(1966) 3 SCR 352]*, it was held that the sales transactions involved in the instant case are covered under CST Act and therefore not liable to VAT under DVAT Act.

*Commissioner, DVAT vs ABB Ltd (Civil Appeal No 2989-3008 of 2016) (SC)*

# High Court Decisions

## Eligibility of credit - pet coke used in manufacturing 'cement' amounted to a 'raw material' and not 'fuel', thereby not requiring reversal of input tax credit

The taxpayer was engaged in manufacture of cement and registered under the Gujarat Value Added Tax Act, 2003 ("GVAT Act"). The taxpayer used pet coke in its manufacturing process and claimed input tax credit of such pet coke as a 'raw material' utilized in manufacturing cement. The RA contended that pet coke was not a raw material, instead it was a fuel utilized in the manufacturing process, thereby requiring reversal of credit to the extent of 4 percent under GVAT Act.

The HC in this case observed for the purpose of manufacture, the raw material should ultimately get a new identity by virtue of the manufacturing process either on its own or in conjunction or combination with other raw materials. The input would not cease to be raw material by reason alone of the fact that in the course of the chemical reactions, the ingredient is consumed or burnt up. All the same, it would still remain a raw material. Applying the principle, in the instant case while the pet coke may lose its apparent identity during the process of manufacture, but it forms part of the end product. Thus it met the criteria of 'raw materials' which should ultimately get a new identity either on its own or by use in combination with other raw material. Hence, no credit reversal required.

*The State of Gujarat vs Balram Cement Ltd [Civil Application (OJ) No 809 of 2015] (HC, Gujarat)*

## Input tax credit eligible irrespective of date of purchase invoice, amendment relaxing the provision related to eligibility of credit was clarificatory in nature and therefore had a retrospective effect

The taxpayer, registered under the Karnataka Value Added Tax Act, 2003 ("KVAT Act") due to practical difficulties, claimed input tax credit of the purchases made in a

month in which goods were recorded in the books instead of the month in which the purchase invoices were raised by sellers. As per section 10(3) of the KVAT Act, dealers were required to avail input tax credit of the purchases in the month when the invoices were issued by the selling dealer. In case such credit was not availed by the dealer, credit could be availed only by filing a revised return (within a period of six months). Section 10(3) of the KVAT Act was amended vide KVAT (Amendment) Act, 2015, to remove this condition and provided that the credit could be availed upto 6 months from the date of purchase.

The HC on the above amendment clarified that the Scheme of the KVAT Act provides for set off of all tax paid at the earliest points of purchase against the tax payable by him on his sales and by compelling a dealer to avail credit of tax paid on purchases only in the month in which the selling dealer raises invoices the purpose of the Scheme would be defeated and it may result in double taxation. The ambiguity under section 10(3) [prior to amendment] has been put to rest by the amendment in section 10(3). Thus, amendment to Section 10(3) is clarificatory and could be given retrospective effect.

*M/s Sonal Apparel Private Limited vs The State of Karnataka & Ors (WP No 22483-22494 of 2015) (HC, Karnataka)*

# Notification & Circulars

## Mega exemption notification amended to insert entries related to exemption on services provided by Government or local authority

Central Government has issued a notification amending the mega exemption notification ie Notification No 25/2012-Service Tax dated June 20, 2012. As per the amendment, the following services provided by the Government or local authority to a business entity are exempted from the levy of service tax:

- Services provided to another Government or local authority
- Services provided by way of issuance of passport, visa, driving licence, birth certificate or death certificate
- Where the gross amount charged for services does not exceed INR 5000
- Services provided by way of tolerating non-performance of a contract for which consideration in the form of fines or liquidated damages is payable to the Government or local authority
- Services provided by way of registration required under any law for the time being in force, testing, calibration, safety check or certification relating to protection or safety of workers, consumers or public at large, required under any law for the time being in force
- Services provided by way of assignment of right to use natural resources to an individual farmer for the purposes of agriculture
- Services provided by way of any activity in relation to any function entrusted to a Panchayat under article 243G of the Constitution
- Services provided by way of assignment of right to use any natural resource where such right to use was assigned by the Government or the



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local authority before the April 1, 2016

- Services provided by way of allowing a business entity to operate as a telecom service provider or use radiofrequency spectrum during FY 2015-16 on payment of licence fee or spectrum user charges, as the case may be
- Services provided by way of deputing officers after office hours or on holidays for inspection or container stuffing or such other duties in relation to import export cargo on payment of Merchant Overtime charges

*Notification No 22/2016-Service Tax dated April 13, 2016*

## Interest on delayed payment of service tax on any consideration for provision of service or sale of property liable to service tax where such interest is payable in respect of service provided by Government or local authority

Central Government has issued a notification to insert a proviso under the Rule 6(2)(iv) of the Valuation Rules, providing that interest on delayed payment of any consideration for provision of service or sale of property (whether movable or immovable) is liable to service tax, where such service is provided by the Government or local authority and the payment against such services is allowed to be deferred on payment of interest or any other consideration.

*Notification No 23/2016-Service Tax dated April 13, 2016*

## Rule 7 of the Point of Taxation Rules, 2011 ("POT Rules") to include the point of taxation on services provided by Government or local authority to any business entity

Central Government has issued a notification to amend the Rule 7 of POT Rules whereby point of taxation for any service provided by the Government or local authority to any business entity shall be the date on which the payment, part or full in respect of services, becomes due or when the payment for such services is made, whichever is earlier.

*Notification No 24/2016-Service Tax dated April 13, 2016*

## Designation of Wednesday as Taxpayers' Day

It has been decided by the Central Board of Excise and Customs to observe Wednesday as the Taxpayers' Day wherein heads of all offices of Central Excise / Service Tax / Customs will meet the taxpayers / other stakeholders between 9:00 A.M. to 1:00 P.M. without any prior appointment in order to address their grievances expeditiously.

*Circular F.No.DGTS/19/2015 dated April 12, 2016 issued by Directorate General of Taxpayer Services, CBEC*

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based on the specific facts and circumstances. This newsletter does not substitute the need to refer to the original pronouncement"