**August 2013**

# TAX UPDATES

**(containing recent case laws, notifications, circulars)**

Prepared in association with

# Foreword

I am pleased to enclose the August 2013 issue of FICCI's Tax Updates. This contains recent case laws, circulars and notifications pertaining to direct and indirect taxes.

The Report of the Parliamentary Standing Committee on Finance on the Constitution (One Hundred Fifteenth Amendment) Bill, 2011 enabling the introduction of GST has been tabled in the Lok Sabha. FICCI will be examining the recommendations of the Standing Committee and will engage with the Government for finalizing the contours of GST regime.

In the meanwhile, FICCI has submitted its comments on the document circulated by the Secretariat of the Empowered Committee of State Finance Ministers at the Interactive Meeting with Mr. Sushil Kumar Modi held on June 7, 2013. FICCI's comments on issues relating to GST design, revenue neutral rates, Dual administrative control and other related matters are appended with this edition of the Tax Updates.

As our members are aware, Government has constituted a Forum with Dr Parthasarathi Shome as its Chairman for exchange of views between the taxpayers and the Government on tax related issues and tax related disputes that concern the industry as a whole. FICCI has invited suggestions from its members for being placed before the Forum. We will make an earnest effort to represent the concerns of our members. FICCI has been invited for an interaction with the Forum on August 21, 2013 to discuss tax matters concerning the 'Financial Services Sector'. The issues impacting other sectors, based on inputs received from our members, would also be taken by FICCI in the coming weeks.

On the taxation regime, the Madras High Court has delivered an important judgement in the context of the India-Thailand tax treaty. M/S Bangkok Glass Industry Co. Ltd. (resident of Thailand) entered into a contract with an unrelated Indian company to provide both know-how and on-going technical services relating to the Indian company's construction of a glass factory. The issue before the High Court was to determine the taxability of such services in India. The High Court held that the services rendered towards transfer of know-how were royalty under the India-Thailand tax treaty whereas the services of providing technical

advice and assistance was to be treated as business profits, in the absence of Fees for Technical Service clause in the India-Thailand tax treaty. Further, it was held that there was no permanent establishment of the taxpayer in India and therefore the fees for technical services cannot be brought to tax under the tax treaty. The High Court also held that since the said payments do not fall under the miscellaneous income, it cannot be taxable under residuary article of the tax treaty.

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 Decisions

### The absence of Fees for Technical Service clause does not make payments for technical services taxable under residual article of the tax treaty

The taxpayer, a company incorporated in Thailand, entered into a technical know-how agreement with an Indian company for transfer of glass technology know-how to the Indian company and for providing technical assistance to the employees of the Indian company to operate the glass plant in India.

The Assessing Officer (AO) held the consideration for the transfer of know-how and technical assistance to be taxable under Article 22 i.e. Other income Article of the India-Thailand tax treaty. The Tribunal however held the consideration for transfer of know-how to be in the nature of royalty and for technical assistance to be in the nature of other income under the India-Thailand tax treaty.

The issue for consideration before the Madras High Court, inter alia, was whether the consideration for technical assistance would be taxable in India in the hands of the taxpayer. Based on the facts of the case, the High Court, inter alia, observed and held as follows:

- The services rendered by the taxpayer cover transfer of know-how as well as giving technical assistance and therefore a part of the payment has to be classified as 'royalty' and the other part has to be assessed as 'technical services'.

- As the taxpayer did not have a Permanent Establishment (PE) in India, the consideration for technical services cannot be brought to tax under Article 7 of the India-Thailand tax treaty. The income which would be taxable in India in the instant case is only the income falling under Article 12 of the India-Thailand tax treaty as royalty income and nothing beyond that.

- Further, the consideration for technical assistance cannot even be taxed under the other income article of the India-Thailand tax treaty since it does not classify as miscellaneous income.

*Bangkok Glass Industry Co. Ltd. v. ACIT (2013) 34 taxmann.com 77 (Mad) (HC)*

### Losses from derivatives are speculative in nature, where the underlying security was shares and stock

The taxpayer had declared a loss from trading in derivatives in its return of income for AY 2007-08. The taxpayer contended that this loss was not speculative in nature, in view of provisions of Section 43(5) of the



FICCI

Act. The AO rejected this contention and held that the loss was to be treated as a speculation loss in view of provisions of the Explanation to Section 73 of the Act. The Explanation to Section 73 provides that if any part of business of a company includes the purchase and sale of shares, then the company would be deemed to be carrying on speculation business to the extent of which the business consists of such activity. As per Section 43(5), transactions in respect of trading in derivatives in a recognized stock exchange are not to be treated as speculative transactions subject to the satisfaction of certain conditions.

The AO held that Explanation to Section 73 can be applied to trading in derivatives. A division bench of Delhi High Court held that losses from derivatives where the underlying security was shares and stock were to be treated as speculative losses as per deeming fiction of Explanation to Section 73 of the Act. The High Court noted that the scope of Section 43(5) is restricted to the application of Sections 28 to 41, which apply to the computation of business income, and is confined to that. The High Court observed that Section 43(5) was enacted for a limited purpose and it could not be extended to achieve other ends or purposes, as doing that would be contrary to the statute and would amount to violence towards parliamentary intendment, as the parliamentary intendment that derivatives are also excluded from the mischief of Explanation to Section 73 is not borne out. The High Court observed that wherever the context and setting of a provision indicates an intention that an expression defined in some other place in the enactment, cannot be applied, that intent prevails, regardless of whether standard exclusionary terms (such as 'unless the context otherwise requires') are used. The High Court relied on the decisions of Supreme Court in the case of Vanguard Fire & General Insurance Co. Ltd., M/s Madras v. Fraser And Ross & Anr [AIR 1960 SC 971] and N.K. Jain and Ors. v. C.K. Shah and Ors. [AIR 1991 SC 1289].

Further relying on the decisions in the case of Rajshree Sugars and Chemicals Ltd. v. Axis Bank Ltd. [AIR 2011 Mad 144], the High Court noted that derivatives are assets whose values are derived from values of underlying assets, which in the taxpayer's case were stock and shares. The High Court held that the Explanation to Section 73(4) has been enacted to clarify beyond any doubt that share business of certain types or classes of companies is deemed to be speculative. As in the taxpayer's case all derivative transactions were based on stock and shares, it squarely falls within the Explanation to Section 73 of the Act. When the underlying asset itself does not qualify for the benefit, derivatives based on the same would certainly not. Hence, losses from derivatives are speculative in nature.

*CIT v. DLF Commercial Developers Ltd [TS-316-HC-2013(DEL)]*

## Madras High Court upholds long term capital gain exemption prior to set-off of long term capital loss

The Madras High Court held that effect has to be given first to the provisions of computation of capital gains and thereafter provisions relating to the set-off of losses should be applied.

*CIT v. Mr. Vijay M. Mahtaney (ITA No. 152 of 2010, dated 18 June 2013) Assessment Year 2003-04*

# Tribunal Decisions

## ESOP discount (difference between market price and issue price) is a deductible expenditure at the time of vesting of the option. An adjustment has to be made if the market price is different at the time of exercise of the option

The taxpayer framed an Employee Stock Option Plan (ESOP) pursuant to which it granted options to its employees to subscribe for shares at the face value of INR 10. As the market price of each share was INR 919, the taxpayer claimed that it had given a discount of INR 909, which should be allowable as a deduction as 'employee compensation' under Section 37 of the Income-tax Act, 1961 (the Act) in the Assessment Years (AYs) 2003-04 to 2007-08. Although the options vested equally over four years, the taxpayer claimed a larger amount in the first year than was available under the Securities Exchange Board of India (SEBI) guidelines. The AO and Commissioner of Income-tax (Appeal) [CIT(A)] rejected the claim on the ground that there was no expenditure.

The Bangalore Special Bench held as follows:

- The difference (discount) between the market price of the shares and their issue price is expenditure in the hands of the taxpayer because it is a substitute for giving a direct incentive in cash for availing the services of the employees. There is no difference between a case where the company issues shares to the public at market price and pays a part of the premium to the employees for their services and another where the shares are directly issued to employees at a reduced rate. In both situations, the employees are compensated for their effort.
- The liability cannot be regarded as being contingent in nature because the rendering of service for one year is sine qua non for becoming eligible to avail the benefit under the scheme. Once the service is rendered for one year, it becomes obligatory on the part of the company to honor its commitment of allowing the vesting of 25 percent of the option.
- There is likely to be a difference in the quantum of discount at the stage of vesting of the stock options (when the deduction is allowable) and at the stage of exercise of the options. The difference has to be adjusted by making suitable northwards or southwards adjustment at the time of exercise of the option depending on the market price of the shares then prevailing. The fact that the SEBI Guidelines do not provide for the adjustment of discount at the time of exercise of options is irrelevant because accounting principles cannot affect the position under the Act.
- Adverse decision of Delhi Tribunal in the case of Ranbaxy Laboratories Ltd. v. Add. CIT [2009] 124 TTJ 771 (Delhi) is reversed.

*Biocon Ltd. v. DCIT [TS-322-ITAT-2013(Bang)]*



FICCI

## The penalty under Section 271(1)(c) cannot be levied on disallowances made by treating an expenditure as capital since treatment of expenses as capital or revenue is highly debatable. Penalty on ad-hoc disallowances is also not sustainable

The AO inter alia in its assessment order for AY 2004-05 disallowed certain repairs and maintenance expenditure on plant & machinery and building by treating it as capital in nature and also made ad-hoc disallowance of miscellaneous expenses for want of supporting evidence. It was explained to the AO that the expenses on repairs and maintenance were inadvertently claimed as revenue expenditure and there was no attempt to make any false claim in respect of the said expenses, which were otherwise genuine expenses relating to the business. With regard to miscellaneous expenses, it was submitted before AO that relevant supporting vouchers were not produced as the relevant record was lost/misplaced during the course of shifting of office. The AO, ignoring the submission, levied the penalty on the disallowances, which was upheld by CIT(A).

On appeal, the Mumbai Tribunal deleted the levy of penalty and held that whether the particular repair expenses are of revenue or capital nature is highly debatable issue and there was no case of furnishing of inaccurate particulars of income. The Tribunal inter alia observed that the action of the AO in allowing the depreciation clearly shows that genuineness of the expenses was not disputed and the fact that the said expenses were related to the business of the taxpayer. The Tribunal also relied on the decision of Delhi Tribunal in the case of DCIT v. Shivalik Global Ltd [2011] 8 ITR 761 (Delhi). In so far as levy of penalty on estimated disallowance of miscellaneous expenses is concerned, the Tribunal deleted the levy of penalty and held that the disallowance of miscellaneous expenses was made on estimated basis for want of supporting voucher and there was no case that any bogus expenses not relating to business were claimed by the Taxpayer under the head miscellaneous expenses. The Tribunal inter alia relied on the decision in the case of DCIT v. Eagle Iron & Metal Industries Ltd [2011] 11 ITR 384 (Mum).

*Dresser Rand India Private Limited v. DCIT (ITA No. 3558/M/2010)*

## No disallowance under Section 14A to be made if satisfaction not recorded. Under Rule 8D(2)(ii) loans for specific business purposes cannot be included. Under Rule 8D(2)(ii) & (iii) investments which have not yielded income cannot be included

During the AY 2008-09, the taxpayer invested INR 1.3 billion in shares on which it earned tax-free dividends of INR 0.13 million. The taxpayer claimed that although its borrowings had increased by INR 1.22 billion, the investments were funded out of own funds like capital and profits. It claimed that no expenditure had been incurred to earn the dividends and no disallowance under Section 14A could be made. The AO applied Rule 8D of the Income-tax Rules, 1962 (the Rules) and computed the disallowance at INR 40 million. The CIT(A) reduced the disallowance to INR 2.6 million.


FICCI

On cross appeals, the Kolkata Tribunal held as follows:

- When the AO does not accept the taxpayer's claim regarding the non-applicability/ quantum of disallowance under Section14A, the AO has to record satisfaction on that issue. This satisfaction cannot be a plain satisfaction or a simple note but it has is to be done with regard to the accounts of the taxpayer;
- The interest expenditure, which is directly relatable to any particular income or receipt which is taxable, is not to be considered under rule 8D(2)(ii);
- Further, referring to Rule 8D(2)(ii), it was held that only the average value of the investment from which the income has been earned which is not forming part the total income is to be considered. Thus, it is not the total investment at the beginning of the year and at the end of the year, which is to be considered, but it is the average of the value of investments which has given rise to the income, which does not form part of the total income which is to be considered.
- Thus, the disallowance under Section 14A read with Rule 8D of the Rules is to be in relation to the income which does not form part of the total income and this can be done only by taking into consideration the investment which has given rise to this income, which does not form part of the total income.

*REI Agro Ltd. v. DCIT (ITA No.1331 & 1423 /Kol/2011 dated 19 June 2013)*

## The application of the Transactional Net Margin Method does not necessitate the similarity of products, and the internal Transactional Net Margin Method should be given priority over external for determining the arm's length price

Taxpayer had purchased certain raw material from its Associate Enterprise (AE) and had also incurred advertising, marketing and promotion (AMP) expenses. The taxpayer carried out a comparability analysis based on internal TNMM for the transaction of purchase of raw-material. The Transfer Pricing Officer (TPO) rejected the internal Transactional Net Margin Method (TNMM) analysis of the taxpayer considering that the apportionment of the huge AMP expenses between the associated enterprises (AE segment) and the non-AE segment would be a significant point in determining the ALP and that the products in the AE and non-AE segment are not similar. The TPO therefore applied external TNMM.

The TPO also held that the transaction of AMP expense should be considered as an international transaction, and the taxpayer should receive compensation from its AE as it had acted to increase the value of the brand name owned by its AE. TPO benchmarked the ratio of AMP expenses to sales of the taxpayer with the arithmetic mean of the AMP expenses of comparables adopted by him and determined the ALP of the compensation to be received by the taxpayer by applying TNMM.

In respect of import transaction, the Tribunal held in favour of the taxpayer, by stating that product comparability is not essential for applying TNMM and based on the facts and circumstances of the case, internal comparability analysis is acceptable since it would require lesser adjustments considering the similarity in functions of the same entity. However, the Tribunal upheld the stand of the revenue that an excessive AMP expense is an international transaction following the ruling in the case of LG Electronics India Pvt. Ltd v. ACIT [2013] 140 ITD 41 (Del) (SB) and restored the matter to the TPO, with a direction to adjudicate the case in light of the ruling in the case of LG Electronics.

*Diageo India Private Limited v. DCIT Mumbai [ITA Nos. 7932/Mum/2011]*

## Hyderabad Tribunal adjudicates on principles of comparability analysis, treatment of reimbursement cost for the purpose of mark-up and admissibility of economic adjustments

The taxpayer was engaged in the provision of Business Process Outsourcing (BPO) services to its AEs and selected TNMM as the most appropriate method. TPO conducted a fresh benchmarking analysis and adjusted the ALP of the international transaction of the taxpayer after providing for working capital adjustment. While arriving at the operating margin of the taxpayer from the BPO services rendered to the AEs, the TPO included value of reimbursements in the cost base and also denied economic adjustments claimed by the taxpayer. The CIT(A) upheld the decision of the TPO.

The Tribunal held as follows:

- Companies incurring substantial outsourcing cost and companies which had undergone amalgamation during the year under consideration should be rejected as functionally not comparable.
- Ruled in favour of the tax authorities, to include companies which have high turnover similar to taxpayer's turnover for the year under consideration as comparables. The taxpayer failed to bring out any other non-comparability reasons.
- Upheld the TPO's decision on application of the related party transaction filter of 25 percent, the employee cost filter, foreign exchange earnings filter and diminishing revenue filter.
- Agreed to the taxpayer's contention that reimbursement costs should be excluded from the cost base of the taxpayer while determining the mark-up, as this cost does not involve any functions to be performed so as to consider it for profitability purposes.
- Acknowledged the admissibility for depreciation adjustment and remanded the matter back to the file of AO for verification of the computation of depreciation adjustment.
- Agreed to the contentions of the taxpayer that some of the comparables may be undertaking market/ entrepreneurial risks and directed the AO to re-examine this issue afresh. The Tribunal, however, rejected the risk quantification and

the method of quantification submitted by the taxpayer.

*HSBC Electronic Data Processing India Private Limited v. ACIT [ITA No.1624/Hyd/2010]/ [ITA No. 1623/Hyd/2010]/ ITA No. 1677/ Hyd/ 2010]/ [Cross Objection No17/ Hyd/ 2011]/ [ITA No. 76/Hyd/2008]*

## Revenue can question genuineness of share-swap not businessman's prudence

The taxpayer, a foreign institutional investor registered with SEBI, was holding 502,430 shares in a Singapore company. The taxpayer received 31,402 shares in an Indian Company in exchange of its holding in the Singapore company in the ratio of one share of an Indian company for every 16 shares held in the Singapore company. As a result, the taxpayer claimed long term capital loss of INR 0.52 billion. The AO disallowed the long term capital loss on the grounds that the taxpayer had failed to submit documentary evidence with regard to the cost of acquisition of shares in Singapore Company. The taxpayer referred the matter to the Dispute Resolution Panel (DRP). The DRP held that no sound reason was furnished by the taxpayer to explain as to why it entered in an exchange transaction that resulted in huge loss of INR 0.52 billion and that no prudent businessman would enter into such a transaction.

The Tribunal held that the AO/DRP can question the genuineness of the transaction but could not question the prudence of the businessman to carry out the transaction. Once it is proven that a transaction had taken place, the resultant profit or loss has to be assessed as per the tax statutes. Therefore, according to the Tribunal, by casting doubt about the prudence of the transaction, members of the DRP had stepped into an exclusive discretionary zone of a businessman, which is not permissible.

*Capital International Emerging Markets Fund v. DDIT [ITA No.8796/Mum/2010]*

## Rental from commercial property being declared as income from House Property does not render the property as a residential property

The Chennai Tribunal held that commercial property cannot be treated as a residential property merely on the grounds that rental income received from it is offered under the head Income from House Property.

The Act provides that annual value of the property (any building or land appurtenant thereto), owned by an individual, other than such portion of the property that he may occupy for purpose of business or profession, shall be chargeable to income-tax under the head 'income from house property'. The Act does not make any distinction between rental income from residential property or from commercial property.

*Mr. I. Ifthiqar Ashiq v. ITO (ITA No. 232/Mds.2013 dated 11 June 2013) Assessment Year 2009-10*

## Ahmedabad Tribunal held that improvement expenses on new ready-made property are eligible for capital gain exemption

The Ahmedabad Bench of the Income-tax Appellate Tribunal held that the improvement expenses incurred even after purchasing a new house to make the house

livable are eligible for capital gains exemption under the Act.

*Mr.Shrinivas R Desai v. ACIT (ITA No. 1245 and 2432/Ahd/2010, Assessment Year 2007-08, dated 28 June 2013)*

# Notifications/Circulars/ Press releases

## India signs tax treaty with Albania

The GoI has signed an agreement with the Government of Albania on 8 July 2013 for avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital (tax treaty). The said tax treaty is expected to provide tax stability to the residents of India and Albania, facilitate mutual economic cooperation and stimulate the flow of investment, technology and services between India and Albania.

Key highlights of the Tax Treaty are as follows:

- Business profits will be taxable in the source state if the activities of an enterprise constitute a PE in the source state;
- Dividends, interest, royalties and fees for technical services will be taxed both in the country of residence and in the country of source;
- Provisions for the effective exchange of information, including exchange of banking information between the tax authorities of India and Albania have been incorporated; and
- Anti-abuse provisions have been incorporated to ensure that the benefits of the tax treaty are availed of by genuine residents of the two countries.

*Source: Press release dated 8 July 2013 – www.pib.nic*

## CBDT Instruction regarding grant of interest on refunds under Section 244A of the Act

Pursuant to the decision of the Delhi High Court in Court On Its Own Motion v. UOI (2013) 352 ITR 273, the Central Board of Direct Taxes (CBDT) has issued Instruction No. 7/2013 dated 15 July 2013, stating that when the delay in processing the refund is not attributable to the taxpayer but is due to the fault of the Revenue, interest should be paid under Section 244A of the Act. The High Court had held that false or wrong uploading of past arrears and failure to follow the mandate before adjustment is made under Section 245 of the Act, cannot be attributed and treated as the fault of the taxpayer. The CBDT has directed that in view of the direction of the High Court, in no case should interest under Section 244A of the Act be denied to the taxpayer where the taxpayer is not at fault. It is also stated that the observation of the High Court should be strictly kept in mind while dealing with such matters.

*Instruction No. 7/2013 dated 15 July 2013*

## CBDT clarifies the process of set-off and carry forward of losses in relation to eligible units pertaining to Section 10A, 10AA, 10B and 10BA of the Act

The CBDT has issued a Circular pertaining to Sections 10A, 10AA, 10B and 10BA of the Act, setting out the tax department's view in relation to set-off and carry forward of losses of ineligible units against the profits



FICCI

of the eligible units. The income computed under various heads of income has to be aggregated in accordance with the provisions of Chapter VI of the Act. Accordingly, first the income/loss from various sources, i.e. eligible and ineligible units, under the same head would be aggregated in accordance with the provisions of Section 70 of the Act. Thereafter, the income from one head would be aggregated with the income or loss of the other head in accordance with the provisions of Section 71 of the Act. If after giving effect to the provisions of section 70 and 71 of the Act, there is any income (where there is no brought forward loss to be set off in accordance with the provisions of section 72 of the Act), and the same is eligible for deduction in accordance with the provisions of Chapter VI-A or section 10A, 10B etc. of the Act, it shall be allowed in computing the total income of the taxpayer. If after aggregation of income, in accordance with the provisions of section 70 and 71 of the Act, the resultant amount is a loss (pertaining to AY 2001-02 and any subsequent year) from the eligible unit, it shall be eligible for carry forward and set-off in accordance with the provisions of section 72 of the Act. Similarly, if there is a loss from an ineligible unit, it shall be carried forward and may be set off against the profits of eligible unit or ineligible unit as the case may be, in accordance with the provisions of section 72 of the Act. The provisions of Chapter IV and Chapter VI of the Act shall also apply in computing the income for the purpose of deduction under Section 10AA and 10BA of the Act subject to the conditions specified in these sections.

*File No: 279/Misc./M-116/2012-ITJ dated 16 July 2013*

## Withdrawal of stringent R&D circulars

On 26 March 2013, CBDT had issued two circulars. The first Circular (Circular no.2) provided that PSM should be adopted as the most appropriate method in all transactions involving unique intangibles or multiple inter-related transactions, unless it could be demonstrated by the taxpayer and accepted by the tax officers that reliable data for application of such method was not available.

The second Circular (Circular no.3) provided certain stringent conditions that were required to be cumulatively fulfilled by the taxpayer to be classified as a contract R&D service provider with insignificant risks.

Based on representations made by the IT industry, CBDT changed its stance and agreed to rescind Circular No. 2 relating to application of PSM and amend and reissue Circular No. 3. This indicates willingness of the Indian Government to adopt the representations/recommendations of the industry. Vide Circular No.5, the CBDT withdrew Circular No.2 and clarified the situations where PSM may be applied, instead of the earlier situation where PSM appeared to be the preferred method in cases involving unique intangibles or multiple inter-related transactions.

Further Circular No.6 has been issued amending the Circular No.3, wherein the words ‘cumulatively complied with’ has been eliminated in relation to the ‘conditions’ which were stated in the earlier circular for classification of a taxpayer as a contract R&D service provider with insignificant risks.

These modifications, brought about by CBDT, appear to have given a breather to R&D centres operating in India, which seemed to be stirred by the introduction of the earlier circulars. The restoration to selection of most appropriate method instead of PSM as a preferred method should help settle some of the anxiety that was created by the introduction of the earlier Circulars.

In its Press Release, the CBDT provided that Safe Harbour rules are under consideration and will be issued shortly. The Safe Harbour Rules are expected to bring further certainty in taxation of Development Centres.

### OECD releases a Discussion Draft for tax treaty treatment of termination payments

On 26 June 2013, OECD released a Discussion Draft on tax treaty treatment of termination payments. Considering that there is inconsistent tax treaty characterisation of payments received after cessation of employment, there is a risk of double taxation or non-taxation. To address this concern, the OECD has released the Discussion Draft with proposals of making addition and amendments to the Model Tax Convention, and has invited comments from interested parties (by 13 September 2013).

# II. SERVICE TAX

## High Court Decisions

### Flying Training Institutes providing training for obtaining Commercial Pilot License and Aircraft Engineering Institutes providing training for Basic Aircraft Maintenance Engineering License are exempt from payment of service tax

The taxpayer was an Aircraft Engineering Institute which provided training for obtaining Basic Aircraft Maintenance Engineering Licence (“BAMEL”) as approved by Directorate General of Civil Aviation (“DGCA”) and issued certificates approved by the DGCA to candidates who successfully completed the approved training curriculum and passed the examinations.

Section 65(105)(zzc) of the Finance Act, 1994 (“Finance Act”) was introduced w.e.f. from July 1, 2003 which provided for levy of service tax on commercial training or coaching services. However, preschool coaching and training centre or any institute or establishment which issued any certificate or diploma or degree or any educational qualification recognized by law for the time being in force, was excluded from the meaning of commercial training or coaching centre under section 65(27) of the Finance Act.

Section 65(27) was amended w.e.f. May 1, 2011 whereby the exclusion earlier

provided to preschool coaching and training centre or any institute or establishment which issued educational qualification recognized by law was withdrawn but similar exemption was granted to preschool and educational qualifications and training which were recognized by law vide Notification No 33 /2011-ST dated May 25, 2011 w.e.f. from May 1, 2011.

Meanwhile, Central Board of Excise & Customs ("CBEC") vide Instruction No 137 /132/2010-ST dated May 11, 2011 ("Circular") clarified that Flying Training Institutes providing training for obtaining Commercial Pilot License (CPL) and Aircraft Engineering Institutes providing training for obtaining BAMEL come under the category of coaching centers as laid down in section 65(27) of the Finance Act and were assessable to service tax.

Basis this Circular, SCN was issued to the taxpayer. The Writ Petition was filed by the taxpayer before the Delhi HC raising the question whether Flying Training Institutes providing training for obtaining CPL and on Aircraft Engineering Institutes for obtaining Basic Aircraft Maintenance Engineering License are liable to service tax.

The taxpayer contended that the Course Completion Certificates issued by the taxpayer were recognized by law and the taxpayer should be exempt from service tax. On the other hand, the Revenue Authorities contended that taxpayer was not issuing any certificate, degree or diploma recognized by law and was only imparting training and prepared the candidate to appear in the DGCA Basic License Examination.

The Delhi HC held that an educational qualification recognized by law will not cease to be recognized by law merely because for practicing in the field to which the qualification relates, a further examination held by a body regulating that field of practice is to be taken. Accordingly the said Circular and SCN issued to the taxpayer were quashed. The HC held that the activity of the taxpayer squarely falls under the exclusion from the definition or the exemption notification.

*Indian Institute of Aircraft Engineering v Union of India & Ors (2013-TIOL-430-HC-DEL-ST)*

## Tribunal Decisions

### Incentive received from a bank for temporarily keeping share application money as lead banker is not for promoting or marketing of any services of the bank nor has any service been provided by the taxpayer on behalf of any client and is not liable to tax. Share of income received from a NBFC company for the activity of financing done on a principal-to-principal basis is not liable to tax under business support services. No services rendered when reimbursements received from other group companies for common expenses in the nature of electricity charges and office expenses


FICCI

The taxpayer was a merchant banker, registered with Securities Exchange Board of India and service tax department. It provided various services classifiable under the category of business auxiliary services, banking & financial services and business support services but was not discharging service tax liability on some of the services namely brokerage / commission on Initial Public Offer ("IPO"), brokerage / commission on fixed income product, IPO finance fee, processing fee, recovery of commission expenses.

The Revenue Authorities were of the view that the taxpayer is liable to pay service tax under the following service tax categories for the aforementioned services:

- Business Auxiliary Services
- Banking and Financial Service
- Business Support Services

The matter reached before Tribunal who considered the submissions of the parties and passed an order in respect of all the aforementioned categories as mentioned below:

*Business Auxiliary Services*

The taxpayer temporarily kept share application money in a particular bank as lead banker in lieu of an incentive. The Revenue Authorities were of the view that the amount received towards income from financing of application money and processing fees received from the bank for choosing that particular bank for deposit of the application money shall be subject to service tax.
It was held that no service tax was leviable on the incentive received by the taxpayer as there was no element of promoting or marketing of neither any services of the bank nor any service has been provided to the bank by the taxpayer on behalf of any client.

*Banking and financial service*

As a lead manager and advisor for the IPO, the taxpayer advised its clients (prospective investors) to invest in the shares / debentures of a particular company. In order to provide short term funds to its clients, it entered into an agreement with the NBFC ("finance company") whose main object was of leasing investment and lending. The Revenue Authorities contended that the taxpayer rendered a service to the NBFC in lieu of which it received share of income.
It was held that no service has been rendered by the taxpayer to the finance company as the activity has been done on a principal-to-principal basis.

*Business Support Services*

The taxpayer claimed reimbursement of common expenses like electricity etc from other group companies. Revenue Authority was of the view that such reimbursements received represent the consideration for services rendered under the category of 'Business Support Services'.

It was held that no service can be stated to have been rendered in respect of receipt of reimbursement of common expenses by the taxpayer and accordingly, the same was not liable to service tax.

*JM Financial Services Pvt Ltd v Commissioner of Service Tax, Mumbai-I*

*(2013-TIOL-757-CESTAT-MUM) (Mumbai CESTAT)*

### Services received by taxpayer from a foreign company for accessing their own data maintained in different countries do not fall within the ambit of 'Online information and database access or retrieval'

The taxpayer entered into a contract with M/s Equant Pte Ltd, Singapore ("Singapore Company") for providing Virtual Private Network ("VPN") which enables the taxpayer and its branches to retrieve data from the data centre maintained by the taxpayer in India, USA and UK.

The Revenue Authorities were of the view that the taxpayer is receiving online information and data base access or retrieval service through computer network and hence liable to service tax on reverse charge basis. The matter reached before the Tribunal, where it was contended by the Revenue Authorities that the taxpayer had received online connectivity to their data base in the data centres for access to or retrieval of online information/database and this connectivity is provided by the Singapore Company. Since the service is provided through online computer network, the taxpayer appeared to be the beneficiary of this service in as much as the same enables data updation on regular basis.

The Tribunal held that since the data being retrieved or accessed by the taxpayer is its own data centre which was maintained by it in India, USA and UK, prima facie it cannot be said that the taxpayer has received service of online information and database access or retrieval and pre-deposit of the assessee was waived and stay granted to the assessee.

*State Bank of India v CST, Mumbai-II (2013-TIOL-767-CESTAT-MUM) (Mumbai CESTAT)*

### Services of dismantling an existing structure for erection of a new structure in the factory premises are valid input services for availing Cenvat credit

Taxpayer was engaged in manufacturing of steel pipes and tubes and claimed Cenvat credit on services of dismantling an existing structure in the factory for erection of a new structure. This was opposed by the Revenue Authorities and the matter reached before the Tribunal.

The Tribunal after hearing both the sides held that the inclusive part of the definition of 'input services' under Rule 2(l) of the Credit Rules specifically includes services used in relation to renovation or repairs of a factory. The service of dismantling was nothing but renovation of the existing structure to create a new structure and accordingly, these services were valid input services for availing Cenvat credit. The appeal of the Revenue Authorities was therefore rejected.

*CCE, Meerut-II v Jindal Pipes Ltd [2013 (30) STR 686 (Tri-Del)]*

### Hiring of an aircraft where the entire control and possession including liability to maintain and repair is with the hirer is not liable to service tax under Supply of Tangible Goods ("STG") service

Taxpayer hired an aircraft from a foreign company for rendering cargo services in India. The aircraft was transferred by the foreign company to the taxpayer who exercised entire control over the aircraft including appointment of crew, repair and maintenance etc. Demand was raised by the Revenue Authorities alleging that the above activity is liable to service tax under the head STG service under the Finance Act. Aggrieved by the above the taxpayer made an application before the CESTAT for waiver of pre deposit and grant of stay.

Taxpayer relied on the definition of STG service under the Act and contended that since the effective control and possession of the aircraft was with him the above activity would not be liable to service tax. Revenue Authorities however argued that the control was exercised only for operational purposes and such control cannot be considered to be effective control.

CESTAT held that neither the fact that the possession of the aircraft was transferred to the taxpayer nor the fact that the aircraft was operated for cargo aviation purposes in India was in doubt. Since the aircraft was handled by the crew appointed by the taxpayer as well as the maintenance and repairs were also undertaken by the taxpayer it can be held that taxpayer was exercising effective control of the aircraft. Therefore, the above transaction did not fall within the definition of STG service under the Act and accordingly prima facie not liable to service tax. Hence, pre deposit was waived and stay was granted.

*Blue Dart Aviation Ltd v Commissioner of Service Tax, Chennai (2013-TIOL-777-CESTAT-MAD)*

## Overseas group company is not providing services of Manpower Supply or Recruitment Agency Service ("MSRS") to Indian group company if the contract for employment is entered into with the employees directly by the Indian company

Taxpayer, an Indian company, entered into agreements with personnel of the overseas group company located in Germany for their employment for a specific period. Employees being foreign nationals received 25 percent of their salary in India and the rest 75 percent of the salary in Germany. The overseas group company paid 75 percent salary to the employees and consequently claimed the reimbursement from the Indian company. The taxpayer also deducted tax on the income earned by the personnel in India. Revenue Authorities issued a SCN on the basis that the amount remitted to the overseas group company was a consideration for Manpower Supply & Recruitment Service ("MSRS") that the overseas group company provides to the Indian entity. Aggrieved by the same, the taxpayer filed an appeal before the Tribunal.

Taxpayer contended that since they employed the personnel by entering into agreements with them, there is no supply of manpower by the overseas company. Merely because 75 percent of the salary was paid by the German company, the above activity cannot be made liable to service tax. Taxpayer also placed reliance on various favourable decisions of the Tribunal. On the basis of the foregoing, the

taxpayer prayed for grant of interim stay and waiver of pre-deposit. Revenue Authorities on the other hand reiterated the finding of the adjudicating authority.

Basis the above facts and arguments, the Tribunal held that the above services would not qualify as MSRS merely on the fact that the overseas company pays 75 percent of the salary to the personnel employed by the Indian company. Also, since the contract of employment was with the employees directly and not with the group company, the services under consideration could not be said to be provided by the group company. Accordingly, pre deposit was waived and stay was granted.

*Volkaswagen India Pvt Ltd v CCE, Pune-I (2013-TIOL-774-CESTAT-MUM)*

# III. VAT/ CST

## High Court Decisions

### For determining whether multi functional machine is an input or output unit of an automatic data processing machine or not, dominant / principal purpose for which the machine was designed and manufactured needs to be determined

The taxpayer was in the business of manufacturing office automation products. The VAT authority raised a demand against the taxpayer by classifying the automation product as a multi functional printer resulting in a higher VAT rate of 12.5 percent. On the other hand, taxpayer contended that the automation products manufactured by them would qualify as an input or output unit of an automatic data processing machine and would attract VAT at a lower rate.

The taxpayer filed a writ petition before the Delhi HC challenging the tax demand raised by the VAT authority. HC held that the issue in question required determination of factual aspects viz, whether or not the multi functional machine in dispute is an input or output unit of an automatic data processing machine. For determining the aforesaid fact, the dominant / principal purpose for which the machine was designed and manufactured needed to be ascertained. Basis this factual finding only, it could be determined and decided whether the machine in question would be taxable at the special rate as an input or output unit of an automatic data processing machine or would be taxable under the residuary category. Accordingly, while the HC did not entertain the writ petition and directed the taxpayer to exhaust statutory remedies where both questions of law and facts could be elucidated and examined and it endorsed the ‘dominant purpose’ test for classification

*Infres Methodex India Pvt Ltd v CCE, Pune – I (2013-TIOL-424-HC-DEL-VAT)*

### The right to use a vehicle is dependent upon the monthly payment of rentals and therefore, the monthly rentals received or receivable by the dealer during the tax period qualifies as the sale price

The taxpayer entered into an agreement for lease of vehicles. The VAT authority held that the amount to be paid for the entire term of lease shall be included as turnover for the month when the vehicle was delivered to the lessee. The matter finally reached before the HC.

Before the HC, the taxpayer contended that the provisions of the VAT Act are in pursuance to Article 366(29A)(d) of the Constitution of India which provides for tax on transfer of right to use any goods for any purpose. Thus, incidence of tax is not on delivery of the goods but on the transfer of right to use goods. The transfer of right to use goods is subject to condition of payment of monthly rental and therefore, the rentals received or receivable during the entire term cannot be included in the turnover for the month when the vehicle was delivered to the lessee.

While allowing the appeal of the taxpayer, HC held that the right to use vehicle was dependent upon the monthly payment of rentals and therefore, the monthly rentals received or receivable by the dealer during a particular tax period was the turnover of the taxpayer for that tax period and would become exigible to tax.

*GE Capital Transportation Financial Services Ltd v The State of Haryana and Another (2013-VIL-34-P&H)*

### Input Tax Credit (“ITC”) refund cannot be denied under the Tamil Nadu VAT Act (“TNVAT Act”) merely on the grounds of payment of VAT at a rate which is more than the prescribed rate, if the Taxpayer is rightfully entitled to the same

The taxpayer was a 100 per cent, Export Oriented Unit (“EOU”), engaged in the manufacture and export of all its finished products comprising of cotton made-ups and fabrics. The taxpayer purchased certain raw materials and capital goods, for the manufacture of the finished products, locally on payment of VAT at a rate of 12.5 percent. The taxpayer filed an application for refund of 12.5 percent VAT paid on procurement of raw materials and capital goods which are used for manufacture of finished goods subsequently exported outside India. The refund claim was sought to be denied on VAT paid in excess of 4 percent on the ground that the actual VAT payable on such raw materials and capital goods was 4 per cent and not 12.5 per cent.

The taxpayer filed a writ petition before the HC challenging the order rejecting the refund claim of the taxpayer. The HC referred to the provisions of TNVAT Act wherein section 18(1) provided for the zero rating of the products under certain stated circumstances. The HC also considered section 18(2) that dealt with the right of a dealer, who makes a zero rated sale for refund of the input tax paid or payable by him on purchase of the goods which are exported as such or used in the manufacture of the exported goods. HC held that going by the provisions of the TNVAT Act, given the fact that the taxpayer is entitled for refund of input tax paid on purchase of goods under section 18(2) of the TNVAT Act, the taxpayer’s claim for refund of amount has to be given in toto without any adjustment. HC rejected the contention of the Revenue Authorities that purchaser of goods is not entitled to the benefit of total refund of the amount and

held that if the seller charges tax at a rate over and above what is payable under TNVAT Act when effecting sale to the taxpayer, all that the Revenue Authorities could do is to proceed against the seller of the goods for charging purchaser at a rate not legally sustainable

*Summer India Textile Mills Pvt Ltd v The Commercial Tax Officer, Erode (2013-TIOL-427-HC-MAD-VAT)*

### ITC cannot be denied to the purchasing dealer on the ground that the selling dealer has not paid tax, when the purchasing dealer has paid the same in the manner so prescribed

The taxpayer was a dealer in lubricants and purchased lubricants from M/s Classic Enterprises ("selling dealer"). On verification of the returns of the selling dealer, it was found that the selling dealer had neither filed monthly returns nor deposited the tax so collected from the taxpayers. Notice was issued to the taxpayer contending that the ITC should be reversed on the failure of the selling dealer to deposit tax although it was an admitted fact that the taxpayer had paid tax to the selling dealer and an adverse order was passed by the Revenue Authorities.

Being aggrieved by the aforesaid order, the taxpayer filed a writ petition before the Madras HC. After referring to the provisions of the TNVAT Act, Madras HC held that section 19(1) of the TNVAT Act states that the input tax credit can be claimed by the registered dealer, if it is established that the tax due on such purchase has been paid by him in the manner prescribed and that was accepted at the time when the self assessment was made. Thus, the liability of non-payment of tax would fall on the selling dealer and not the taxpayer, which had shown the proof of payment of tax on purchase made. Further, the HC held that section 19(16) does not empower the authority to revoke the ITC availed on the plea that the selling dealer had not deposited such tax. Thus, HC set aside the impugned order.

*Sri Vinayaga Agencies v Assistant Commissioner (CT), Vadapalani-I Assessment Circle, Chennai [2013 (060) VST (0283)]*

# IV. CUSTOMS

## High Court Decisions

### Goods stock transferred from the Special Economic Zone unit to its DTA unit would be eligible for exemption from the payment of whole of the additional duty of customs leviable under section 3(5) of the Customs Tariff Act, 1975 under Notification No 45/2005-Cus dated May 16, 2005 ("Notification")

The taxpayer proposed to establish a unit in a Free Trade Warehousing Zone ("FTWZ") in the State of Maharashtra for warehousing parts and components of wind operated electricity generators procured from outside India and stock transfer the aforesaid goods to its manufacturing unit in



FICCI

Pune. Though the aforesaid goods were subject to VAT at the rate of 5 percent, no VAT was payable as the taxpayer proposed to stock transfer the aforesaid parts.

The taxpayer proposed to avail the benefit of exemption Notification that exempts goods cleared from a Special Economic Zone unit to a DTA from payment of whole of the additional duty of customs leviable (hereinafter referred to as "SAD") under section 3(5) of the Customs Tariff Act, 1975 (in short Tariff Act). The exemption granted under the Notification was subject to the fulfillment of the conditions mentioned in the proviso of the aforesaid notification which inter alia provided that such clearance should not be exempted from sales tax / VAT. The taxpayer approached the Authority for Advance Rulings ("AAR") for a confirmation of its proposal to avail the benefit of exemption Notification No 45/2005-Cus.

It was noted by the AAR that in case of a stock transfer two persons are not involved as stock transfer is between the units of the same legal entity, therefore, it does not fall within the definition of "sale" as defined under section 2(24) of the Maharashtra VAT Act ("MVAT"). It was held that VAT is a tax on sale of goods within the State and the same cannot be levied on stock transfer and therefore, no VAT is leviable on such transaction – as opposed to the same being 'exempt' from VAT. It was held that since the goods cleared by the taxpayer by way of stock transfer were not exempted from payment of sales tax/ VAT, the condition of the Notification could not be considered to have been violated. In view of the fact that the goods are stock transferred and thus do not fall within the ambit of MVAT, the AAR held that the condition of the Notification stands fulfilled and the benefit of exemption Notification is available to the taxpayer.

*GE India Industrial Private Limited (2013-TIOL-01-ARA-CUS)*

# V. CENTRAL EXCISE

## High Court Decisions

### Application for settlement can be made after 180 days of seizure even if no Show Cause Notice ("SCN") has been issued. Also, a pragmatic and practical view should govern the proceedings before the Settlement Commission

The taxpayer had filed an application for settlement after 180 days of seizure, without receiving a SCN. Pursuant to the said application, the Settlement Commission duly settled the case by taking into account all pertinent factors. Vide the order, the Settlement Commission settled the duty along with applicable interest and the said duty was to be adjusted out of cash seized from the taxpayer. The Settlement Commission also granted immunity from penalty and prosecution to the taxpayer.

Aggrieved by such settlement, a writ petition was filed by the Director General, Central Excise Intelligence against the order passed by the Settlement Commission. The Revenue Authorities was aggrieved by the order of the

Settlement Commission on the ground that the Commission did not go into the question of full and true disclosure at the stage of admission of the application. The impugned order was also to be considered invalid as there is no recording therein of satisfaction of true and full disclosure on behalf of the taxpayer. Further, the application under section 32E of the Central Excise Act, 1944 ("CEA") was filed by the taxpayer before the issuance of the SCN and was thus, not maintainable.

The Delhi HC observed that only after investigation by the Commissioner (Investigation), the Settlement Commission settled the total duty. Therefore, if the taxpayer has not made a complaint against the amount settled by the Settlement Commission, which is twice the amount admitted by them before the Commission, it is not open for the taxpayer-Revenue Authorities to assail that amount. Further, the Settlement Commission was conscious of the requirement of true and full disclosure by the taxpayer and this requirement was considered as fulfilled by the Settlement Commission before arriving at the impugned settlement. It was also observed by the HC that section 32E(b) provides that no application for settlement shall be made unless a SCN for recovery of duty issued by the Central Excise Officer has been received by the applicant. The HC also considered section 32E(2) which states that the assessee shall not be entitled to make an application before the expiry of 180 days from the date of the seizure, where any excisable goods, books of accounts or other documents have been seized. In the present case, the taxpayer had filed the application for settlement after the expiry of 180 days from the date of seizure. In this regard, the HC held that both these provisions are directory in nature and need not be obeyed or fulfilled exactly. The HC also held that the aforesaid provisions are to be interpreted harmoniously, which is essential to ensure that neither one of them is rendered repugnant. On this basis, the HC held that the application could have been made after 180 days of the seizure or after receipt of SCN, whichever occurred earlier.

Before dismissing the present writ petition filed by the Director General, Central Excise Intelligence, the HC emphasized that a pragmatic and practical view should govern the proceedings before the Settlement Commission because the very scheme of the provisions of the Settlement Commission is settlement and not adjudication.

*Director General, Central Excise Intelligence v Murarilal Harishchandra Jaiswal Pvt Ltd [2013 (291) ELT 484 (DEL- HC)]*

## Cenvat credit balance standing in the books of accounts as on the date of conversion of a DTA ("Domestic Tariff Area") to a 100 percent EOU can be utilized for clearances made by the EOU

The taxpayer, a DTA unit converted into a 100 percent EOU, utilized the Cenvat credit balance standing in their books of accounts as on the date of conversion against the clearances made by them post conversion to a EOU.


FICCI

The Revenue Authority was of the opinion that the taxpayer was not entitled to avail the said Cenvat credit. The matter reached the Tribunal which held that the taxpayer was entitled to avail the credit standing in the books of accounts as on the date of conversion as there is no restriction in the Cenvat Credit Rules, 2004("Credit Rules") to this effect. The Tribunal relied upon the decisions given in the cases of Sun Pharmaceuticals Industries Ltd v CCE [2010 (251) 312 (Tri – Chennai)], GTN Exports Ltd v CCE [2009 (240) ELT 53 (Tri – Chennai)] and CCE v Ashok Iron & Steel Fabricators [2002 (140) ELT 227 (Tri – LB)].

On an appeal filed before the Bombay HC, the HC observed that the decisions given in the case of Sun Pharmaceuticals and GTN Exports Ltd have been accepted by the Revenue Authorities. The HC further observed that the departmental appeal against the CESTAT decision in the case of Ashok Iron & Steel Fabricators has been rejected by the Apex Court. Basis above, the HC dismissed the present appeal filed by the Revenue Authorities and decided the case in favour of the taxpayer

*CCE, Belapur v Sandoz Pvt Ltd [2013 (291) ELT 325 (Bom)]*

### Cenvat credit of basic excise duty can be utilized for payment of Education cess

The taxpayer paid education cess liability on its manufactured products by utilizing the Cenvat credit of basic excise duty from balance in Cenvat credit account. The Revenue Authorities not satisfied by the same demanded the duty on the ground that basic excise duty cannot be used for discharging the liability of education cess. The matter reached before the Tribunal. The Tribunal held the issue in favour of the taxpayer on the basis that the utilization of credit of basic excise duty for the payment of Education Cess is allowable since there is no restriction to this effect in the Credit Rules. The CESTAT placed reliance on the decisions of the Ahmadabad CESTAT in the case of CCE v Balaji Industries [2008 (232) ELT 693]. The matter went in appeal before the Gujarat HC. Basis the facts and arguments Gujarat HC agreed with the view taken by the Tribunal and dismissed the Revenue Authority's appeal.

*CCE v Madura Industries Textiles [2013 (39) STT 541(Guj HC)]*

## Tribunal Decisions

### Rule 10A of Central Excise Valuation Rules, 2002 ("Valuation Rules") is not applicable if a taxpayer manufactures final products after procuring inputs by its own, utilizing his own manpower and sells the finished products to the purchaser based upon the price agreed between them even if the purchaser supplies moulds required for the manufacture of final products

The taxpayer was engaged in the manufacture of various plastic moulded articles. The taxpayer entered into a purchase agreement ("Agreement") with M/s Symphony Limited ("Symphony") wherein it agreed to manufacture Air

Coolers with Symphony brand name. Under the terms of said agreement:

- The mould required for manufacturing of coolers were supplied by Symphony on returnable basis

- Symphony was allowed to supervise and monitor the production of Air Coolers on random basis

The inputs required for manufacturing of coolers were procured by taxpayer on his own without any interference of Symphony. The taxpayer cleared the coolers to Symphony after discharging Central Excise duty under Rule 6 of Valuation Rules read with section 4(1)( a) of CEA on the basis of transaction value.

The Revenue Authorities relied upon various clauses of the agreement, mentioned below and alleged that the relationship between taxpayer and Symphony is of job worker:

- Sale price of coolers was decided by Symphony and Agreement nowhere provides for determination of price of Air Coolers, price was based upon the cost of material plus processing charges and is nothing but cost of production

- Supervision and monitoring of the Air Coolers were done by Symphony

- The moulds required for the manufacture of Air Coolers were supplied by Symphony

Revenue Authorities alleged that the valuation of the goods should be done under Rule 10A of Valuation rules

The matter reached the Tribunal where the taxpayer contended the issue involved in this case is squarely covered by the decision of the Tribunal in the case of CCE, Hyderabad v Innocorp Limited (2012-TIOL-956-CESTAT-BANG). The Tribunal held that the Explanation to Rule 10A requires the manufacture / production of goods on behalf of principal manufacturer from inputs / goods supplied by any such principal manufacturer or by any other person authorized by him. This indicates that tax payer should have manufactured the air coolers from the inputs or the goods supplied by Symphony. Tribunal observed that the entire raw material required for the manufacturing of air coolers was purchased by tax payer independently and Symphony has no say in such purchases. Further taxpayer has received only moulds from Symphony for the manufacturing of such air coolers. Supply of moulds per se would not mean that tax payer is a job worker of Symphony and therefore Rule 10 A of the valuation rule should not be attracted. Mere fact that supervision is done by Symphony doesn’t mean that Symphony is acting as a principal manufacturer for the manufacturing of air coolers.

Tribunal also held that cost of free supply of moulds needs to be included in the transaction value for the discharge of duty liability under Rule 6 of the Valuation

Rules. Tribunal directed the lower authorities to quantify the amount of duty liability on the taxpayer on such amortized cost of the

*Symphony Comfort Systems Limited, Shri Paresh P Mehta, Abhishri Packaging Private Limited, Shri R Tainwala, Shri Rejendran v CCE, Vapi (2013-TIOL-772-CESTAT-AHM)*

# Notification & Circulars

## Introduction of Risk Management Systems in exports

While Risk Management System was introduced earlier vis a vis imports as a trade facilitation measure and for selective interdiction of high risk consignments for Customs control, the same concept is now being introduced for exports too vide a Customs Circular.

*Customs Circular No 23/2013 dated June 24, 2013*

## Notification amending Legal Metrology (Packaged Commodities) Rules, 2011 ("Legal Metrology Rules")

The Central Government has issued Notification dated June 6, 2013 amending Legal Metrology Rules. The main amendment is that the definition of 'industrial and institutional consumers' has been deleted from Rule 3 and fresh definitions have been inserted under Rule 2 of Legal Metrology Rules.

*Notification No GSR 359(E) dated June 6, 2013*

"This newsletter has been prepared with inputs from KPMG and BMR & Associates and does not express views or expert opinions. The newsletter is meant for general guidance. It is recommended that professional advice be sought based on the specific facts and circumstances. This newsletter does not substitute the need to refer to the original pronouncement"

## GST Framework - Comments submitted to the Secretariat of the Empowered Committee of the State Finance Ministers

**I. Exemptions**

- In accordance with principles followed in the matured and successful GST framework across the world, GST in India should be broad-based with minimal exemptions/ concessions. This would achieve the objectives of simplicity in administering, reducing the cascading impact and enabling a moderate rate of tax to be introduced. This would, in turn, incentivize domestic consumption and hence growth.

- While following the above principle, only critical items of mass consumptions (food grains, edible oils, etc.) may be exempted. In relation to other non critical goods (such as earthen pots), instead of granting exemption to such goods, the objective of granting relief to the targeted consumer segment may be achieved by prescribing a higher threshold (for instance earthen pots sold by small dealers would be exempted however where it is sold through super markets it would be taxable). Alternatively, targeted subsidies or benefits may be provided to identified segments in the form of non-fiscal incentives.

- Goods that are currently exempted under the VAT schedules of most of the States and exempted under Central Excise should continue to be exempted under the GST regime.

- Goods which are currently exempted from Central Excise and taxable under VAT should be taxed under GST with the caveat that current exemptions need to be withdrawn in a phased manner over a period of 24 to 36 months.

  Goods which are exempt under VAT and taxable under Central Excise must be charged to CGST. As regards SGST, the VAT exempt goods which are of local importance should be aggregated across various states and a basket of say 30 to 40 such products should be identified. States should thereafter be given the authority to exempt a specified number of goods (say 10) out of this basket.

- The rationale behind exemptions granted to special sectors / projects should be consistently applied to all goods and services. Exemptions are currently granted under Central Excise, Customs (conditional exemptions), service tax and VAT for special sectors/projects. However, the exemptions are not comprehensive. For instance, service tax is exempt on setting up of certain infrastructure projects such as road, airport however, no exemption is allowed to power projects. Further, only specified services (construction, repair, etc.) used for certain infrastructure projects are exempt.

Special sectors / projects should be identified in order to grant blanket exemption to all the goods and services required in relation to such sector / project. The exemption should be both in respect of CGST and SGST components.

This would help achieving the purpose of exemptions. Alternatively, no exemption should be allowed and a time bound automatic refund mechanism may be adopted for such sectors / projects on the lines of duty drawback mechanism. This would help in maintaining the GST chain and extension of benefit to the sector / project

- Area based Central Excise exemptions should be protected, i.e., these exemptions should appropriately be grandfathered and benefits should accrue for the promised period. Area based VAT exemptions can be switched to the remission model for the remainder of the stated period.

**II. Threshold limit**

Following points should be taken into consideration while determining the threshold limit:

- It is advisable to have a higher threshold limit of Rs.50 lakhs for both goods as well as services taken together (including value of exempted goods and services, and exports). Higher threshold limit would provide much anticipated relief to small dealers who would find difficult to meet the cost of compliances. Additionally, the threshold limit should be common for both Centre and the State.
- The threshold should be the same for all the states. In case, a lower threshold limit for North Eastern states is considered imperative, it should also be stipulated that the limit would be raised to the normal limit of Rs.50 lakhs in a phased manner over a 3 to 5 years period.
- The concept of keeping threshold limit as 'Zero' in case of inter-state sale / purchase should be revisited as it may result in unwarranted inclusion of a large number of small dealers in the tax net for following reasons:-
  - Over the past few years the inter-state trade has become more common even for small dealers (dealers in NCR, dealers in Union territories, etc.).
  - Even small dealers may be sourcing or supplying inter-state services.

  Option of payment of tax for such inter-state small dealers should be allowed to maintain the GST chain.
- Further, threshold limit should be determined per dealer/ entity wise and not State wise (i.e. where a dealer has presence in more than one State, its turnover in all the

States taken together should determine whether such dealer has breached the threshold limit).

- Centralized CGST registration should be allowed. In case the registration is required in each State, excess CGST credit in one State should be allowed to be set off against the CGST liability in any other State.

**III. Composition/ Compounding scheme**

Composition/ compounding scheme for small dealers should be introduced at dual levels:

- Upto Rs.60 lakhs with a tax rate of 1%: This would largely take care of dealers who are currently paying VAT under the composition scheme.

- Upto Rs.150 lakhs with a tax rate of 2%: This would take care of dealers who are currently not paying Central Excise but paying VAT at the normal rate.

This would help in taking onboard small dealers and traders and significantly reduce the cost of tax collection.

**IV. Control over Taxpayers**

- Assessees should be required to submit one composite return covering CGST, SGST and IGST through the GSTN portal which should be accessible to both the Central Government and State Authorities.

- Assessees should be subjected to one common jurisdiction with uniform assessment procedures. Assessment, scrutiny, audit etc. should be the responsibility of a single authority, representing both the Centre and the State. Dual control by the Central Government and the State Authorities should be avoided for simplified administration.

- Small dealers having a turnover upto Rs.1.50 crores should be within the jurisdiction of the State Governments. The Central Government may delegate its responsibilities / powers in respect of such dealers to the States wherever it deems fit.

- Large dealers having a turnover of Rs.1.5 crores or more should be within the jurisdiction of the Central Government. The State Governments may delegate their responsibilities / powers in respect of such dealers to the Central Government.

- Any dispute that may arise should be subjected to adjudication by the designated single authority and its decisions should be binding on both the administrations.

### V. Place of Supply Rules

Place of Supply Rules often bring challenges depending upon the industry. Hence, the industry bodies should be consulted before finalizing the rules.

### VI. IGST

- C-VAT model will be burdensome on the industry as well as Government. The current refund system is plagued with lot of inefficiencies in terms of procedural impediments, time lag, etc. Introducing a refund mechanism in the GST regime for such routine transactions would entail a high administrative cost and would effectively negate the perceived advantages of GST. It will be counter-productive for the "One-India One-Market" concept that the GST is supposed to usher in.
- IGST model should be followed for inter-state transactions.
- Requirement of sanctions for taking out amounts from the Consolidated Fund of the States may not be necessary. In the existing system of Central levies, no sanction of Parliament is required for payments of refunds, drawback, input credit etc. If this requirement is legally considered necessary, the provisions of the Constitution may be amended to waive off this requirement.
- Concerns around potential delay in transfer of tax by the exporting State as well as false claim in return as may be addressed by a robust IT system where transaction matching may be undertaken on continuous basis by the exporting States and data may be shared with the importing States on a periodic basis (say on a weekly/ monthly basis). The credits pertaining to matched transactions may be transferred at the end of specific period. The unmatched transaction should be reported to the importing States and verification should be undertaken by the exporting States. Exporting States should put a mechanism in place (such as random review of transactions and examination of dealers under suspect) to ensure false claim is not made by the dealers in the State. In case false claim is made by the dealers in the exporting State, such State should bear the incidence