June 2014

# TAX UPDATES

(containing recent case laws, notifications, circulars)

Prepared in association with

KPMG cutting through complexity

BMR & Associates

# Foreword

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

FICCI has submitted its Pre Budget Memorandum for the year 2014-2015 to the Government on May 5, 2014. The copies of the document have been sent to various officials in the Ministry of Finance and other important ministries of the Government. The document has also been placed on the FICCI's website.

FICCI was invited for a Pre-Budget Meeting with Mr. Rajiv Takru, Revenue Secretary, on May 29, 2014. Core issues and other areas of concern on taxation matters were highlighted by the FICCI delegation.

Mr. Sidharth Birla, President, FICCI, along with Dr Jyotsna Suri, Senior Vice President and I met Mr. Arun Jaitley, the Hon'ble Finance Minister, on the 1st June, 2014. While welcoming him on his appointment, the delegation requested for creating a conducive tax regulatory environment. Amongst other issues, it was requested on behalf of FICCI that Government should declare as a policy that retrospective amendments shall not be resorted to except in rarest of cases. Concerns were also expressed regarding taxation of capital.

Under the taxation regime, the Delhi High Court in the case of Linde AG held that the consortium between Linde and Samsung was not forming an Association of Persons and the contract between them was divisible. The High Court held that offshore supply was not taxable in India since the property was transferred outside India and the contract was not resulting in a business connection in India. In relation to the taxability of offshore services under the Income-tax Act, 1961, it was held that if such services are linked with the manufacture and fabrication of the material and equipment to be supplied overseas and form an integral part of the said supplies, it was not taxable in India.

In a VAT case the Karnataka High Court upheld the decision of the Revenue Authorities to disallow the quantity discounts as deduction from the taxable turnover on the ground that the discounts were not relatable to the sales affected in the relevant tax invoices. It was held that discount shown in the invoice should

relate to the sales in that invoice and not for sales affected earlier, hence deduction was not permissible.

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

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# Recent Case laws

## I. DIRECT TAX

## Supreme Court Decisions

### Proceeds generated from scrap sales should not be included in 'total turnover' for the purpose of deduction under Section 80HHC of the Act

The taxpayer is a manufacturer and exporter of stainless steel utensils. In the process of manufacturing stainless steel utensils, some portion of the steel, which cannot be used or reused, is treated as scrap. The taxpayer disposes of the said scrap in the local market and the income arising from the said sale is also reflected in the Profit and Loss Account, separate from turnover. For the purpose of availing deduction under Section 80HHC of the Act, the taxpayer was not including the sale proceeds of scrap in the total turnover. According to the tax department, the sale proceeds from the scrap should have been included in the 'total turnover' as the scrap was also part of the sale proceeds. The taxpayer objected to the said inclusion of scrap sales in total turnover as it would reduce the amount deductible under Section 80HHC of the Act. The High Court decided the said issue in favour of the taxpayer. Aggrieved by this, the tax department filed an appeal before the Supreme Court.

The Supreme Court noted that the term 'turnover' was neither defined in the Act nor was explained by any of the Central Board of Direct Taxes (CBDT) circulars; therefore, the meaning of the term in ordinary accounting or commercial parlance had to be examined. The Supreme Court held that, the word 'turnover' would mean only the amount of sale proceeds received in respect of the goods in which an taxpayer is dealing. It would not include the amount received, if any, from the sale of scrap of metal pieces or sale proceeds of old or useless things sold during that accounting year. The Supreme Court also noted that the buyer of such scrap would, however, treat the same as turnover for the simple reason that the buyer would be a person who is primarily dealing in scrap. The Supreme Court also referred to the 'Guidance Note on Tax Audit Under Section 44AB of the Income Tax Act' published by the Institute of Chartered Accountants of India, which has explained the meaning of the words 'Sales', 'turnover' and 'gross receipts' held that in normal accounting parlance the word 'turnover' would mean 'total sales'. The Supreme Court also observed that the intention behind Section 80HHC enactment was to encourage export and earn more foreign exchange and once government decides to give benefit, tax department should also make all possible efforts to encourage such traders/manufacturers by giving such businesses more benefits as contemplated under law.

*CIT v. Punjab Stainless Steel Industries (Civil Appeal No. 5592 of 2008)*

### The Supreme Court held that carried forward losses of amalgamating co-operative societies cannot be claimed by amalgamated co-operative societies

The Supreme Court held that since there is no specific provision for set off of carried forward losses of amalgamating co-

operative society by amalgamated co-operative society, amalgamated co-operative society cannot claim the carried forward losses of amalgamating co-operative societies. The Supreme Court observed that Section 72A of the Act provides for setting off losses on amalgamation of companies only. Also if one class of legal entities is given some benefit which is specifically stated in the Act, it does not mean that the legal entities not referred to in the Act would also get the same benefit. Thus the Supreme Court held that the amalgamated co-operative society cannot claim set-off of losses of amalgamating co-operative societies.

*Rajasthan R.S.S. & Ginning Mills Fed. Ltd. v. CIT (Civil Appeal No.3880 of 2003)*

# High Court Decisions

## A consortium formed for the limited purpose of acquiring a contract does not lead to the constitution of an Association of Persons under the provisions of the Act

An Indian Company floated tender inviting bids for executing a turnkey project in India. A German Company (the Company) and a Korean company (collectively called 'the Companies') entered into a Memorandum of Understanding (MOU) for jointly submitting a bid for the project. The Indian Company accepted the proposal made by the Companies. The project involved the offshore and onshore supply of services and equipment.

On a petition filed by the Company before the AAR, it was held that the Companies constituted an Association of Persons (AOP) under the provisions of the Act and that the profit/income of the AOP was taxable in India.

Aggrieved by the AAR ruling, the Companies filed a writ petition before the High Court.

The High Court held that the consortium formed between the Companies was only for acquiring the project/contract and no AOP was formed, *inter alia*, for the following reasons:

- An AOP is one in which two or more persons join together for a common purpose or common action and there is joint management or joint action by the said two or more persons. A mere cooperation of one person with another in serving one's business objective would not be sufficient to constitute an AOP merely because the business interests are common;

- The consortium was established for the limited purpose of representations and dealing with the Indian Company with independent and separate scope of work as set forth explicitly in the MOU;

- The Companies were independent of each other and were responsible for their own deliverables under the Contract, without reference to each other; and

- The fact that a third party is desirous to deal with the members as one consortium cannot be the determinative factor in considering whether the members constitute an AOP.

Further, the High Court held that the offshore supply of equipment/materials was not taxable in India since the property in the equipment/materials was transferred to the buyer outside India. In relation to the taxability of offshore services, the High

Court held that if such services form an integral part of the offshore supply of equipment/materials, such services would not be taxable in India under the provisions of the Act.

*Linde AG, Linde Engineering Division v. DDIT [2014] 44 taxmann.com 244 (Del)*

## Employees seconded to provide business support services constitute a Service PE in India

The taxpayer, an Indian Company, was established as a wholly owned subsidiary of a UK based company to overlook and manage certain back office functions outsourced to Indian vendors by two subsidiaries (one in UK and other in Canada) of the UK based parent (overseas entities).

To seek support during initial years of operations, the taxpayer sought some employees on secondment from the overseas entities. The seconded employees were to work under the supervision and control of the taxpayer. The taxpayer reimbursed the salary cost of the seconded employees to the overseas entities on a cost-to-cost basis and also withheld and paid tax in India on the salary paid to the seconded employees.

The taxpayer filed an application before the AAR, seeking a ruling on the issue of taxability of the sums reimbursed in the hands of the overseas entities and consequential withholding tax obligations on the taxpayer. The AAR ruled that the overseas entities constituted a service PE in India under the tax treaty and hence the taxpayer was obliged to withhold tax at source.

Aggrieved by the ruling given by the AAR, the taxpayer filed a writ petition before the High Court seeking to quash the ruling of the AAR.

The High Court ruled that the services rendered by the seconded employees qualified as 'technical services', *inter alia*, for the following reasons:

- The overseas entities have provided 'technical services' to the taxpayer, since, inter alia, the expression FTS/Fees for Included Services (FIS) in the tax treaty includes the provision of the service of personnel;
- The payment is not, in nature, a reimbursement, but rather a payment for rendering services. The nomenclature or less than expected charge for such service cannot change the nature of the service;
- The seconded employees possessed the necessary technical knowledge and skills which were 'made available' to the employees of the Indian Company till the necessary skill set was acquired by the employees of the Indian Company.

Further, the High Court upheld the ruling of the AAR that the seconded employees create a Service PE of the overseas companies. While reaching its conclusion the High Court noted, *inter alia*, the following:

- There was no employment relationship between the taxpayer and the seconded employees since the assessee had no right to terminate the employment of the seconded employees;
- The seconded employees could not sue the taxpayer for default in the payment of their salary; and
- The seconded employees retained their entitlement to participate in the retirement and social security plans of the overseas entities.

*Centrica India Offshore (P.) Ltd. v. CIT [2014] 44 taxmann.com 300 (Del)*

## Gains arising from PMS transactions are capital gains and not business profits

The taxpayer offered long-term capital gain (LTCG) and short term capital gain (STCG) on the sale of shares, which had arisen through a Portfolio Management Scheme (PMS) of Kotak and Reliance. The investments were shown under the head 'investments' in the books and were made out of surplus funds. The purchase and sale of shares were done through actual delivery The AO, CIT (A) and Tribunal held that as the transactions by the PMS Manager were frequent and the holding period was short, the income is assessable as business profits.

The Delhi High Court allowing the appeal of the taxpayer held that the PMS Agreement in this case was a mere agreement of agency and could not be used to infer any intention to make profit. The intention of the taxpayer must be inferred holistically, from the conduct of the taxpayer, the circumstances of the transaction, and not just from the seeming motive at the time of depositing the money. Along with the intention of the taxpayer, other crucial factors like the substantial nature of the transactions, frequency, volume, etc, must be taken into account to evaluate whether the transactions are adventure in the nature of trade. The block of transactions entered into by the portfolio manager must be tested against the principles laid down, in order to evaluate whether they are investments or adventures in the nature of trade. In the instant case, the sources of funds of the taxpayer were its own surplus funds and not borrowed funds. About 71 per cent of the total shares had been held for a period longer than six months, and had resulted in an accrual of about 81 per cent of the total gains to the taxpayer. Only 18 per cent of the total shares were held for a period less than 90 days, resulting in the accrual of only 4 per cent of the total profits. This shows that a large volume of the shares purchased were, as reflected from the holding period, intended towards the end of investment. The fact that an average of four to five transactions were made daily, and that only eight transactions resulted in a holding period longer than one year is not relevant because the number of transactions per day, as determined by an average, could not be an accurate reflection of the holding period/frequency of transactions. Moreover, even if only a small number of transactions resulted in a holding for a period longer than a year, the number becomes irrelevant when it is clear that a significant volume of shares was sold/purchased in those transactions.

*Radials International v. ACIT (ITA No.485/2012 dated 25 April 2014)*

## Payment for provision of passive infrastructure by petitioner, an owner of network of telecom towers, to telecom service providers, amounts to 'rent for use of machinery, plant or equipment'

The taxpayer provided passive infrastructure services to its customers, i.e., major telecom service providers in the country which, inter alia included, tower, shelter, diesel generator sets, batteries, air conditioners, etc. Petitioner applied for issue of a lower deduction certificate on its projected receipts under Section 194C of the Act. The AO however issued a lower deduction certificate treating receipts under Section 194-I. Aggrieved by that

certificate, the taxpayer filed a writ petition before the Delhi High Court, which by its order directed the taxpayer to prefer a revision petition before the CIT who was to dispose it of expeditiously. The CIT by its impugned order under Section 197 of the Act declined its request for determination of a lower rate of tax deduction at source. Thus, the crucial question to be decided in the instant case was whether the activity, i.e., provision of passive infrastructure by the taxpayer to the mobile operator, constituted renting within the extended definition under Explanation to Section 194-I or whether the activity was service, pure and simple without any element of hiring or letting out of premises. The taxpayer urged that there was no intention to rent or lease the premises or facilities or equipment and what was contemplated by the parties was a service. On the other hand the tax department contended that the use of the premises, and the right to access it, amounted to renting the premises.

The Delhi High Court held that the dominant intention in these transactions between taxpayer and its customers was use of equipment or plant or machinery, hence, operative intention here, was use of equipment. Since the use of premises was incidental, in that sense there the transaction was inseparable, therefore the submission of the taxpayer that the transaction involved no 'renting' at all, was incorrect. Equally, tax department's contention that transaction was one where parties intended renting of land because of right to access being given to mobile operators was also incorrect. The underlying object of arrangement or agreement was use of machinery, plant or equipment, i.e. passive infrastructure services to mobile operators which amounted to 'rent' for use of machinery, plant or equipment and thus tax deductions were to be at a rate directed in Section 194-I for use of any machinery or plant or equipment at two per cent.

*Indus Towers Ltd. v. CIT [2014] 44 taxmann.com 3 (Del)*

## Payments made for the use of database and human skill transfer are revenue in nature though the benefit may be enduring

The taxpayer is a newly incorporated company due to the division of software and hardware business by the erstwhile TATA IBM. During the year under consideration the taxpayer made payment of i) INR 53 million towards transfer of domestic customer database ii) payment of INR 93.8 million (cost belonging to non STP unit) towards transfer of human skills which was claimed as revenue expenditure by the taxpayer. The AO disallowed the aforesaid claim on the ground that same were capital in nature and incurred enduring benefit. The CIT(A) confirmed the AO's order. The Tribunal reversing the order of the AO and the CIT(A) decided the said issue in favour of the taxpayer. Aggrieved by the same, the tax department appealed before the High Court.

The Karnataka High Court after perusing the agreement between IBM and TATA held that the amount paid by taxpayer towards domestic customer database was only for the right to use that database and not for acquisition of such database. The transferor company was not precluded from using the database. Relying on the judgment of the Karnataka High Court in the case of Wipro Ge Medical System Ltd, it held that the payment made for access to database is revenue in nature. With respect to payment made for the transfer of human skills, the

High Court observed that TATA IBM had spent lot of money to give training to the employees who were transferred to the taxpayer. The High Court noted that the expenditure was incurred for the employees' past services in TATA IBM and it cannot be said that payment has been made for expenses incurred by TATA IBM on training to employees transferred to the taxpayer and hence the same are revenue in nature. The High Court held that the concept of payment made once and for all and of the enduring benefit respond to the changing economic realities of business and hence the expenditure incurred on processing domestic customer database and transfer of human skill is a revenue, though the benefit may be of enduring in nature.

*CIT v. IBM Global Services India Private Limited (ITA NO.735/2007)*

### Transfer of undertaking not involving monetary consideration is an exchange transaction and not a slump sale.

The Bombay High Court upheld the finding of the Tribunal that the transfer of an undertaking in exchange for the issue of preference shares and bonds without any mention of monetary consideration for the transfer was a case of exchange and not a sale, and therefore, provision of Section 50B of the Act were inapplicable and dismissed the appeal filed by the tax department.

*CIT v. Bharat Bijlee (Appeal No. 6401/MUM/ 2008)*

## Tribunal Decisions

### Transponder fees are taxable as royalty under the Act as well as under the India-USA tax treaty

The taxpayer, Viacom 18, is primarily engaged in the business of broadcasting television channels from India. The taxpayer was provided with satellite signal reception and re-transmission services (transponder services) by Intelsat Corporation, US (Intelsat). In consideration for transponder services, the taxpayer paid a transponder service fee to Intelsat.

The taxpayer approached the Assessing Officer (AO) for an order under Section 195(2) of the Act for Nil withholding tax on payments to be made to Intelsat. The AO held that the transponder fee payable by the taxpayer to Intelsat was, in nature, 'royalty' income under the Act and also under India-USA tax treaty and accordingly the payments were liable to withholding tax.

The Tribunal, based on the facts of the case, held as follows:

- The definition of royalty is common under the tax treaty as well as under the Act to the extent of "*payment of any kind received as consideration for the use of, or the right to use …… any process, industrial, commercial or scientific equipment*".
- The term 'process' is defined in Explanation 6 to Section 9(1)(vi) of the Act. The retrospective introduction of Explanation 6 to Section 9(1)(vi) from 1 June 1976 is clarificatory in nature and it did not amend the definition of 'royalty' *per se.*

- The use of a transponder by the taxpayer falls within the expression 'process' under Explanation 6 of Section 9(1)(vi) of the Act. Further, the term 'process' is not defined in India-USA tax treaty. Therefore, the meaning of such a term under the Act shall apply to the India-USA tax treaty.
- Hence, the payments made for use/ right to use of process falls in the ambit of expression 'royalty' under the India-USA tax treaty as well as provisions of Act.

The decision of the Delhi High Court in the case of Asia Satellite Communication Co. Ltd. [2011] 197 taxman 263 (Del) is not applicable in view of the insertion of an explanation below sub-section (2) of Section 9 (inserted vide the Finance Act, 2010) and Explanation 6 to Section 9(1)(vi) of the Act (inserted vide the Finance Act, 2012). The Tribunal also relied on the decision of the Madras High Court in the case of Verizon Communications Singapore Pte. Ltd. [2014] 361 ITR 575 (Mad) which had distinguished the decision of the Delhi High Court in case of Asia Satellite Communication Co. Ltd.

*Viacom 18 v. ADIT [2014] 44 taxmann.com 1 (Mum)*

## TDS under Section 194-I of the Act attracted on employee's car hire and Section 194C of the Act for chauffeur's services for the purpose of deduction of tax at source

The taxpayer is in the business of providing telecommunication network and services across the country. For the smooth functioning of its business, it enters into maintenance contracts with various contractors. For AYs 2007-08 to 2009-10, the taxpayer deducted tax at source for payments to contractors. The taxpayer inter alia made payments toward 'vehicle hiring' and deducted tax under Section194C of the Act. However, the AO considered it to be covered under Section 194-I of the Act dealing with Tax Deducted at Source (TDS) on rent payments. On appeal, the Commissioner of Income-tax [CIT(A)] held that the nature of services contracted were not towards car hiring but for the facility of transportation from one place to another, with the rates fixed for a particular vehicle with reference to distance and timing. Further, the cars were not at the disposal of the taxpayer. Being aggrieved, tax department preferred an appeal before Mumbai Tribunal.

The Mumbai Tribunal observed that as per Section 194-I of the Act, rent means a payment, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any land; building; land appurtenant thereto; machinery; plant; equipment; furniture; or fittings. Thus, a vehicle or motor car would come within the purview of the words 'plant' or 'machinery' which are generic terms and accordingly, the arrangement for providing cars to the taxpayer's personnel for their work would stand to be covered by Section 194-I of the Act. The Tribunal further clarified that chauffeur's services included in vehicle hiring arrangement as well as meeting the fuel cost of transportation, could not be considered as toward car rental and would attract TDS under Section 194C of the Act.

*ITO v. Bharat Sanchar Nigam Ltd. [2014] 45 taxmann.com 124 (Mum)*

## Deduction under Section 35 on account of raw material purchased

## for research and development to be allowed in the year of purchase of raw materials, though they remained unused/unconsumed during the year

The taxpayer is engaged in the business of manufacture and sale of specialty chemicals and intermediates. It purchased certain raw materials for research and development (R&D) activities. It claimed the expenditure for raw materials of INR 27.5 million under Section 35 of the Act for AY 2007-08. The AO observed that the taxpayer failed to furnish the relevant supporting details like- the nature of the expenditure in detail, evidence for purchase of raw material, stock register of raw material consumed etc. Further, the AO noted that expenditure of raw materials for R&D was over and above the total expenditure claimed on raw materials reported in the statutory audit report. Thus, the AO concluded that taxpayer could not establish that R&D expenditure was incurred over and above the expenditure on raw material already debited in the audited Profit and Loss Account and so disallowed the expenditure. The CIT(A) upheld the order of the AO. Aggrieved by the same, the taxpayer preferred an appeal before the Pune Tribunal.

The Pune Tribunal held that when a material is purchased for R&D purposes, it is immaterial whether the material is consumed during the year or held as closing stock and the entire expenditure incurred on raw material for the purpose of R&D qualifies for deduction under Section 35 of the Act irrespective of the accounting treatment of the same in the books of account. The Tribunal referred to certain decisions wherein R&D expenditure was allowed in respect of capital expenditure and it was observed that the Revenue should not deprive the taxpayer of the benefit of deduction under Section 35 even if the asset was not put to use for R&D.

*Balaji Amines Pvt. Ltd. v. ACIT (ITA No.1448/PN/2011)*

## Municipal Committee, a tax exempt entity is also subject to disallowance of expenditure if tax is not deducted on the same

During AY 2010-11, the taxpayer, a Municipal Committee, made payment of INR 3.46 million towards supply, erection, testing & commissioning of lights. As per the AO, TDS provision under Section 194C of the Act for contract payment was applicable in taxpayer's case. Since the taxpayer failed to deduct tax at source, the AO disallowed the payment under Section 40(a)(ia) of the Act and did not grant the exemption under Section 10(20) of the Act on such amounts added to the income. The CIT(A) further confirmed the AO's order. Aggrieved, by the Order of the CIT(A), the taxpayer filed an appeal before the Amritsar Tribunal.

Before the Amritsar Tribunal, the taxpayer argued that being a municipal corporation, its income was exempt under Section 10(20) of the Act and therefore, it was submitted that its income was not covered under the head 'Profit & Gains of Business and Profession' and accordingly provisions of Section 40(a)(ia) of the Act were not applicable. The Tribunal held that the provisions of Section 40(a)(ia) of the Act are deeming provisions and such deeming provisions were applicable notwithstanding anything otherwise provided under the Act. Since the taxpayer had violated the provisions of Section 194C of the Act, provisions of Section 40(a)(ia) of the Act were triggered. Further, the Tribunal also held that no benefits in the form of

deduction or exemption could be allowed on violating the provisions of the Act. Separately, the Tribunal relying on co-ordinate bench ruling in Mahabir Cotton Traders [ITA No. 326(Asr)/2010] rejected taxpayer's contention that since no amount was payable as on balance-sheet date, no disallowance under Section 40(a)(ia) of the Act can be made.

*Municipal Committee v. ITO (ITA No. 34(Asr)/2014)*

## The Delhi Tribunal upheld taxpayer's residual Profit Split Method over TPO's Transactional Net Margin Method and held that the allocation of residual profits was to be based on contributions from each entity

The taxpayer is a company incorporated in India which is a subsidiary of EGN BV, Netherlands and is engaged in providing internet and related network services to the group's customers in India. An upward adjustment was made to the Arm's Length Price (ALP) for Assessment Year (AY) 2007-08 and 2008-09 by the Transfer Pricing Officer (TPO) by adopting the Transactional Net Margin Method (TNMM) as the as Most Appropriate Method (MAM) and rejecting the Profit Split Method (PSM) adopted by the taxpayer. The Dispute Resolution Panel (DRP) upheld the conclusion drawn by the TPO.

The taxpayer contended that as the group operations are highly integrated, interconnected and intrinsically linked, wherein multiple entities are engaged in the transaction and where one group entity incurs expenditure and one group entity records revenue, only PSM can be the MAM, and if not correctly applied, the remedy is to correct the same rather than concluding to change the method itself.

The Tribunal held that:

- The nature of the taxpayer's group operations is integrated, interconnected and interdependent as the transaction passes through various Associated Enterprises (AE's) and their contribution and revenue is also shared.
- Agreed with the taxpayer's contention that TNMM cannot be used for benchmarking returns earned by the number of complex entities/entrepreneurs, where each make valuable unique contributions. The TPO, while adopting the TNMM, considered operating profit at the entity level whereas TNMM contemplates benchmarking at the transactional level.
- Guidance to determine the ALP can be taken from the OECD commentaries, the UN guidelines and other such literature.
- When the transaction involves contributions of multiple entities and is integrated and interrelated, the PSM is the MAM and presence or use of unique intangibles is not a must for adopting the PSM.
- The Tribunal, rejecting the tax department's contention that the residual PSM cannot be applied as reliable external market data necessary for the same was not available, held that the basic routine rate of returns determined by the taxpayer was based on external benchmarking.
- A harmonious interpretation of the provisions is required to make the Rules workable as any benchmarking at this stage may not be practicable as comparables having similar, multiple, interrelated and integrated transactions, would be difficult to find.

The Tribunal upheld the allocation of residual profits on the basis of contribution made by each entity.

- The legislature has introduced Rule 10AB by the Income-tax (Sixth Amendment) Rules, 2012 with effect from 1 April 2012 under the sub head 'Other method of determination of ALP'. When a new method is allowed, with the objective of enabling determination of the proper ALP, such a provision operates retroactively, and can be used to determine the ALP in the earlier AYs also.

The Tribunal remitted the matter back to the file of the AO for fresh adjudication in line with the observations made by the Bench.

*Global One India Pvt. Ltd. v. ACIT [ITA No. 5571/Del/2011 and ITA No.5896/Del/2012]*

# Authority for Advance Rulings

## The MFN clause in the protocol cannot be used to provide the benefit of 'make available' clause in tax treaties with other nations

An Indian company (the Company) entered into a Master Services Agreement (the Agreement) with a non-resident partnership firm (the Service Provider) formed in France to receive various management services.

The Company filed an application with the AAR seeking a ruling on the issue of taxability of the payments for the management services in the hands of the Service Provider, and the Company's obligation to withhold tax at source on such payments.

The Company contended that the benefit of 'make available' clause in the India-UK tax treaty, which was signed much after 1 September 1989 should be available under the India-France tax treaty (the tax treaty) by virtue of the Protocol signed between India and France. Thus in absence of the technical knowledge, experience, skill, know-how or processes being 'made available' by the Service Provider to the Company, the services ought not to qualify as FTS under the tax treaty.

The AAR ruled that payment for management services will be taxable as FTS as the benefit of 'make available' clause under the India-UK tax treaty cannot be imported to interpret the provisions of the tax treaty with France, *inter alia*, for the following reasons:

- A Protocol cannot be treated in the same way as the provisions contained in the tax treaty itself, though it may be an integral part of the tax treaty;
- As per the Protocol, the restrictions are on the rates and the benefit of 'make available' clause cannot be read into it; and
- The Notification No. GSR 681(E), dated 7 September 1994 and Notification No. 11438 [SO 650(E), (F.No.501/16/80-FTD)], dated 10 July 2000 do not cover the 'make available' clause. Had the intention been to include the 'make available' clause in the India-France tax treaty, it should have been included in the notification.

*Steria (India) Ltd. [2014] 45 taxmann.com 281 (AAR)*

# II. SERVICE TAX

## High Court Decisions

### Refund claim to be within the limitation period even if tax paid erroneously under a bona fide belief

The taxpayer entered into an agreement with Andrew AG Switzerland to provide services of identifying customers in India to the latter. For the provision of such services, the taxpayer was paid commission in convertible foreign exchange which it realised through normal banking channel. The provision of service in their case qualified as export as per the service tax regulations and the taxpayer was not liable to discharge any service tax liability on the same. However, the taxpayer was ignorant of this benefit and it was under the bona fide belief that its services did not qualify as export till the circular of the Central Board of Excise and Customs ("CBEC") came to be issued. Therefore, it did not file a refund claim within one year of paying the service tax in terms of section 11B of the CEA. The Revenue Authorities were of the opinion that the matter was time barred and no refund could be allowed for such erroneous payment of tax.

The matter came up for consideration before the Bombay HC which held against the taxpayer. The HC reasoned that it was an undisputed position that the amount paid by the taxpayer to the Revenue Authorities was service tax. Such tax was not imposable or leviable on the export of services was clarified by the Revenue Authorities and relying on such clarification, the refund of service tax was claimed. Therefore, the claim of the taxpayer fell squarely within the scope of the provisions of CEA and therefore the rule of limitation under section 11B was consequently applicable. Such application of the rule of limitation was made when the applicant took recourse to section 11B. Therefore, if section 11B has been invoked, the same has to apply with full force and the period of limitation under the same has to be adhered to. The HC further opined that the outcome of this case would have been different if the amount deposited with the Revenue Authorities could not have been taken to be service tax at all. Since the amount deposited with the Revenue Authorities is service tax, there cannot be any doubt about the application of section 11B to this case. In addition, the HC also held that there is no warrant or justification for holding that a stale or belated claim can be granted even in a constitutional remedy, by ignoring the statutory prescription. Accordingly the claim of the taxpayer was disallowed

*Andrew Telecom India Private Limited vs Commissioner of Central Excise [Central Excise Appeal no 72 of 2013 Bombay HC]*

### Liability to pay service tax independent of liability to pay Value Added Tax on supply of food and beverages in a canteen

The taxpayer was a registered society and had entered into agreements with National Thermal Power Corporation ("NTPC") and Lanco Infratech Limited ("LANCO") for running and maintenance of an administrative building canteen for catering services. The taxpayer was discharging applicable Value Added Tax ("VAT"), but did

not discharge any service tax on the undertaken arrangement. The Revenue Authorities sought to levy service tax on the running and maintenance of the canteen under the service category of "Outdoor Catering Service".

The matter came up before the Bombay HC which held that the levy of service tax under the contractual agreements was justified. The HC reasoned that although the taxpayer discharged the applicable VAT on the sale or purchase of goods as per Article 366(29A) of the Indian Constitution, there was no bar on the levy of service tax. It was observed that the taxpayer was a person who supplied food, edibles and beverages to provide a facility of a canteen to cater to the employees of NTPC and LANCO. Further, LANCO and NTPC engaged the services of the taxpayer as a caterer. Therefore it was held that since the taxpayer provided these services at a location which was not his own, he qualified as an "Outdoor Caterer". Accordingly, the contention of the taxpayer that it was liable to pay only VAT on the sale involved in the supply of food and beverages and that he was not liable to pay service tax; was rejected

*Indian Coffee Worker's Cooperative Societies Limited vs Commissioner of Service Tax [Central Excise Appeal no 50/ 2014 Bombay HC]*

# Tribunal Decisions

## Service tax already deposited by the contractors not to be demanded again from the builders

The taxpayer, a real estate developer, undertook construction of flats and commercial complex in 2004. For this purpose, it had employed various contractors for such construction activities. Since there was no specific entry of service tax to this effect, no service tax was being paid at that time. Thereafter, service tax levy was introduced on "commercial complex construction" wef September 10, 2004 and on residential premises wef June 16, 2005. Pursuant to this, the taxpayer commenced the collection of the same from buyers representing it as "reimbursement of service tax".

Since the taxpayer was not providing construction services per se, it had not obtained service tax registration and consequently, did not itself deposit the service tax so collected from customers. However, it paid such service tax amount to the contractors, who in turn, were depositing it with the Revenue Authorities. The Revenue Authorities were of the view that the taxpayer was obligated to deposit the same with the Revenue Authorities and therefore in terms of section 73A of the Finance Act, 1994 ("Finance Act"), the Revenue Authorities sought to recover the same from the taxpayer along with applicable interest and penalty. The taxpayer on the other hand contended that service tax so demanded already stood deposited through the various contractors engaged in the construction of flats / commercial property.

The matter came up for consideration before the Delhi Bench of CESTAT which set aside the demand of service tax on the ground that as per section 73A of the Finance Act if a person collected any amount from another person representing

the same as service tax, he is required to deposit the same with the Revenue Authorities. After the service tax categories were introduced, the liability to pay service tax was on the contractors; and the same albeit collected by the taxpayer from the customers, was rightfully deposited by the contractors in terms of the agreement between them. The CESTAT further observed that the question of who collected and deposited the service was immaterial as long as the same was collected and deposited with the Revenue Authorities. The Revenue cannot be allowed to receive service tax twice in respect of the same construction activities, once from the contractor and the second time from the person who collected the same.

*Jaipuria Infrastructure and Developers vs Commissioner of Service Tax, Delhi [Service Tax Appeal no 754 of 2008 Delhi CESTAT]*

## Nature of the payments to be analysed before ascertaining the chargeability of service tax on it

The taxpayer was inter alia engaged in the provision of stock broker services and was a registered member of recognized Stock Exchange Boards. It made payments towards stock exchanges, on behalf of their clients in advance, irrespective of the receipt of transacted amount and consequently recovered the same from their clients by the settlement date. In cases where payments were delayed, the tax payer recovered 'Delayed Payment Charges' ("DPC") from its clients. The Revenue Authorities contended that such DPC were includible in the taxable value in terms of section 67 of the Finance Act as the said charges were part and parcel of the services and hence liable to service tax. On the other hand, the contention of the taxpayers was that such DPCs were not in lieu of stock broking services but a mere penal recovery for late payment of the dues by their clients.

The Delhi Bench of CESTAT observed that the DPCs were being collected by the taxpayer only from those clients, who had not paid them well within the time limit period and the taxpayer being under a legal contract with the Stock Exchange, had to deposit the value of the securities, sold or/ and purchased by their clients. In view of this, it was established that the nature of the said DPCs was of a penal charge and not on account of any stock broking services provided by the taxpayer. The CESTAT accordingly held that DPC was not a commission or a brokerage for sale/ purchase of securities, as the same was not collected from each and every customer but was relatable to only delayed payments by some of the customers. Therefore, there was no justification for inclusion of the same in the value of the services for levying service tax.

*Religare Securities Limited vs Commissioner of Service Tax, Delhi [2014 TIOL 539 CESTAT Delhi]*

## Computer reservation system services to qualify as "online information and database access or retrieval services"

The taxpayer was an airline company and had entered into agreements with several foreign based companies which hosted content related to airline reservations. Based on intelligence, it was found that it was evading the payment of service tax

under the reverse charge mechanism on the category of "Online Information and Database Access or Retrieval Services ("OIDAR") through the Computer Reservations System ("CRS") of foreign based companies ("CRS Companies"). The mechanism of CRS operates as follows:

- The initial data recording of the flight details, number of seats available, fare of tickets, etc are uploaded by the taxpayer on the servers of a company called Sabre Decisions Technologies International Inc USA ("Sabre");

- The CRS Companies access the uploaded data and loads/ hosts it on their own master computer system;

- This data pertaining to the booking of tickets by travel agents is further transmitted to the taxpayer; and

- The taxpayer accesses the data pertaining to cancellations and bookings on a particular flight along with the details of the passengers.

The Revenue Authorities alleged that the taxpayer was receiving OIDAR services from foreign based service providers by using the latter's CRS; as this CRS acted as the sole online interface between the computer network of the taxpayer and other travel agents, who sold the products and services of the taxpayer. On the other hand, the taxpayer contended that it was only able to access / retrieve the data which it owned and it was not able to access / retrieve the data belonging to any other airline; therefore it was not receiving OIDAR services and was thus not liable to pay service tax under the reverse charge mechanism.

The matter came up for consideration before the Mumbai Bench of CESTAT which held that the taxpayer was liable to discharge service tax liability under the reverse charge mechanism as a recipient of service under section 66A of the Finance Act. The CESTAT reasoned that the contention of the taxpayer that it could only access/ retrieve its own data was incorrect as it could access/ retrieve information about booking and cancellations done by travel agents on a real time basis. Therefore, there was a clear evidence of provision of OIDAR services. The CESTAT further held that it was possible that the travel agents were the beneficiaries under this arrangement, but the principal contract for provision of service existed between the taxpayer and the CRS companies, where the taxpayer was the service recipient. Accordingly, the CESTAT held against the taxpayer and held it to be liable for payment of service tax under the erstwhile section 66A of the Finance Act

*Jet Airways India Limited vs Commissioner of Service Tax, Mumbai [Service Tax Appeal No ST / 87494 to 87498 / 13 CESTAT Mumbai]*

## Export of service to be decided as per the situs of consumption and not situs of performance

The taxpayer provided services of evaluation of market trends and identification of prospective customers in India for an unrelated overseas entity, for its modular furniture business by providing a list of prospective customers on a regular basis etc for sale of the latter's products to customers. The agreement recorded a clear

stipulation that the ultimate customer had to deal directly with the overseas entity (ie goods would be supplied by the overseas entity directly to the customers and payments against supplies received had to be directly remitted to it). Further, it was also stipulated that the taxpayer was not authorized to collect any payments from customers on behalf of the overseas entity but had to bear the minor and incidental expenditure incurred for assembly of the finished components at customer's premises, for or on behalf of the overseas entity (reimbursement of these expenses was estimated not to be more than 1% of the Free On Board value of the products and was included in the commission payable); while commission had to be paid to the taxpayer in US dollars at the stipulated rates (in percentage terms) for every successful sale made in India.

The Revenue Authorities contended that the taxpayer provided Business Auxiliary Services to the overseas entity and was liable to remit service tax. However, the taxpayer contended that the services provided to the overseas entity amounted to export of services within the ambit of Export of Service Rules, 2005 ("Export Rules"), since the services were utilized by the recipient outside India and consideration was received in convertible foreign exchange. Therefore, this provision of service qualified as 'export of services' and was liable to be excluded from scope of the service tax.

The matter came up for consideration before the Delhi Bench of CESTAT which held that the taxpayer fulfilled the twin conditions for export of service; being – (a) that the service was used in a place outside India and (b) the consideration was received by the taxpayer in convertible foreign exchange. Therefore, in terms of the decisions in Paul Merchants vs Commissioner of Central Excise [2012 TIOL 1877 Delhi CESTAT] and GAP International Sourcing India Private Limited [2014 TIOL 465 Delhi CESTAT], the appeal of the taxpayer was allowed

*Alpine Modular Interiors Private Limited vs Commissioner of Service Tax [2014 TIOL 517 Delhi CESTAT]*

## If risks and rewards are on the account of the brand owner, a bottling unit cannot be said to have received Intellectual Property Rights services or Franchisee services

The taxpayer, was engaged in the manufacture and sale of beer and owned the brand name 'Foster'. As the taxpayer lacked manufacturing facility to produce beer in Maharashtra, it had entered into an agreement with Foster India Private Limited ("FIPL"), a company engaged in the business of manufacturing and bottling of beer.

The Revenue Authorities contended that the brand name and technical know-how of the taxpayer was being used by FIPL, in lieu of which consideration was paid by FIPL to the tax payer and hence, the taxpayer was liable to discharge service tax on the consideration received under the service category of 'Intellectual Property Rights services' ("IPR") and 'Franchise services'. On the other hand, the taxpayer contended that FIPL was only a Contract Bottling Unit ("CBU") for manufacture and supply of beer, operating under the former's instructions and the sale was made to it or its indenters as per its directions and thus,

neither Franchise service nor IPR service was rendered to FIPL.

The matter came up for consideration before the Mumbai Bench of CESTAT which observed that the alcoholic beverages were sold by or as per the directions of the taxpayer, profit or loss on manufacturing and sale of alcoholic beverages was entirely accountable to brand owner and also noted that in terms of agreement, the risk of manufacture and sale of beer by FIPL was upon the taxpayer. It was further observed that FIPL was responsible for manufacture of Foster beer and was only responsible for bottling, packing and dispatch as per the specification, terms, formula laid down by the taxpayer and that FIPL was bound to charge the price from the Intender as fixed by the taxpayer. Accordingly, the CESTAT held that only for the risks associated with the manufacturing process fastened on FIPL, it cannot be said that as FIPL is responsible for proper quality, quantity and timely production; or the taxpayer is providing Franchisee Service and / or IPR service

*SKOL Breweries Limited vs Commissioner of CE & ST, Aurangabad [ST / 35 & 82 / 09, ST / 539 / 10 and ST / 85575 / 13 Mumbai CESTAT]*

# III. VAT/ CST/Entry Tax

# Supreme Court Decision

### Revenue Authorities justified in estimating total taxable turnover on the basis of piecemeal facts presented to them

The taxpayer was a manufacturer of sweets, namkeen and other eatables. During the relevant period, the Commissioner of Sales Tax visited the business premises of the taxpayers and checked the total cash inflow on those days. It was found that the accounts of the taxpayer were not maintained properly and all the sales effected during a day were not recorded. Upon observation of the information provided to the Commissioner, he estimated the taxable turnover by extrapolating the figures available to him and passed the assessment order. The taxpayer opposed the assessment order on the basis that no notices were issued to the taxpayer before passing the order and therefore the taxpayer had no chance to explain his case to the Revenue Authorities.

The matter reached the SC which held in favor of the Revenue Authorities. The SC stated that the Revenue Authorities did not jump to a conclusion and had called upon the taxpayer to explain the difference in the recorded and estimated revenue in his books of accounts. However, no such explanation was provided by the taxpayer to the Revenue Authorities, following which they passed the orders in question. The SC further stated that there was no doubt that the books of accounts were not maintained properly and were not reflecting each and every transaction and therefore the Assessing officer had rightly come to a conclusion that total possible sale was much higher and the conclusion so arrived at was based on sound reasons. The SC further observed there was a presence of an oblique motive on part of the taxpayer to do the same. Accordingly it was held that demand of sales tax along with penalty was justified

*Nathu Ram Ramesh Kumar vs Commissioner of Delhi Value Added Tax [2014 VIL 09 SC]*

# High Court Decision

## Discount shown in the invoice should relate to the sales in that invoice and not for sales effected earlier, else deduction not permissible

The taxpayer was a manufacturer of home appliances such as wet grinders, mixer grinder, gas stoves etc. As a regular trade practice, the taxpayer used to offer trade / quantity discounts to its distributors and claimed the same as deductions from its taxable turnover. The Revenue Authorities disallowed the quantity discounts as deduction from the taxable turnover on the ground that the discounts were not relatable to the sales effected in the relevant tax invoices.

The matter came up for consideration before the Karnataka HC which held against the taxpayer. It was reasoned that as per rule 3 of the Karnataka Value Added Tax Rules, 2005 ("KVAT Rules") the tax invoice or the bill of sale should be in respect of the sales relating to such discount shown therein and only then it will be allowed as a deduction. There was no dispute in the case of the taxpayer that the discount was not for sales in the relevant invoice, but for sales effected earlier. Accordingly, in terms of rule 3 of the KVAT Rules, the claim of the taxpayer was rejected.

*Maya Appliances Private Limited vs Commissioner of Commercial Taxes [Sales Tax Appeal no 120 / 2012 Karnataka HC]*

## In the absence of necessary records and failure to produce invoices and vouchers before the Assessing Authority, the expenditure incurred for execution of works contract has to be assessed by invoking rule 3(2)(m) of the KVAT Rules

The taxpayer was engaged in the business of execution of works contract of 'Road Marking' by way of using marking materials and glass beads. While filing monthly VAT returns, the taxpayer claimed deduction of 30 percent towards labour and other like charges of the actual contract receipt. The VAT audit authorities visited the taxpayer's premises and subsequently verified the books of accounts for the period April 2005 to March 2007. During the audit, the VAT authorities observed that the taxpayer had neither maintained records pertaining to the labour charges nor was the taxpayer able to produce invoices or vouchers relating to the labour charges. Thereafter, the taxpayer was issued a proposition notice in pursuance to which the taxpayer filed detailed objections. Consequently, the Assessing Officer passed the reassessment order and allowed a deduction of only 25 percent for the labour charges as per rule 3(2)(m) of the KVAT Rules.

The taxpayer being aggrieved by the reassessment order preferred an appeal before the First Appellate Authority challenging the same. Being satisfied by the grounds put forth by the taxpayer, the First Appellate Authority allowed the appeal and set aside the reassessment order. On scrutiny of the order passed by the First Appellate Authority, the Revisional Authority found the order to be

erroneous in law and prejudicial to the interest of the Government revenue. Accordingly, invoking its power under section 64(1) of the Karnataka VAT Act, 2003 a notice was issued to the taxpayer calling upon them to file a statement of objections. The Revisional Authority observed that as no invoices or vouchers had been produced to support the claim of labour charges having been incurred, the order of the Assessing Authority was restored setting aside the order of the First Appellate Authority.

Given the above, the taxpayer approached the Karnataka HC for relief. The HC observed that the taxpayer has executed works contracts of road marking using certain specific materials. As the taxpayer had incurred labour charges, it had claimed deduction of 30 percent to that extent. However, books of accounts in relation to the labour expenses had not been appropriately maintained and neither had the invoices or vouchers in this connection been produced by the taxpayer. The HC held that as there were no supporting documents to substantiate the taxpayer's claim of having incurred labour charges, it would not be in a position to enjoy the benefit of 30 percent deduction. Accordingly, the labour expenditure incurred has to be assessed invoking rule 3(2)(m) of the KVAT Rules. Therefore, the HC decided against the taxpayer and allowed only 25 percent deduction from the value of works contracts executed

*Creative Marking & Controls Pvt Ltd vs The Additional Commissioner of Commercial Taxes, Bangalore [2014 VIL 85 Kar]*

## Interstate movement of goods need not be explicitly mentioned in the contract of sale, if the movement of goods is a result of a covenant of, or incidental to, the contract of sale, central sales tax becomes payable

The taxpayer was engaged in the manufacture and sale of electrical and electronic goods as well as execution of works contract. A works contract was executed between the taxpayer and Karnataka Power Transmission Corporation Limited ("KPTCL") for completion of a project. The contract stipulated that the taxpayer was obliged to procure goods from manufacturers within the state of Karnataka who complied with certain stipulated conditions. In case the taxpayer was not able to procure goods from Karnataka, he could do so from other states after KPTCL deducted 9.5 percent of the amount from the value of such goods at the time of payment. The taxpayer was unable to find any such manufacturers who complied with the said conditions. Consequently, he procured goods from other states. The Revenue Authorities sought to levy tax on the sales of goods under the works contract as per section 5B of the Karnataka Sales Tax Act, 1957 ("KST Act") on the ground that the transfer of title in the goods from the taxpayer to KPTCL happened locally. The taxpayer resisted the contention of Revenue Authorities and held that the sales of goods were not liable to tax under the KST Act, as they would qualify as interstate sales (since procured from outside Karnataka) and tax was also paid under the Central Act to the States from where the goods were purchased under the Central Sales Tax Act, 1956 ("Central Act").

The matter reached before the Karnataka HC which held in the favor of the taxpayer and allowed exemption from payment of tax under the KST Act. The HC held that to qualify as interstate sales, it is not necessary that the contract itself should provide for the movement of goods. It is sufficient if the movement was in pursuance of and incidental to the contract of sale. It was specifically held that the movement of goods from one state to the other may or may not be as a result of a covenant of the contract, but it was definitely incidental to the contract. The HC also relied on its decision in State of Karnataka vs ECE Industries [2006 (144) STC 605] which held that where the description of the goods was clear and the goods of that description were dispatched, then the goods so dispatched from one state to another could be taken to be in pursuance of that contract unconditionally to an identified customer. Accordingly, the HC held in favor of the taxpayer.

*ASEA Brown Boveri Limited vs The State of Karnataka [2014 VIL 90 Kar]*

## Sale of SIM cards not a sale of goods, but a component of the Telecommunication Service

The taxpayer was a public sector undertaking engaged in the provision of telecom services including CDMA Mobile, wireline, internet, broadband etc. The Revenue Authorities issued notices to the taxpayer demanding sales tax under the Himachal Pradesh General Sales Tax Act, 1968 ("HPGST Act") on the sale of SIM cards. The taxpayer resisted the demand on the ground that the issue of the sale of SIM cards for the provision of Telecommunication services was settled in view of the SC ruling in the case of Idea Mobile Communications Limited vs Commissioner of Central Excise and Customs [2011 VIL 17 SC] wherein it was held that the sale of SIM card was not liable to sales tax.

The matter reached before the Himachal Pradesh HC which held in favor of the taxpayer. The HC held that the SIM card had no intrinsic value and was supplied to customers for providing mobile service to them and that the charges paid by the subscribers for procuring the SIM card were generally processing charges for activating the cellular phone and consequently the same would be included in the value of the SIM card. Further, SIM cards are never sold as goods independent from services provided and are considered to be a part and parcel of the telecommunication services. Since the dominant intention in the transaction is to provide services and not sell the property involved therein, the case of the Revenue Authorities was liable to be rejected

*Bharat Sanchar Nigam Limited vs State of Himachal Pradesh [2014 VIL 93 HP]*

## Provision of loan equal to the gross value of the VAT or sales tax not to be considered as a refund of tax

The matter came up before the Gujarat HC in a Public Interest Litigation ("PIL") against the actions of the Government of Gujarat wherein the government extended a loan equal to the gross value of the VAT and state sales tax. It was the contention of the petitioner that such

action of the Government of Gujarat tantamounts to refund of tax and the same is not permissible under the Constitution of India. On the other hand, the Government of Gujarat argued that the amount disbursed to Tata Motors Limited did not amount to a refund of tax but instead was a loan to encourage industry in the state.

While delivering its opinion, the Gujarat HC considered the decision of the Supreme Court in the case of Amrit Banaspati Company Limited vs State of Punjab [1992 (2) SCC 411] wherein the policy of the state government was to refund the sales tax which would be paid by the industry to the state government on the sales made by the industry; and the same was held to be contrary to the tenets of the Indian Constitution. The HC in the instant case distinguished the Amrit Banaspati (Supra) and said that the amount paid by way of loan cannot be considered as a refund of tax and that exemption from the payment of tax should not be confused with refund of tax. In the same manner, deferment of payment of tax should not be considered to be refund of tax. The amount disbursed in the present case is a loan and it is important to appreciate the fine line of distinction between a loan and a refund. Accordingly, the PIL of the petitioner was dismissed.

*Himanshu Patel vs State of Gujarat [2014 VIL 105 Gujarat]*

# IV. CUSTOMS

## High Court Decisions

### Deposit of 'accepted liability' – whether taxpayer can approach Settlement Commission

The taxpayer vide a show cause notice ("SCN") was indicted of smuggling gold jewellery and coins valued at INR 9.79 Cr into India. The said articles involved a customs duty at the baggage rate of 36.50 percent. The SCN sought to confiscate the gold items so imported and also proposed penalty under sections 112 and 114 AA of the Customs Act, 1962 ("Customs Act"); however, no demand for duty was raised under the same. The taxpayer sought relief from the Customs and Central Excise Settlement Commission ("Settlement Commission") under section 127B of Customs Act. However, the Revenue contended that Settlement Commission has no jurisdiction in cases of fraud and misrepresentation, and the same is restricted to mis-classification, under-valuation or inapplicability of exemption notification or otherwise.

The taxpayer on the other hand claimed that the Settlement Commission is well within powers to entertain the matter and that in the absence of determined duty liability under the SCN the taxpayer is also not required to deposit duty with the Settlement Commission under clause (c) of first proviso to section 127B of Customs Act.

The HC of Delhi relying on the decisions in Union of India vs Hoganas India Limited [2006 (199) ELT 8 (Bom)] and Commissioner of Customs vs Ashok Kumar Jain [2013 (292) ELT 32 (Del)] observed that both open-ended text of Section 127B and the purpose for inclusion of "Settlement Commission" in the Act, ie to

create incentives for taxpayer to disclose revenue which has escaped tax, supported the broad jurisdiction of the Settlement Commission. This however, did not mean that those who violated / evaded tax could escape penalty or the rigours of adjudication which occur in the normal course; rather, HC observed that their fate would be decided by the Settlement Commission in accordance with law. Further, it held that drawing arbitrary lines between 'outright smuggling' and other 'lesser' forms of mis-description that could be condoned by the Commission under section 127B of Customs Act is uncalled for.

As regards the requirement of deposit as pre-condition to approach Settlement Commission, HC rejected taxpayer's argument that in absence of any 'due' amount, the pre-condition under clause (c) of the proviso to Section 127B of Customs Act did not apply to the present case. HC observed that the duty 'accepted by' the applicant must be paid before the matter can even be considered by the Commission. The Settlement Commission is, in essence, a safe haven for applicants who are otherwise at risk of punishment under the penal provisions of the Customs Act. Thus, HC observed that in order to approach the Settlement Commission, and to avail the beneficial regime of limited immunity, the applicant must – as a reciprocal statutory good faith measure pay the liability of duty.

Further, HC observed it is not compulsory for the SCN to propose a liability amount for it to be "due". The words "accepted by him" in clause (c) of the proviso to section 127B of the Customs Act meant that when no duty amount has been mentioned, the applicant must use his best-judgement to determine the amount. It observed, "The use of the words "accepted by him" clearly include such a situation, and support the use of self-assessment to require the applicant to deposit what he or she thinks is the duty payable, since that in any case, is due in law, and cannot be waived by the Settlement Commission."

*Komal Jain vs Union of India [WP (C) 210/2014 in Delhi HC]*

# Tribunal Decisions

## Royalty / License fee includible in the value of imported goods if found to be a condition for sale

The taxpayer was in the business of purchase of cinematic, television, video, mobile, internet rights for Indian Territory from foreign suppliers. It entered into agreements with licensors of foreign films for distribution in India. During the period April 2004 to October 2007, it had imported recorded media such as beta tapes, digibeta tapes etc. under Customs Tariff Heading ("CTH") 8523 of Customs Tariff Act, 1975 ("CTA") through courier. The customs duty was discharged only on the cost of media as declared by the courier agency, based on the invoice submitted by foreign supplier.

On investigation, the Revenue Authorities found that the taxpayer had paid license fees to the overseas suppliers for exploiting the intrinsic content of said media, ie such media was sub-licensed to various companies for replication / manufacture. The taxpayer paid fixed amount of license fee / minimum guarantee amount before

importation of said goods. The taxpayer contended that such fee had been paid for acquiring reproduction rights towards sale and distribution in India, not relatable to the imported goods; and was not a pre-condition for sale; therefore such consideration was not liable to be included in determining the customs value.

On the other hand, the Revenue Authorities contended that as per the condition of license under which the goods were imported, the tax payer was required to pay a fixed fee which is a condition for sale and since such payment of royalty / license fee was a pre-condition for import of goods, therefore includible in assessable value as per rule 9(1)(c) of Customs Valuation Rules, 1988 / rule 10(1)(c) of Customs Valuation Rules, 2007, ("Valuation Rules"). The Revenue Authorities further contended that the tax payer in various agreements entered into with the foreign suppliers had agreed to pay the entire cost including the cost of intellectual input contained in the beta / digibeta tapes much before the goods were actually delivered in India. Therefore, the Revenue Authorities contended that the amounts paid to the suppliers were liable to be included in the assessable value of the imports.

The matter ultimately came up for consideration before the third member of Mumbai CESTAT wherein he ruled in favor of the Revenue Authorities on the merits of the case. The third member relied upon Supreme Court's ("SC") decision in Living Media Ltd vs. CC [2002 (148) ELT 441] wherein the SC held that such royalty was to be included in the price of imported goods as the amounts paid to the supplier was a condition of sale/ supply of imported goods. The third Member also perused the agreement with foreign supplier and observed that such payment was a condition for sale of goods in question. Therefore, in accordance with the said SC ruling, the issue was decided against the taxpayer. However, on the issue of limitation, he observed that the claim of the Revenue Authorities was time barred and granted consequential relief to the taxpayer.

*Star Entertainment Private Limited vs Commissioner of Customs [Appeal nos C / 486 & 487 / 2010 Mumbai CESTAT]*

# V. CENTRAL EXCISE

## High Court Decisions

### Taxpayer has the option to avail exemption under a notification or to pay duty on the product by taking Modified Value Added Tax credit of the tax paid on inputs

The taxpayer was a Small Scale Industrial Unit ("SSI Unit") and at the relevant point in time was eligible to for benefit of exemption on clearances upto aggregate value of INR 30 lacs in terms of Notification No 1/ 93 ("Notification"). The taxpayer instead of claiming the benefit under the said Notification, decided to claim Modified Value Added Tax ("MODVAT") credit of the duty paid on inputs. This credit was sought to be used to discharge excise duty on the final product. The Revenue Authorities sought to deny credit to the taxpayer alleging that since it was eligible for exemption under the said Notification and no duty was payable on the manufactured

products, no credit on inputs could be claimed by it.

The matter came up for consideration before the Delhi High Court ("HC") which held in the favor of the taxpayers. The HC reasoned that if a taxpayer is covered under both, exemption notification and MODVAT credit scheme, he cannot take the benefit under both simultaneously, unless expressly provided so to do. Further, if a taxpayer is covered under both the schemes, then he should have the option to choose whichever is more beneficial and attractive for his business. This choice once exercised is binding and final upon him and any subsequent interchange may not be permissible but this is different to argue that the choice itself is not available. The HC concluded that the two schemes were in the alternative, but the taxpayer had the right to choose which scheme he wanted to adopt for his business purposes

*Commissioner of Central Excise vs Grand Card Industries [Central Excise Revision 7/ 2000 Delhi HC]*

# Tribunal Decisions

## Reimbursement of expenses to dealers not to qualify as trade discount for deduction from the transaction value for the computation of excise duty

The taxpayer was a manufacturer of two brands of cars- Indigo and Indica. The taxpayer was selling these cars from its factory to its dealers who ultimately sold them to the consumers. To promote the sales, the taxpayer offered incentives to its dealers, who hit a certain sales target. This allowed the dealers to provide certain extra benefits such as free accessories, free insurance cover, loans with soft interest rates etc to their customers. To ensure that the dealers did not lose their margin, the taxpayer offered a special discount by reducing the value of the cars. Upon investigation, it was found that the taxpayer was discharging excise duty on this reduced value of cars. It was also noticed by the investigating authorities that if the sale target of Indigo was met, the price of Indigo was not reduced but instead the price of Indica was reduced in subsequent sales. The Revenue Authorities objected to the payment of excise duty on the reduced value of cars and denied the deduction of the special discount from the assessable value of the cars.

The matter came up for consideration before the Mumbai Bench of Customs, Excise and Service Tax Appellate Tribunal ("CESTAT") which held in the favor of the Revenue Authorities. The CESTAT found that the special discount was not relatable to any particular transaction between the taxpayer and the dealers and that the dealers themselves were not aware of the exact conditions that were to be met to qualify for a special discount. It was observed by the CESTAT that deduction of a discount was allowable only if the terms and conditions of the discount were known to both parties prior to receiving such a discount. However, in the present case, the CESTAT observed that the discount offered was not in accordance with established trade practice, not uniform within same class of buyers, purely arbitrary, the discount in essence was a compensation for services rendered by dealers on behalf of tax payer, the discount was not passed on to the end customer and it was not passed on

as a price reduction of the goods to which it pertain to.

On the issue of cross model utilization of discounts it was held that the same is not allowable as per section 4(1)(a) of the Central Excise Act, 1944 ("CEA") as the article preceding the word 'goods' in the said section is "the". Since "the" is a definite article, it is amply clear that discounts can be allowed only in the respect of goods whose transaction value is in question. Therefore, cross model utilization of discounts was held to be not permissible. In conclusion, the CESTAT stated that special discount allowed by the taxpayer to its dealers was nothing but reimbursements for the expenses incurred by them and there was in effect no reduction in the value of the cars. In terms of the points stated above, the special discount was held to be an impermissible deduction from the transaction value for the computation of excise duty.

*Tata Motors Limited, Pune vs Commissioner of Central Excise [Appeal no E/ 1362 to 1365/ 2012 Mumbai CESTAT]*

# Notification & Circulars

## Draft circular issued to amend CESTAT Appeal forms

CBEC has issued a draft circular to invite comments and suggestions from all stakeholders to amend and simplify the CESTAT appeal forms

*F No 390 / Misc / 46 / 2011- JC*

## New exchange rates for currencies notified

CBEC has notified new exchange rates for the purposes of imports and exports for all foreign currencies with effect from May 16, 2014

*Notification no 41 / 2014- Customs (NT) dated May 15, 2014*

## Import tariff of gold and silver increased

CBEC has notified the increased import tariff of gold from USD 422 / 10 grams to USD 424 / 10 grams and of silver from USD 632 / kg to USD 650 / kg. New tariff values for 8 other import items have also been notified

*Notification no 42 / 2014- Customs (NT) dated May 15, 2014*

## Classification of rice par- boiling machine and dryer clarified

CBEC has issued a clarification regarding classification of rice par- boiling machine and dryer. Rice par-boiling machine and dryer are now classifiable under Central Excise Tariff Heading ("CETH") 8419 instead of CETH 8437.

*Circular no 982 / 06 / 2014- Central Excise dated May 15, 2014*