January 2014

TAX UPDATES

(containing recent case laws, notifications, circulars)

Prepared in association with

Foreword

I am pleased to enclose the January 2014 issue of FICCI's Tax Updates. This contains recent case laws, circulars and notifications pertaining to direct and indirect taxes.

FICCI participated in the meeting of the Advisory Group on Customs, Central Excise and Service Tax issues held on 17th December, 2013, under the Chairmanship of Finance Secretary. Issues regarding levy of VAT and Service Tax on software, Excise valuation in the context of Supreme Court's judgment in the Fiat case, delay in sanctioning of refund claims, delay in disposal of adjudication cases etc. were discussed in the meeting.

On the taxation regime, the Delhi High Court in the case of Infrasoft Ltd., dealt with the issue of taxability of consideration for grant of licences for the use of software under the provisions of the India USA treaty. The High Court held that in the said case what was transferred was neither the copyright in the software nor the use of the copyright in the software, but the right to use the copyrighted material or article which was clearly distinct from the rights in a copyright. Accordingly, the High Court held that the consideration received for the transfer of licences for the use of software does not amount to royalty under the India-USA tax treaty.

In a decision having implications for the retail / FMCG sector, the Customs, Excise and Service Tax Appellate Tribunal (CESTAT) has held that the electricity charges collected by the landlords from the tenants are not to be included in the value of taxable service. The taxpayer (landlord) was a provider of renting of immovable property service. He did not pay service tax on the reimbursement of electricity charges received from the tenants. The CESTAT held that electricity was goods chargeable to duty under the Central Excise Tariff Act as well as the Maharashtra VAT Act. Supply of electricity was, therefore, sale of goods and not supply of services. It further observed that Notification No. 12/2003-ST dated 20th June, 2003 exempted from the service tax the value of goods supplied to the service recipient.

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.

Recent Case laws

I. DIRECT TAX

Supreme Court Decisions

High Court has unfettered powers to frame additional questions of law during hearing: Supreme Court

The revenue had filed an appeal under Section 260A of the Act before the High Court, raising several questions of law. The High Court had admitted the appeal and two substantial questions of law were framed by the High Court for consideration. The revenue felt aggrieved on the ground that the other questions raised in the memo of appeal before the High Court were rejected, by necessary implication therefore the revenue filed a Special Leave Petition before Supreme Court.

The Supreme Court observed that the revenue seemed to be under some misconception that other substantial questions of law were rejected by necessary implication. The Supreme Court observed that Section 260A(4) of the Act stated that appeal could be heard only on questions of law formulated by the High Court, however as per the proviso to Section 260A(4) of the Act, the High Court had the power to hear the appeal on additional questions framed by it during the hearing of appeal with only to two conditions, first being that the High Court must be satisfied that appeal involves such questions, and second being that the High Court has to record reasons for the same. In view of the same the Supreme Court dismissed the Special Leave Petition filed by the revenue.

CIT v. Mastek Ltd. (Supreme Court SLP (Civil) CC 3075/2013)

High Court Decisions

No royalty income on payment for transfer of software which is a 'copyrighted article' and not a 'copyright right'

The taxpayer, a US tax resident company engaged in the business of developing and manufacturing civil engineering software developed and licenced customized software to Indian customers and provided installation and training services in respect of the said software through its branch office in India.

The Assessing Officer (AO) and the Commissioner of Income-tax (Appeals) [CIT(A)] held that the consideration received by the taxpayer for grant of license for the use of customized software was in the nature of 'royalty' under the provisions of the Income-tax Act, 1961 (the Act) as well as the India-USA tax treaty. However, the Tribunal held that the consideration received by the taxpayer was not in the nature of royalty.

The question before the Delhi High Court was whether the consideration received by the taxpayer was in the nature of royalty under the provisions of the tax treaty.

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

- For a consideration to qualify as royalty, it is necessary to establish that there is transfer of all or any rights (including the granting of any licence) in respect of copyright of a literary, artistic or scientific work.

- Distinction has to be made between the acquisition of a 'copyright right' and a 'copyrighted article'.

- Right to use a copyrighted article or product with the owner retaining his copyright, is not the same thing as transferring or assigning rights in relation to the copyright. The enjoyment of some or all rights which the copyright owner has, is necessary to invoke the royalty definition.

- Copying the program onto the computer's hard drive or random access memory or making an archival copy is an essential step in utilizing the program. Therefore, rights in relation to these acts or copying, where they do no more than enable the effective operation of the program by the user, should be disregarded in analyzing the character of transaction for tax purposes.

- A non-exclusive and non-transferable licence enabling the use of a copyrighted product cannot be construed as an authority to enjoy any or all of the rights in the copyright.

- The right to use a copyright in a programme is totally different from the right to use a programme embedded in a cassette or a CD which may be software and the payment made for the same cannot be said to be received as consideration for the use of or right to use of any copyright.

- The High Court expressed its disagreement with the decision of the Karnataka High Court in the case of Samsung Electronics Companies Ltd. v. ITO [2005] 276 ITR 1 (Bang) and thereby held that the payments received by the taxpayer in the instant case are not in the nature of 'royalty' under the provisions of the Tax Treaty.

DIT v. Infrasoft Ltd. (ITA No. 1034/2009) [Delhi HC]

Subvention receipts from the parent company to recoup losses of the subsidiary is taxable as revenue Receipt

The taxpayer was engaged in the business of manufacturing digital electronic switching systems, computer software and rendering software services. The taxpayer incurred loss in, AY 1999-2000 and subsequent two years. In relation to these three years, the taxpayer received subvention payment from the parent company, since the taxpayer was potentially a sick company, and its capacity to borrow had reduced substantially leading to shortage of working capital. The taxpayer claimed that the subvention payment was a capital receipt and hence, not taxable. However, the AO treated the subvention payment as a revenue receipt. The CIT(A) and the Tribunal ruled in favour of the taxpayer.

The High Court observed that the Supreme Court had ruled in the case of Ponni Sugars & Chemicals Ltd. [2008] 306 ITR 392 (SC) that the character of the receipt in the hands of the taxpayer has to be determined with respect to the purpose for which the subsidy is given. The point of time at which the subsidy was paid, the source, or the form of subsidy is not relevant. Therefore, the object for which the subsidy/assistance is given, determines the nature of the incentive subsidy. The High Court also observed that the Supreme Court had ruled in the case of Sahney Steel & Press Works Ltd. [1997] 228 ITR 253 (SC) that the subsidy payments not made for the purpose of setting up of the industries, but to run the industries more profitably were held as a revenue subsidies and not capital subsidies. In the present case, the amount paid by the parent company to the taxpayer was not only to set-off loss, but also to run the business more profitably. The payments were neither utilized for repayment of the loan taken for setting up their unit nor for expansion of existing unit/business. After getting the financial aid from the parent company, the taxpayer turned its business from loss to profit, which is evident from the facts reflected in the return of income filed for all the three assessment years. Also, the amount was not paid for acquiring or bringing into existence some new asset. In the view of above, the High Court held that the payment was received by the taxpayer on revenue account.

CIT v. Siemens Public Communication Networks Ltd. (ITA No. 489/2007, 59/2007 & ITA No. 488/2007) (Kar HC)

TDS under Section 194-I of the Act applies on vehicle hire

The taxpayer is engaged in mechanized manufacturing and sale of granites. It entered into an agreement with a contractor for loading - unloading and transportation of granite within its mining area and outside. During AY 2007-08, assessee deducted tax at the rate of 2 percent under Section 194C of the Act towards the payment to contractors for their work. As per the AO, TDS should have been deducted under Section 194I of the Act towards the payment of hire charge hence the AO disallowed the payments under Section 40(a) (ia) of the Act. The CIT(A) and the Tribunal ruled against the assessee and held that Section 194I of the Act was applicable.

The High Court observed that there was a composite agreement for hire of vehicles which were to be used for loading and unloading and transport of products. It was further observed that assessee made use of vehicles and equipment and paid hire charges on the basis of number of hours of use. Section 194C of the Act defined 'work' to include carriage of goods or passengers by any mode of transport other than by railways. The taxpayer contended before the High Court that as it was material which was being carried in vehicles, it was carrying out 'work' as per Section 194C of the Act. However the High Court rejected the taxpayer's contention and observed that the Tribunal had returned a finding that what is involved is hire charges paid for the goods (vehicles) taken on hire. The High Court also observed that the agreement does not require the owner of the vehicle to do any work at all and it is the assessee who makes use of the vehicles and the equipment and pays hire charges.

The High Court referred to the definition of 'rent' as provided in Explanation to Section 194I of the Act wherein 'rent' meant to include any payment, under any lease or sublease or any other agreement or arrangement for the use of (either 4 separately or together) machinery or equipment, whether or not owned by the payee. The High Court held that as the Legislative intent was clear to deduct tax in respect of machinery or equipment and there was no reason to dilute the width of the words 'any machinery' contained in sub-section (i) with the aid of the Explanation defining the word 'rent' as only machinery which is immovable property. Thus, High Court ruled that TDS under Section 194I of the Act shall be applicable in the present case.

Three Star Granites Pvt. Ltd. vs. ACIT (ITA No. 85 of 2012) (Kerala HC

Reassessment to examine expense allocation between tax holiday and non tax holiday unit beyond 4 years Invalid

The taxpayer is engaged in the business of manufacturing of chemicals. It has two manufacturing units, one at Tarapur and another at Silvasa. During AY 2006-07, the taxpayer claimed deduction under Section 80IB of the Act in respect of its Silvasa unit for INR 3.199 million. However, in scrutiny assessment, the AO restricted the deduction to INR 2.767 million. On 28 March 2013, notice for re-assessment Under Section 148 of the Act was issued to the taxpayer wherein AO claimed that based on allocations of expenses between two units, there will be no profit left for Silvasa unit, to claim deduction under Section 80IB of the Act. The AO, thus, had reasons to believe that income of INR 2.767 million (amount eligible for Sec 80IB deduction) had escaped assessment. The taxpayer filed its objections against the reopening of assessment with the AO which were rejected by him vide his order dated 1 August 2013.

The High Court noted that as the assessment sought to be reopened was beyond the expiry of 4 years from the end of the relevant AY i.e. 2006-07, two conditions precedent have to be satisfied. The first condition is that the AO must have reason to believe that income chargeable to tax has escaped assessment on the basis of tangible material. The second condition is that there must be a failure to disclose truly and fully all facts necessary for assessment when the original assessment proceedings took place. The High Court observed that the material that formed the basis of reasons to believe that income chargeable to tax has escaped assessment was allocation of expenditure between two units leading to higher deduction under Section 80IB of the Act in respect of Silvasa unit. The High Court further observed that such allocation was very much present before the AO while considering claim for deduction under Section 80IB of the Act. The High Court thus held that as there is no tangible material to lead to a reason to believe that income has escaped assessment but only change of opinion on the part of the AO on the material available cannot be a subject matter of reassessment as the assessee had disclosed fully and truly all material facts necessary for assessment. The High Court quashed and set aside the notice under Section 148 dated 28 March 2013 and order dated 1 August 2013.

Lalitha Chem Industries Pvt. Ltd. v. DCIT And Ors. (Writ Petition (L) No.2741 Of 2013)

Tribunal Decisions

Helicopter hire charges paid for transportation of goods/passengers is not 'rent' under Section 194-I of the Act

The taxpayer for AY 2009-10, made a payment to Global Vectra Helicorp Ltd. (GVHL) for hiring of helicopter service and deducted tax at source at 2 percent under Section 194C of the Act. The AO held that tax deducted at source under Section 194-I of the

Act was applicable since payment was a rent for the use of equipment. The AO noted that GVHL had applied for certificate under Section 197 read with Section 194-I of the Act for lower deduction which was granted on 9 July 2008 and which authorized deduction at 2 percent. Therefore, the AO held that tax at source at 10 percent was deductible till the date certificate was granted, i.e., till 9 July 2008. The taxpayer submitted that Helicopter services were in relation to air logistic support for crew and personnel of the assessee and/or any of its consultants and/or suppliers etc. as well as supply of essential cargo to and from offshore. The taxpayer submitted that though the AO has invoked Section 194I of the Act vide certificate dated 9 July 2008, CBDT Circular No. 715 dated August 8, 1995 stated that where plane or other mode of transport is chartered, the rate of tax would be 2 percent as this would be falling within Section 194C of the Act. The CIT(A) ruled in favour of the Revenue, holding that transaction was for hiring of helicopter and not for transportation.

The Tribunal observed that the taxpayer had executed a service contract with GVHL for availing helicopter services. The taxpayer had not taken possession of helicopters from GVHL and responsibility of operating and maintaining of the helicopters was of GVHL only. The Tribunal placed reliance on the Gujarat High Court ruling in the case of Reliance Engineering Associates P. Ltd [ITA No. 2286 of 2010, order dated 6 March 2012], wherein it was held that payment for transportation of goods/passengers by buses, cars, etc attracted tax deduction at source under Section 194C of the Act. The High Court had remarked that since the agreement for carriage by vehicles other than railways came within the purview of explanation of 'work' within the meaning of Section 194C of the Act, it followed that the Legislature had never intended to include the amount taken for hiring of such vehicles within the meaning of the word 'rent'. The Tribunal therefore, ruled in favour of the taxpayer stating that the revenue was not justified in applying Section 194I of the Act for deduction of tax at source.

Gujarat State Petroleum Corporation Ltd. v. ITO (ITA No.2884/Ahd/2010)

Going concern condition under demerger [Section 2(19AA) of the Act] applies to transfer, not to demerged unit

The taxpayer is engaged in the business of manufacturing Liquors. Maruti Organic Limited (MOL), a sick company was in the business of spirit. However, its operations were stand still from 23 December 1999. During the year, MOL demerged its undertaking to the taxpayer with appointed date of 1 January 2006, along with business losses of INR 70 million and the taxpayer claimed set off of such brought forward loss. In spite of the fact that the undertaking was not in any operation since 5 years prior to the demerger, the court approved the scheme and provided that the demerged undertaking be transferred on a going concern basis. The AO disallowed the set off of loss. The AO contended that as per Section 2(19AA) of the Act, the transfer of an undertaking should be on a going concern basis and since the undertaking did not carry out any operations at the time of demerger, it cannot be construed that it is transferred on a going concern basis and disallowed the set-off of losses. The CIT(A) upheld the stand of AO.

The taxpayer contended that Section 2(19AA) of the Act requires that the transfer of undertaking should be on a 'Going Concern' basis and not that the undertaking should be a going concern. The facts that all assets, liabilities, employees, contracts etc. are transferred, establishes that the undertaking is transferred on a going concern basis which is also confirmed by the High Courts. The Tribunal held that the Act does not state that the undertaking being demerged ought to be a going concern at the time of demerger. It only states that the undertaking being demerged should stand transferred in a manner similar to the manner in which a 'going concern' is transferred. Since the undertaking was transferred on a going concern basis, the Tribunal allowed the set-off of losses.

*KBD Sugars & Distilleries Ltd. v. ACIT (ITA Nos.1362 & 1363/
Bang/2011)*

Disallowance under Section 14A of the Act applicable even in case of shares held as stock in trade

The taxpayer is a dealer in shares and securities. Shares and securities were held as a stock in trade by the taxpayer. The taxpayer had sou moto disallowed INR 0.122 million as expenditure incurred in earning exempt income. However, the AO did not accept this disallowance and worked out the disallowance as provided under Rule 8D of the Income Tax Rules, 1962 ('Rules') read with Section 14A of the Act.

The Tribunal held that Section 14A of the Act is a code in itself and is independent of head of income. Dividend income in any case is specifically to be included under the head Income from other sources irrespective of the fact that the same is held as investment or as stock-in-trade. The Tribunal upheld the applicability of Section 14A of the Act read with Rule 8D of the Rules even to shares held as stock-in-trade. However, the Tribunal also noted that the taxpayer is in business of dealing in shares and is primarily interested in share trading profit and not only in earning dividend, therefore, to disallow entire result of computation under Rule 8D will mean share trading income is taxed on gross basis. Therefore, it is necessary to bifurcate such result between two sources of incomes. Based on the facts of the case the Tribunal suggested that 20 percent of computation under Rule 8D be disallowed.

In view of the disagreement between the two members, the matter was referred to the Third Member who concurred with above decision of the Accountant Member.

DCIT v. D.H. Securities Pvt. Ltd. (Mum)

Chennai Tribunal held that Discounted Cash Flow method is most appropriate for determining arm's length value of
Shares

The taxpayer held 91 percent shares in Visteon Powertrain Control Systems India Pvt. Ltd. (Visteon India). The entire stake in Visteon India was transferred by the taxpayer to its AEs. The taxpayer had arrived at the transfer price of INR 10.32 per share against the face value of INR 10 per share. Relying on the CCI Guidelines, the valuation was done using the Net Asset Value (NAV) method and the Profit Earning Capacity Value (PECV) method. The taxpayer adopted the average of the two values arrived at by adopting the two methods and further discounting it by 15 percent, since the shares were unlisted. TPO performed a DCF analysis and valued the share at INR 36.31 per share and made a TP adjustment. This was upheld by the Dispute Resolution Panel (DRP).

Taxpayer contended that during the year under consideration, the five methods prescribed were not applicable to the transaction. Hence, computation provisions with reference to ALP failed and Section 92C of the Act cannot be applied. Taxpayer contended that the objective of CCI Guidelines and Transfer Pricing are the same and the fact that the DCF method was introduced prospectively cannot be used to disregard the existing provisions which allowed yield method. Tax department contended that valuation based on CCI Guidelines provided by the taxpayer cannot be equated with determination of ALP. The DCF method was accepted in the taxpayer's own case in the subsequent Assessment Year (AY) 2008-09 and hence, consistency needs to be adopted.

Relying on the Tribunal ruling in the case of Ascendas (India) Pvt. Ltd. (ITA No. 1736/Mds/2011), the Tribunal held that it is not necessary to ignore the methods because the methods are not water-tight compartments and reflect the acceptability of permissible methods. The Tribunal held that DCF method is preferable over the Yield method or NAV method prescribed in CCI Guidelines for determining the ALP for sale of shares. Relying on the ruling in the case of Ascendas (India) Pvt. Ltd., the Tribunal held that the valuation of shares based on the erstwhile CCI Guidelines were for a different purpose and cannot be applied for ALP determination. The Tribunal also upheld the principle of consistency, ruling that DCF method should be applied, since the same was accepted in the subsequent AY. However, the Tribunal accepted the taxpayer's argument that a fresh DCF analysis be presented before the TPO and restored the matter to the TPO for arriving at the value afresh as per the principles and parameters adopted in AY 2008-09

VIHI LLC v. ADIT (ITA No. 17(Mds.)/2012)

Mumbai Tribunal upheld guarantee commission charged on loans and letter of credit facility at 0.53 percent and 1.47 percent respectively as arm's length

The Taxpayer had charged guarantee commission of 0.53 percent and 1.47 percent in respect of guarantee provided in connection with bank loans and LC facilities availed by its Associated Enterprises (AEs). The TPO determined arm's length guarantee commission at 3 percent of the guaranteed amount based on guarantee commission rates charged by various banks, i.e. Allahabad Bank (3 percent per annum); Dutch State, FMO (2.5 percent per annum); HSBC Ltd (0.15 percent to 3 percent per annum); and EXIM Bank of USA (3 percent per annum). CIT(A) upheld the adjustment made by the TPO.

The taxpayer distinguished each of the comparables selected by the TPO on various grounds and contended that bank guarantees are not comparable to the corporate guarantee provided by the taxpayer.

Tribunal held that there are conceptual differences between a bank guarantee and a corporate guarantee and explained the difference between corporate guarantee and bank guarantee. Tribunal held that a bank guarantee comparable may not clear the Functions, Assets and Risks (FAR) analysis test in case of a corporate guarantee. Tribunal further held that bank guarantee rates cannot be applied mechanically and need to be adjusted for various factors, such as (i) risk profiles of the respondents for the guarantee, (ii) financial position of the loan applicants, (iii) terms of the guarantee, (iv) securities involved,(v) quantum of guarantee,(vi) amount involved, (vii) period of guarantee, (viii) past history of the customers, etc. Tribunal analyzed various rulings like Asian Paints Ltd. (ITA No. 1937/Mum/2010), Everest Kanto Cylinder Ltd. (ITA No. 542/ Mum/2012) and Reliance Industries Limited (ITA No. 4475/Mum/2011) on guarantee commission and concluded that the guarantee commission rates of 0.53 percent and 1.47 percent on loans and LC facility are at arm's length.

Glenmark Pharmaceuticals Ltd v. ACIT (ITA No. 5031/M/2012)

Notifications/Circulars/ Press releases

Protocol amending the India-Spain tax treaty

India and Spain had signed a Protocol on 26 October 2012 amending the existing tax treaty. The salient features of the protocol are as follows:

- Limitation of Benefits (LOB) clause has been introduced in the tax treaty. The LOB clause provides that the:
  - Domestic rules and procedures regarding abuse of law (including tax treaties) are applicable;
  - Tax Treaty benefits do not apply to non-beneficial owners;
  - The Tax Treaty does not prevent both the states from applying their domestic Controlled Foreign Company rules; and
  - Benefits derived from the tax treaty will not apply to a resident of one of the states, or in respect of a Transaction made by such resident, if the main purpose or one of the main purposes of the creation, existence, set up, registry or presence of the resident, or the transaction made by him, is to obtain treaty benefits that would not otherwise be available.
- A new paragraph to Article 10 (Associated enterprises) is included to provide for a corresponding adjustment to profits to be made in a counter party's jurisdiction where an adjustment has been made under this article.
- The existing article on exchange of information has been amended to bring the same in line with Article 26 of the OECD Model Convention.
- Article on Assistance in collection of taxes has also been incorporated in the tax treaty.

Source: www.ibfd.org

II. SERVICE TAX

Tribunal Decisions

Pre-construction and construction services provided on the Continental Shelf and the Exclusive Economic Zone, prior to July 1, 2012 were not liable to service tax

The taxpayer was engaged in exploration and production of mineral oil and natural gas. It also received various services like seismic survey, data acquisition, well bore survey, core analysis etc from various Foreign Service Contractors at offshore locations including Continental Shelf of India ('CSI') and Exclusive Economic Zone of India ('EEZ'). The taxpayer paid service tax on reverse charge on pre-construction and construction activity pertaining to installations, structures, vessels. The taxpayer claimed refund of the service tax so paid on pre-construction activities and on construction activities on the ground that the services were either not taxable or exempted by virtue of Taxation of Services (Provided from outside India and received in India) Rules, 2006 ('Import Rules').

The taxpayer contended that prior to February 27, 2010, the services provided in CSI and EEZ were not taxable, however vide Notification no 14/2010, the said services were made taxable for certain specific purpose. As per the said notification, any service provided for all activities pertaining to construction of installations, structures and vessels for the purposes of prospecting or extraction etc was chargeable to service tax. Hence, the services relating to seismic survey, data acquisition, and well bore survey were not pertaining to construction of installation, structure or vessel and hence not liable to service tax. It was only after July 1, 2012 that the service tax legislation was further extended to the whole of CSI and EEZ by way of a statutory amendment in Chapter V of Finance Act, 1994.

The taxpayer further contended that simultaneously, vide Notification no 16/2010 dated February 27, 2010, the definition of 'India' was amended in Rule 2(e) of Import Rules. The amended definition of India included installations, structure and vessel. Service tax on reverse charge basis is payable only when the services fall under the Import Rules. Thus, services to installation, structure and vessels were taxable under reverse charge prior to the amendment, but services for construction of such installation, structure or vessel were not taxable as they were not covered in the definition of India.

The matter reached before the CESTAT wherein it was held that no services were provided to installations, structures and vessels or supply of any goods connected with such activity to installations, structure and vessels in the CSI and EEZ and therefore appeal of taxpayer was allowed.

Reliance Industries Limited vs Commissioner of Service Tax, Mumbai [Order No A/2197-2207/13/CSTB/C-I]

Electricity charges collected by the landlords from the tenants not to be included in value of taxable service, electricity is goods and hence 'sale of goods' and not provision of service

The taxpayer (landlord) was a provider of renting of immovable property service and paid service tax on it; however they did not pay service tax on the reimbursement of electricity charges received from tenants. Revenue Authorities contended that the electricity charges should be added to the value of renting of immovable property service under Rule 5 of the Service tax (Determination of Value) Rules, 2006 ('Valuation rules') providing that all expenditure and cost incurred for providing the service should be added to the value for charging service tax.

The matter reached before the CESTAT wherein it was held that electricity was goods chargeable to duty under the Central Excise Tariff Act, 1986 as well as Maharashtra Value Added Tax Act, 2002 and hence supply of electricity was sale of goods and not supply of service. Further, notification no 12/2003-ST dated June 20, 2003 exempts from service tax, the value of goods supplied to the service recipient.

ICC Realty India Private Limited & others v Commissioner of Central Excise & Service Tax- Pune III [2013 TIOL 1751(CESTAT-Mum)]

Painting of motor vehicle parts is a manufacturing activity as per Section Note and hence, not liable to service tax

The taxpayer painted parts of motor vehicles which are further used in the manufacture of motor vehicles on which duty was paid. The Revenue Authorities demanded service tax in respect of this painting activity under the category 'business auxiliary services'.

The matter reached the CESTAT wherein it was held that painting of parts of a motor vehicle forms a part of the manufacturing activity, and hence not liable to service tax. The CESTAT referred to section note to Section XVII of the Central Excise Tariff Act which states that "conversion of an article which is incomplete or unfinished but having the essential character of the complete or finished article, into complete or finished article shall amount to manufacture". Thus the appeal of the Revenue Authorities was dismissed.

Commissioner of Pune-I v Krishna Fabricators Private Limited [2013 TIOL 1753 (CESTAT- Mum)]

III. CUSTOMS

High Court Decisions

Entry 'free' occurring in the column 'rate of duty' in the Customs Tariff Schedule is also a rate of duty and can be increased by the notification under Section 8-A of the Customs Tariff Act

The taxpayers imported duty free wheat from Australia for which 'Free' was mentioned in the column for rate of duty under the Customs Tariff Schedule prior to December 1, 1999. Thereafter, by way of Notification no 127/99-Customs dated December 1, 1999 ('Notification no 127/99') issued under Section 8-A of the Customs Tariff Act (i.e. emergency power of the Central Government to increase import duties), the Central Government imposed duty at the rate of fifty percent of value of goods on its importers.

The taxpayers challenged the vires of the Notification no 127/99 by way of a writ petition before the Madras HC contending that there is no duty leviable under the Customs Tariff Act as in the rate column 'Free' is mentioned. It was argued on behalf of the taxpayers that notification under section 8-A cannot be invoked for fresh levy of duty.

The HC held that word 'Free' appearing in the column of 'rate of duty' is also a 'rate of duty'. Principally, there is not much of a difference between an item being notified as 'Nil' or 'Free'. Further, the main test to be satisfied for invoking section 8A is that the goods should be included in the First Schedule of the Customs Tariff Act. Thus, the writ petition was dismissed.

Century flour Mills v Union of India & others [2013 TIOL 913 (Mad)]

Tribunal Decisions

Reduction in price is acceptable for assessment of customs duty if there is a genuine reason for such reduction

The taxpayer had imported a vessel at an agreed price. After importation it realized that there were certain features of the vessel which were different from the one agreed between the parties; this resulted in vessel being prone to corrosion also. Accordingly, the prices were re-negotiated and an addendum to this effect was also signed. The price actually paid was the re-negotiated price. The Revenue authorities contended that there was no provision for a varied price in the Memorandum of Association ('MOA') and hence duty was sought to be imposed on the original price, which was higher than the re-negotiated price.

The matter reached before the SC, where it was remanded to the CESTAT to examine the genuineness of the addendum. The CESTAT found that there was genuine cause for reduction in price and even the supplier had accepted the reduction in price. Section 14 of the Customs Act also requires the actual price paid or payable to be the assessable value and there was no dispute that the re-negotiated price was paid to the supplier. Hence, the actual transaction value i.e. the re-negotiated price was required to be accepted for assessment of customs duty.

Choudhary Ship Breakers v Commissioner of Customs, Ahmedabad [2013 TIOL 1736 (CESTAT-Ahd)]

IV. CENTRAL EXCISE

Supreme Court

'Reasonable steps' does not mean that the taxpayer has to verify payment of duty on inputs from the Department; that would be travelling beyond the Notification, it would be practically impossible and lead to transactions getting delayed

The taxpayer availed deemed Modified Value Added Tax ('MODVAT') Credit on the strength of the invoices raised by the manufacturers of input goods. On verification, it was found that the supplier of inputs had not paid his duty for the period covered by the invoices. The Revenue Authorities were of the view that the taxpayer had not taken 'reasonable steps' to find out whether the duty on the inputs which were used in the manufacture of their final product was paid or not, as required under Rule 57A(6) of the Central Excise Rules read with Notification no 58/97 dated August 30, 1997. On this ground, the Revenue Authorities sought to disallow the deemed MODVAT Credit. The Revenue Authorities also contested and argued that taxpayer should have verified from the concerned authorities whether the duty had actually been paid or not.

The matter reached before the SC wherein it was held that the proviso to Rule 57A(6) postulates that the taxpayer has to take reasonable care that the duty was paid. In the instant case, the manufacturer (supplier) had given a declaration that the excise duty was paid on the goods and followed all the prescribed conditions. The failure to pay duty on inputs was a lapse of the seller and not the taxpayer. The SC held that when all the conditions precedent were satisfied, to require the taxpayer to find out from the concerned authorities about the payment of duty would be travelling beyond the notifications, and in a way, transgressing the same. It would be practically impossible and would lead to transactions getting delayed. [Rule 9(3) of the CENVAT Credit Rules, 2004 ('Cenvat Credit Rules'), until March 1, 2007, required the taxpayer to take all reasonable steps to ensure that duty / tax of which Credit is taken, has been paid by the supplier].

Commissioner of Central Excise, Jalandhar vs Kay Kay Industries [2013 (38) Taxmann 336 (SC)]

High Court

Special Economic Zone ('SEZ') Unit and SEZ Developers are on the same footing: Rule 6(6)(i) of CENVAT Credit Rules 2004 merits retrospective application

The taxpayer was engaged in the manufacture of various iron and steel products. These items were sold to the co-developers of SEZ. The Revenue Authorities raised an objection on not following the provisions of Rule 6 of CENVAT Credit Rules prescribing reversal of CENVAT Credit relating to exemption or payment of an amount 10 percent on exempted goods. The taxpayer made sales to SEZ developer for the period from October 2008 to December 2008. The reason for dispute was that obligation under Rule 6 was waived only for SEZ units till December 31, 2008. From December 31, 2008, even SEZ developers were allowed for such waivers by virtue of Notification no 50/2008- Central Excise, which as per the notification was effective from the date of publication, i.e. December 31, 2008. The Revenue Authorities contended that the said waiver cannot apply retrospectively. Thus the taxpayer was liable to pay an amount of 10 percent on the value of exempted goods.

The matter reached before the HC wherein it was held that the amended Rule 6(6)(i) has retrospective application. The exclusion of SEZ developers from the unamended rules was an inadvertent error because the position of the SEZ unit and the SEZ developer was same under the SEZ Act. The amendment only rectifies this error, hence the amended Rule 6(6)(i) merits retrospective application. Central Government is prohibited to discriminate under Article 14 of the Constitution of India and in case the submission of Revenue Authorities is accepted, it would leave the Central Government to the charge of discrimination. The HC held that the amendment should have retrospective application in order to not discriminate between SEZ units and SEZ developers. Thus the court concluded that the amendment was clarificatory as it corrected an obvious mistake, removed discrimination and provided the correct legal principle; hence should have retrospective application.

Union of India vs Steel Authority of India Limited [2013 (297) ELT 166 (Chhattisgarh)]

Exemption is available if the conditions specified in the beneficial legislations are met, no need to read it in a restrictive manner so as to preclude potential misuse

The taxpayer was the manufacturer of a variety of 'earth- moving' equipment that was supplied to the contractors for executing the Golden Quadrilateral Project. The taxpayer claimed exemption from payment of excise duty under Notification no 108/95 dated August 28, 1995. This project was financed by the United Nations and other International Organization hence the benefit of exemption was available to goods being supplied to the said project. The Revenue Authorities sought to deny this exemption to the taxpayer on the ground that the equipment was not supplied to the "project implementing authority", but to individual contractors who continue to own it thereby leaving room for potential misuse.

The matter reached before the Madras HC which held in favour of the taxpayer. It held that based on a factual finding and in the absence of material placed by the Revenue Authorities indicating possible misuse of the equipment for unintended purposes, no case could be made out against the taxpayer. It further held that the beneficial Notification being issued in public interest and the project itself being fully executed by the contractors and sub-contractors as per the directions of the project implementing authority, the fact that the machinery/equipment was supplied to the contractors and not given directly to the said authority cannot go against the taxpayer's claim. The court further held that the use of the phrase 'supplied to the projects financed by the United Nations or International Organization' clearly shows that the condition is to supply the goods to the project and nothing beyond.

Commissioner of Central Excise, Pondicherry v Caterpillar India Private Limited [2013 (297) ELT 8 (Mad)]

Tribunal Decisions

Additional duties of Excise payable even if goods are exempt from excise duty

The taxpayer had claimed exemption from excise duty under Notification no 67/95. The goods were also liable to Additional Duty of Excise ('ADE') Textile and Textiles Act, 1978 which is calculated as a percentage of excise duty. The taxpayer contended that its goods were exempt from the ADE on the ground that when the central excise duty is Nil, ADE is also Nil. The Revenue Authorities disputed this stand of the taxpayer and the matter reached the CESTAT.

The CESTAT relied on the decision of the Himachal Pradesh High Court in the case of Indo Farm Tractors and Motors Limited vs Union of India [2008 (222) ELT 184 (HP)] wherein for education cess, it was held that even if the excise duty was exempted, still education cess should be payable on notional amount of excise duty. Accordingly, the CESTAT allowed the appeal of the Revenue Authorities and held that ADE was leviable.

Commissioner of Central Excise, Ahmedabad v Mahendra Petrochemicals [2013 (297) ELT 232 CESTAT-Ahd]

CENVAT Credit can be availed on the strength of a debit note if it contains all the information required to be provided in a valid document for availing credit; denial of credit on the ground that individual premises were not registered was held to be unsustainable

The taxpayer rendered Business Auxiliary Services to its client HDFC Bank in the latter's premises. The client charged the taxpayer rentals for the occupied area and issued debit notes at the end of the month on the taxpayer. The said debit notes contained the details of the service rendered, the monthly license fees charged and the details of the service tax amount. The taxpayers availed CENVAT Credit on the services of the same.

The Revenue Authorities disputed the CENVAT Credit to the taxpayers on two grounds. Firstly, it contended that the debit note containing the annexures with the relevant details is not a 'prescribed document' under Rule 9 of the CENVAT Credit Rules, 2004 and secondly, the individual premises for which the rentals were charged and from where services were provided were not registered by the taxpayer.

The issue reached before the CESTAT wherein it was held that prescription of document is only a machinery provision achieving the object of law to enable the Revenue Authorities to verify the fact of payment of service tax. Since the debit note contained all the information that were prescribed by the Service Tax Rules, 1994 and in the absence of a specific prescribed format, the debit notes were sufficient for availing CENVAT Credit. On the second count, the CESTAT held that at the relevant time, the law required the taxpayer to register only that office from where centralized billing was done or centralized accounts were maintained. All the invoices (debit notes) for input services were addressed to this registered address; hence denial of credit on the ground that individual premises were not registered was unsustainable.

Altas Documentary Facilitators Private Limited v Commissioner of Service Tax, Mumbai [2013 TIOL 1727 (CESTAT- Mum)]

Assembly of various, machinery, equipment, appliances and parts to set up an immovable plant cannot result in denying CENVAT Credit on capital goods

The taxpayer was a manufacturer of HR coils and sponge iron. It entered into a contract with Inox Air Products Limited ('Inox') for setting up an oxygen plant. As per the arrangement, certain goods were procured by the taxpayer and the rest were procured by Inox, which were assembled by Inox and the plant was leased by Inox to the taxpayer. The Revenue Authorities were of the opinion that the taxpayer was not eligible to avail CENVAT Credit of duty of machinery, equipment etc gone in fabrication of the plant as the plant was immovable and thus not excisable.

The matter reached before the CESTAT which ruled in favour of the taxpayer. It held that the view of the Revenue Authorities was not correct because in none of the manufacturing plants, the machinery / capital goods could be used directly as they are. Merely because all the individual equipment, machinery or components are assembled together, it will be preposterous to suggest that the capital goods credit cannot be allowed on this individual machinery / equipment or appliances. The various machineries and equipment have to work in conjunction and unison to perform a process and for this reason they are assembled.

It was thus absurd to suggest that the taxpayer would not be able to take credit of the capital goods procured by it because the whole point of allowing credit on capital goods is to eliminate the cascading effect of tax. If the interpretation of law does not facilitate this elimination, it cannot be accepted. The law has to be read in a manner which is reasonable and hence it was held that the immovability of the plant cannot preclude the taxpayer from taking CENVAT Credit on capital goods.

Commissioner of Central Excise, Raigad v JSW Ispat Steel Limited [2013 TIOL 1758 – CESTAT -Mum)]

CENVAT Credit on capital goods used in relation to manufacture of exempted goods and exported goods can be taken; goods exported are not exempted goods

The taxpayer was engaged in manufacture of knitted readymade garments and cleared garments both in Domestic Tariff Area ('DTA') and also for export purposes. Clearance of goods in DTA was after availing benefit of excise duty exemption under Notification no 30/2004-CE, dated July 9, 2004. One of the conditions of said notification was that credit of duty on 'inputs' should not be availed. The taxpayer did not avail credit on 'inputs', but instead it availed credit on 'capital goods' which were used in the manufacture of knitted garments.

In addition, the taxpayer also procured zippers and hangers from DTA, under Notification no 43/2001-CE (NT) dated June 26, 2001, which provided for procuring excisable goods without payment of duty for manufacture/processing of export goods. A part of zippers and hangers which could not be utilized for manufacture of export goods were cleared by the taxpayer in the DTA on payment of duty.

In doing so, the taxpayer utilized credit of 'capital goods' for payment of duty.

Revenue Authorities sought to deny the credit on 'capital goods' stating that the capital goods were exclusively used for manufacture of exempted goods. The taxpayer contended that 'exported' goods are not 'exempted' goods. Hence it would be incorrect to state that the taxpayer utilized capital goods credit exclusively in manufacture of 'exempted' goods.

The taxpayer further stated that he had not taken credit on inputs as per Notification no 30/2004 and since there was no bar in taking CENVAT Credit on capital goods, he was entitled to do so. Hence the discharge of duty in respect of the unused hangers and zippers was in accordance with the law.

The CESTAT held that export goods were not exempted goods and only in the case of DTA clearance, the exemption was availed. It was thus held that the capital goods credit was rightly availed and it could not be attributed entirely to the manufacture of exempted goods. It was further observed that as regards removal of zippers and hangers, the taxpayer had two options:

(i) clear goods on payment of duty, or

(ii) clear goods without payment of duty to the original manufacturer of hangers and zipper, who shall add the same to his non-duty paid stock.

The CESTAT held that there is no bar in the CENVAT Credit Rules in clearing the goods on payment of duty and the duty had been discharged as per law.

Ginger Clothing Private Limited v Commissioner of Central Excise, Thane [Appeal no 86809/13 CESTAT-Mum]

CENVAT Credit availed on input services for expansion/diversification of business not admissible if actual expansion/diversification is not carried out

The taxpayer had availed CENVAT Credit on the services relating to research formation, standardization of raw material and pre-clinical studies for various herbal products for diversification of business. Later, owing to business exigencies, the taxpayer abandoned the idea to manufacture these herbal products. The Revenue Authorities disputed the availment of credit on the ground that there was no nexus between input services and the manufacture and clearance of final products.

The matter reached before the CESTAT wherein the CENVAT Credit for research to expand the existing business was denied. The CESTAT held that Rule 3 of CENVAT Credit Rules states that CENVAT Credit on input services is eligible if it is utilized in manufacturing or clearance of final product. In the instant case, final product for which research was done was never manufactured. CESTAT also overruled that input service was service in the course of business activity, as the same was not used for manufacture of final product either directly or indirect, in or in relation to. CESTAT also held that interest was payable on wrongful availment as per rule 14 of CENVAT Credit Rules; however, no penalty would be payable as they availed the same under the bona- fide belief that they would venture into the activity of manufacturing herbal products.

Lyka Labs Limited v Commissioner of Central Excise, Surat [2013 (32) STR 79 CESTAT-(Ahd)]

CENVAT Credit availed on capital goods to be reversed on removal goods after allowing a deduction of 2.5 percent for each quarter of the year even for the period before November 13, 2007

The taxpayer was manufacturer of PVC pipes and they had taken CENVAT Credit on certain capital goods during 2004 and 2005. Later in 2006 they removed these capital goods by paying an amount equal to the applicable duty on transaction value of the goods. The Revenue Authorities demanded the difference between the CENVAT Credit taken and the amount so paid at the time of clearance. The Customs, Excise and Service Tax Appellate Tribunal ('CESTAT') in Commissioner of Central Excise v Geeta Industries Private Limited [2008 (232) ELT 350 (Tri-Del)] had allowed reversal of credit after reducing 2.5 percent per quarter. The matter was referred to larger bench of *CESTAT.*

The larger bench of CESTAT observed that a decision to the effect that the taxpayers can bring in capital goods, use them for a few years and then remove them without the reversal of any CENVAT Credit is not consistent with the scheme of CENVAT Credit. CESTAT further observed that reversal of credit after reducing 2.5 percent per quarter of usage of capital goods existed under the MODVAT regime and was also introduced with effect from November 13, 2007. Apart from this, Central Board of Excise and Customs ('CBEC') vide circular 643/34/2002/CX dated July 1, 2002 also provided for reversal of credit after reducing 2.5 percent of usage. Consequently, CESTAT relying upon the Madras HC judgment in the case of Commissioner of Central Excise vs Rogini Mills [2011 TIOL 05 (Mad)] held that that a manufacturer or the provider of an output service will have to reverse the CENVAT Credit after deducting 2.5 percent for each quarter of the year from the date of taking of CENVAT Credit.

Commissioner of Central Excise, Hyderabad-III v Navodhaya Plastic Industries Limited [2013 TIOL 1773 (CESTAT-Mad-LB)]

Notification & Circulars

For online payment of excise duty and service tax, the pecuniary limit reduced from INR 10 lacs to INR 1 lac

The Central Government has amended the third proviso to Rule 8(1) of the Central Excise Rules 2002 and proviso to Rule 6(2) of the Service Tax Rules 1994 to make online payment of excise duty and service tax mandatory for taxpayers whose service tax liability is INR 1 lac or more.

Notification no 15/2013 dated November 22, 2013

Canteen services serving food and beverages in a factory exempt from service tax

The notification has added an entry into the mega exemption notification to include canteen services serving food and beverages in factories (within the meaning of Factories Act, 1948)

Notification no 14/2013 dated October 22, 2013

Central Excise Valuation (Determination of Price of Excisable Goods) Rules amended

The Central Government has amended the Central Excise Valuation Rules relating to valuation for captive consumption and for related party and inter-connected undertakings.

Notification no 14/2013 dated November 22, 2013

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