September 2012

# TAX UPDATES

(Containing recent case laws, notifications, circulars)

Prepared in association with

# Foreword

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

In a significant decision, the Supreme Court in the case of Columbia Sportswear Company has ruled that an appeal against a ruling of Authority for Advance Ruling (AAR) should be filed with the jurisdictional High Court (not the Supreme Court) and that the Division Bench of the High Court should hear and pronounce its decision as expeditiously as possible. The Supreme Court further ruled that the appeal against an AAR ruling by way of Special Leave Petition (SLP) would be entertained by it only in cases involving substantial questions of general importance or in cases where a similar question is already pending before it.

Another important development in the recent past has been the publication of its draft report by the Committee on General Anti Avoidance Rules (GAAR) chaired by Dr Parthasarathi Shome. FICCI welcomes the recommendations made by the Committee in the draft report. It would urge the Government to accept the recommendations for implementation as and when the report is finalized so that uncertainty is put to rest and investments can flow in.

The Taxation Committee of FICCI has reviewed the working of the new Service Tax regime based on the concept of the Negative List introduced in July, 2012 in its meeting held on 31st August, 2012. A FICCI delegation is scheduled to meet the officials of the Ministry of Finance to put forth issues which need to be addressed by the Government.

The International Chamber of Commerce (ICC) in partnership with FICCI is organizing an International Taxation Round Table from November 21-22 at Federation House, New Delhi. This roundtable will focus on emerging trends in Indian tax policies and deliberate on the impact of these developments on businesses and tax administration.

I also take this opportunity to remind all our members to forward their suggestions and comments for inclusion in the Pre-Budget Memorandum for the year 2013-14 by September 17, 2012.

Rajiv Kumar

# Recent Case laws

## I. DIRECT TAX

## Supreme Court Decisions

### The Supreme Court held that the AAR ruling can be challenged by way of writ under Articles 226/227 of the constitution, and if so filed, the High Court should dispose the same expeditiously

The taxpayer has filed SLP before the Supreme Court under Article 136 of the Constitution of India, challenging the ruling of AAR. The question before the Supreme Court in this petition was whether the ruling pronounced by the AAR can be challenged by the petitioner or by the tax department before the Supreme Court or the High Court.

The Supreme Court held that AAR is a body exercising judicial power conferred on it under chapter XIX-B of the Income-tax Act, 1961 (the Act) and hence it is a Tribunal within the meaning of Articles 136 and 227 of the constitution of India. It further held that Articles 136, 226 and 227 of the Constitution are constitutional provisions vesting jurisdiction on the Supreme Court and the High Courts and a provision of the Act of legislature making the decision of the AAR binding could not come in the way of the Supreme Court or the High Courts to exercise jurisdiction vested under the Constitution. Further the Supreme Court overruled the AAR ruling in the case of Groupe Industrial Marcel Dassault [2012] 340 ITR 353 (AAR) and held that to not permit an advance ruling of AAR to be challenged before the High Court under Articles 226 and/or 227 of the Constitution of India would be to negate a part of the basic structure of the Constitution. Further, the Supreme Court also held that when an advance ruling of AAR is challenged before the High Court under Articles 226 and/or 227 of the Constitution of India, the same should be heard directly by a Division Bench of the High Court and decided as expeditiously as possible. Though Article 136 of the Constitution of India states that the Supreme Court may 'in its discretion' grant special leave to appeal against any order passed by any court or Tribunal in the territory of India, the Supreme Court may still, in its discretion, refuse to grant special leave on the ground that the challenge to the advance ruling of the AAR can also be made to the High Court on the same grounds even if good grounds are made out in SLP under Article 136. In this SLP, neither a substantial question of general importance arise nor is it shown that a similar question is already pending before this Court for which the petitioner should be permitted to approach this Court directly against the advance ruling of the AAR.

Accordingly, the SLP is disposed by granting liberty to the petitioner to move the appropriate High Court under Article 226 and/or 227 of the Constitution.

*Columbia Sportswear Company v. DIT [SLP (C) No. 31543 of 2011, dated 30 July 2012]*

# High Court Decisions

## Where delay in investing to claim exemption of LTCG is due to non-availability of bonds, exemption under Section 54EC of the Act cannot be denied to the taxpayer

The taxpayer sold a factory building on 22 March 2006 and earned Long Term Capital Gain (LTCG). The LTCG was invested in bonds of Rural Electrification Corporation (REC Bonds) on 31 January 2007, beyond the period of 6 months specified in Section 54EC of the Act. The taxpayer claimed that the delay was due to the fact that for the period from 4 August 2006 to 22 January 2007, the bonds were not available and the investment was made when available. The Tribunal allowed the taxpayer's claim.

The Bombay High Court held that the taxpayer was entitled to wait until the last date to invest in the bonds. As of that date, the bonds were not available. The fact that they were available in an earlier period after the transfer (1 July 2006 to 3 August 2006) makes no difference because the taxpayer's right to buy the bonds up to the last date cannot be prejudiced. The legal maxims "law does not compel a man to do that which he cannot possibly perform" and "law does not expect a party to do the impossible" are well known maxims in law and would squarely apply to the present case. The Bombay High Court also held that if Section 54EC of the Act confers a choice investing either in the REC bonds or the National Highway Authority of India (NHAI) bonds, the revenue cannot insist that the taxpayer ought to have invested in the NHAI bonds.

*CIT v. Cello Plast (Bombay HC ITA No. 3731 of 2010, dated 27 July 2012)*

## Unabsorbed depreciation in the hands of the amalgamating company should be added to the WDV of the asset acquired in amalgamation

The Madras High Court held that Explanation 3 to Section 43(6) of the Act has no relevance in working out the Written Down Value (WDV) of the block of assets in the hands of the amalgamated company and that the unabsorbed depreciation in hands of the amalgamating company should be added to the WDV of the asset acquired in amalgamation.

*EID Parry India Limited v. DCIT [2012] 23 taxmann.com 348 (Madras)*

## Accounting Standard – 14

The Delhi High Court, while approving the scheme of arrangement, has clarified that accounting standards issued by the Institute of Chartered Accountants of India dealing with 'Accounting for Amalgamation' is applicable only to amalgamations and not to demergers.

*Company Petition no. 137/2012 of Sony India Private Limited*

### Compliance with Section 2(19AA) of the Act is not a pre-condition for sanction of demerger under Section 391-394 of the Companies Act

The Delhi High Court, considering the review petition for a scheme sanctioned in 2003, held that compliance with Section 2(19AA) of the Act is meant for availing tax concession and is not mandatory requirement for all Schemes under Section 391-394 of the Companies Act. It was further held that it is a settled legal position that the said provisions of the Companies Act do not require transfer of all common assets/liabilities relatable to the undertaking being demerged.

*Indo Rama Textile Ltd. [2012] 23 taxmann.com 390 (Delhi)*

## Tribunal Decisions

### Protocol to a tax treaty does not apply retrospectively unless explicitly intended otherwise

The taxpayer, a banking company incorporated in the UAE, operated in India through its branches which constituted a Permanent Establishment (PE) of the taxpayer in India within the meaning of Article 7 of the India-UAE tax treaty. During the year under consideration, the income from banking operations in India was offered to tax in India after claiming deduction for head office expenditure attributable to the operations in India.

The taxpayer relied on the provisions of Article 7(3) of the India-UAE tax treaty (prior to 1 April 2008) to hold that the restrictions with respect to the allowability of head office expenditure contained in Section 44C of the Act is not applicable to it for periods prior to 1 April 2008.

The Assessing Officer (AO) and the Commissioner of Income-tax (Appeals) [CIT(A)] held that the protocol amending the provisions of Article 7(3) of the tax treaty is clarificatory in nature and is to be applied retrospectively and accordingly disallowed head office expenditure in excess of the restrictions contained in Section 44C of the Act.

In connection with the above, the Mumbai Tribunal, inter alia, observed and held as follows:

- It is a cardinal principle that, when two sovereign nations enter into a tax treaty and have come to an understanding regarding the terms expressed in the tax treaty, such terms cannot be unilaterally changed.

- Where both the countries had not used the limitation clause for applicability of domestic law in determining the profits and deduction of expenditure of a PE under Article 7(3) of the tax treaty, such limitation cannot be read into even impliedly, that such a provision existed.

- When a particular provision in a tax treaty is introduced from a particular date, it has to be, prima facie, taken to be prospective in



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operation, unless it is expressly or by necessary implication provided to have retrospective operation.

- The parties interpreting the tax treaty get a vested right under existing tax treaty and any such interpretation giving retrospective effect not only impairs the vested right but attracts the new disability in respect of transactions already entered in the past.

- In the instant case, the retrospective operation cannot be taken to be intended unless, by necessary implication, it has been made to have the retrospective effect.

Thus, the amendment brought in Article 7(3) of the tax treaty will not apply retrospectively.

*Abu Dhabi Commercial Bank Ltd. v. ADIT [2012] 23 taxman.com 359 (Mum)*

## Payment for online advertisement on the portal of a foreign company is not royalty

The Mumbai Tribunal has held that the payments made to a foreign company for services rendered relating to uploading and display of the banner advertisement on its portal is not taxable in India as royalty or Fees for Technical Services (FTS). In rendering this decision, the Tribunal has followed its earlier decision in the case of Yahoo India (P.) Ltd.v. CIT [2011] 46 SOT 105 (Mum).

*Pinstorm Technologies Pvt. Ltd. v. ITO (ITA No. 4332/Mum/2009)*

## Reimbursement under secondment agreement does not qualify as FTS

The taxpayer, an Indian Company, in terms of the secondment agreement with Abbey Plc., reimbursed the salary and other administrative costs relating to the seconded employees to Abbey Plc. without any deduction of tax at source. The AO held that with Abbey Plc. being the legal employer of the seconded employees, the payments made by the taxpayer to Abbey Plc. were for managerial services and would fall within the purview of FTS.

The issue for consideration before the Bangalore Tribunal was whether such payments constituted FTS under the Act and the India-UK tax treaty.

Based on the facts and circumstances of the case, the Tribunal, inter alia, observed and held as follows:

- In terms of the secondment agreement between the taxpayer and Abbey Plc. and the decision in the case of IDS Software Solutions India Private Limited v. ITO [2009] 122 TTJ 410 (BANG), the taxpayer was the real and economic employer of the seconded employees;

- As the taxpayer had reimbursed to Abbey Plc only the actual expenditure incurred without any mark-up, the same ought not to be treated as income in the hands of Abbey Plc; and

- As the agreement was for

secondment of employees and not for rendering any services, such re-imbursement cannot be treated as FTS under the Act. Further, even if such payments are held to be taxable under the Act, they cannot be taxed under the treaty as the term 'managerial services' is not present in Article 13(4) of the India-UK tax treaty and also such services do not satisfy the condition of 'make available' under the treaty.

*Abbey Business Services (India) Private Limited v. DCIT [(2012)-TS -532-ITAT]*

## Laboratory expenditure on R&D incurred by a foreign head office and allocated to its Indian branch is fully allowable and the restriction provided under Section 44C of the Act is not applicable to such expenditure

The taxpayer is an Indian Branch of a foreign company with the HO located in the UK. While computing the business income for Assessment Year (AY) 1981-82 and 1982-83, the taxpayer claimed as deduction, the laboratory expenditure incurred by the HO for R&D in the UK and attributable to the Indian Branch. The AO held that the entire claim of laboratory expenditure is restricted by the provision of Section 44C of the Act holding that the R&D is centralised by the HO in the UK and the R&D matters are connected with executive and general administration. Accordingly, the expenditure incurred is merely general administrative and executive in nature and hence Section 44C of the Act is applicable.

The Mumbai Tribunal observed that the Bombay High Court in the taxpayer's own case had examined the provisions of Section 44C of the Act and held that the Tribunal was right in remanding the matter back to the file of the CIT(A) for disposal afresh where the taxpayer would be free to demonstrate that the expenditure was incurred towards laboratory expenditure and satisfy the CIT(A) that they did not include any executive and general administration expenditure as indicated in clauses (a) to (d) of Explanation (iv) to Section 44C of the Act. On such demonstration, the expenditure claimed by the taxpayer would be allowable.

The Mumbai Tribunal further observed that the taxpayer has filed its financial statements to show that the UK Company has separately shown executive or general administration expenditure for AY 1981-82 and for AY 1982-83 and therefore the taxpayer has proved beyond doubt that the expenditure claimed on the laboratory expenditure did not include any executive or general administration expenditure indicated in clauses (a) to (d) of Explanation (iv) to Section 44C of the Act.
Hence the Tribunal held that the said expenditure could not be disallowed under Section 44C of the Act.

*John Wyeth & Brother Limited v. ACIT (ITA No. 6772 & 6773/Mum/2002, dated 25 July 2012)*

## Provisions of Section 10A(9) of the Act, denying Section 10A benefit for 'change in ownership or beneficial interest' not applicable to genuine reorganisation of business

The taxpayer is engaged in the business of providing IT enabled s ervices, outsourcing (BPO) and is a part of the WNS Group. The taxpayer company is jointly held by Warburg Pincus Group, British Airways and others. In AY 2004-05, the taxpayer claimed deduction under Section 10A in respect of two units, which had commenced operations in March 1997 and December 1999. The assessment under Section 143(3) was completed and subsequently the Commissioner of Income-tax (CIT) issued a notice under Section 263 of the Act for revision of the assessment order. The CIT observed that during Financial Year (FY) 2002-03, Warburg Pincus Group acquired the majority stake in the WNS Group from British Airways. Hence, the CIT invoked the provisions of Section 10A(9) of the Act and held that the deduction under Section 10A of the Act was not available.

The Mumbai Tribunal held that provisions of Section 10A(9) of the Act were not applicable to AY 2004-05. Accordingly, the CIT was not justified in revising the assessment order, invoking provisions of Section 263 of the Act. The Tribunal also observed that as per Central Board for Direct Taxes (CBDT) Circular No. 8 of 2002 dated 27 August 2002, which recorded the intention behind insertion of Section 10A(9) of the Act, the provision was introduced to prevent trading in incentive by shell companies formed only for that purpose. It was also clarified in the Circular that the provision was not intended to bring within its purview, the genuine cases of business reorganization. In the present case, there was a change in the holding pattern, whereby Warburg Pincus Group acquired the shares from British Airways, who had a majority stake in the WNS Group. Such a change in shareholding was by way of global re-organisation of the business and nothing has been brought on record that such a re-organization was non-genuine or was solely for the purpose of unscrupulous shopping of Software Technology Park (STP) provisions for claiming the deduction. Hence, even if there was change in ownership in FY 2002-03, deduction under Section 10A could not be denied on that ground.

*WNS Global Services P Ltd v. ITO (ITA No. 2566/Mum/2009, dated 10 August 2012)*

## Long term capital loss relating to AY prior to 2003–04 can be set off against short-term capital gain

The taxpayer in AY 2003-04 earned short-term capital gains (STCG) and set it off against the long-term capital loss (LTCL) relating to AY 2001-02. Section 74 of the Act was amended with effect from AY 2003-04 to provide that brought forward LTCL could only be set-off against LTCG and not against STCG. The AO & CIT(A) disallowed the claim of the taxpayer relying on Reliance Jute Industries v. CIT [1979] 120 ITR 921 (SC) where it was held that the assessment for one AY cannot be affected by the law in force in another AY and that the law prevailing in AY 2003-04 alone had to be considered. On appeal to the Tribunal, the issue was referred to a Special Bench.

The Special Bench held that Section 74(1) of the Act, as substituted with effect from 1 April 2003, uses the present tense and refers to the LTCL of the current year. It applies to the long-term capital loss of AY 2003-04 onwards and not to the LTCL relating to the period prior to AY 2003-04. The set-off of LTCL relating to a period, pri-

or to AY 2003-04 is governed by Section 74(1) of the Act as it stood in that AY. The Special Bench also accepted the taxpayer's contention, relying on CIT v. Shah Sadiq & Sons [1987]166 ITR 102 (SC), that it had a 'vested right' in AY 2001-02 to carry forward the LTCL and set it off against the STCG and that this right cannot be defeated without express language in the statute. In Govinddas v. ITO [1976] 103 ITR 123 (SC), it was held that unless the terms of a statute expressly so provide or necessarily require it, retrospective operation should not be given to a statute so as to take away or impair an existing right otherwise than as regards the matters of procedure.

*Kotak Mahindra Capital Co. Ltd. v. ACIT (ITA No. 521/Mum/2007 dated 10.8. 2012)*

## The amount received on dissolution of a Trust is not received 'without consideration' and hence it is not liable to tax under Section 56 of the Act

The Mumbai Tribunal held that the amount received by the beneficiaries of a Trust on dissolution of the Trust could not be termed an amount received by the beneficiaries 'without consideration' as this was received in accordance with the terms of the dissolution deed. Hence the same cannot be taxed under Section 56(2)(vi) of the Act. Even otherwise, as the Trust was created by the taxpayer's mother, exemption relating to 'Relative' under Section 56(2)(vi) of the Act should be available to the taxpayer.

*Ashok C. Pratap v. ACIT [2012] 23 taxmann.com 347 (Mum)*

## The Pune Tribunal allowed adjustments on account of excess depreciation and under utilisation of capacity to eliminate the differences between the tested party and the comparables

The taxpayer, a wholly owned subsidiary of Amdocs Development Ltd., Cyprus (ADL) is engaged in the business of providing Information Technology enabled services (ITes) to its Parent Company. The Transfer Pricing Officer (TPO) rejected the economic adjustment performed by the taxpayer, rejected the use of multiple-year data and disallowed the benefit of 5 percent variation from the arithmetic mean. The Dispute Resolution Panel (DRP) confirmed the additions made by the TPO/AO. At the Appellate level the taxpayer contended that it had charged higher depreciation vis-à-vis the rates prescribed under the Companies Act and therefore such excess depreciation was liable to be excluded while benchmarking the financial results of the taxpayer with the comparable companies. The taxpayer further contended that being in its first year of operations, it had incurred certain start-up costs and also could not use its full capacity for which adjustments were required.

The Tribunal observed that in 9 out of 11 comparables selected by the TPO, the depreciation had been charged at rates prescribed under Schedule XIV to the Companies Act, 1956 and thus accepted the plea of the taxpayer for considering due adjustments on account of difference in depreciation. The Tribunal further observed that the taxpayer had incurred certain

start-up cost and the capacity utilisation was not satisfactory, whereas the comparables selected were established entities and had been set up over the years. The Tribunal directed the AO to allow appropriate economic adjustments on reasonable basis. The Tribunal also allowed the benefit for adjustment of +/- 5 percent variation while computing the Arm's Length Price (ALP) but did not accept the contention of the taxpayer for use of multiple-year data.

*Amdocs Business Services Pvt. Ltd. [ITA No. 1412/PN/11]*

# Decisions of Authority for Advance Rulings

## Legal ownership prevails over beneficial ownership for determining capital gains

CRL Mauritius, a company based in Mauritius sold its entire holding in CRIL, India to Moody's Analytics Inc, Cyprus (M Cyprus). Further, CMRL Mauritius sold its entire holding in Exevo US (E Inc) to another US company, Moody's US (M US).

The question posed by the Moody's and Copal Group (Group entity included CRL, CMRL) for consideration before the AAR, inter alia, was whether the capital gains arising on direct and indirect transfer of shares in Indian companies (i.e. sale of shares of CRIL by CRL Mauritius to M Cyprus and sale of shares of E Inc by CMRL Mauritius to M USA) would be chargeable to tax in India under the provisions of the India-Mauritius tax treaty.

The revenue contended before the AAR that the transaction was a scheme for avoidance of tax in India for the following reasons:

- The place of effective management of CRL Mauritius and CMRL Mauritius was the UK, for the reason that the whole transaction under consideration was left to the discretion and management of an individual, a resident of the UK, who was the CEO of CPL Jersey and was also a common director of E Inc and CRIL.

- The beneficial ownership of shares rested with CPL Jersey, since the shares in Indian companies were held by it through its wholly owned subsidiaries.

The AAR, based on the facts of the case, observed and held as follows:

- The role of the resident of UK did not appear to be a role in connection with the running of business of CRL Mauritius and CMRL Mauritius. Also, as there is no sufficient or cogent material to deny that the control and management of these companies is with their board of directors, it cannot be concluded that the place of effective management of these companies is not in Mauritius.

- The AAR is bound by the decision of the Supreme Court in the case of Azadi Bachao Andolan, wherein it was held that what is relevant in the context of a tax treaty is not

whether the income is actually taxed in Mauritius, but whether in terms of the tax treaty, it can be taxed in Mauritius.

- Company law recognizes the recorded owner of the shares and not the person on whose behalf it may have been held. The theory of legal ownership prevails over the apparent legal ownership.

Therefore, the benefit of tax treaty to the Applicant cannot be denied and the capital gains on sale of shares by Mauritian companies cannot be taxed in India

*Moody's Analytics Inc. [2012] 24 taxmann.com 41 (AAR)*

## Minimum Alternate Tax applicable to foreign companies

The Applicant, a company incorporated in Mauritius, holds investments in a listed company in India viz., Glaxo Smithlkine Pharmaceuticals Limited (Indian company). As a part of the group restructuring exercise, the Applicant proposes to transfer its holding in Indian company by way of off-market sale to its group company in Singapore.

The question for consideration before the AAR, inter alia, was whether the gains arising on sale of shares of the Indian company would be chargeable to tax in India under the provisions of the India-Mauritius tax treaty and whether Section 115JB of the Act would be applicable to foreign companies.

The AAR, based on the facts of the case, observed and held as follows:

- In terms of the India's tax treaty with Mauritius and the decision of the Supreme Court in the case of UOI v. Azadi Bachao Andolan [2003] 263 ITR 706 (SC), the capital gains on sale of shares of an Indian company by a Mauritius company will not be taxable in India;

- The term 'company' used in Section 2(17) of the Act includes a company incorporated outside India. Also, Section 115JB of the Act on its wording makes no distinction between a resident company and a non-resident company. Hence, Minimum Alternate Tax (MAT) provisions would equally apply to foreign companies and this would be irrespective of the existence of a PE of the foreign company in India. In this regard, the AAR has deviated from its earlier ruling in the case of Timken Co. [2010] 326 ITR 193 (AAR).

- Also, the application of Section 115JB of the Act cannot be limited to domestic companies for the reason that there are practical difficulties for the foreign companies to prepare their accounts in terms of Schedule VI of the Companies Act, 1956 (Companies Act).

*Castleton Investment Limited [AAR No. 999 of 2010, dated 14 August 2012]*

### Gift by a corporation to another corporation is a strange transaction and would not fall under Section 47(iii) of the Act

The AAR declined to give a ruling on the taxability of gift of shares of an Indian Company by a foreign Company citing a lack of material to conclude on the genuineness and validity of the transaction. However, while declining to give ruling, the AAR observed that a gift by a corporation to another corporation is a strange transaction and would not fall under Section 47(iii) of the Act.

*Orient Green Power Pte Limited [AAR No. 973 of 2010]*

## Notifications/Circulars/ Press releases

### India notifies tax treaty with Estonia

India and Estonia had signed an agreement for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income on 19 September 2011. The agreement has now been notified and shall be effective in India from the fiscal year beginning 1 April 2013.

*Notification No. 27/ 2012, dated 25 July 2012*

### India notifies tax treaty with Lithuania

India and Lithuania had signed an agreement for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital on 26 July 2011. The agreement has now been notified and shall be effective in India from the fiscal year beginning 1 April 2013.

*Notification No. 28/ 2012, dated 25 July 2012*

### India and Indonesia sign revised tax treaty

India and Indonesia had signed a revised tax treaty on 27 July 2012. The revised tax treaty inter-alia provides for taxation rights in respect of capital gains on alienation of shares of a company to the source state and rationalization of the tax rates on dividend income, royalties and FTS in the source state up to 10 percent threshold.

The revised tax treaty also has provisions for effective exchange of information including banking information, effective collection of taxes between tax authorities and has limitation of benefits and anti-abuse provisions to ensure that the benefits of the tax treaty are availed of only by genuine residents.

*Press release dated 31 July 2012*

### India and Monaco sign an agreement for exchange of information with respect to taxes

India and Monaco have signed an agreement for exchange of information with respect to taxes on 31 July 2012. It is the ninth tax information exchange agreement signed by India. The

Agreement, inter alia, provides for effective exchange of information on tax matters including banking information. It also provides that the authorities of one state can be present in tax examination of the tax payer in the other state.

*Press release dated 1 August 2012*

## India and Guernsey sign an agreement for exchange of information with respect to taxes

India and Guernsey had signed an agreement for exchange of information with respect to taxes on 20 December 2011. The Agreement will be effective in India from 11 June 2012. The Agreement, inter alia, provides for exchange of information relevant to the determination, assessment and collection of taxes covered, recovery and enforcement of such tax claims and investigation or prosecution of tax matters.

*Press release dated 1 August 2012*

## Freebies to doctors violate law and are not allowable as deduction

The Medical Council of India, which is a regulatory body Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 on 10 December 2009 imposing a prohibition on medical practitioners and their professional associations from taking any gift, travel facility, hospitality, cash or monetary grant from the pharmaceutical and allied health sector industries. Section 37(1) of the Act provides for deduction of any revenue expenditure from the business income if such expense is laid out/expended wholly and exclusively for the purpose of business or profession.

However, the Explanation appended to this sub-section denies claim of any such expense, if this has been incurred for a purpose which is either an offence or prohibited by law.

Thus, the claim of any expense incurred in providing above mentioned or similar freebies being in violation of the provisions of the Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations, 2002 shall be inadmissible under Section 37(1) of the Act, being an expense prohibited by the law. This disallowance shall be made in the hands of such pharmaceutical or allied health sector Industries or other taxpayer which has provided aforesaid freebies and claimed it as a deductible expense in its accounts against income.

*Circular No. 5/2012 [F. No. 225/142/2012-ITA.II], dated 1 August 2012*

## Companies (Second Amendment) Act, 2002 and delegation of powers

The Central Government has notified 12th August, 2012 as an effective date for amendments made by Companies (Second Amendment) Act, 2002 to Sections 17,18,19,41 and 188 of the Companies Act.

- Section 17 of the Companies Act was amended to provide a change of object clause with a Special Resolution of General Body meeting. It further provided that a change of registered office of the Company should be approved by the Central Government. Earlier the powers were with the Company Law Board.

- Sections 18,19,141 and 188 of the Companies Act were amended to shift the approving powers from the

Company Law Board to the Central Government.

The Central Government has delegated powers under the above amendments and certain other existing provisions of the Companies Act to the Regional Director.

The Central Government has also delegated powers under Sections 21, 25, 31(1), 108(1D) and 572 to the Registrar of Companies.

*Notification No 1538(E)/ 1539(E) and 1540(E) dated 10 July, 2012*

## Tolerance band of 5 percent for FY 2011- 12 notified

The Finance Act 2011 had amended the standard variation of 5 percent range applied to all segments of business activity and range of international transactions, as the government believed that the application of +/- 5 percent had out-lived its utility. This amendment stated that the fixed variation percentage would be replaced with an allowable variation which will be such percentage as may be notified by the Central Government in this regard (effective from FY 2011-12, i.e. AY 2012-13).

Pursuant to introduction of the above amendment, for a considerable amount of time there was no clarity on the rate of variation applicable for FY 2011-12. The Central Government has finally issued a clarification on 17 August 2012 to this effect vide a Notification stating that the tolerance band of 5 percent shall be applicable for FY 2011-12, i.e. AY 2012-13.

*Notification No. 21/2012 [F. NO. 500/185/2011 – FTD I], dated 7 August 2012*

In exercise of the powers conferred by the second proviso to sub-section (2) of Section 92C of the Act, the Central Government hereby notifies that where the variation between the ALP determined under Section 92C and the price at which the international transaction has actually been undertaken does not exceed five per cent of the latter, the price at which the international transaction has actually been undertaken shall be deemed to be the ALP for AY 2012-13.

The tolerance band of +/- 5 percent is in line with the tolerance band available for the earlier AY 2011-12. Prescribing the above percentage should provide welcome relief and clarity to taxpayers and assist taxpayers in proper closure of their financial statements after making adequate provisions in respect of their international transfer prices.

# II. SERVICE TAX

## High Court Decisions

### Service tax levied on services rendered by "consulting engineer" in any discipline of engineering will not cover the valuation services rendered by such qualified engineer

The petitioner sought clarification as to whether service as a valuer can be said to be service provided to a client by a consulting engineer, in relation to any advice, consultancy or technical assistance in any manner. The petitioner contended that valuation broadly means assessing the worth of something whether tangible or intangible. Further, they argued that there is no legislation in India to regulate the profession of valuation. It was also contended that a valuation course predominantly consists of law, economics, and finance rather than engineering. Additionally for the purpose of rendering services as a valuer, the person concerned is not required to be qualified engineer in any one or more disciplines of engineering.

Office of the commissioner of Central Excise, Mumbai – I had issued clarification addressed to the Institution of Valuers, Maharashtra stating that valuers of immovable property fall within the purview of "Consulting Engineer" and therefore will attract service tax. Further, proceedings were initiated against the petitioner seeking imposition of service tax on the service of valuer.

The High Court held that the provision of the wealth tax law does not stipulate graduation in civil engineering to be a condition precedent for being eligible to be registered as a valuer of immovable property. Additionally, the syllabus makes it amply clears that the course in Master of Valuation does not predominantly pertain to any discipline of engineering. It also noticed that services rendered by a valuer are not in relation to advice, consultancy or technical assistance in any one or more disciplines of engineering.

Basis the above, the High Court ruled that service tax levied on services rendered by "consulting engineer" in any discipline of engineering will not cover the valuation services rendered by such qualified engineer.

*Institution of Valuers vs Union of India (2012 (27) STR 113 (Guj)*

### Limitation under Section 11-B does not apply to refund of accumulated CENVAT Credit

Assessee was a 100% STPI Unit engaged in development and export of software. It claimed refund of accumulated credit of INR 4,36,985 during the FY 2006-07. The assistant commissioner rejected the claim on the ground that assessee has not submitted documents required under law to process the claim. Further, it was held that the claim was time barred upto Sept 2006. Aggrieved by the order, the assessee preferred an appeal to the CCE, who upheld the order of the assistant commissioner. The matter further went to the tribunal which upheld that the assessee was entitled to take credit of service tax paid on input services utilized for export of services, but however did not



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grant refund on the ground that the assessee was not registered with the service tax department.

The High Court categorically held that assessee cannot be denied refund of credit and is entitled for refund of the accumulated credit. Further the limitation under Section 11-B does not apply to refund of accumulated CENVAT Credit. Further the High Court also held that registration under Service tax is not a pre requisite for availing credit as per the provisions of law. Hence order passed denying credit on this ground is bad in law and liable to set aside.

The High Court however concluded that the assessee is required to furnish the details and documents asked by the Assistant Commissioner for approving the refund claim, hence it remanded the matter back to the adjudicating authority for deciding the correctness of claim.
*mPortal India Wireless Solutions P Ltd vs CST, 2012 (27) STR 134 (Kar)*

## Key Notification & Circulars

1. The new service tax regime based on a negative list of services has come into existence from July 1, 2012 onwards.

2. Various circulars have been issued by the department in order to clarify issues that have been faced by assessees like, Circular number 162/13/2012-ST dated July 6, 2012 clarifying applicability of Point of Taxation Rules vis a vis the new service tax regime, Circular dated July 10, 2012 clarifying applicability of service tax on foreign remittances and Circular number 161/12/2012-ST dated July 6, 2012 clarifying the Accounting Code for payment of service tax under the Negative List.

3. A draft circular was issued on July 27, 2012 which discussed service tax applicability on staff benefits and employment related transactions. This was in the public domain for discussion until August 24, 2012 and feedback was to be provided to the Government during this time.

4. Vide notification dated July 2, 2012 exemption from service tax on transportation of passengers (with or without accompanied belongings by 1st class or AC) and goods by Indian railways upto September 30, 2012 has been provided.

# III. VAT/ CST

## High Court Decisions

**The principle for ascertaining whether certain expenses would qualify as part of 'turnover' would need to be examined in the light of the fact whether such expenses are towards the delivery of goods to the customer for use. The underlying contracts would also play a crucial role reflecting the understanding of**

### the parties with respect to the point of delivery

ACC effected sale of ready mix concrete to its customers and collected separate charges for pumping the ready mix concrete to its customers. ACC claimed exclusion of the pumping charges from its turnover on the basis that such pumping charges were post-sale expenses and therefore, the same were not liable to sales tax. The Deputy Commissioner did not accept the position adopted by ACC and levied tax along with interest and penalty which was upheld by the Joint Commissioner (Appeals) and the Tribunal. The moot point was whether charges collected by ACC from its customers for pumping of ready mix concrete to point of use is includible in the turnover.

The High Court of Karnataka upheld the decision of the Tribunal dismissing the petitions of ACC. On the basis of review of the underlying agreement, it was held that all charges collected till the point of delivery are pre-sale charges and therefore, includible in the turnover of the dealer. The order refers to various cases including the judgment of the Hon'ble Supreme Court in the case of State of Karnataka vs Bangalore Soft Drinks Pvt Ltd cited as [2000] 117 STC 413 (SC) wherein it was held that transportation charges are pre-sale charges.

*ACC Ltd v. State of Karnataka - [2012] 52 VST 129 (Karnataka High Court)*

### The true effect of a transaction has to be determined from the terms of the agreement considered in the light of the surrounding circumstances.

The respondent dealer was engaged in the distillery business and sold oak wood barrels to finance companies and took these barrels back on lease basis. The assessing authority, on the basis of the invoices, considered the sale and lease back transaction as a 'sale' and subjected the transaction to levy of sales tax.
The Tribunal went beyond the actual contract documents and held that the sale and lease back option was not a genuine sale transaction but only a mechanism to raise funds as the barrels never moved from the dealer premises and were used by the dealer without any interruptions. The High Court upheld the decision of the Tribunal by referring to the apex court decision in the case of Sundaram Finance Ltd vs. State of Kerala [1966] 17 STC 489 (SC) wherein the apex court emphasized that the true effect of a transaction may be determined by going beyond the underlying contractual documents, if so required under the facts at hand.

*State of Karnataka v. Khoday Eshwara & sons – [2012] 52 VST 204 (Karnataka High Court)*

### Lease rentals received for providing cellular telephony towers on rent to telecom service providers is liable to VAT since the towers are superstructures in the form of movables and the transaction essentially involves transfer of right to use goods although service is incidentally involved

The Petitioner, who was engaged in providing infrastructure service in relation to cellular telephones entered into


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contracts with various telecom/ cellular operators for rendering services in relation to passive telecom network including operation and maintenance. The Revenue authorities sought to levy VAT on providing of cellular telephony towers on rent to various service providers as a 'deemed sale' under Section 2(29)(d) of Karnataka Value Added Tax Act, 2003 ("KVAT Act").

The Petitioner filed a writ petition contending that the activity of erection, construction and leasing out of the space on tower sites is considered a "service" as per the provisions of Finance Act, 1994 and that activity cannot be considered as "sale" as per the provisions of KVAT Act. The Petitioner further contended that the equipment installed cannot be considered as movable goods as they are embedded in the earth or on a building and cannot be shifted without damage, involving no transfer of right to use goods liable to VAT.

The High Court held that the towers being superstructures in the form of movables and lent to various telecom companies under agreements either for cash or liquidated payment or some other consideration, it would be a transfer of right to use the goods which attracted provisions of KVAT Act. Further, it could be seen from the agreement that the component of delivery was involved and that effective control and maintenance of the equipment was with the Petitioner. Thus what was being lent, in pith and substance was the right to use the goods though service was incidentally involved. Therefore, the assessment order passed treating the transaction as transfer of right to use goods was to be upheld.

*Essar Telecom Infrastructure (P) Ltd vs Union of India and Ors [2012] 52 VST 306 (Karnataka High Court)*

# IV. CUSTOMS

## High Court Decisions

### If goods are fully exempted or are chargeable to nil rate of duty or are cleared without payment of duty under specified procedure such as clearance bond, there is no collection of duty and, therefore, no education cess would be leviable on such clearances.

The petitioner had imported edible oils under the Duty Entitlement Pass Book ("DEPB") scheme by paying customs duty and additional duty at 50% of the normal rate applicable using the DEPB scrips. The petitioner contended that no education cess is levied when the customs duty and additional duty are exempt or nil rated or cleared without payment of duty i.e. there is no collection of duty on the clearance of goods. Accordingly, where partial exemption is granted under a scheme, education cess shall be levied on the amount of duty actually paid. In the present case, the petitioner contended that education cess should only be demanded on the partial duty paid by him under the DEPB scheme. However, as per the respondent, under the DEPB scheme, duty on import is not fully exempt but importer has the option to reduce the liability using the DEPB



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scrips unlike other exemption scheme for eg Advance Authorization scheme. Further, Circular No. 5/2005 – Cus dated January 31, 2005, clarified that in case of imports under the DEPB scheme, education cess at the rate of 2% would be debited from the DEPB scrip.

The High Court held that DEPB scheme is also a scheme notified under the foreign trade policy by the government with the aim to neutralize the effect of duty and promote exports from India like other exemption schemes. It also placed reliance on the decision of the Apex court in the case of Liberty India vs. Commissioner of Income-Tax reported in [317 ITR 218], wherein the nature of the DEPB incentives has been analysed. Accordingly, where DEPB scheme provides only partial exemption, education cess would be levied on such partial duty which is not exempt under the scheme.
*Gujarat Ambuja Exports Ltd & 1 vs Govt of India Thr' under Secretary (DBK) & 2 [2012-TIOL-546-HC-AHM-CUS]*

## If the credit availed on inputs used in the manufacture of final products is reversed before it is utilised either by reversing the credit or by cash payment with interest, then, it should be treated that the assessee has not availed the credit

The Petitioner had obtained a Duty Free Import Authorization ("DFIA") license dated October 29, 2009 for import of raw material without payment of duty used in the manufacture of cold rolled full hard CRCA with an obligation to export the same upto the quantity specified. Further, since it was ambiguous that the final goods manufactured would be exported or cleared to the domestic market, the petitioner took the CENVAT credit of the duty paid by it on the consumables. However, once the final product was exported outside of India under DFIA, the CENVAT credit taken by the petitioner was reversed along with interest on the same. Later, on the completion of the export obligation, the petitioner made an application for the transfer of the DFIA license along with a declaration stating that CENVAT credit has not been availed on the imported / domestic inputs used in the manufacture of final products so that the transferee could avail the benefits under para 4.2.6 of the Foreign Trade Policy 2009-2014 ("FTP"). However, vide office memorandum dated February 22, 2011, the CBEC held that for the purposes of DFIA, the CENVAT credit once availed is to be treated as availed, even if the said credit is reversed or paid back along with interest after the goods are cleared for export. The petitioner relied upon the decision of the Apex court in the case of *C. Ex., Mumbai Vs Bombay Dyeing & Mfg. Co. Ltd. [2007 (215) ELT 3 (SC)]*, wherein it was held that the CENVAT credit taken if reversed before its utilisation, it amounts to not taking the credit.

Accordingly, relying on the ratio laid down by the apex court in this regard, the court held that, in the case of DFIA if the credit availed on inputs used in the manufacture of final products is reversed before it is utilised either by reversing the credit or by cash payment with interest, then, it should be treated that the assessee has not availed the credit and accordingly, the benefits under para 4.2.6 of the FTP cannot be denied while transferring the DFIA.
*Steelco Gujarat Ltd vs The Union of India [2012-TIOL-572-HC-MUM-CUS]*

# Notification & Circulars

## Customs notification amended to align same with the Central Excise Notification No. 29 – 33/ 2012 dated July 9, 2012

The government has amended multiple notifications issued under the Customs Act, 1962 ("Customs Act"). The same has been done to align the notifiations issued under the Customs Act with changes brought in terms of Notification No. 29 – 33/2012 dated July 9, 2012 issued under the Central Excise Act, 1944.
*Notification No 44/2012 (T) dated July 9, 2012*

## Amendments in customs duty rates

The government has amended Notification No. 12/2012 – Customs (the mega exemption notification under customs). Changes made pertain to sugar and iron and steel products.
*Notification No 45/2012 (T) dated July 13, 2012*

## Amendment in Foreign Trade Policy

The Foreign Trade Policy, 2009-14 (RE-2012) ("FTP") has been amended and few modifications have been introduced in the same. Some of these amendments/modifications pertain to definition of capital goods and spares etc. Further, some of the amendments have been made effective retrospectively from June 5, 2012. Similarly, the government has also brought retrospective amendments to the Handbook of Procedures Vol I (RE 2012)/ 2009-14
*Notification No 8 (RE-2012)/2009-14 and Public Notice No 12 (RE-2012)/2009-2014 dated July 26, 2012*

## Key changes in Foreign Trade Policy, explained

CBEC has issued a Circular explaining the changes in the Foreign Trade Policy introduced vide the Annual Supplement of 2012 and Notifications and Circulars issued under Customs Law.
*Circular No 20/2012 dated July 5, 2012*

## Vehicles which are in the nature of professional equipment - relevant vis a vis imports against SFIS scrips

CBEC has issued circular clarifying that the vehicles which are in the nature of professional equipment may also include Ambulance, Sewage Disposal Truck, Refuse Disposal Vehicle, that are pre-designed structurally and pre-fitted with relevant devices and mechanisms that make for their use for the intended purposes and enable a reasonable conclusion that they cannot be put to generalized or personal use; and Dumpers designed for off-highway use (as described in the Explanatory Notes to Chapter 87 of the Harmonized System of Nomenclature-HSN), for use by the service provider in his regular service business. Personal vehicles such as motor cars/ Sports Utility Vehicles (SUVs)/ Multy Utility Vehicles (MUVs), etc. are not permitted to be imported against Served from India Scheme ("SFIS") scrips.
*Circular No 18/2012 dated July 5, 2012*

# V. CENTRAL EXCISE

## High Court Decisions

### No need to maintain separate accounts or to pay a percentage of total price of exempted goods under Rule 6 of the Cenvat Credit Rules if entire quantity of input was used in manufacture of taxable final product, even though some amount of exempt product is also generated during the manufacturing process as by-product and cleared availing excise exemption

The assessee was producing Spent sulphuric acid as by-product during manufacture of soap using acid slurry. Spent sulphurinc acid, so generated was cleared availing exemption under Notification 6/2002-C.E.

The High Court of Gujarat held that there was no question of maintaining separate accounts or of paying percentage of total price of exempted goods under Rule 6 of the Cenvat Credit Rules, 2004. The High Court observed that a division bench of the same court, in a similar matter, was considering a product, i.e. mother liquor as a by-product generated during manufacture of gelatin. Referring to Rule 6 of the Cenvat Rules, the Division Bench opined as under:

- When the entire quantity of input is used in the manufacture Gelatin, the question of maintaining separate accounts or of paying a percentage of the total price of the exempted goods would not arise;

- In the peculiar facts of the present case, sub rule (1) of rule 6, itself would not come into play in as much the manufacturer does not deliberately use any quantity of inputs, viz. Hydrochloric Acid for the purpose of manufacturing Di-Calcium Phosphate;

- There would be no question of maintaining separate accounts for receipt, consumption and inventory of input.

Basis the above, the Gujarat High Court in this case also, concluded that even though the products may be different, the ratio laid down by this Court would apply to the facts of the present case.
*CCE, Ahmedabad-III Vs Nirma Ltd – 2012 (281) E.L.T 654 (Guj.)*

### Cutting and polishing of granite and marble slabs does not amount to manufacture, therefore Cenvat credit of duty paid on capital goods, will not be available to the assessee

The assessee was engaged in the business of sawing of marble blocks into slabs and tiles. The marble blocks were excavated by the mine owners in raw uneven shapes which have to be properly sorted out. Such blocks were then processed using machines to square them by separating waste materials. Squared up blocks were then sawed, reinforced and polished on different machines and then the slabs were cut into required dimensions as per market requirements using other varieties of machines.

Assessee was also engaged in the business of purchasing rough granite slabs and manufacturing cut and sized polished tiles.

Assessee had purchased machinery worth Rs. 750 lacks for its business. The assessee had been availing benefit of Cenvat credit accrued on receipt of capital goods, which has been utilized while clearing its finished goods. The assessee had sought clarification about credit eligibility; from the Excise Department and the Assistant Commissioner confirmed the entitlement of the assessee to avail the Cenvat credit in respect of capital goods.

The Apex Court had considered the matter regarding applicability of Central Excise duty on marble slabs and tiles in Aman Marble Industries (P) Ltd. v Collector of Central Excise (2005) 1 SCC 279 and in its order dated September 18, 2003 laid down that cutting of marble blocks into slabs does not amount to manufacture, therefore, the Central Excise duty was not payable in respect of the marble slabs and tiles.

The assessee was exporting some of the tiles prepared by it and had presented a claim for refund (of excise duty paid) on account of export of excisable goods (by treating its activity as 'manufacture') for the period upto July 2004. Said refund was granted by the Assistant Commissioner, Central Excise, vide Order dated May 12, 2005.

However, the Commissioner Central Excise, vide Order dated April 25, 2006 reviewed the Order dated May 12, 2005 passed by the Assistant Commissioner holding the same to be illegal. Subsequently, a SCN was issued by the Deputy Commissioner on May 9, 2006 calling upon the assessee to show cause as to why an amount of Rs. 4,37,229/- should not be recovered from them. Subsequently the Deputy Commissioner, Central Excise vide this Order dated April 30, 2007 confirmed the demand. A revision petition was preferred by the assessee however the same was also dismissed.

The matter finally came up for hearing before the High Court of Rajasthan. The Honorable High court clearly held that it was not open to the assessee to avail Cenvat credit as the process performed by the assessee in question itself does not amount to manufacture within the purview of Excise Law and Cenvat Credit Rules and there is no vested right to CENVAT Credit even if excise duty was paid by them on an activity that doesn't amount to 'manufacture'.
*Arihant Tiles & Marbles Pvt Ltd vs Union of India 2012 (281) ELT 685 (Mad)*

# Notification & Circulars

### Exemption from excise duty on goods cleared against the various duty credit scrip schemes (Focus Product Scheme, Focus Market Scheme, Status Holder Incentive Scheme etc)

Exemption granted from excise duty and other specified duties on goods when cleared against the various duty credit scrip schemes (Focus Product Scheme, Focus Market Scheme, Status Holder Incentive Scheme etc). It is to be noted that exemptions were available from payment of custom duties when goods were imported against such duty credit scrips. Now goods can be procured domestically too by availi

against such duty credit scrips. Now goods can be procured domestically too by availing exemption from excise duty and other specified duties if they are cleared against these duty credit scrips.
*(Notification No 29 to 33/2012 (T) dated July 9, 2012)*

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