December 2013

TAX UPDATES

(containing recent case laws, notifications, circulars)

Prepared in association with

Foreword

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

The Empowered Committee of State Finance Ministers held a meeting in Shillong on 18th-19th November, 2013 to discuss the reports of the sub-committees constituted to deliberate on the GST framework. As per reports in the media, the states have opposed inclusion of petroleum products or alcohol in the scheme of GST. They also want status quo to continue on the entry tax which they do not want to be subsumed in the GST. Matter of compensation to be given to the states on abolition of Central Sales Tax (CST) and for short fall in revenues, if any, consequent upon introduction of GST was also taken up. In the absence of any tangible progress, implementation of GST in the foreseeable future seems unlikely.

On the taxation regime, the Bombay High Court dismissed the writ petition of Vodafone India Services Pvt. Ltd. in a case related to a transfer-pricing adjustment over the issue of shares by Vodafone India and sent the matter back to the Dispute Resolution Panel (DRP). Vodafone India issued shares to a Mauritian-based group company at a fair market value. However, the tax department has determined the value of the shares substantially higher than what was adopted by the Vodafone India. The differential amount is being sought to be taxed by the authorities as income in the hands of Vodafone India.

In a service tax matter, the Delhi High Court ruled that no recovery proceedings can be initiated against a taxpayer whose application filed by him under the Voluntary Compliance Encouragement Scheme (VCES) is pending. The High Court observed that the taxpayer demonstrated that he had fulfilled the conditions for VCES and thus in the absence of application being considered and decided, no recovery proceedings can be initiated else the whole object of the scheme would be defeated.

The Finance Ministry has issued notifications reducing the threshold limit for mandatory e-payment of service tax / excise duty from Rs.10 lakhs to Rs.1 lakh. As a result, manufacturers and service providers would be required to pay duty/tax

through internet banking with effect from 1st January, 2014, if the total duty/tax paid in the previous financial year exceeds Rs.1 lakh.

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

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

A. Didar Singh

Recent case laws

I. DIRECT TAX

High Court Decisions

Payment for 'International Private Lease Circuit' taxable in India as royalty

The taxpayer, a non-resident company, was engaged in the business of providing international connectivity services in the Asia Pacific region including India. The taxpayer provides International Private Lease Circuit (IPLC) that can transport voice data and video traffic. While the Indian leg of the connectivity service was provided by an Indian company (VSNL) using the gateway/ landing station belonging to it, the international leg of the connectivity service was provided by the taxpayer outside India, using its telecom service equipments situated outside India.

The Assessing Officer (AO) held that the payments received by the taxpayer for providing IPLC to customers in India was taxable as 'royalty' under the provisions of Section 9(1)(vi) of the Act and under Article 12(3) of India-Singapore tax treaty. The Commissioner of Income-tax (Appeals) [CIT(A)] and Income-tax Appellate Tribunal (the Tribunal) also confirmed the AO's order.

Based on the facts of the case, the Madras High Court (High Court), inter-alia, observed and held as follows:

- The payments received by the taxpayer are in the nature of 'royalty' under the provisions of the Act and under the tax treaty;

- Even if the payment is not treated as one for the use of the equipment, it would be for use of the 'process' provided by the taxpayer;

- Explanation 5 to Section 9(1)(vi) of the Act clearly points out that the traditional concepts relating to control, possession, location on economic activities and geographic rules of source of income recede to the background and are not of any relevance in considering the question of royalty; and

- The decisions in the cases of Asia Satellite Telecommunications Co. Ltd. v. DIT [2005] 332 ITR 340 (Del) (HC), Dell International Services India Pvt. Ltd. [2005] 305 ITR 37 (AAR) and Cable and Wireless Networks India (P) Ltd. [2009] 315 ITR 72 (AAR) are distinguishable as these decisions were rendered prior to the insertion of the aforesaid Explanation 5, which gives a very expansive meaning to the term 'royalty'.

Verizon Communications Singapore Pte Ltd., [Appeal Nos.147 to 149 of 2011 and 230 of 2012 (Madras HC)]

Non-resident taxpayer liable to pay interest for default in payment of advance tax, since the tax liability was not admitted in its tax return and the Indian payers did not deduct tax

The Delhi High Court held that the taxpayer was liable to pay interest under Section 234B of the Act for default in payment of advance tax, since the liability to pay tax in India was not admitted by the taxpayer in its Indian tax return and the Indian payers did not deduct tax on payments made to such taxpayer.

While reaching its conclusions, the High Court distinguished its earlier decision in the case of DIT v. Jacabs Civil Incorporated and Mitsubishi Corporation [2010] 330 ITR 578 (Del) on the basis that in that case the taxpayer had admitted taxable income in its income-tax return. However, in the present case, the taxpayer did not admit any taxable income in the income tax return.

DIT v. Alcatel Lucent USA Inc. and DIT v. Alcatel Lucent World Services Inc (ITA 327/2012, ITA 330/2012, ITA 338/2012, ITA 339/2012, 328/2012, ITA 329/2012, ITA 336/2012, ITA 337/2012 & ITA 340/2012)

Where taxpayers' returns, claiming interest deduction, were treated as non est, waiver of such interest could not be subsequently taxed as remission of liability

During the year under consideration, the taxpayer availed the one-time settlement scheme of the bank, whereby a portion of interest was waived, which related to previous AYs. The taxpayer claimed that since the returns filed for the years to which interest was related, were held as non est, the deduction of interest was to be held as not allowed. Therefore, the interest waived could not be taxed under Section 41(1) of the Act as cessation of liability. However, the AO rejected the taxpayer's contention on the grounds that the taxpayer had been issued notice under Section 139(9) to rectify its returns for such years, to which it had not responded. Therefore, in absence of any specific order on disallowance, interest was included as income under Section 41(1) of the Act. The CIT(A) held that the claim of interest cost in the books of account for the previous years would constitute an allowance or deduction of expenditure or trading liability, and thus, it was taxable under Section 41(1) of the Act. However, the Tribunal allowed the taxpayer's appeal.

The Madras High Court held that in the context of Section 139(9) of the Act, when the return filed is treated as non est in the eyes of law, the expression 'where an allowance or deduction has been made in the assessment for any year' has to be read as any allowance or deduction considered in the assessment for the purpose of invoking Section 41(1) of the Act. For the applicability of Section 41(1) of the Act, the pre-requisite condition is that an allowance or deduction has been made in the assessment for any of the years in respect of an expenditure, loss or trading liability incurred by the taxpayer and subsequently during any previous year, the taxpayer has received remission or obtained refund of the said amount. Thus, Section 41(1) of the Act creates a legal fiction and hence, has to be strictly complied with if any addition to the income is sought to be made by the revenue. Thus, unless the amount had been allowed as a deduction in the earlier years, the question of invoking Section 41(1) of the Act does not arise. The Tribunal further held that, when a taxpayer makes a self assessment under section 140A and pays self assessment tax thereon, it does not mean an assessment by a competent authority and hence it cannot

be said that the amount had been allowed as a deduction in the earlier years, therefore the question of invoking Section 41(1) of the Act on this count also does not arise.

CIT v. Rayala Corporation (P.) Ltd. [2013] 36 taxmann.com 285 (Mad)

Where there was a tacit agreement in the form of offer and acceptance for sale of assets and existence of such assets could not be doubted, said sale and its lease back should not be rejected for the purpose of allowing depreciation

The taxpayer, a leasing company, entered into a sale and lease back (SLB) agreement in respect of certain assets, namely, meters, shunt capacitor banks and outdoor circuit breakers with the Tamil Nadu Electricity Board (Electricity Board). As per the SLB agreement, the taxpayer purchased certain assets from the Electricity Board and leased them back to Electricity Board and claimed depreciation on said assets. The AO disallowed the claim for such depreciation, treating those SLB transactions as loan transactions. The CIT(A) held that the taxpayer satisfied all the conditions for claiming depreciation and allowed the depreciation claimed. The Tribunal took the view that there was no actual delivery or handing over of possession of the machinery/equipment by the Electricity Board to the taxpayer on completion of the sale and there was also no redelivery or handing over of possession of the equipment by the taxpayer to the Board. The Tribunal therefore held that it was purely a finance transaction and, therefore, no depreciation could be allowed.

The Madras High Court held that there was a tacit agreement in the form of offer and acceptance for the sale of the assets and the existence of such assets cannot be doubted and the parties to the transaction were convinced about it. There is no reason why the said sale and its lease back should be rejected. The parties to the sale-cum-lease back agreement were an existing leasing company and a reputed State owned Electricity Board and hence in the absence of any material to the contrary, the claim made based on the sale-cum-lease back agreement cannot be rejected. As far as the ratification of the said transaction on the subsequent date by the Electricity Board is concerned, such later ratification by itself cannot be a ground to reject the sale-cum-lease back. Merely because the agreement provided for the deduction of the lease installments from the current consumption charges by way of priority, it cannot be held that the transaction is not a SLB, but a mere loan transaction. The provision for repayment of the lease amount by way of installments from the current consumption charges is one mode of repayment in order to ensure that there is no default in paying the installments. Merely because the assets were all eligible for 100 per cent depreciation, it cannot be held that the entire transaction would become doubtful. So long as the sale-cum-lease back agreement was real as between the parties and the transaction was carried out in accordance with the law, in the absence of any flaw in the agreement, one should not doubt the whole transaction. The very fact that the sale was accepted as between the taxpayer and the Electricity Board and after the settlement of the lease amount, the taxpayer would continue to retain its ownership in no uncertain terms stipulated in the agree-

ment, and when such a transaction was not against law, there was no reason to doubt the transaction. Thus the taxpayer was eligible for the depreciation.

First Leasing Co. of India Ltd. v. ACIT [2013] 38 taxmann.com 213 (Mad)

High Court allows filing of revised return during assessment along with condonation request and directs revenue to consider the application and revised returns on merits and in accordance with law

The taxpayer during assessment proceedings for AY 2007-08 had made an additional claim for deduction by filing a revised computation. The AO rejected the taxpayer's claim. However the CIT(A) and the Tribunal admitted the taxpayer's plea. Aggrieved, the tax department preferred an appeal before the Karnataka High Court. The question before the High Court was whether during the course of scrutiny of return or revised return of income, a taxpayer can make an additional claim for deduction, otherwise than by filing a revised return. In response, the taxpayer requested for permission to file a revised return to make the additional claim along with an application for condonation of delay under Section 119(2)(b) of the Act and prayed for directions for condonation to be considered by the appropriate authorities within a stipulated time frame. The High Court accepted the taxpayer's plea and allowed the taxpayer to file a revised return of income within a period of four weeks along with an application for condonation of delay before the appropriate authority. The High Court also directed the AO and the appropriate authority to consider the application for condonation of delay and revised return on merits and in accordance with law, expeditiously.

CIT v. Axa Business Services Pvt Ltd. [TS-530-HC-2013(KAR)]

Depreciation on Non-Compete Fees

The taxpayer acquired software development and training divisions from PMGL. The taxpayer paid INR 3.64 billion towards acquisition of IPRs and INR 1.80 billion as non-compete fees. The taxpayer claimed depreciation on IPR as well as non-compete fees. The Tribunal reversed the decision of the CIT(A) allowing depreciation on non-compete fees on the basis that a non-compete fee is not an asset but only a right to sue for breach of agreement and depreciation cannot be allowed on the same. The High Court held that the IPRs were acquired and non-compete fees were paid under a composite agreement, therefore, the non-compete clause should be considered as a supporting clause which strengthens the IPRs acquired and should be eligible for depreciation under Section 32 of the Act.

Pentasoft Technologies Limited v. DCIT [TS-578-HC-2013(MAD)]

Taxation of cash payment to retiring partner

The taxpayer, a partnership firm, was in the real estate business. In terms of the reconstitution deed dated 28 April 1993, 5 new partners were introduced to the firm. Prior to the reconstitution, the assets of the firm were revalued on the basis of a valuation report dated 28 March 1993. All the three

existing partners of the firm retired with effect from 1 April 1994 and received enhanced value in FY 1994-95. The AO alleged that there was a transfer from old firm to new firm and was liable to capital gains tax.

According to the AO, reconstitution was a devise to transfer immovable properties avoiding income-tax and stamp duty. The taxpayer contended that it had paid credit standing to the credit of the retiring partners' capital accounts and there was no transfer of asset liable to any capital gains tax. The CIT(A) upheld the order of the AO. The Tribunal, considering the fact that retirement was after one year from admission and also that there was no transfer as defined under Section 2(47) of the Act, held that the firm was not liable to pay capital gains tax.

On an appeal the question before the Court was whether the taxpayer firm was liable under Section 45(4) of the Act when a retiring partner takes only money towards the value of his share without any distribution of capital asset/assets? The Karnataka High Court held that the five new partners brought in cash and three partners retired taking their share in the partnership and the business was carried on by five new partners and thus, on 1 April 1994 there was neither dissolution of the firm nor distribution of assets. Therefore, there was no question of the taxpayer being liable under Section 45(4) of the Act.

CIT v. Dynamic Enterprises [TS-556-HC-2013(KAR)]

Tribunal Decisions

Cogent reasons recording AO's dissatisfaction mandatory for invoking Section 14A disallowance

The taxpayer was engaged in the business of production and distribution of feature films, T.V. serials, trading in shares and securities and financing and manufacturing of PVC. For Assessment Year (AY) 2008-09, the AO found that the taxpayer had earned dividend income of INR 3.125 million which was claimed exempt under Section 10(34) of the Act. Further, the AO noted that the taxpayer had made investment of INR 108.1 million in shares and mutual funds. The AO held that the provisions of section 14A were applicable to the taxpayer's case. Referring to the Bombay High Court ruling in Godrej & Boyce Mfg. Co. Ltd. v. DCIT & Anr. [2010] 328 ITR 81 (Bom), the AO worked out the disallowance under Rule 8D(2) (iii) at INR 0.353 million and added it to the total income of the taxpayer. The CIT(A) confirmed the disallowance.

Before the Mumbai Tribunal, the taxpayer submitted that it had not borrowed funds for earning any exempt income. It further submitted that the investment in mutual funds was made out of surplus funds and investment in shares was made several years back. The taxpayer argued that it had not incurred any expenditure directly in respect of investment made by it. Further, a direct expenditure of INR 62 thousand was already suo-moto disallowed. Hence, the further disallowance under Section 14A of the Act was not warranted. The Tribunal noted that Section 14A of the Act read with Rule 8D of the Rules are attracted, when a

taxpayer claims an expenditure for earning exempt income and the AO is not satisfied with the correctness of the claim. Section 14A(3) of the Act provides that if any taxpayer claims that no expenditure has been incurred in relation to exempt income, the AO, being not satisfied about such claim, can make disallowance. Rule 8D deals with the methodology of calculating the disallowance. The Tribunal, relying on the decision of Delhi High Court in the case of Maxopp Investment Ltd. & Ors. v. CIT [2012] 247 CTR 162 (Del), held that for invoking Section 14A of the Act, the AO should indicate 'cogent reasons' why he is not satisfied with the correctness of the claim of the taxpayer and remanded the matter back to the file of AO.

Rajshri Production Pvt. Ltd. v. Addl. CIT [TS-570-ITAT-2013(Mum)]

Tribunal refuses depreciation claimed through rectification application under Section 154 of the Act. Also rejects taxpayer's reliance on amended Section 32

The taxpayer filed the return of income (ROI) for AY 2003-04 without claiming depreciation. The taxpayer did not provide for depreciation in its books of account. The taxpayer then filed an application under Section 154 of the Act to allow depreciation. The AO, accepting the claim, passed an order under Section 154 of the Act. Thereafter, in the reassessment proceedings, the AO withdrew the depreciation allowed in the rectification order on the ground that since the taxpayer had failed to claim the depreciation in the ROI, there was no mistake apparent which could be rectified under Section 154 of the Act. The CIT(A), relying on Mumbai Tribunal ruling in Jay Bharat Co-op. Housing Society Ltd. v. ITO [2011] 10 ITR (Trib) 717 (Mum), confirmed the AO's order. The CIT(A) also observed that the taxpayer's Income would be lesser than the returned income if the depreciation claim was allowed. Aggrieved, the taxpayer filed an appeal before the Tribunal. Before the Delhi Tribunal, the taxpayer submitted that the Revenue had disallowed depreciation merely on the ground that it was not claimed in the ROI. The taxpayer argued that the Revenue has overlooked the Explanation 5 to Section 32(1) of the Act which was inserted by the Finance Act (2001) with effect from April 1, 2002. Explanation 5 provides that the provisions of Section 32(1) of the Act shall apply, whether or not the taxpayer has claimed a deduction for depreciation in computing its total income. The taxpayer relied on the ruling in Dr. Mrs. Sudha S Trivedi v. ITO [2009] 31 SOT 38 (Mum) and submitted that the claim of depreciation should be allowed in the light of Explanation 5. Ruling in favor of the Revenue, the Tribunal observed that the taxpayer had not claimed depreciation either in its ROI or in the course of the assessment proceedings. Further, it did not claim depreciation in return against notice under Section 148 of the Act or in reassessment proceedings. The Tribunal held that the taxpayer was not entitled to depreciation and dismissed its claim.

Tibrewala Industries Pvt. Ltd. v. ITO [TS-573-ITAT-2013(DEL)

Forward contract is a integral part of exports and hence constitutes hedging and not speculative transaction

The taxpayer exported diamonds and usually had outstanding receivables in foreign currency. It entered into forward contracts with the banks to hedge the exchange loss, if any. Further, in accordance with the statutes, the taxpayer also revalued the outstanding export receivable. It incurred loss of INR 46.9 million on forward contracts (FC) which were entered to safeguard the outstanding receivables. The taxpayer referred to the provisions of Section 43(5) of the Act and contended that the loss was outside the scope of the 'speculation transaction' and the loss, being integral part of the export business, constituted 'business loss'. During the assessment proceedings, the AO noted that the total outstanding receivable in foreign exchange was much higher than any of the figures of export trade and receivable. The AO dismissed the applicability of clause (a) of the proviso to Section 43(5) of the Act stating that the taxpayer had failed to demonstrate that the transactions were incurred for hedging the risk against the raw material or merchandise. The AO concluded that the foreign exchange contracts constituted speculative transactions. The AO contended that the FCs could not have any nexus with the export of diamonds. Accordingly, the AO concluded that the foreign exchange/ currency derivative transactions were not covered by the exclusions provided in the proviso to Section 43(5) of the Act and treated the loss as speculative loss. Thus, the assessment was completed with an addition of INR 46.9 million. The CIT(A) also dismissed the taxpayer's appeal. Aggrieved, the taxpayer filed an appeal before the Tribunal.

The Mumbai Tribunal had to determine whether the taxpayer's transactions constituted 'hedging transactions' covered under clause (a) of the proviso to Section 43(5) of the Act. The Tribunal referred to judicial precedents which supported the proposition that the FC transactions, when entered into with the banks for hedging the losses due to foreign exchange fluctuations on the export proceeds, were to be considered integral or incidental to the export activity of the taxpayer. Therefore, Tribunal held that the losses or gains constituted business loss or gains and not speculation activities. The Tribunal also agreed with taxpayer's argument that the 'fact of premature cancellation cannot alter the nature of the transaction'. The Tribunal stated that it is not the requirement of the law that 1:1 correlation between the FCs and the export invoices should exist and should be established by the taxpayer. However, the Tribunal noted that considering the fact that these FCs were an integral part or incidental to the core business of export of diamonds and hence constitutes 'hedging transaction' and not the 'speculative contracts'. Further the Tribunal also held that the onus was on the taxpayer to explain satisfactorily why premature cancellation of some FCs was resorted to. Based on the above discussion, Tribunal subdivided the alleged speculation loss of INR 46.9 million into the following two types:

- Loss on Cancellation of Matured FCs amounting to INR 41.48 million related to FCs cancelled or terminated on or after the due date was to be allowed. As, the FCs booked as integral parts of the export invoices lived their booking period in full and they were either terminated by the Bank on or after due date of maturity of the contract as the actual realizations were not received in time.

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- For the loss amounting to INR. 4.21 million on premature cancellation three days prior to due date the Tribunal held that since the maturity date of these premature cancelled FCs fell during the weekend and therefore, the taxpayer cancelled such FCs three days prior to the due date was an acceptable explanation and directed the AO to allow the claim after due verification of the concerned weekends. The issue of allowability of the balance premature loss amounting to INR 1.89 million was set aside before the AO to examine the argument of the taxpayer that it should be allowed as a general business loss, which contention was earlier not examined by the AO.

London Star Diamond Company (I) P. Ltd. v. DCIT [TS-547-ITAT-2013(Mum)]

In the absence of specific provision, amalgamation does not take away benefits given under the Act

The taxpayer had sold shares of Reliance Salgaocar Power Co. Pvt. Ltd (RSPCL) on 29 September 2003. RSPCL was approved for the purpose of deduction under Section 10(23G) of the Act for AY 1999-2000 to AY 2004-05. Pursuant to resolution dated 15 October 2003 resolving to amalgamate RSPCL with REL with appointed date of 1 April 2003 and court order, approving the same, dated 18 December 2003, RSPCL ceased to exist from 1 April 2003. The taxpayer had claimed exemption on long term capital gain under Section 10(23G) of the Act. The AO denied the exemption stating that RSPCL ceased to exist from 1 April 2003 and the exemption was not available to the company unless the new company was an eligible enterprise approved under Section 10(23G) of the Act.

The Tribunal held that RSPCL has enjoyed the approval of the central government under Section 10(23G) of the Act up to 31 March 2004 and such approval was not withdrawn and, therefore, approval had to be presumed to be in force on date of sale. It also held that the taxpayer was assured at the time of investment that it would be entitled to benefit under Section 10(23G) of the Act, which cannot be denied in the case of events like amalgamation in which the taxpayer has no role to play. Where amalgamation puts the taxpayer in a disadvantageous/negative position in claiming any benefit, the legislative intent is clearly expressed in terms of a specific provision such as clause 12 to Section 80-IB of the Act. Therefore, the Tribunal allowed the exemption to the taxpayer.

Goa Trading Private Limited [ITO ITA.No.2185/Mum/2009]

‘Beneficial ownership’ under Section 79 of the Act

The taxpayer had claimed set-off of brought forward losses. During the previous year one of the corporate shareholders holding 80 percent shares in the taxpayer transferred 76.8 percent shares to new shareholders of the taxpayer. It was claimed that the new shareholders were shareholders of the transferee company and therefore, in spite of the change in shareholding, the same group continued to control the shares and the taxpayer was entitled to claim set-off of losses. The taxpayer further argued that Section 79 refers to the beneficial holding which means that the section would not

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apply if shares carrying 50 percent voting power continued to be held by the same group of persons. The AO denied the claim of the taxpayer and disallowed the set-off of losses in view of Section 79 of the Act. The Tribunal held that the shareholders and the company are distinct entities and it could not be construed that any change in shareholding between them has not resulted in change in shareholding in the taxpayer. The Tribunal held that provisions of Section 79 were applicable to the case and dismissed the appeal.

Just Lifestyle Pvt Ltd v. DCIT [TS-562-ITAT-2013(Mum)]

Asset revaluation accounted as loan held violative of conditions under Section 47(xiii) of the Act

The taxpayer, a partnership firm engaged in the business of automobile dealership, got converted into a company. At the time of conversion, the land belonging to the partnership firm was revalued as per the market value and the difference of book value and the revalued value was credited to the partner's current accounts. This amount was treated as a loan to partners in the company's books at the time of conversion. The taxpayer claimed the conversion was not a transfer under Section 47(xiii) of the Act and therefore there was no capital gain liability. The AO denied the exemption on the ground that the partners were getting consideration such as loan which violated the conditions under Section 47(xiii) of the Act.

The Tribunal held that treatment of revaluation difference as loan violated the condition that all assets of the firm should be treated as the assets of the company. It was also held that it was an indirect transfer of land and an accounting technique enabling distribution of the assets to partners. The Tribunal denied the exemption under Section 47(xiii) of the Act.

K.T.C. Automobiles (P) Ltd. v. DCIT (Coch) [ITA No. 446/Coch/2013]

The Mumbai Tribunal upheld attribution of 20 percent of fees and other charges after excluding interest charged by foreign branches, as appropriate compensation for the Indian branch

The taxpayer facilitated foreign currency loans to its clients from overseas branches but did not show any income on the said transaction. All negotiations and discussions with potential clients were done by the syndication desks in Hong Kong. The role of the taxpayer was to provide financial analysis of the borrower, general market conditions in India and regulatory environment. The arrangement fees were received by the lead arrangers or co-lead arrangers. All other support and facilities like preparation of loan documents, legal opinions, signature and execution of loan document were done by the syndication desk and legal team in Hong Kong. The Transfer Pricing Officer (TPO) computed the arm's length charges being 25 percent of the total amount comprising interest and fee received by the offshore branches. The CIT(A) reduced the adjustment from 25 percent to 20 percent of the interest and fee amount.

The Tribunal held as follows:

- The taxpayer provided services regarding client's creditability analysis, the capacity to repay the loan and risk involved in the loan transaction. Therefore, the role of the taxpayer in providing such a crucial service is inevitable for taking the decision of providing loan. The plain reading of paragraph 4 of the protocol of the tax treaty makes it clear that if the role of the Permanent Establishment (PE) is only to facilitate the conclusion of foreign trade or loan agreement or mere signing thereof, then no profit shall be attributed to PE in terms of Article 7(2) of the tax treaty.
- Since the taxpayer's role in providing the services was the core-basis for taking the decision to grant the loan, the nature of services provided by the taxpayer did not fall under the terms of facilitation of conclusion of loan agreement or signing thereof as stipulated under paragraph 4 of the Protocol.
- When the loan was provided by the syndicate and the taxpayer had not contributed to the loan amount then as regards the interest charged on loan, this cannot be attributed to the taxpayer. Only the fee and other charges received by the foreign branches should be taken into consideration for making adjustment under TP provisions.
- Since none of the parties to the appeal had come out with the suitable comparables, the estimation made by the CIT(A) at the rate of 20 percent was just and proper, however, this would be only in respect of the fee and charges excluding the interest received by the foreign branches.

Credit Lyonnais v. ADIT (ITA No.1935/Mum/2007)

Notifications/Circulars/ Press releases

The Ministry of Finance notifies Cyprus as a notified jurisdictional area under section 94A of the Act

The Ministry of Finance vide Notification 86/2013 has notified Cyprus as a notified jurisdictional area under Section 94A of the Act. The key implications of the notification are:

- If taxpayer enters into a transaction with a person in Cyprus, then all the parties to the transaction shall be treated as associated enterprises and the transaction shall be treated as an international transaction resulting in application of transfer pricing regulations including maintenance of documentation;
- No deduction in respect of any payment made to any financial institution in Cyprus shall be allowed unless the taxpayer furnishes an authorization allowing for seeking relevant information from the said financial institution;
- No deduction in respect of any other expenditure or allowance arising

from the transaction with a person located in Cyprus shall be allowed unless the taxpayer maintains and furnishes the prescribed information;

- If any sum is received from a person located in Cyprus, then the onus is on the taxpayer to satisfactorily explain the source of such money in the hands of such person or in the hands of the beneficial owner, and in case of his failure to do so, the amount shall be deemed to be the income of the taxpayer; and

- Any payment made to a person located in Cyprus shall be liable for withholding tax at 30 percent or the rate prescribed in the provisions of the Act or the rates in force, whichever is higher.

Notification No. 86/2013 dated 1 November 2013, published in Official Gazette through SO 4625 GI/13

II. SERVICE TAX

High Court Decisions

No recovery proceedings under section 87 of the Finance Act, 1994 can be initiated against the taxpayer whose application filed by him under Voluntary Compliance Encouragement Scheme, is pending

The Revenue authorities initiated recovery proceedings against the taxpayer who had filed an application under the Service Tax Voluntary Compliance Encouragement Scheme, 2013 ("VCES"). The taxpayer approached the Allahabad HC vide a writ petition.

The HC ruled in favor of the taxpayer and held that the taxpayer demonstrated that he had fulfilled the conditions for VCES under sections 106 and 107 of the Finance Act, 1994 as amended by Finance Act, 2013. In the absence of application being considered and decided, no recovery proceedings can be initiated else the whole object of the scheme would be defeated. The HC directed the jurisdictional Commissioner to decide the taxpayer's application under the VCES Scheme within 60 days and suspended the recovery proceedings until disposal of the application.

K Anand Caterers v Union of India [2013-TIOL-741-HC-ALL-ST]

Taxpayer eligible to exit from the Large Taxpayer Unit scheme and transfer its pending assessments and other proceedings to normal jurisdiction

The taxpayer was engaged in the business of installation and supply of computer hardware, development and export of computer software and related service. The Central Government introduced the Large Taxpayer Unit ("LTU") scheme pursuant to which the taxpayer consented to be administered under such scheme and filed prescribed form thereunder. Thereafter, they regularly filed returns under the said scheme for both service tax and Income tax Act, 1961 and were assessed. Subsequently, in exercise of its option under the scheme, the taxpayer intimated the intention to opt out of the scheme. The taxpayer was informed that since no reasons had been indicated for opting out of the scheme and assessment for the year 2009-2010 had not been completed, the request was kept pending till completion of the assessment.

The taxpayer approached the HC vide a writ petition seeking directions to exit from the LTU scheme with immediate effect and notify it to the new/regular jurisdictions to which records, pending proceedings under the Income Tax , Customs and Service Tax would be transferred.

The HC took note of the fact that for various other companies who have applied for exit from LTU schemes, such applications have been accepted and the exit have been facilitated vide transfer of pending proceedings to the normal jurisdictions (these facts emerged vide Right to Information actions undertaken by the taxpayer). Accordingly, the HC directed the Commissioner under the said scheme to accept request of the

taxpayer and pass appropriate directions within a period of three weeks.

IBM India Pvt Ltd v CC of CE, CIT and CCE and CST [2013-TIOL-712-HC-KAR-MISC]

Tribunal Decisions

Section 66A of the Finance Act is attracted only when services are received in India by a person situated in India even if such persons may have PE abroad. If the services rendered abroad have been subject to local taxation, the question of levying service tax in India on the very same transactions would not arise at all

The taxpayer was having branch office in countries outside India. These branch offices were engaged in providing "Software Development and Consultancy Service" to overseas customers. The consideration for the services rendered abroad was received by the branches that raised such bills on the customers. After deducting the expenditure incurred for rendering the services abroad, excess of income over expenditure of the branches was remitted to the head office in India.

The Revenue Authorities were of the view that the services rendered by the overseas branches on behalf of the parent-company falls under the category of "Business Auxiliary Service" and accordingly, the entire amount received by the overseas branches are liable to service tax on a reverse charge basis. As per the Revenue Authorities, the taxpayer had PE abroad by way of personnel located in the offices of their various clients abroad. These personnel rendered the service to the overseas clients and for rendering such services, they incurred various expenditure such as rentals, telephone etc. overseas.

The matter reached before the Tribunal and it was held that the provisions of section 66A are attracted only when the services are received in India by a person situated in India even if such person may have PE abroad. In the present case, the taxpayer has provided services to customers located abroad through its overseas branches. Therefore, it is not a case of the taxpayer receiving the services but it is a question of rendering services abroad. Secondly, if the services rendered abroad have been subject to local taxation, the question of levying service tax in India on the very same transactions would not arise. There cannot be two taxing jurisdictions for the same transaction. Service tax is a destination based consumption tax and the taxability would arise only at the place where the consumption takes place. In the instant case, the service has been rendered to the clients abroad and, therefore, the consumption of the service was not in India but abroad. Therefore, the question of subjecting the said activity to service tax in India was not sustainable in law.

Kpit Cummins Infosystems Ltd v CCE [2013-TIOL-1568-Tribunal-MUM]

Goods loaned for use by a manufacturer of industrial gases to their customers without the right to sell or offer for sale, mortgage and pledge does not fall within banking and other financial services

The taxpayers were engaged in the manufacture & supply of industrial gases to their customers. At the request of certain customers, they were also supplying vacuum insulated storage tanks on lease basis under agreements. According to the agreement, the taxpayers were charging a fixed monthly amount for lease of the equipment for three years. The equipment was only loaned for use to their customers and the customers were not entitled to sell or offer for sale, mortgage and pledge the tanks.

The Revenue Authorities contented that the taxpayers were liable to pay service tax on the ground that the taxpayers were providing banking and other financial services which are taxable as per the provisions of section 65(12) read with section 65(105)(zm) of the Finance Act, 1994.

The matter reached the Tribunal and the decision was taken in the favor of the taxpayer. It was noted that the taxpayer was engaged in the manufacture of industrial gases and they cannot be said to be a banking company or other financial institution etc. On this basis, the demand of service tax was set aside.

Inox Air Products Ltd v CCE [2013-TIOL-1606-TRIBUNAL-MUM]

Development fee charged as part of air fare for allowing access to airport not liable to service tax

The taxpayers were a joint venture company undertaking the operations of Mumbai International Airport. They were collecting development fee from every departing passenger in terms of section 22A of the Airport Authority of India Act, 1994.

The taxpayer did not discharge any service tax liability on the ground that the purpose of collection of the said fund was financing the cost of up-gradation, expansion or development of the airport and they did not have any obligation to provide any services to the passengers from whom the fee was collected. The Revenue Authorities were of the view that the taxpayer was liable to pay service tax on the fee.

The matter reached the Tribunal. Tribunal held that the development fee was charged as part of the air fare or the cost of the ticket by the airlines. When an airline ticket is issued to a passenger, it pre-supposes access to the airplane; otherwise, the issuance of ticket becomes meaningless. It was like asking a passenger who had a ticket to travel by train/bus to take platform/entry ticket so that he can board the train/bus. If the access to a road was not leviable to service tax, it did not stand to any logic or reason that access to the airport /airplane by a passenger should be subjected to levy of Service Tax. On the above reasoning, the Tribunal allowed the appeal filed by the taxpayer.

Mumbai International Airport Pvt Ltd v CST, Mumbai-I [2013-1487-TRIBUNAL-MUM]

Commission received in the form of trade discounts does not fall under Business Auxiliary Services and hence not liable to service tax

The taxpayer was an authorized dealer for cars and was also engaged in the activity of

servicing, repairing the vehicles and selling spares of the vehicles. The Revenue Authorities contended that the various commissions received by the taxpayer towards vehicles / target incentive, sale of spare parts for promoting and marketing of products would be liable to service tax under Business Auxiliary Services.

The matter reached before the Tribunal. Tribunal held that the commission received from various banks/finance institutions for arranging loan to their prospective buyers by acting as direct sales agent comes under Business Auxiliary Services. However, the commission received by the taxpayer on account of sales of vehicles / target incentive, sale of spare parts for promoting and marketing of products are in the form of trade discounts and cannot be treated as consideration for Business Auxiliary Services

CST, Mumbai-I v Sai Service Station [2013-TIOL-1436-TRIBUNAL-MUM]

Supply of reusable and returnable containers containing helium gas form part of sale of gas (liable to sale tax) and accordingly not liable to service tax

The taxpayer imported helium gas in reusable and returnable containers that have to be returned. During the period the containers remained in the possession of the importer who charged rentals for the use of the containers from the taxpayer.

The question in dispute was whether the renting of containers falls within the taxable service category of supply of goods for tangible use and the recipient of the service in India has to discharge service tax liability on the rent paid to the foreign supplier.

The matter reached Tribunal. Tribunal prima facie held that the transaction did not involve the supply of tangible goods for use. The taxpayer imported helium gas and the helium gas had to be filled in returnable containers. The supply of cylinders is part of sale of gas and it is not a separate activity in itself and therefore, the rental charges for the cylinders form part of the value of the goods sold. Tribunal granted stay to the taxpayer.

K-Air Speciality Gases Pvt Ltd v CCE, Pune [2013-TIOL-1378-TRIBUNAL-MUM]

III. VAT/ CST/Other State Level Taxes

High Court Decisions

Residuary entry would not be applicable when a specific rate of tax has been prescribed for a particular commodity

The dispute in question was whether the taxpayer, a manufacturer of aluminum granules has been correctly assessed at 12.5 percent. The rate of tax for ferrous and non-ferrous metals such as aluminum, copper, metal scrap was prescribed at 4 percent.

The HC held since aluminum granules was same as Aluminum, it is not taxable under residual entry under the Madhya Pradesh

Value Added Tax Act, 2002. Tax could not be levied at 12.5 percent on the ground that the taxpayer had been selling Aluminum granules since the nature of the product remained materially unchanged. The Aluminum granules which had been supplied by the dealer to the railways were used as aluminum. On the above reasoning, it was held that the taxpayer was liable to be assessed at 4 percent

G. K. Micro Metal Private Limited v State of Madhya Pradesh and Others [2013] 64 VST 147 (MP)

IV. CUSTOMS

High Court Decisions

For provisional assessments, claim for refund can be made within one year of finalization of assessment

The taxpayer was engaged in the marketing of Pioneer branded products in India and imported several electrical goods. The goods were cleared after payment of customs duty on provisional basis. The customs authorities referred the case to the Special Valuation Branch of the Customs for the purposes of valuation and clearance. During the intervening period, all Bills of Entry were cleared by the Customs Authorities provisionally. The liability was determined and the taxpayer applied for finalization of the Bills of Entry. On the finalization of the Bills of Entry, the final duty was assessed and the provisional duty paid was adjusted towards the final assessment. The taxpayer sought to claim refund of the excess customs duty deposited on provisional basis which was opposed by the Revenue Authorities on the ground of limitation.

The matter reached before the Delhi HC. The HC inter alia held that where the goods are released on provisional assessment followed by the final assessment, the application seeking refund can be made within the period of one year (or six months, as the limitation period may be), from the date of the final assessment.

Pioneer India Electronics (P) Ltd. v UOI & Anr [2013-TIOL-731-HC-DEL-CUS]

V. CENTRAL EXCISE

Tribunal Decisions

Area-based excise exemption benefit under Notification No 50/2003-CE available even if a small part of the premises fall outside specified Khasra numbers

The taxpayer availed exemption from excise duty under exemption Notification No 50/2003-CE for goods manufactured in the factory situated in Khasra Nos 282, 283 and 284 – plots of land specified in the excise notification. The boundary wall of the said premises enclosed a strip of land; a public drainage situated in Khasra No 281 which was not specified in the exemption notification. The Revenue Authorities contended that the excise duty exemption was not available since part of the factory was not located in specified Khasra.

The matter reached the Tribunal who in its stay order held that, since the primary factory premises fell within the specified Khasra numbers and only a drainage on the boundary of the land was situated in Khasra No 281, prima facie excise duty exemption is available.

Diamond Entertainment Technologies P Ltd v CCE, Meerut – II [2013 (295) ELT 732 (Delhi - Tribunal)]

Excise duty exemption for clearances to World Bank funded projects available even if only a part of the project cost is borne by the project developer himself and the clearances are made prior to the date of the financing agreement with World Bank

The taxpayer manufactured transmission towers for electricity and supplied it to the HVDC transmission system project financed by the World Bank vide financing agreement dated March 01, 2000. The goods were cleared during September 1999 to March 2001 and exemption under Notification No 108/95-CE dated September 28, 1995 was availed. The dispute in question was whether the said exemption would be available to goods cleared prior to the date from which funds were received.

The matter reached the Tribunal. Tribunal held that the language of the Notification does not suggest in any way that exemption is not available to goods supplied prior to the date from which finance was provided by the World Bank. It further held that the exemption could not be denied for the reason that part of the project cost was met by the beneficiary of loan from the World Bank.

Larsen & Toubro Ltd. v CCE, Indore [2013 (295) ELT 572 (Delhi – Tribunal)]

Excise duty can be recovered from the buyer of defaulter's fixed assets only if the business was succeeded and not purchased

The taxpayer purchased fixed assets from RIICO Ltd which were earlier owned by Jain Biscuits Industries Private Limited. ("JBC"). JBC owed arrears of revenue to the Central Excise Authorities which were due for recovery. The taxpayer opposed such recovery and contended that they were not successor in the business of JBC but had only purchased the land previously owned by JBC.

The matter reached before the Tribunal. The Tribunal allowed the plea of the taxpayer and held that the relevant recovery provision under section 11 of the Central Excise Act, 1944 was applicable only if the person had succeeded the business of the defaulter. Also the statutory provision enables the Revenue to attach only those articles which the successor in business got from the defaulter and not the assets which the successor possess from his other business. On the above reasoning, the Tribunal held that the recovery proceedings were invalid.

Eklinggji Finance Pvt. Ltd. v CCE, Jaipur [2013 (295) ELT 81 (Delhi - Tribunal)]

Supply of goods to power projects and refineries would still be eligible

for excise duty exemption even if not appropriately covered by specific clauses of Foreign Trade Policy for deemed export purposes

The taxpayer was a manufacturer of transformers and supplied transformers for setting up a mega power project. The goods were supplied against International Competitive Bidding and a certificate to that effect had been issued by the Joint Secretary to the Government of India in the Ministry of Power. The goods were cleared under an excise duty exemption under Serial No 91 of Notification No 6/2006-CE. The availment of exemption was challenged on the ground that the Project Authority Certificate had been issued under clause 8.2 (g) of Chapter 8 of the Foreign Trade Policy and not under clause 8.2 (f).

The dispute reached before the Tribunal. The Tribunal noted that a reading of the clause 8.2 (f) indicated that the supply of goods to any project or purpose in respect of which the Ministry of Finance, by a notification, permits import of goods at zero percent duty, is given the benefit of deemed export. Clause (g) further states that the supply of goods to power projects and refineries not covered by clause (f) above will get the deemed export benefit. The Tribunal held that Clause (f) or clause (g) are relevant for granting the deemed export benefit and have no relevance whatsoever for granting exemption under Notification No 6/2006-CE and allowed the benefit of the excise duty exemption.

Crompton Greaves Ltd v CCE [2013-TIOL-1595-TRIBUNAL-MUM]

'Commencement of commercial production' in the context of area-based excise duty exemption does not include "trial production"

The benefit of the area-based excise duty exemption in terms of Notification No 50/2003-CE dated June 10, 2003 was extended to the units located in the Hardwar area subject to the condition that they commence commercial production prior to March 31, 2010. The dispute in question is whether the taxpayer who undertook trial production prior to March 31, 2010 would be considered to have commenced commercial production prior to March 31, 2010, so as to avail the said area-based excise exemption.

The matter reached the Tribunal. Tribunal held that the commencement of commercial production means starting manufacture of the finished products on commercial scale and is preceded by installation of complete plant & machinery on the day the plant is ready in all respects for manufacture of finished products in commercial quantity and trial production. Tribunal took a prima facie view that in the context of area-based excise duty exemption, commercial production does not include "trial production" and ordered for pre-deposit.

Simplex Electronics Pvt Ltd v CCE [2013-TIOL-1491-Tribunal-DEL]

Notification & Circulars

DGFT notification strengthening the anti-abuse provisions vis a vis advance authorization for supplies to SEZ and deemed exports

The DGFT vide this notification have amended paragraph 4.1.15 of the Foreign Trade Policy pertaining to Advance Authorization and specified that the said provision would apply even for supplies to SEZ and deemed exports.

Notifications 48 (RE-2013)/ 2009-2014 dated October 30, 2013

DGFT Policy Circular clarifying vis a vis requirement of declaration of non-availment of CENVAT credit

The DGFT vide this policy circular have clarified vis a vis the declaration of non-availment of CENVAT credit required under paragraph 8.5 of the Foreign Trade Policy pertaining to deemed export drawback.

Policy Circular No 9 (RE-2013)/2009-14 dated October 30, 2013

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