KPMG Tax Highlights

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Permanent establishment and income attribution
Indian subsidiary of a foreign company providing back office support operations does not constitute a PE in India The taxpayers are residents of USA. e-Fund Corp was the ultimate holding company of e-Fund India, a company incorporated and resident of India, and also of e-Fund Inc. The taxpayers had four main business lines, namely electronic payments, ATM management service, decision support and risk management and professional services. e-Fund India had performed back office operations in respect of the first three. This included data entry operations etc. in respect of decision support and risk management. The Delhi Tribunal held that e-Fund India constitutes a fixed place/service PE in India of the Associated Enterprises (AEs). The Delhi High Court held as follows: ***A subsidiary per se does not form a PE*** • Subsidiary constitutes an independent legal entity for the purpose of taxation. Holding or a subsidiary companies by themselves would not become PE of each other. • A subsidiary can become a PE of the holding/controlling company or the related company, if it satisfies the prescribed requirements of Article 5, notwithstanding and negating the protection provided under Article 5(6), which recognises legal independence of the two entities for tax purposes. ***Fixed place PE*** • Even if the foreign entities have saved and reduced their expenditure by transferring business or back office operations to the Indian subsidiary, it would not by itself create a fixed place or location PE. • The fact that the subsidiary company was carrying on core activities as performed by the foreign taxpayer does not create a fixed place PE. If an enterprise enters into contracts, assign or sub-contracts work or renders services to a third party on behalf of the principal, by itself would not lead to a subsidiary becoming a PE unless the relevant requirements of Article 5 are satisfied. • The taxpayers did not have any branch office or factory or workshop in India, and merely because they had a subsidiary in India, that by itself did not create a fixed place of business/location PE within the meaning of Article 5(2)(b) to (k) of the India-USA tax treaty. ***PE due to 'Place of Management'*** • President of e-Fund India had provided management support services in U.K. and Australia, while certain personnel of South-east Asia region had provided marketing support services to e-Fund India as well as e-Fund group entities overseas. Accordingly, employees of said entities reported to the President who in turn was reporting to e-Fund Corp. • Aforesaid factual position prima facie indicates that the said activities may have resulted in a PE under Article 5(2)(a) under the heading 'Place of Management' but the said provision has not been invoked. The High Court held that extent and timing of applicability of the 'Place of Management' principle in such cases, require findings of facts at the first instance and cannot be made matters to be decided for the first time in an appeal before the High Court under section 260A of the Act. • The Delhi High Court also observed that as the transactions between the AEs and e-Fund India were at arm's length, Article 5(5), dealing with Agency PE was not triggered. ***Article 5(3) and its over-riding effect and consequences*** • Article 5(3) is a non-obstante provision which overrides Article 5(1) and 5(2) of the India-USA tax treaty. While analysing whether taxpayer has PE, first and foremost, Article 5(1)/(2) should be applicable but then if the activities fall under the Article 5(3), PE cannot be created for imposing tax in

the second state.

- The Tribunal was not correct in concluding that all activities performed and undertaken by the Indian subsidiary and their employees would create a PE in India because the activities of e-funds India were not preparatory or auxiliary in character i.e. the activities are not satisfying the conditions of Article 5(3). Article 5(3) is not a positive provision but a negative list. The said Article does not create a PE but has a negative connotation and activities specified when carried on do not create a PE.

Service PE

- Employees of E-Fund India were their employees, i.e. employees of an Indian entity and not employees of the taxpayer. The employees of e-fund India did not become other personnel of the taxpayer, once and if the said persons were defacto and dejure employed by the Indian entity/enterprise.
- The words 'employees and other personnel' under the Article 5 of the tax treaty have to be read along with the words 'through' and 'furnishing of services' by the foreign enterprise within India. Thus, the employees and other personnel must be of the non-resident to create a Service PE.
- The High Court relied on the Supreme Court decision in the case of Morgan Stanley and held that merely because the non-resident taxpayer to protect their interest, for ensuring quality and confidentiality has sent its employees to provide stewardship services, will not make the Indian subsidiary or another entity, a PE of the non-resident company even if the employees of the non-resident taxpayer were taken on deputation.

Agency PE

- Subsidiary by itself cannot be considered to be a dependent agent PE of the Principal. However, a subsidiary may become dependent or an independent agent PE provided the tests as specified Article 5(4) and (5) are satisfied.
- It was not the case of tax department that e-Fund India was authorised and habitually exercised authority to conclude contract or was maintaining stock or merchandise from which it delivered goods or merchandise on behalf of the taxpayer or secured orders on behalf of the taxpayer. Therefore, the conditions and requirements of Article 5(4)(a) to (c) are not satisfied.

Attribution of profits

- The activities, which were not undertaken by e-Fund India and the assets of the taxpayers outside India, cannot be taken into account or attributed for earning/income of the taxpayers.
- The taxpayers activities though broadly divided into four heads were interconnected and not independent. Method of apportionment has to be fair, rational and logical. Assets and net income criteria applied must collate and refer to the assets which have contributed to the earning of the net income. In the MAP proceedings a formula was adopted and it should be consistently followed but if the said formula was irrational and inappropriate, it could be corrected in subsequent years.
- The anomaly while computing the proportion of net income attributable to Indian PE was that the net income of the group less income of e-Fund India was attributed to the group assets including assets of e-fund India. The Tribunal was correct in rectifying this anomaly. In view of the income declared and taxed in the hands of e-Fund India, nothing remains to be attributed or taxed in the hands of the taxpayers.

DIT v. E-Fund IT Solution [2014] 226 Taxman 44 (Del)

For further details please refer to our Flash News dated 11 February 2014 available at this link

Income from supply of telecommunications network equipment and software taxable as business income under India-China tax treaty

The taxpayer, a Chinese company, is engaged in the business of supplying telecommunications network equipment. During the year under consideration, a survey was undertaken at the office premises of Huawei India Pvt. Ltd. (Huawei India), a taxpayer's subsidiary.

During the course of survey, several documents were found and impounded and statements of various senior executives were recorded. The AO held that the taxpayer had PE in India and the income from the supply of telecommunications network equipment was taxable in India. The AO allocated the revenue from supply of equipment between two portion i.e. hardware supplied and the software, which is embedded with hardware/equipment. The AO treated receipt from the software as royalty and receipt from sale of hardware as business income under the India-China tax treaty.

The Delhi Tribunal held as follows:

Business connection

Huawei India was economically, technically and financially dependent upon the taxpayer. Further the telecom equipment supplied by the taxpayer are invariably installed and commissioned by its wholly owned subsidiary Huawei India and hence, it is clear that the taxpayer has a business connection in India.

Fixed place PE

Employees of Huawei India along with employees of the taxpayer have jointly prepared bidding documents for contracts, negotiated and concluded the contract on behalf of the taxpayer with its Indian customers. The taxpayer had given power of attorney in favour of its employees for signing the contracts, conducting negotiation and executing all necessary matters for the project in India.

The taxpayer's business in India was carried out with the help of its employees, who regularly work from the premises of Huawei India. In view of the above, it was clear that the taxpayer, being tax residents of China, had fixed place PE in India in form of office premises of Huawei India.

Agency PE

The employees of Huawei India forms the sales teams of the taxpayer, such employees have habitually secured orders in India, wholly or almost wholly for the taxpayer. The documents in the form of agreements/purchase orders/copies of contracts also prove the active involvement of the employees of Indian company in the conclusion of contracts on behalf of the taxpayer.

Huawei India was economically, technically and financially dependent upon the taxpayer. Therefore, Huawei India also constitutes the agent other than an agent of independent status of Huawei China. This results into the creation of the dependent agent PE under the India-China tax treaty and business connection under the Act.

Installation PE

The taxpayer's employees also visited India to perform activities relating to installation projects lasting for more than 180 days, which constitutes Installation PE.

Service PE

The statements recorded during the survey also show that the employees render technical services continuing for more than 183 days, constitute Service PE.

Taxability of income from supply of equipment and software

- The facts of the present case are identical with facts of the Delhi High Court in the case of Ericsson A.B. [2012] 341 ITR 162 (Del), where it was held that the software that was loaded on the hardware

did not have any independent existence. The taxpayer sold the hardware and software together and therefore, both software and hardware cannot be assessed separately. Similar view is also expressed by the High Court in the case of Infrasoft Ltd. [2014] 220 Taxman 273 (Del).

- On referring to the clauses of the agreement, it was evident that the software is a set of program embedded in the equipment necessary for control, operation and performance of the equipment. The contract price was for supply of equipment and thus there was a consolidated price for the supply of equipment which consists of hardware and software.
- The buyer was granted a non-exclusive, non-transferable and non-sub-licensable license to use the software. Further, the buyer was granted no title or ownership rights or interest in the software.
- Accordingly, following the decisions of jurisdictional High Court in the case of Ericsson A.B. and Infrasoft Ltd. it was held that there was only one contract for supply of equipment which included hardware and software both and, therefore, the income from supply of the equipment is taxable as business income arising from the taxpayer's business connection/PE in India.

Huawei Technologies Co. Ltd. v. ACIT [2014] 149 ITD 323 (Del)

For further details please refer to our Flash News dated 25 March 2014 available at this link

Employees seconded to provide business support services constitute a service PE in India. Further such Services also 'make available' technical knowledge, skill, etc. and therefore taxable as FTS/FIS

The taxpayer, an Indian company, was established as a wholly owned subsidiary of a U.K. based company. The U.K. based company also had overseas subsidiaries (overseas entities) located in different countries. These entities were in the business of supplying gas and electricity to consumers across the U.K. and Canada. The overseas entities outsource their back office support functions to the taxpayer. The taxpayer was acting as a service provider to these overseas entities. Accordingly, the taxpayer entered into 'service agreement' with overseas entities to provide locally based interface between overseas entities and Indian vendors.

To seek support during the initial years of the 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.

Service PE

The Delhi High Court held that the seconded employees create a service PE of the overseas companies. The High Court observed as follows:

- There was no employment relationship between the taxpayer and the seconded employees. There was no entitlement or obligation, clearly spelt out, whereby the taxpayer had to bear the salary cost of these employees.
- The seconded employees could not sue the taxpayer for default in the payment of their salary. All direct costs of such seconded employee's inter alia basic salary and other compensation, cost of participation in overseas entities' retirement and social security plans and other benefits were ultimately paid by the overseas entity.
- The employment relationship between the secondees and the overseas organisation was at no point terminated, nor was the taxpayer given any authority to even modify that relationship. The salary was paid through the overseas entity, which was not a mere conduit.

- Further, OECD Model Commentary on Article 15 states that 'the situation is different if the employee works exclusively for the enterprise in the state of employment and was released for the period in question by the enterprise in his state of residence'. This was clearly not done in the present case.
- Accordingly, overseas entities constituted Service PE in India.

Fees for technical services

The Delhi High Court, held 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 the expression FTS/Fees for Included Services (FIS) in the tax treaty includes the provision of the service of personnel. The seconded employees, who work for the taxpayer, were seconded by overseas entities and work conducted by them was through the overseas entities.
- The payment is not, in nature, a reimbursement, but rather a payment for rendering services. The nomenclature or less than expected charge for such services 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.
- The activity of the secondees was thus to transfer their technical ability, to ensure quality control vis-à-vis the Indian vendors, or in other words, 'make available' their know-how of the field to the taxpayer for future consumption.

Centrica India Offshore (P.) Ltd. v. CIT [2014] 364 ITR 336 (Del)

For further details please refer to our Flash News dated 2 May 2014 available at this link

Indian subsidiary of a foreign company constitutes a PE under the India-US tax treaty. 50 percent of the profits attributed to the PE in India

The taxpayer, incorporated in the USA, is a part of a group engaged in the supply of hardware and software products to telecom companies. An Indian group company entered into a contract with a customer in India for the supply (including installation, testing and commissioning) of hardware equipment. Immediately thereafter, the Indian company assigned the supply part of the contract to the taxpayer without any consideration.

In terms of the said contract, the taxpayer has supplied telecommunication hardware to Reliance Infocom. The equipments supplied by the taxpayer was purchased from a group company i.e. Nortel Canada. Nortel Canada was not engaged in providing any services and undertook only liaison activities in India.

The taxpayer did not file its return of income for the relevant year. The profit and loss account of the taxpayer was unaudited and certified by the tax manager. In the said profit and loss account, the taxpayer had booked huge losses.

The AO held that the Indian company and the LO of Canadian company constituted a PE of the taxpayer in India under the India-USA tax treaty. Further, based on Rule 10 of the Income-tax Rules, 1962 (the Rules), the Income-tax authorities applied the global gross profit margins of the group to the consideration for the supply of equipment and computed profits attributable to the PE.

The Delhi Tribunal, based on facts, held that the Indian Company/the LO constituted a fixed place

PE/dependent agent PE of the taxpayer in India. The Tribunal observed as follows:

PE

- The contract was a turnkey and indivisible contract for supply, installation, testing, commissioning etc. The compensation received for the sale of equipment represented the payment for a work contract.
- The Indian company was responsible for negotiating and securing contracts. Further, the Indian company also undertook the installation and commissioning activities. The LO was also rendering service to the taxpayer.
- The entire business activity of the taxpayer was managed by the Indian Company and hence, constitutes a PE.

Apportionment of profit

- The profit of the taxpayer from the supply of equipment, computed by reference to the gross profit rate of the group was accepted. Further, allowance for selling, general marketing expenditure and research and development expenditure were also accepted.
- Since the accounts of the taxpayer have no sanctity and the same were not audited, resorting to Rule 10 of the Rules would be justified.

Nortel Networks India International Inc. v. DDIT [2014] 65 SOT 158 (Del)

For further details please refer to our Flash News dated 16 June 2014 available at this link

Supervisory services not connected with the building, construction and assembling activity, in itself does not constitute a PE in India

The taxpayer, a German company, was primarily engaged in the activity of supervision, erection, and commissioning of plant and machinery for steel and allied plants. The taxpayer entered into an agreement with certain Indian companies for supervision, erection, ramping-up, commissioning, demonstration of performance, performance guarantee test, etc. of various 'plant and machinery' for their steel and allied plants.

The receipts from the aforesaid services were offered to tax as FTS under the India-Germany tax treaty

The AO held that since the duration of the stay in India of the taxpayer's technicians exceeded six months, the taxpayer had a PE in India under Article 5(2)(i) of the India-Germany tax treaty. Accordingly, the receipts were liable to be assessed in accordance with the provision of Section 44DA of the Act, or as 'business profits' under Article 7 of the India-Germany tax treaty.

On appeal, the Hyderabad Tribunal held that the supervisory activities of the taxpayer did not constitute a PE in India. The Hyderabad Tribunal held as follows:

- To constitute a 'fixed place of business', the foreign enterprise must have at its disposal certain premises or a part thereof.
- In the present case, the taxpayer does not own or operate project sites independently, but rather such sites were provided by its Indian companies under contractual obligations. Hence, it cannot be said that the taxpayer has a fixed place of business for its supervisory activities.
- As per Article 5(2)(i) of the India-Germany tax treaty, supervisory activities by themselves cannot constitute a PE since the activities are required to be in connection with a building, construction or assembly activity of the non-resident. In the instant case, the activities are not covered under Article 5(2)(i) of the India-Germany tax treaty as the taxpayer does not have any building site or construction

site of its own.

- The activities being technical in nature, would fall within the ambit of FTS under Article 12 of the India-Germany tax treaty, and are taxable at the rates specified therein.

GFA Anlagenbau Gmbh v. ACIT [2014] 34 ITR(T) 73 (Hyd)

For further details please refer to our Flash News dated 2 July 2014 available at this link

Liaison Office is engaged in the actual marketing of the products of the foreign company, and therefore the income attributable to the Liaison Office is taxable in India

The taxpayer is a company incorporated in the USA. In November 2002, the Registrar of Companies (RoC) issued a certificate of registration as a foreign company, to the taxpayer. During the relevant year, the taxpayer had received an approval from the RBI subject to certain conditions for establishing a LO in India.

During the assessment proceedings, the taxpayer disclosed that besides the fixed remuneration, it had a sales incentive plan under which the employees were entitled to receive upto 25 per cent of their annual remuneration as an incentive.

The AO held that the taxpayer was carrying on business activities in India and therefore, computed the taxable profit from business activities carried on in India.

The Delhi High Court held as follows:

- The activities of the LO included: (i) explaining the products to buyers in India; (ii) furnishing intimation in accordance with the requirements of the buyers; and, (iii) a discussion of commercial issues pertaining to the contract through the technical representative, after which an order was placed by the buyer directly.
- Also, it is significant that the performance of the personnel in India was judged by the number of direct orders that the taxpayer received and by the extent of awareness of the taxpayer that was generated in India.
- It is relevant that the nature of the incentive plan would indicate that the purpose of the LO in India was not merely to advertise the products of the taxpayer or to act as a link of communication between the taxpayer and a prospective buyer. The LO was involved in activities which traversed the actual marketing of the products of the taxpayer in India because it was on the basis of the orders generated that an incentive was envisaged for the employees.
- The LO was promoting the sales of the goods of the taxpayer company through its employees, to whom a sales incentive plan was provided for achieving a sales target and the performance of the employees was being judged by the orders secured by the taxpayer. Accordingly, the AO was justified in holding that the income attributable to the liaison office was taxable in India.

Brown and Sharpe Inc. v. CIT [2014] 51 taxmann.com 327 (All)

For further details please refer to our Flash News dated 24 November 2014 available at this link

Royalty and fees for technical services

Payments to a Philippine company for providing business information services are not taxable in the absence of FTS clause under the tax treaty and PE in India

The taxpayer, an Indian company, was a wholly owned subsidiary of IBM World Trade Corporation, USA.

The taxpayer made certain payments to IBM Business Services, Philippines (IBM Philippines) for certain business information services, work force management, web content management and human resources accounting services rendered by them to the taxpayer.

The AO, relying on the Central Board of Direct Taxes (CBDT) Circular No. 333 dated 2 April 1982 and Article 24 - Elimination of Double Taxation, held that since there is no Article in the India-Philippine tax treaty dealing with Fees for Technical Services (FTS), domestic law will govern the taxation of the sums paid by the taxpayer to IBM Philippines and therefore, the taxpayer is an 'assessee in default' for not deducting tax on such payments.

The Bangalore Tribunal held as follows:

Nature of payments under the tax treaty

- Payments to IBM Philippines, for providing services in the course of its business would be covered by Article 7 (Business Profits) since the specific Article dealing with FTS is absent in the India-Philippines tax treaty.
- As per Article 7(1) of the India-Philippines tax treaty, the business profits arising out of payments made by the taxpayer to IBM Philippines are not chargeable to tax in India in the absence of a PE in India.
- Article 23 of the India-Philippines tax treaty deals with 'Other Income' and provides that items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of the tax treaty, shall be taxable only in that state. An item of income is said to have been dealt with other Articles of the tax treaty if such income can be classified as taxable or not under any of the Articles of the tax treaty.
- In the present case, the payments are dealt with by Article 7 of the India-Philippines tax treaty and therefore, Article 23 has no application even though the business profits are not chargeable to tax in India in the absence of a PE of IBM Philippines in India.
- In the case of Bangkok Glass Industry Co. Ltd. [2013] 257 CTR 326 (Mad), the Madras High Court held that the FTS earned by the Thailand Company in the course of business was covered under Article 7 of the India-Thailand tax treaty and in the absence of a PE in India the income was not chargeable to tax in India. Further, the income was not chargeable to tax under Article 22.
- Even if it is assumed that payments to IBM Philippines are not covered by Article 7 but are covered by Article 23 of the India-Philippines tax treaty dealing with 'Other Income', the payments would be chargeable only in Philippines since as per Article 23, items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing articles of the tax treaty shall be taxable only in that State (i.e. Philippines in the present case).

Non-taxability of FTS under Article 24 of the tax treaty

- Article 24(1) of the India-Philippines tax treaty provides that the law in force in either of the Contracting State shall continue to govern the taxation of income in the respective contracting state, except where provisions to the contrary are made in the tax treaty.
- If Article 24(1) of the India-Philippines tax treaty is interpreted as dealing with taxation of items of income not dealt within the foregoing Articles 6 to 23 of the India-Philippines tax treaty, as per domestic laws, it would render Article 23 thereof redundant.
- Article 24 of the India-Philippines tax treaty deals with the elimination of double taxation and therefore, it has no applicability regarding taxation of an item of income, FTS in this case, dealt with under the India-Philippines tax treaty.
- Based on the above, the payments would not be chargeable to in India and consequently not liable

for TDS under Section 195 of the Act.

IBM India Private Limited v. DDIT [I.T. (IT) A. Nos. 489 to 498/Bang/2013]

For further details please refer to our Flash News dated 25 February 2014 available at this link

Most favoured nation clause

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

The taxpayer, an Indian 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 taxpayer filed an application with the Authority for Advance Ruling (AAR) seeking a ruling on the issue of taxability on the payments for the management services in the hands of the service provider, and the company's obligation to withhold tax at the source on such payments.

The taxpayer contended that the benefit of the 'make available' clause in the India-U.K. tax treaty should be available under the India-France 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 India-France 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-U.K. 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 [Most Favoured Nation (MFN)] 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;
- 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] 364 ITR 381 (AAR)

For further details please refer to our Flash News dated 20 May 2014 available at this link

Payments for BSP link services are not 'Fees for Technical Services' under India-France tax treaty by virtue of MFN clause

- The taxpayer is a branch office of IATA, Canada. In pursuance of an agreement entered into by IATA Canada through its administrative office in Switzerland, ADP-GSI, a French entity developed the system as per the specific need of the airlines and agents. The said system called BSP link, whereby the manual operations such as issue of debit notes/credit notes, issue of refund, billing statement, etc., relating to tickets are carried out electronically for agents as well as airlines who participate in the BSP Link.
- These BSP Link services were provided to the agents and airlines operating in India, for which invoices were initially raised by ADP-GSI on Switzerland office of IATA, Canada who in turn raised the invoices on IATA, India. The payment against the said invoices thus was liable to be made by the

taxpayer to Switzerland office of IATA, Canada.

- An application under Section 195(2) of the Act was filed by the taxpayer before the AO seeking permission to remit the said amounts to Switzerland office of IATA, Canada without deduction of tax on the ground that the Switzerland office of IATA, Canada was not rendering any service to IATA, India and it was only collecting the funds from various IATA offices including IATA, India for making payments to ADP-GSI.
- The AO held that the payment for the said services was in the nature of FTS chargeable to tax in India at 10 per cent as provided in Article 13 of the India-France tax treaty.

The Mumbai Tribunal held as follows:

- The restricted scope provided in the India-USA tax treaty and India-Portuguese tax treaty is applicable to the India-France tax treaty as per clause 7 of the Protocol (MFN clause) of India-France tax treaty. As per the restricted scope of the tax treaty, the BSP link services provided by ADP-GSI France did not make available to the agents/air lines any technical knowledge, experience, skill, know-how, or processes so as to enable them to apply the technology.
- The services envisaged in certain clauses of the agreement related to development services, testing and other facilities which were provided to the agents/airlines to enable them to operate and implement BSP link services in order to utilise the same for their own use.
- Accordingly, the Mumbai Tribunal upheld the order of the Commissioner of Income-tax (Appeals) [CIT(A)] holding that the payment made for BSP link services rendered by ADP-GSI France is not in the nature of FIS chargeable to tax in India.

DDIT v. IATA BSP India [2014] 64 SOT 290 (Mum)

For further details please refer to our Flash News dated 24 June 2014 available at this link

Non-discrimination

In view of the non-discrimination clause under the India-Japan tax treaty, no disallowance under Section 40(a)(i) is to be made in the hands of deductor if the non-resident has considered payments as income, paid taxes on the same, and filed the return of income

The taxpayer is a subsidiary company of Mitsubishi Corporation-Japan (MCJ) in India. MCJ also has a Liaison Office (LO) in India. During the relevant year, the taxpayer made payments to MCJ for purchase of goods. Even after the incorporation of the taxpayer in India, MCJ continues to operate through LO and looks after the interests of MCJ divisions.

The AO held that since MCJ had a PE in India, the taxpayer was required to deduct tax from the payments made to MCJ and therefore, the payments were disallowed under Section 40(a)(i) of the Act.

The Delhi Tribunal held as follows:

- There are a series of decisions on this issue where it was held that the tax treaty protection against non-discrimination, to ensure deduction parity, can be extended in the assessments of the domestic enterprise claiming the deduction.
- Relying on the UN/OECD Model Convention Commentary, the Tribunal agreed with the scope of the deduction neutrality clause in non-discrimination provision under the India-Japan tax treaty.
- A different treatment to the foreign enterprise *per se* is enough to invoke the non-discrimination clause in the India-Japan tax treaty.

- Relying on the decision of Rajeev Kumar Agarwal [2014] 149 ITD 363 (Agra), it was observed that disallowance under Section 40(a)(ia) of the Act cannot be made in respect of payments made to a resident taxpayer, even in case of non-deduction of tax at source, as long as related payments are taken into account by the recipients in computation of their income, and taxes in respect of such income are duly paid and income tax returns are duly filed under Section 139(1) of the Act.
- There was no binding judicial precedent contrary to coordinate bench decision in the case of Rajeev Kumar Agarwal; therefore, there was an element of discrimination, in terms of Article 24(3) of the tax treaty, in the deductibility of payments made to resident entities vis-à-vis non-resident Japanese entities.
- Article 24(3) of the tax treaty requires similar relaxation which is available to resident of India under the Act, in respect of the disallowance for payments made to the Japanese entities. Accordingly, the relaxation under second proviso to Section 40(a)(ia) of the Act is to be read into Section 40(a)(i) of the Act as well and it is required to be treated as retrospective in effect in the same manner as second proviso to Section 40(a)(ia) has been treated. Such an interpretation will lead to the deduction parity as envisaged in Article 24(3) of the tax treaty.
- On interpretation of the words specified in Article 24(3) of the tax treaty, it indicates that the payments made by an Indian enterprise to a resident of Japan shall be deductible in the assessment of Indian enterprise, under the same conditions as if the payments were made to the Indian residents.
- In view of the above, the disallowance under Section 40(a)(i) of the Act was deleted on the ground that MCJ, the recipient, has taken into account the related payments in computing its business income in India, paid taxes on the same and duly filed, under Section 139(1), its income tax return in India.

Mitsubishi Corporation India Pvt. Ltd v. DCIT [2014] 50 taxmann.com 379 (Del)

For further details please refer to our Flash News dated 6 November 2014 available at this link

Admissibility of application by AAR

The Supreme Court ruling on admissibility of an application by the AAR when the income-tax return has already been filed

Before the judgement of the Delhi High Court in the cases of NETAPP B. V. and Sin Oceanic Shipping ASA, there were quite a number of rulings by AAR contrary to each other on the issue of admissibility of the application.

NETAPP B. V. and Sin Oceanic Shipping ASA, aggrieved by the AAR's order, filed a writ petition with the Delhi High Court. The Delhi High Court held that once the return of income has been filed under Section 139(1) of the Act, it is construed as a question pending before the tax authority and therefore, the AAR cannot allow the application for advance ruling.

In August 2013 the AAR in the case of Hyosung Corporation held that mere filing of return of income before filing of the application does not necessarily mean that the question raised in the application is already pending before the tax authority. It is important to note that in this case the notice under Section 143(2) was also issued by the tax authorities before filing the AAR application. Hence, the AAR considered the issue as pending and did not admit the application.

In the case of Mitsubishi Corporation, return of income was filed before the AAR application, but that, according to the AAR, did not create any bar to file the application. Moreover, notice under Section 143(2) was issued after the filing of the AAR application. Hence, according to the AAR, the issue was not

pending before any authority as on the date of application and accordingly admitted the same. This decision is dated December 2013.

The Supreme Court in the case of Sin Oceanic Shipping ASA has put an end to a long drawn controversy relating to admission of an application by AAR when the income-tax return has already been filed. The Supreme Court, in the light of AAR ruling in the case of Mitsubishi Corporation Ltd [2013] 40 taxmann.com 335 (AAR), set aside the High Court and AAR's rulings and restored the matter back to the AAR for fresh ruling in accordance with the law.

Sin Oceanic Shipping ASA v. AAR [2014] 223 Taxman 102 (SC)

For further details please refer to our Flash News dated 31 January 2014 available at this link

Composite contracts

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.

The Delhi 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 a 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 MOU between the Companies specified that each consortium member would be responsible for its share of work and would also provide the information, data and material required for performance of work by the other member.
- Neither of the members had any role to play with respect to the scope of work which was allocated to the other member. The equipment/material to be supplied and the works to be executed by each member under the MOU as well as under the contract entered into was well defined and the members were to act separately and in accordance with the respective work allocated to them.
- The Companies were independent of each other and were responsible for their own deliverables under the Contract, without reference to each other;
- 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, 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.

With regards to onshore supply and services, it was held that there can be no dispute that the taxpayer would be liable to pay tax on the component of income included in the amounts received by it on account

of onshore supply and services, viz, supervision during the pre-commissioning construction, post commissioning services and supplies, training and other items of work/activities to be performed in India.

Linde AG, Linde Engineering Division v. DDIT [2014] 365 ITR 1 (Del)

For further details please refer to our Flash News dated 29 April 2014 available at this link

Commercial substance

Gains arising in the hands of a Mauritian company from sale of equity shares and CCDs of an Indian company are not taxable as interest income in India

The taxpayer is a company incorporated in Mauritius and a tax resident of Mauritius. The taxpayer along with Vatika Limited (Vatika), an Indian company, invested in SH Techpark Developers Ltd. (JV company) to undertake development of a real estate project in India.

The taxpayer entered into a Securities Subscription Agreement (SSA) and a Shareholder's Agreement (SHA) with Vatika and the JV company. The SHA recorded the terms of the relationship between the taxpayer, Vatika, and the JV company, their inter se rights and obligations, including matters relating to transfer of equity shares and the management and operation of the JV company.

As per the SSA, the taxpayer agreed to acquire 35 per cent ownership interest in the JV company by making a total investment of INR1 billion in five tranches. The taxpayer agreed to subscribe to 46,307 equity shares having a par value of INR10 each, and 882,585,590 zero per cent CCDs having a par value of INR1 each, in a planned and phased manner. The SHA also provided for a call option given to Vatika by the taxpayer to acquire all the aforementioned securities during the call period and likewise, a put option was given by Vatika to the taxpayer to sell to Vatika all the aforementioned securities during the determined period.

Vatika partly exercised the call option and purchased 22,924 equity shares and 436,924,490 CCDs from the taxpayer for a total consideration of INR800 million. Subsequently, the taxpayer transferred further equity shares and CCDs to Vatika.

The taxpayer filed an application with the AAR, wherein the AAR concluded that the entire transaction which is embodied in the SSA, SHA, and other documents is a sham and the real transaction was only of the taxpayer granting a loan to Vatika. Based on Article 10 of the SHA, the AAR concluded that these agreements indicated that the taxpayer would receive a fixed rate of return.

Accordingly, the AAR held that the entire gains on the sale of equity shares and CCDs held by the taxpayer are interest within the meaning of Section 2(28A) of the Act and Article 11 of the India-Mauritius tax treaty, and are taxable in India.

The taxpayer filed a writ petition before the Delhi High Court. The High Court observed that there was sufficient commercial reason for the taxpayer to have routed its investment from Mauritius into the real estate project in India through equity shares and CCDs. Thus, neither the legal nature of CCD's could be ignored nor the corporate veil between the Indian investee company and the Indian JV company can be lifted.

Therefore, the High Court held that the gains from sale of equity shares and CCD's are not taxable as interest under the Act and the India-Mauritius tax treaty.

Zaheer Mauritius v. DIT International Taxation-II [2014] 47 taxmann.com 247 (Del)

For further details please refer to our Flash News dated 5 August 2014 available at this link

Transfer pricing

'Sogo shosha' different from normal trading, no allocation for location saving and assembled workforce required; and Berry ratio an appropriate PLI where no funds are blocked due to inventory

The taxpayer is a wholly owned subsidiary of Mitsubhishi Corporation Japan (MCJ) which is one of the leading sogo shosha establishments in Japan. Sogo shosha is a Japanese expression which means general trading company engaged in both import and export of a diverse range of products.

In the instant case, the taxpayer was engaged in two segments namely, trading segment i.e. import of goods from an associated enterprise (AE) for resale and service fees/commission income segment pertaining to sales and marketing support services to the AE.

The taxpayer selected the transaction net margin method (TNMM) as the most appropriate method with Berry ratio (gross profit/operating expenses) as the profit level indicator (PLI). The taxpayer mentioned in its functional, risk and assets (FAR) analysis that it is essentially in the business of providing sales support and coordination activities in relation to international transaction, and therefore it will be akin to that of a service provider rather than that of a trader.

During the course of TP assessment proceedings, the Transfer Pricing Officer (TPO) rejected the PLI adopted by the taxpayer stating that in case of Berry ratio, entire international transactions relating to sales and services of commodities will remain out of PLI. Also, while considering operating expenses as the cost base, the cost of sales will get excluded from the denominator of the PLI used. The TPO proposed adjustment by selecting comparable companies with an arithmetic mean of 2.49 per cent and taking Operating Profit /Total Operating Cost (OP/TC) as the PLI for the combined segments i.e. trading and service.

The Tribunal held as follows:

The Tribunal pointed out the importance of inventory level as a crucial factor in determining the kind of activity the taxpayer has carried out and upheld the difference between sogo shosha (general trading) and normal trader.

The Berry ratio is an appropriate PLI where the business does not assume any significant inventory risk or perform any functions or add any value to the goods traded.

Additionally, the Tribunal upheld that no additional allocation for location savings is required if the savings are directly flowing to the independent customers and do not add to the profits of the group as a whole.

The Tribunal also clarified that the mere existence of a routine supply chain or human intangibles with a taxpayer does not automatically require additional returns to be attributed.

Mitsubishi Corporation India Pvt. Ltd. v. DCIT [ITA No. 5042/Del/11 – AY 2007-08]

For further details please refer to our Flash News dated 7 November 2014 available at this link

The Bombay High Court upholds in favour of Shell India and Essar Projects on the issue of share valuation

The taxpayer is an affiliate of and belonging to Shell group of companies headquartered in Holland. In 2009, the taxpayer had issued 0.85 billion equity shares to its non-resident AE at a face value of INR 10 per share. In its Form 3CEB, the taxpayer disclosed various international transactions with its AEs. However, the taxpayer did not disclose the issue of equity shares to its AEs as the taxpayer was of the

view that in the absence of income arising, it was not an international transaction.

The AO in terms of Sections 92CA(1) of the Act referred the international transaction disclosed by the taxpayer in Form 3CEB to the Transfer Pricing Officer (TPO). The TPO issued a show cause notice to the taxpayer as to why the ALP should not be recomputed in respect of the equity shares issued to non-resident AE.

In reply to the TPO's notice, the taxpayer pointed out that Chapter X of the Act would not apply as the transaction of issue of equity shares to the non-resident AE would not give rise to any income. The transaction was on capital account not giving rise to any income. However, the TPO held that in view of Chapter X of the Act, once a transaction between the parties is an international transaction, adjustment to transfer pricing can be done even on capital account (balance sheet items).

The TPOs order held that shares were allotted to the AE at a price which was lower than the ALP of issue of shares which resulted in short receipt of consideration. Accordingly, the TPO on the basis of the ALP, computed enhancement of the issue price to INR 183.44 per share and also charged interest on the amount short received resulting in transfer pricing adjustment of INR 152.20 billion.

The Bombay High Court held as follows:

- Regarding alternate remedy, since the tax department does not dispute that the issue on merit stands covered by the decision of Vodafone IV, it would serve no useful purpose by directing the taxpayer to prosecute its objections before the DRP and then the DRP disposing the same in accordance with the decision in the case of Vodafone IV. Further, the taxpayer had given an undertaking to withdraw its objection on the issue of jurisdiction before the DRP.
- The second distinguishing feature as contended by the tax department was that the taxpayer had not disclosed the transaction as an international transaction in Form 3CEB which was in fact done by the taxpayer in the case of Vodafone IV. The Bombay High Court held that the stand of the tax department was little curious as in the case of Vodafone IV they had contended that the petitioners therein had filed Form 3CEB in respect of the issue of shares and had submitted to the jurisdiction of Chapter X and cannot then contend that proceedings to tax such shortfall on Capital account was without jurisdiction. It was observed that in the Shells case, the tax department was taking an exactly opposite stand. The Bombay High Court observed that *"The State is expected to be consistent and not change its stand from case to case"….*

  "The fact that the petitioner chose not to declare issue of shares to its non-resident AEs in Form 3CEB as in its understanding it fell outside the scope of Chapter X of the Act……If the petitioner did not file a particular transaction in Form 3CEB when so required to be filed, the consequences of the same as provided in the Act would follow. However, the mere not filing of Form 3CEB on the part of taxpayer would not give jurisdiction to the tax department to tax an amount which it does not have jurisdiction to tax"
- Regarding the scope of the clause (e) of Explanation to Section 92B of the Act, the Bombay High Court held that in the present facts, we need not examine whether a transaction would include restructuring or reorganization, for the reason that even if it is assumed that it is an international transaction, the jurisdictional requirement for Chapter X of the Act to be applicable is that income must arise. In this case, admittedly following Vodafone IV, no income has arisen. Accordingly, the issue in the present case has been decided in the case of Vodafone IV and would be binding on all authorities within the state till the Apex court takes a different view on it.

Shell India Markets Pvt. Ltd. v. ACIT LTU and ors (Writ Petition No. 1205 of 2013 – Bombay High Court)

For further details please refer to our Flash News dated 1 December 2014 available at this link

ALP of an international transaction cannot exceed the 'Final Sales Price'- Supreme Court dismisses Revenue SLP against Global Vantedge Ruling

The taxpayer had entered into an arrangement with RCS Centre Corp (RCS), its AE, and was engaged in rendering IT enabled services/back office support services in the field of credit collection and telemarketing to its AE. The taxpayer considered RCS as the tested party and compared the profit margin of RCS with the average margin of foreign comparable companies in its transfer pricing study report.

The TPO concluded that the AE is not to be treated as a tested party and considered the taxpayer as the tested party. The CIT(A) upheld the action of the TPO treating the taxpayer as 'tested party'. The CIT(A) granted partial relief in favour of the taxpayer by stating that the total adjustment together with the ALP cannot exceed the total revenue earned by the taxpayer and it's AE from third party clients. The Tribunal upheld the order of the CIT(A) on the grounds that neither the taxpayer nor the Revenue had been able to provide any basis or material to rebut the findings and conclusions of the CIT(A).

The issue before the High Court was with regard to the determination of ALP. The High Court observed that with regard to the determination of ALP, the Tribunal had examined the issue at length and extensively quoted the decision of the CIT(A), examined the CIT(A)'s order, and thereafter confirmed his order. The High Court observed that after examining the findings of the CIT(A), the Tribunal had given the tax department an opportunity to controvert or rebut the findings and conclusions arrived by the CIT(A). However, the tax department was unable to controvert those findings and point to any new evidence to enable the Tribunal to deviate from the CIT(A)'s view. Further, it was not the case that the Tribunal ignored any of the points made by the tax department, which could have been rectified.

The Supreme Court did not find any substantial question of law arising out of the (impugned) High Court, and hence it dismissed the tax department's SLP against the High Court order.

CIT v. Global Vantedge Pvt. Ltd. [2014] 225 Taxman 193 (Del)

For further details please refer to our Flash News dated 14 January 2014 available at this link

The Delhi High Court rules that transfer pricing reference does not curtail the test of deductibility of expenses under Section 37 of the Act. Further, cost-to-cost reimbursement transactions should also be benchmarked from an arm's length perspective

The taxpayer, an Indian company, reported several international transactions including (i) payment of referral fees to associated enterprises (AEs); and (ii) reimbursement to AEs for the costs incurred by them for certain coordination and liaison services provided to the taxpayer.

The TPO disallowed reimbursement of expenses transaction by determining its arm's length price (ALP) as nil, and held that no intra-group services existed in this case as the taxpayer was unable to file any evidence to support the specific need for such services and the benefits that were actually accrued from them. No benchmarking or transfer pricing analysis was conducted to substantiate the arm's length nature of such transactions.

The TPO also noted that the taxpayer may have received only incidental benefit from the global relationship between the AEs and clients. As regards the payment of the referral fees, the TPO concluded it to be at arm's length. However, the AO disallowed the same under Section 37 of the Act, stating that the taxpayer failed to demonstrate the genuineness of the transaction, the receipt of any such services, and the business purpose of the same. The DRP upheld the adjustments made by the AO. The Tribunal reversed the findings of the AO/TPO on both of the above-mentioned transactions.

On appeal, the High Court held as follows:

- The High Court observed that whether a third party, in an uncontrolled transaction with the taxpayer,

would have charged amounts lower, equal to or greater than the amounts claimed by the AEs, has to be tested under the various methods prescribed in Section 92C of the Act. The argument of the taxpayer that it only reimbursed the cost incurred, while an uncontrolled transaction would involve an additional element of profit, is not tenable. This being a transaction between related parties, whether the cost itself is inflated or not is a matter to be tested under a comprehensive transfer pricing analysis. The High Court also noted that the application of Section 92(3) of the Act is not a logical inference from the fact that the AEs have only asked for reimbursement of costs.

- The jurisdiction of the AO under Section 37 and that of the TPO under Section 92CA of the Act, are distinct. The High Court noted that the authority of the TPO is to conduct a TP analysis to determine the ALP, and not to determine whether there is a service or not from which the taxpayer benefits. That aspect of the exercise is left to the AO under Section 37 of the Act.
- In reference to the referral fee transaction, the High Court noted that the TPO determines whether the transaction value represents the ALP or not (including whether the ALP is nil), while the AO makes the decision as to the validity of the deduction under Section 37. This would include the decision as to whether the expenditure was 'laid out or expended wholly and exclusively for the purposes of the business' as the same is a fact determination or verification to be undertaken by the AO. The authority of the AO under Section 37 is not curtailed in any manner by a reference under Section 92C of the Act.
- The findings of the Tribunal on both the transactions were set aside, and the matter was remanded to the file of the AO, for an ALP assessment by the TPO, followed by the AO's assessment order in accordance with law.

CIT v. Cushman and Wakefield (India) Pvt. Ltd. [2014] 225 Taxman 8 (Del)

For further details please refer to our Flash News dated 02 June 2014 available at this link

The Mumbai Tribunal confirms concealment penalty under Section 271(1)(c) of the Act and also rules on the validity of revised return

The taxpayer is a joint venture between two companies and entered into a software development service agreement with one of the joint venture partners to provide software related services. The TPO accepted all transactions to be at arm's length except reimbursement of market services availed, (similar to two preceding years). The TPO was of the opinion that the taxpayer was not required to undertake any marketing function as per the master service agreement and that both the parties had a clearly demarcated role to play for which they were compensated. Accordingly, the TPO held that there was no valid reason for the joint venture partner to allocate any part of the cost incurred by it to perform the role agreed by it, which is the marketing function. The TPO accordingly determined the ALP of the reimbursement of market services availed as zero and proposed to make TP adjustments.

The taxpayer had pointed out to the TPO that it had revised its return of income for the AY 2003-04 and AY 2004-05 on 29 March 2006 and 14 December 2007 respectively, disallowing the entire marketing expense claimed in the original return, and therefore, there was no question of any TP adjustment under Section 92CA of the Act. The TPO rejected this claim observing that the taxpayer had failed to file a revised Form 3CEB in line with the revised returns. Further, in the regular assessment the AO disallowed the claim of the taxpayer for enhanced deduction under Section 10A on disallowance of reimbursement of marketing services in view of the provisions of Section 92C(4) of the Act. The AO did not give cognise to the revised returns or the suo moto disallowance of the reimbursement of marketing services. Penalty under Section 271(1)(c) of the Act was accordingly levied at 100 per cent of the tax on the amount initially claimed as marketing expense. The CIT(A) upheld the AO's order.

The Tribunal held as follows:

- The joint venture partner markets the taxpayer's capabilities, which is precisely what it is required to do under its arrangement with the taxpayer. Accordingly, it was held that there was no question of any reimbursement by the taxpayer to the joint venture partner for the marketing services provided.
- The taxpayer had failed to demonstrate the service it received or the benefit it received from receipt of such marketing services. No separate documentation; the cost allocation as made and incurred by the taxpayer was submitted to the TPO.
- Since the return was revised only after a reference was made to the TPO, the revision was made in anticipation of the proposed adjustment with a motive to avoid the adjustment, and thereby the disallowance of Section 10A benefit on the amount of TP adjustment.
- If anything wrong is discovered in Form 3CEB filed, the same needs to be withdrawn and replaced by a revised Form 3CEB to give a correct picture although there is no specific provision in the Act for the same.
- Since the taxpayer failed to demonstrate that any service was in fact rendered, the foreign exchange to that extent stands lost to the country, warranting a denial of deduction under Section 10A to which the amount may otherwise be eligible.
- With regard to the taxpayer's plea that there has been a complete disclosure of material facts, the Tribunal observed that the taxpayer failed to demonstrate any business purpose of its relevant international transaction. It is only by way of reference to and inquiry by the TPO, which brings forth the complete absence of business purpose, leading to its valuation at nil and, resultantly, a retraction by the taxpayer. The disclosure per the audit report under Section 92E of the Act forming part of its return is thus both false and misleading.
- Since the Tribunal had concluded that the withdrawal or revision was not voluntary, but with a sole objective to avoid the rigour of the Section 92C(4) of the Act, the penalty proceedings against the taxpayer were justified.
- The Tribunal concluded that the findings of the CIT(A) are comprehensive and correct in fact and law. The appeal of the taxpayer was rejected.

Deloitte Consulting India Pvt. Ltd. v. ACIT [2014] 151 ITD 454 (Mum)

For further details please refer to our Flash News dated 23 May 2014 available at this link

OECD – BEPS action plan 13: transfer pricing documentation and country-by-country reporting

Organisation for Economic Co-operation and Development (OECD), as a part of Base Erosion and Profit Shifting (BEPS) initiative, released a discussion draft on TP documentation and country-by-country reporting (Draft Guidance) on 30 January 2014 inviting comments from interested parties. On 16 September 2014 it has released guidance on TP documentation and country-by-country reporting (Report) as an output to action plan 13 with the consensus of 44 countries (including all OECD members, OECD accession countries, and G20 countries).

Three tiered structure

The Guidance on Transfer Pricing documentation states the following:

- The OECD has prescribed a 'three-tier' documentation structure consisting of Master file, Local file and Country-by- Country (CBC) report:
  - Master file provides an overview of the multinational group and business

- Local file provides a ‘zoomed-in’ view of operations and transactions relevant to that jurisdiction
- CbC report provides aggregate, jurisdiction-wide information on global allocation of income, taxes, and indicators of economic activity.

- The CbC report which earlier was proposed to be a part of the master file is now delinked from the same and has been prescribed as a separate document.
- The OECD has significantly diluted the reporting norms in the revised CbC report by:
  - Excluding reporting of information such as place of effective management, royalty, interest, services, employee expenses, withholding taxes, bifurcation of income-taxes paid in home country and other countries, etc.
  - Excluding reporting of financial and tax information (such as revenue, taxes, accumulated earning, number of employees, etc.) at the entity-level. Instead, the OECD has now sought such aggregated information at the tax jurisdiction level (i.e. one line item consisting of total revenue/profit etc. for all Constituent Entities of the MNE operating in a tax jurisdiction).
  - OECD has warned that the CbC report should not be used by tax administrations to propose transfer pricing adjustments based on a global formulary apportionment of income.

The OECD has indicated that it will provide further guidance on the implementation mechanism by February 2015.

Source: - http://www.oecd.org

For further details please refer to our Flash News dated 19 September 2014 available at this link

Goodwill

Depreciation is allowed on goodwill under Section 32 of the Income-tax Act

Allowability of depreciation on goodwill has been a matter of debate before various Courts/Tribunal.

Various Courts/Tribunal have held that depreciation is not allowable on goodwill because it is not of similar nature to that of intangible assets viz. know-how, patents, trademarks, licences, franchise, etc. as specified under Section 32 of the Act. In other words, it will not get covered under the expression ‘any other business or commercial rights of similar nature’.

Similarly, the Mumbai Tribunal in the case of Toyo Engineering India Ltd. held that the difference between the consideration paid upon an amalgamation and net book value of assets acquired cannot generally be regarded as ‘goodwill’. Such goodwill shown in the books was a mere book entry and that in the absence of specific valuation of the assets, liability and goodwill of the amalgamating company, depreciation cannot be claimed on the amount of ‘goodwill’.

However, the Supreme Court in the case of Smifs Securities Ltd. [2012] 348 ITR 302 (SC) has put the above controversy at rest and held that the goodwill being a difference between the amount paid and cost of shares in case of amalgamation scheme, is an asset eligible for depreciation under Section 32 of the Act. The Supreme Court has applied the principle of ejusdem generis and held that the expression ‘any other business or commercial rights of a similar nature’ includes goodwill for the purpose of allowability of depreciation.

The Tribunal in various cases followed the decision of the Supreme Court in the case of Smifs securities Ltd. and held that depreciation is allowable on goodwill.

The Bombay High Court relying on the decision of Supreme Court’s in the case of Smifs Securities Ltd.

[2012] 348 ITR 302 (SC) set aside the decision of the Mumbai Tribunal in Toyo Engineering India Limited and restored the matter back to the Tribunal for a fresh consideration on merits.

Pursuant to High Court's order the Mumbai Tribunal in the case of Toyo Engineering India Limited held that:

- Difference between the book value of assets and the liabilities, should be transferred to goodwill account of the taxpayer.
- Considering the decision of the Bombay High Court in the case of Sadanand S. Varde & Ors [2001] 247 ITR 609 (Bom), neither the nature of goodwill nor the quantity of goodwill can be disputed.
- It was not the case of Assessing Officer that there was any difference in quantum of goodwill.
- Accordingly, relying on the decision of the Supreme Court in the case Smifs Securities Ltd. depreciation was allowed on goodwill.

DCIT v. Toyo Engineering India Ltd. [Income Tax Appeal (L) No.1330 of 2012]

For further details please refer to our Flash News dated 31 October 2014 available at this link

Capital gain

Capital gains exemption is not available on conversion of a private limited company into an LLP if exemption conditions are violated

Aravali Polymers Pvt. Ltd (Company), a private company, was converted into Aravali Polymers Limited Liability Partnership (LLP) (the taxpayer), in accordance with the provisions of LLP Act, 2008 on 12 August 2010. At the time of conversion, main assets of the Company were investment in 3,184,807 equity shares of East India Hotels Ltd (Shares). The Company also had reserves and surplus of about INR 30 million.

Post conversion, the taxpayer sold the Shares and earned capital gain of INR 530 million which was offered for taxation as long term capital gain. The taxpayer also gave temporary interest free loans of INR 500 million to its partners in the profit sharing ratio The taxpayer filed its tax return offering long term capital gain on sale of shares and claimed exemption under Section 47(xiiib) of the Act, on conversion.

The AO considered that the loan given to the partners was in violation of Section 47(xiiib) of the Act and therefore, invoking the provisions of Section 47A(4) of the Act, the AO computed capital gain of INR 384.7 million on the basis of market value of shares on the date of conversion.

The Kolkata Tribunal held as follows:

- Clause (f) to the proviso to Section 47(xiiib), does not allow direct or indirect payment to any partner out of the accumulated profit standing in the accounts of the Company on the date of conversion for a period of three years from the date of conversion. The interest-free loan was given to its partners in profit sharing ratio shows that the amount has been given directly to the partners out of the balance of the accumulated profits standing in the accounts of the Company on the date of conversion. Thus, it was a violation of clause (f) to proviso to Section 47(xiiib) of the Act.
- Section 47A(4) of the Act is invoked when provisions of Section 47(xiiib) are not complied with. In the present case, conversion took place in the same year in which the conditions were violated and therefore benefit of provisions of Section 47(xiiib) of the Act was not available to the taxpayer. Accordingly, provisions of Section 45 of the Act were attracted.
- For computation of capital gains, the Act does not provide for deeming the sale price in the case of

equity shares. The value at which the shares or the assets of the Company were taken over by the taxpayer would be the sale price and the cost of acquisition thereof should be as per books of the erstwhile Company.

- The issue regarding computation of capital gains in accordance with provisions of Section 45 was sent back to the AO.

Aravali Polymers LLP v. JCIT [2014] 65 SOT 11 (Kol)

For further details please refer to our Flash News dated 4 July 2014 available at this link

Income under Section 56(2)(vii)(c)

Proportionate allotment of additional shares does not result into income under Section 56(2)(vii)(c) of the Act

The taxpayer, a Hindu Undivided Family (HUF), held 15,000 shares as on the beginning of the relevant previous year, in Dorf Ketal Chemicals Pvt. Ltd. (DKCPL), representing 4.98 percent of the entire share capital being 3,01,316 shares. The entire (or almost the whole) capital in DKCPL was held by the family members of the taxpayer's karta's family.

The taxpayer was offered 313,624 additional shares (which works to about 21 shares for each share held) at the face value rate of INR100 each, on a proportionate basis. The taxpayer subscribed to and was accordingly allotted 194,000 of those shares. Further, the other shareholders were allotted similar shares and also those shares which were not subscribed by the taxpayer i.e. 119,624 shares (313624 – 194000).

The book value of the shares of DKCPL as at the year-end was INR 1,538 per share and the same adopted as a measure of their fair market value (FMV) under the Rule 11U and Rule 11UA of the Rules. In terms of Section 56(2)(vii)(c) of the Act read with the relevant Rules, the AO treated the difference of INR 1,438 per share as inadequate consideration toward the acquisition of additional shares and brought the same to tax.

The Mumbai Tribunal held that as follows:

- Section 56(2)(vii)(c) gets attracted whenever an individual or HUF receives without consideration a specified property, the FMV of which is in excess of INR 50,000, or in case of consideration where the consideration is less than FMV by an amount exceeding the INR 50,000.
- Section 56(2)(vii) includes the 'shares and securities' as the word property occurring in the section is defined to mean capital assets. However, the shareholders get the right to acquire the additional shares on the passing of the board resolution.
- 'Right share' is appropriation out of the previously un-appropriated capital of a company of a certain number of shares to a particular person. Till such allotment, the shares do not exist as such, and in a sense come into existence on their allotment. The valuation date under Rule 11U(j) is the date of the receipt of the property and the shares are received on their allotment.
- In order to demonstrate the wholesomeness of the provision, the matter of bonus share is dwelt upon. Issue of bonus shares is capitalization of its profit by the issuing-company and there is neither any increase nor decrease in the wealth of the shareholder (or of the issuing company) and shareholder's percentage holding therein remains constant. The same has the effect of reducing the value per share. Accordingly, the provision would not apply to issue of bonus shares.
- In the present case, issue of additional shares has reduced the taxpayers holding to 3.17 per cent

from 4.98 per cent. Therefore, the premise on which this provision was not applicable to issue of bonus shares, would to the extent pari-materia, apply in equal measure to the issue of additional shares, i.e. where and to the extent it is proportional to the existing share-holding.

- To the extent the value of the property in the additional shares is derived from that of the existing shareholding, on the basis of which the same are allotted, no additional property can be said to have been received by the shareholder. In support of this the Tribunal placed reliance on the decisions of Dhun Dadabhoy Kapadia v. CIT [1967] 63 ITR 651 (SC) and H. Holck Larsen v. CIT [1972] 85 ITR 285 (Bom).
- The shares are allotted pro-rata to the shareholders based on their existing holdings and therefore, there was no scope for any property being received by them on the said allotment of shares; there being only an apportionment of the value of their existing holding over a larger number of shares. Accordingly, Section 56(2)(vii)(c) of the Act does not get attracted in the present case though, it is *per se* applicable to the transaction, i.e., of this genre.
- Section 55(2)(aa) of the Act clarifies that the values of the original and the additional financial assets are interlinked and accordingly, a gain cannot be computed independent of each other.
- To the extent 'right share' is allotted to a person not against his existing shareholding or, even so, albeit disproportionately, depending on the terms of the allotment, there is a scope for value or property being passed on to him, which cannot be said to be in lieu of or as recompense of his existing property.
- To the extent the shares subscribed are right shares, i.e., allotted pro-rata on the basis of the existing share-holding (as on a cut-off date), the provision though *per se* applicable does not operate adversely. A disproportionate allotment, though could be allotted under a rights issue, would however invite the rigor of the provision to that extent.
- No property is being passed on to the taxpayer in the instant case, on the allotment of the additional shares. Accordingly, the provision of Section 56(2)(vii)(c) of the Act shall not apply.

Sudhir Menon HUF v. ACIT [2014] 148 ITD 260 (Mum)

For further details please refer to our Flash News dated 19 March 2014 available at this link

Disallowance under Section 14A

Disallowance under Section 14A cannot be made unless the exempt income has been received during the year

- During AY 2009-10, the taxpayer had raised loans from a financial institution which was used for its day-to-day working. Further, the taxpayer made an investment in the form of shares in various companies, and also an investment in a partnership firm. These investments continued without any change during AY 2010-11.
- During AY 2009-10 and 2010-11, the taxpayer claimed interest expenditure incurred on loans raised from the financial institution on the return of income. The AO disallowed the interest on borrowed loan since the taxpayer could not prove that the investments were made out of its own funds. The AO applied the formula prescribed in Rule 8D(2)(ii) and (iii) of the Rules and made disallowance under Section 14A of the Act. However, no disallowance for any direct expenditure was made as prescribed in Rule 8D(2)(i) of the Rules.

The Bangalore Tribunal held as follows:

- It is an undisputed fact that the taxpayer had no exempt income during both the years involved.
- The tax department relied on the decision of the Special Bench of Delhi Tribunal in the case of Cheminvest Ltd. v. ITO [2009] 121 ITD 318 (Del), where it was held that disallowance under Section 14A of the Act could be made even in a year in which no exempt income was earned or received by the taxpayer
- The decision in the case of Cheminvest Ltd. has been overruled by various High Courts. In the case of CIT v. Shivam Motors P. Ltd. (ITA No. 88 of 2014, 5 May 2014) (All), the Allahabad High Court held that if the taxpayer had not earned any tax free income, the corresponding expenditure could not be worked out for disallowance under Section 14A of the Act.
- Further, the Gujarat High Court in the case of CIT v. Corrtech Energy Pvt. Ltd. [2014] 223 Taxman 130 (Guj) held that where the taxpayer did not make any claim for exemption, Section 14A of the Act cannot apply.
- The Tribunal relied on the decision of the Punjab and Haryana High Court in the case of Winsome Textile Industries Ltd. where it was held that since the taxpayer did not make any claim for exemption, Section 14A of the Act will not apply. The Bombay High Court in the case of CIT v. Delite Enterprises (Tax Appeal 110 of 2009, dated 26 February 2009) held that since there was no profit derived by the taxpayer from a partnership firm which is exempt under Section 10(2A) of the Act, the interest paid by the taxpayer on the borrowed funds cannot be disallowed under Section 14A of the Act.
- Similarly, the Punjab and Haryana High Court in the case of CIT v. Lakhani Marketing (ITA No.970 of 2008, dated 2 April 2014) held that it was incumbent on the AO to establish a nexus between the expenditure incurred and the income which was exempt under the Act.
- In view of the above, the Tribunal held that unless exempt income has been received during the concerned year, Section 14A of the Act cannot be invoked.

Alliance Infrastructure Projects Pvt. Ltd. v. DCIT [ITA No. 220 & 1043(Bang)/2013] – Taxsuta.com

For further details please refer to our Flash News dated 14 October 2014 available at this link

Tax deducted at source

CBDT extends the concessional rate (5 per cent) of withholding tax on the interest payments to a non-resident on borrowing by way of any long term bonds in foreign currency

Section 194LC of the Act has been introduced by the Finance Act 2012. It provides for lower withholding tax at the rate of 5 per cent on the interest payments by Indian companies on borrowings made in foreign currency from a source outside India.

The Finance (No. 2) Act, 2014, extended the concessional rate of withholding tax to borrowing by way of any long term bonds, not limited to a long term infrastructure bond. The CBDT Circular conveys the approval of the Central Government for the purposes of Section 194LC of the Act in respect of the issue of long term bonds including long term infrastructure bond by Indian companies which satisfy the following conditions:

- The bond issue is at any time on or after 1 October 2014, but before 1 July 2017.
- The bond issue by the Indian company should comply with the relevant ECB regulations.
- The bond issue should have a loan Registration Number issued by the RBI.

- The term 'long term' means that the bond to be issued should have original maturity term of three years or more.

Further, the Central Government has also approved the interest rate for the purpose of Section 194LC of the Act in respect of borrowing by way of issue of long term bond including long term infrastructure bond, as any rate of interest which is within the all-in cost ceilings specified by the RBI under ECB regulations, as is applicable to the borrowing through a long term bond issue having regard to the tenure thereof.

CBDT Circular No. 15 of 2014 [F No. 133/50/2014-TPL] dated 17 October 2014.

For further details please refer to our Flash News dated 20 October 2014 available at this link

Procedures and assessment

TDS credit cannot be denied to the taxpayer on the grounds of mismatch of TDS amount with the details shown in Form 26AS

The taxpayer is a civil contractor deriving income by executing civil contracts in various government departments. During the AY 2010-2011, the taxpayer claimed a refund of INR 2, 32, 370. Subsequently, the income-tax return was processed by the Central Processing Centre (CPC), Bangalore.

The income-tax return was accepted under the deemed assessment scheme. Thereafter, the CPC issued an income-tax refund of INR 43,740 and no intimation was given to the taxpayer as to why the balance amount of INR1, 88, 630 was not refundable.

The taxpayer filed a rectification application under Section 154 of the Act and expected the refund of the balance amount. Subsequently, reminders were sent and when it became known to the taxpayer that his application was not received by the tax department, the taxpayer filed a second application under Section 154 of the Act.

The taxpayer filed a writ petition under Article 226 of the Constitution of India before the High Court praying refund an amount of INR1,88,630 along with the interest.

- The Allahabad High Court held that the mismatch of Tax Deducted at Source (TDS), with the details shown in Form 26AS, is not attributable to the taxpayer, and the fault solely lies with the deductor.
- Accordingly, the taxpayer is entitled for a tax refund once the tax has been deducted and paid to the credit of the government account by the deductor.
- Further, the taxpayer is entitled to interest on the delayed refund since the delay in refunding the amount was attributable solely to the tax department, and there is no fault on the part of the taxpayer.

Rakesh Kumar Gupta v. Union of India and another [2014] 225 Taxman 198 (All)

For further details please refer to our Flash News dated 4 June 2014 available at this link

Tax Audit Report requirements amended

The CBDT has amended Form No. 3CA, Form No. 3CB and Form No. 3CD of the Rules. The amended rules would come into force on the date of their publication in the Official Gazette.

On the direct tax front, the revised Form No. 3CD now requires submission of the valuation related details of transfer of land, building or both for a lower consideration, receipt of share of private limited company without consideration or for inadequate consideration and receipt of any consideration for issue of shares which exceeds the fair market value of the shares.

As information on indirect taxes are now required to be reported, this highlights that there is a change in the perspective of computation of income by the CBDT. The companies should put in place system and processes to collect the information required by the amended Form No. 3CD.

Vide the Income-tax (7th Amendment) Rules, 2014 dated 25 July 2014

For further details please refer to our Flash News dated 1 August 2014 available at this link

Person of Indian origin card scheme

The Government of India amends Person of Indian Origin Card Scheme

A foreign citizen who is a person of Indian origin (PIO) may be allotted a PIO card under the PIO Card Scheme, 2002. The said card allows the foreign citizen to enter India without a visa and exempts him from registration with the Foreigners Registration Office (FRRO/FRO), provided the stay on a single visit does not exceed 180 days.

The Ministry of Home Affairs (MHA) issued a Notification no. 25024/9/2014 – F.I. dated 30 September 2014, amending the PIO Card Scheme, 2002, providing additional benefits to the PIO Card holders. The key changes are replicated below:

(a) The PIO card shall now have lifelong validity. Earlier, the PIO card was issued for a maximum period of 15 years. PIO cards issued prior to 30 September 2014 shall be deemed to have lifelong validity provided that the card holders have a valid passport.

(b) A PIO card holder would not be required to register with the FRRO/FRO even if his stay in India on a single visit exceeds 180 days.

Notification No. 25024/9/2014 – F.I., dated 30 September 2014

For further details please refer to our Flash News dated 8 October 2014 available at this link

Employees' provident funds

The Government of India issues notification on enhancing wage ceiling from existing INR 6,500 to INR 15,000 for schemes framed under the Employees' Provident Funds & Miscellaneous Provisions Act, 1952

Under the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (EPF Act) the statutory wage ceiling for enrolling employees, as well as for making contributions, was INR 6,500 per month (except for some special classes of employees). In the Union Budget 2014, this statutory wage ceiling was proposed to be revised to INR 15,000 per month.

In the above context, the Ministry of Labour and Employment, Government of India, had issued a notification which has made the following amendments in the respective schemes framed under the EPF Act, 1952. The amendments were made effective from 1 September, 2014.

Key amendments in the Notification

Under Employees' Provident Funds Scheme, 1952 (EPFS)

- The wage ceiling for mandatory PF contribution has been revised from INR6,500 to INR15,000 per month
- If the monthly pay (as defined under the EPF Act) exceeds INR15,000, employees can be

enrolled voluntarily and contributions can be made on higher salaries, as well.

Under Employees' Pension Scheme, 1995 (EPS)

- Wage ceiling for the purpose of employer and central government contribution has been revised from INR6,500 to INR15,000 per month
- In case of new members under EPFS , the EPS shall apply to employees whose pay is less than or equal to INR15,000 per month
- The maximum pensionable salary for the purpose of calculating monthly pension, which was limited to wages of INR6,500, has also been increased to INR15,000
- The pensionable salary will be calculated on the average monthly pay for the contribution period of the last 60 months preceding the date of exit from the membership
- The monthly member's pension to any existing or future member shall not be less than INR1,000 for the financial year 2014-2015
- Further, the monthly widow pension shall be a minimum of INR1,000 per month for the financial year 2014-2015.

Under Employees' Deposit Linked Insurance Scheme, 1976 (EDLIS)

- The contribution which was calculated on a monthly pay of INR6,500 shall now be calculated on a monthly pay of INR15,000.
- In the event of death of an employee, the assurance benefits available under the scheme will be increased by twenty per cent.

Notification G.S.R. 608 (E), 609 (E), 610 (E) and 593 (E) dated 22 August 2014 and 19 August 2014

For further details please refer to our Flash News dated 1 September 2014 available at this link

Employees' Provident Fund Organisation issues new circulars to secure proper compliance in respect of International workers

In October 2008, the Government of India (GOI) had made fundamental changes in EPFS and EPS by bringing International Workers (IWs) under the purview of the Indian social security regime.

Thus, with the above context the Employees' Provident Fund Organisation (EPFO) has issued two circulars for securing proper compliance in respect of International Workers. The two circulars issued by EPFO pertain to:

Reconciliation of International Workers data with the office of Foreigners Regional Registration Office (FRRO)

EPFO has directed its officials to coordinate with the respective FRROs to obtain the list of foreign nationals employed in establishments covered under the EPF Act.

EPFO has further asked its officials to reconcile the FRRO data with the IW-1 return filed by the employers and to ensure proper compliance in case of evasion in respect of IWs.

Introduction of revised application form for obtaining a 'Certificate of Coverage' (COC) under Social Security Agreements (SSA) with various countries

To obtain the exemption under respective Social Security Agreements (SSA), an outbound employee requires a COC from EPFO which serves as a proof of social security contribution in India. In order to obtain COC, outbound employees have to submit an application form to the Provident Fund office.

In the new application form, EPFO has changed the joint undertaking by employer and employee.

The above circular clarifies that an outbound employee will be entitled for COC whether or not the employee has earlier worked in a country with which India has an SSA. However, PF contribution will be made as IWs if the applicant has worked in a foreign country with which India has entered into an SSA and the applicant has become eligible to avail the benefits under the social security programme of that country, under the said agreement.

Circulars by EPFO dated 25 March 2014 and 01 April 2014

For further details please refer to our Flash News dated 3 April 2014 available at this link

ESOP guidelines

SEBI replaces the erstwhile ESOP guidelines with new regulations

The Securities Exchange Board of India (SEBI) on 28 October 2014 has notified New Regulations [SEBI (Share based employee benefits) Regulations, 2014] for share based employee benefits which have replaced the erstwhile ESOP guidelines. The New Regulations shall be effective from even date of notification.

In addition to Employee Stock Option Scheme (ESOS) and Employee Stock Purchase Scheme (ESPS), the New Regulations covered the following new employee benefit schemes which deal in shares of the company - Stock Appreciation Rights Scheme (SARS); General Employee Benefits Scheme (GEBS); and Retirement Benefit Scheme (RBS).

The key amendments in relation of operation of the scheme through trust are as follows:

- The company may implement the scheme either directly or by an irrevocable trust. If the scheme involves secondary acquisition and / or gift, then it is mandatory for the company to implement such scheme through a trust and such an implementation has to be decided upfront at the time of taking shareholders' approval for setting up the scheme.
- The trust deed and any modifications thereto is mandatorily to be filed with the stock exchange(s) in India where the company's shares are listed.
- A director, key managerial personnel or promoter of the company or its holding, subsidiary or associate company or any relative of such person; or a person who beneficially holds 10 per cent or more of the paid-up share capital of the company cannot be appointed as a trustee.
- The trustees are to appropriate approval from the shareholders in order to implement the scheme and undertake secondary acquisition.
- The trust shall not deal in derivatives and shall undertake only delivery based transactions for the purpose of secondary acquisitions.
- Secondary acquisition in a financial year by the trust shall not exceed 2 per cent of the paid up equity capital as at the end of the previous financial year.
- The total number of shares under secondary acquisition held by the trust (including multiple trusts and schemes, if any) shall not exceed the prescribed limits as at the end of the financial year immediately prior to the year in which the shareholder approval is obtained for the secondary acquisition.
- The un-appropriated inventory of shares which are not backed by grants, acquired through secondary acquisition by the trust under the New Regulations, shall be appropriated within a

reasonable period which shall not extend beyond the end of the subsequent financial year. If such trust existing as on the date of notification of the New Regulations is not able to appropriate the unappropriated inventory within one year of such notification, the same shall be disclosed to the stock exchange at the end of such period and then the same shall be sold on the recognized stock exchange where shares of the company are listed, within a period of 5 years from the date of notification.

- The trust is required to hold the shares acquired through secondary acquisition for a minimum period of 6 months except under specified circumstances and can undertake off-market transfer of shares only under the specified circumstances.

Other amendments are as follows:

- Independent directors have been excluded from the category of eligible employees to whom share based employee benefits can be granted.
- Approval of shareholders by way of separate resolution in the general meeting is to be obtained by the company in case of secondary acquisition.
- In case of winding up of the schemes, the excess money or shares remaining with the trust after meeting all the obligations shall be utilized for repayment of loan or by way of distribution to employees, as recommended by the compensation committee.
- Any company implementing any of the share based schemes shall follow the requirements of the Guidance Note on Accounting for employee share-based payment or Accounting Standards as prescribed by the Institute of Chartered Accountants of India (ICAI) from time to time, including the disclosure requirements prescribed therein.
- For the GEBS and RBS, the shares of the company or shares of its listed holding company shall not exceed ten percent of the book value or market value or fair value of the total assets of the scheme, whichever is lower, as appearing in its latest balance sheet for the purpose of such schemes.
- To ensure a smooth transition for complying with the new regulatory framework, the existing employee benefit schemes have been provided with a time period of one year from the date of notification.
- Further, a longer transition period of five years from the date of notification has been provided for specified cases.

There were certain other amendments covered by the said regulation which have been covered in our Flash Alert.

SEBI (Share based employee benefits) Regulations, 2014

For further details please refer to our Flash News dated 31 October 2014 available at this link

CENVAT credit

Service tax paid on outward transportation of goods not admissible as CENVAT credit

In the instant case, the issue was whether Service tax paid on outward transportation of the goods upto the point of delivery to customer can be claimed as CENVAT credit. The Kolkata High Court distinguishing the judgment of Karnataka High Court in the case of ABB Limited [2011 (23) STR 97 (Kar)] (wherein it was held that Service tax paid on outward transportation of goods up to the point of delivery to customer was allowable as credit as sale and transfer of property in goods took place at that point),

has held that CENVAT credit of Service tax paid on outward transportation of goods up to the point of delivery is not admissible. The Court made the following observations:

- The amendment made with effect from 1 April 2008 in the definition of 'input service' under CENVAT Credit Rules, 2004, by substituting the phrase 'from the place of removal' by 'up to the place of removal', was brought to clarify the intention to allow CENVAT credit only in the cases of transport of goods from one place of removal to another place of removal.
- The Central Board of Excise and Customs (CBEC) Circular clarifying the issues regarding admissibility of CENVAT credit on output freight and allowing the credit under certain scenarios (such as, where place of removal is customer's premises), cannot amend the definition of 'input service' and hence, was erroneous in nature.

CCE v. Vesuvious India Limited [2013-TIOL-1038-HC-KOL-ST]

In case of specified rates based Assessment, credit can be claimed on outward transportation of goods beyond the factory gate

In the instant case, the taxpayer is engaged in the manufacture of Cement, which is subject to the levy of duty under the "specified rate" based Assessment (i.e. levy of Duty at specified rate on the weight of the goods as against the value of the goods). The taxpayer availed credit of Service Tax paid on the Goods Transport Agency services used for the transportation of goods from factory gate to the premises of the buyers. However, the Central Excise authorities denied Credit on the ground that as per Rule 2 (l) of the Credit Rules, credit could be claimed only with respect to the outward transportation upto the place of removal, and since in the present case, the factory gate is the place of removal, credit cannot be claimed on such services.

The Chhattisgarh High Court held that there is no provision in the Act or in the Rules or in any Circular issued by the CBEC to hold that in case Excise duty is charged on the specified rate then, the place of removal will be factory gate. Accordingly, in case it is proved that the "place of removal" is the premises of the consumer, the taxpayer will be entitled to take the CENVAT credit on such service.

Ultratech Cement Limited v. CCE [2014-TIOL-1437-HC-CHHATTISGARH-CX]

For further details please refer to our Flash News dated 20 January 2014 available at this link

CENVAT Credit on outdoor catering service allowed even for the period post 1 April 2011

In the instant case, the issue was whether CENVAT credit, with respect to cost borne by the company for provision of outdoor catering services to its employees, would be eligible.

The Mumbai Tribunal on the basis of the following observations held that CENVAT credit on such outdoor catering would be eligible:

- 'Outdoor catering' per se is eligible input service but it is not eligible for credit only when it is used for personal use or consumption of any employee.
- Employees have used these services during normal business hours only and cost of such services is borne by the company and not recovered from employees.
- Cost of such input services forms part of the cost of final product.

Hindustan Coca Cola Beverages Pvt Ltd v. CCE [2014-TIOL-2460-CESTAT-MUM]

Service tax

Levy of Service tax

Service tax on 'one time maintenance charges' received by the builders/developers from the flat owners

The taxpayer (a builder), collected 'one time maintenance charges' from each of the flat owners and deposited it to a separate bank account as a fixed deposit. Interest earned on this deposit was utilised to pay charges such as municipal taxes, security charges, electricity charges, etc. The department demanded service tax from the appellant on such deposits under the category of 'Maintenance or Repair Service'.

The Mumbai Tribunal held that the appellant was not providing any maintenance or repair services to the flat owners on the basis of the following observations:

- The taxpayer was not in the business of providing maintenance or repair services as they were paying municipal taxes, security charges, electricity charges, etc., only on behalf of the flat owners as a trustee or pure agent without charging anything on their own.
- The payments were made on a cost to cost basis and were debited from the fixed deposit account.
- To accept maintenance charges, deposit these amounts in a separate bank account and make such payments were statutory obligations on the appellant under the Maharashtra Ownership Flats (Regulation of the Promotion of Construction, sale, management and transfer) Act, 1963.

Kumar Builders and others v. CCE [2013-TIOL-1806-CESTAT MUM]

Levy of Service tax on services received and consumed abroad

One of the issues involved in this case was taxability of services received by the overseas branch offices of the taxpayer from sub-contractors located outside India under the reverse charge mechanism. The overseas branch offices of the taxpayer had availed services from sub-contractors located outside India (the contract was between overseas branch offices and the sub-contractors) for rendering services to overseas clients of the overseas branch offices. Out of the export earnings of the taxpayer (in EEFC account), the taxpayer had allocated certain earnings to overseas branches for payments to subcontractors abroad.

Based on the aforesaid transaction and also, considering that the branch office (situated outside India) and head office (based in India) are separate taxable persons for the purposes of the reverse charge mechanism under Service tax legislation, the Bangalore Tribunal held that since the service was not being received in India but received outside India by overseas branches there would not be any Service tax liability on the Indian head office.

Infosys Ltd v. CST, Bangalore [TS-64-Tribunal-2014 (Bang)]

For further details please refer to our Flash News dated 13 March 2014 available at this link

Constitutional validity of Service tax on service portion involved supply of food/ other articles of human consumption upheld

In the instant case, the issue was whether leviability of Service tax on service portion involved in supply of food/ other articles of human consumption is constitutionally valid. The High Court observed that the Constitution of India [under Article 366 29(A) (f)] does not indicate that the service portion is subsumed in the sale of food, rather it separates sale of food and drinks from service and therefore, the Parliament

was constitutionally competent to charge Service tax on such service portion. It also held that no VAT should be charged on the service portion which has already suffered tax and hence, has advised the State governments to issue a clarification/ direction to ensure that the consumers are not unnecessarily doubly taxed.

Hotel East Park & Another v. Union of India & Others [TS-159-HC-2014(CHAT)-ST]

Service tax Audit

Rule empowering the department to call records for 'general audit' has been quashed

In the instant case, writ petition was filed before the Delhi High Court challenging the validity of Rule 5A (2) of the Service Tax Rules, 1994 ('the Rule') requiring production of records to audit party on demand and the CBEC Circular dated January 1, 2008 ('the Circular') pertaining to general audit.

The Delhi High Court held that the Rule and the Circular, both are ultra vires the Finance Act, 1994 ('the Finance Act') and should be struck down. It made the following observations:

- Sec 72A of the Finance Act envisages special audit of assessee's records only in special circumstances, for example, in case the assessee fails to declare the value of taxable service or when CENVAT credit utilization is in excess. However, the said section does not intend to provide for a general audit that every assessee may be subjected to "on demand".
- Rules must conform to the provisions of Act and be within the rule making powers of executive authority. Any notice, circular, guideline etc. contrary to statutory laws could not be enforced.
- In the present case, the Circular providing clarification on the Rule which is an attempt to widen scope of law is contrary to statute and hence, void.

Travelite (India) v. Union of India and others [TS-310-HC-2014(DEL)-ST]

[Our Comments: To distinguish the aforesaid Case law, the Central Government issued a Circular No. F No. 137/46/2014-Service Tax Dated 10 December 2014, which provides for scrutiny of records by the audit party deputed by the Commissioner. Such scrutiny essentially constitutes audit by the audit party consisting of departmental officers].

Excise duty

Levy of Excise duty

Value of accessories not cleared along with the goods, but supplied separately are not required to be included in the assessable value of the goods

In this case, the taxpayer has manufactured the vehicles (three wheelers) and cleared it to the dealers. However the taxpayer did not supply the accessories namely rear visual barrier, jack assembly and carpet from the unit manufacturing the vehicles. However, these accessories were supplied from the spare parts division situated outside the factory to the dealers directly and the dealers while selling the vehicles supplied these accessories to the buyers. The Central Excise authorities demanded duty on the accessories also, by way of including the same in the assessable value of vehicles, on the ground that, as per the Motor Vehicle Rules, the driver is mandatorily required to ensure that these accessories are available in the vehicle.

The Mumbai Tribunal has held that the Motor Vehicle Rules, no doubt, specify that while plying the vehicle the driver should ensure that these accessories are available in the vehicle, however, this is a condition which needs to be met at the time of using the vehicle on the road. Therefore, it does not

emerge from the Motor Vehicle Rules that the manufacturers are mandatorily required to supply the tool kits or jack assembly along with the vehicle. Hence, duty is not payable on such accessories, especially when these were not supplied along with the vehicle at the time of clearance of the vehicles from the factory of production.

Piaggio Vehicles Private Limited v. CCE [2013-TIOL-1831-CESTAT-MUM]

SAD exemption

SAD is exempt in case of stock transfer of goods from EOU to DTA

In the case of clearance of goods from EOU to DTA, Notification No. 23/2003-C.E dated 31 March 2003 provides exemption from the payment of additional duty of customs leviable under Section 3 (5) of the Customs Tariff Act, 1975 (i.e. SAD). However, no such exemption is applicable if such goods, when sold in DTA, are exempted by the State Government from payment of Value Added Tax (VAT)/Central Sales Tax (CST).

The taxpayer had stock transferred the goods from its EOU unit to its DTA unit. As this is a case of stock transfer, VAT/CST is not leviable. However, the taxpayer claimed exemption from the payment of SAD. The Central Excise authorities demanded SAD on the ground that VAT/CST is exempted by the State Government on stock transfer.

The Mumbai Tribunal held that SAD is not exempted if VAT/CST is 'exempted' by the State Government. However, this is not a case of exemption from payment of VAT/CST by the State Government, but the VAT/ CST itself is not leviable / applicable in the case of stock transfer. Therefore, the taxpayer is entitled to claim the exemption from SAD.

VVF Limited v. CCE [2014-TIOL-04-CESTAT-MUM]

Excise Registration

Pipelines used for transportation of goods beyond factory gate, cannot be covered within the expression 'factory premises or precincts thereof'

In the instant case, the taxpayer, engaged in the manufacture of motor spirit, high speed diesel and liquid petroleum gas, filed an application to amend their approved ground plan of Central Excise registration to include the pipeline laid down from Wadinar (Gujarat State) to the refinery at Bina (M.P State), on the ground that the pipelines laid down on various parts of the land and areas in India were forming integral part of the refineries' premises.

The Delhi Tribunal held that the definition of factory covers the 'premises and precincts of factory' and not the premises or precincts beyond the factory premises. Also, a dam / reservoir located away from the factory cannot be treated as within the factory premises. In the present case, the pipelines were laid beneath the land for transportation of crude through various States and were primarily meant for transportation of the raw material. Accordingly, the Delhi Tribunal upheld the order passed by the Revenue and denied amendment to the Central Excise registration.

Bharat Oman Refineries Limited v. CCE [2014-TIOL-1366-CESTAT-DEL]

Extension of Stay order

CESTAT has the power to grant extension of stay beyond 365 days from the initial grant of an order of stay

As per third proviso to Section 35C (2A) of the Central Excise Act, 1944 where the Appeal is not

disposed of within the specified period, the CESTAT may extend the period of stay not exceeding 185 days. In case the Appeal is not so disposed of within the total period of 365 from the date of order against which the Appeal is filed, the stay order shall, on the expiry of the said period, stand vacated. In this regard, a question was placed before the Larger Bench of the CESTAT, whether the third proviso to Section 35C (2A) disables CESTAT of the power to grant extension of stay beyond 365 days from the initial grant of an order of stay.

The CESTAT held that where the period of 365 days has passed from the date of initial grant of stay but the Appeal could not be disposed of, for reasons not attributable to the appellant/ assessee (in whose favour the stay was granted) and where the CESTAT is satisfied that the appellant/ assessee was ready and willing for disposal of the Appeal and / or had not indulged in any protractive strategies, extension of stay could be granted beyond the period of 365 days.

Haldiram India Private Limited & Others v. CCE [2014-TIOL-1965-CESTAT-DEL-LB]

[Our comments: Similar view is expressed by the Madras High Court in the case of CCE, Chennai Vs FORD INDIA Limited, 2014-TIOL-1634-HC-MAD-CX, but whereas, divergent view has been expressed by the Allahabad High Court in the case of CCE Vs ANNAKUT BISCUITS Company Private Limited, 2014-TIOL-1645-HC-ALL-CX]

Circular/Clarification

Excise registration for Importers

Importers are mandatorily required to obtain registration under Central Excise for passing on CENVAT Credit

The Central Excise Rules, 2002 and the CENVAT Credit Rules, 2004 have been amended with effect from 01 March 2014 to provide the following:

- Registration is made mandatory for importers issuing invoices on which CENVAT Credit can be obtained
- An importer issuing the invoice on which CENVAT Credit can be obtained, will be considered as a 'First Stage Dealer'.

Notification No. 17/ 2013-CX (N.T) and 18/ 2013-CX (NT), both dated 31 December 2013 the contract is titled as 'penalty'

Pre-deposit

Clarifications have been issued pertaining to making pre-deposits for Appeal proceedings

With regard to mandatory pre-deposit provisions for filing appeals post 6 August 2014, CBEC issued a clarification which *interalia* provides for the following:

- Regarding Appeal against the Order of Commissioner (Appeal) before the Tribunal, 10 percent is to be paid on the amount of duty/ penalty demanded by the Commissioner (Appeal), and this need not be the same as the amount of Duty/ Penalty imposed in the Order-in-Original.
- Payment made during the course of Investigation or Audit, prior to the date on which Appeal is filed, to the extent of 7.5 percent or 10 percent, subject to the limit of INR10 crores, will be considered to be deposit made towards fulfillment these provisions.
- No coercive measures for the recovery of balance amount i.e. the amount in excess of 7.5 percent or 10 percent deposited, will be taken during the pendency of Appeal subject to production of following documents:
  - proof of payment of stipulated amount; and
  - the copy of Appeal Memo filed with the Appellate Authority

- In all cases, where the Appellate Authority has decided the matter in favour of the Assessee, refund with interest should be paid to the Assessee within 15 days of the receipt of the letter of the Assessee seeking refund, irrespective of whether Order of the Appellate Authority is proposed to be challenged by the Department or not.
- Similarly, in the event of a remand, refund of the pre-deposit would be paid along with interest.
- Procedure for making the pre-deposit as well as claiming its refund, has also been prescribed.

Circular No. 984/08/2014-CX., dated 16 September 2014

Customs duty

Levy of Customs duty

Utilisation of goods imported under Project Imports Scheme

In the instant case, the taxpayer imported goods under Project Import Regulations, 1986, for the manufacture of transformers. The investigation conducted by the authority's revealed interalia that in certain cases, the imports under the Project Import Scheme had taken place after the transformers had been manufactured and dispatched. Accordingly, the customs authorities denied the concessional rate of duty.

The taxpayer *interalia* contended that the contracts for the projects provided for a strict delivery schedule and a penalty if the delivery was not made on time. Since, it takes substantial time to import the goods under 'project imports', it is not possible to deliver the transformers on time. Therefore, in order to meet the delivery schedule, the similar raw materials lying in stock were utilised, which were either duty-paid or were imported under DEEC scheme. However, the benefit of concessional rate of duty under the Project Import Regulations has been passed on to the customers even though duty paid materials were utilised. Further, the taxpayer contended that the Project Import Regulation does not prescribe one-to-one correlation condition and therefore, in the instant case, it is not mandatory to establish one-to-one correlation between the raw materials imported and the goods manufactured and supplied to a 'specific project'.

The Mumbai Tribunal held that the materials imported for one unit of a specified project cannot be used elsewhere in any other unit or in any other project. If one-to-one co-relation is not maintained, fulfilling of the condition regarding usage of the imported product in a particular project cannot be established. If any goods are allowed to be imported subject to certain conditions, then such conditions are required to be fulfilled in respect of the goods imported and the liability in respect of the imported goods cannot be shifted to another set of goods imported, unless these are expressly allowed under the Customs law. Accordingly, the benefit of concessional rate of duty cannot be claimed in case the goods imported are not used for the project for which they are imported.

***Bharat Bijlee Limited v. Commissioner of Customs (Import) [2014-TIOL-374-CESTAT-MUM*]**

Assessable value

In certain cases, the license fee paid is required to be included in the value of recorded media

In the instant case, the taxpayer has imported recorded media containing feature films/ programmes on payment of a licence fee (fixed amount or minimum guaranteed amount), for exploiting the intrinsic content of the said media. The duty liability was discharged only on the cost of media. The Customs authorities have included the value of license fee paid to the assessable value of media and demanded duty on the same.

The Mumbai Tribunal held that as per the sale agreement the taxpayer was given certain rights such as video rights, cinematic rights, television rights and other ancillary rights in connection to the goods which were sold to him on payment of licence fee. These rights also include the right to exhibit and right to broadcast. The royalty/licence fee is charged either on a flat lump sum basis or on minimum guarantee basis. As per the agreement, the payment of royalty/licence fee is a condition for sale of the goods in question and accordingly, the same is required to be included in assessable value for the purpose of payment of customs duty.

Star Entertainment Private Limited v. Com of Customs [2014-TIOL-583-CESTAT-MUM]

Duty Drawback

DBK at Brand Rate could be claimed subsequently even though at the time of exports, DBK has been claimed at All Industry Rates

In the instant case, at the time of exports the taxpayer filed the Shipping Bill under the claim of Drawback (DBK) at All Industry Rates. Subsequently, the assessee submitted an application for determination of DBK at the Brand Rate and accordingly, claimed the differential amount from the Revenue.

The Customs Authorities have rejected the application on the ground that as per the Circular No. 606/04/2011-DBK dated 30 December 2011, once the DBK is claimed at the All Industry Rates, subsequently the same cannot be claimed at the Brand Rates for the same exports.

The Mumbai High Court held that the Drawback Rules does not debar an exporter from seeking determination of the Brand Rate of DBK, merely because at the time of export, he had already claimed the All Industry Rate of DBK. It has also been held that under the garb of clarifying the Rules, the CBEC cannot incorporate a restriction/limitation which does not find place in the Drawback Rules and accordingly, the Circular dated 30 December 2011 issued in this regard has been struck down to that extent.

Alfa Laval (India) Limited v. UOI & Others [2014-TIOL-1485-HC-MUM-CUS]

[Our comments: However, the Central Government vide Notification No 109/2014-Cus (NT) and Notification No 110/2014-Customs (N.T.), both dated 17 Nov 2014 read with Circular No. 13/2014-Cus dated 18 Nov 2014 have made it explicit that where the claim for duty drawback is filed with reference to the rate in the AIR Schedule, an application for fixation of Brand Rate will not be admissible].

VAT

Levy of VAT

Transfer of independent business constitute sale of business as a whole and exempt from VAT

The issue was whether the taxpayer was eligible to claim VAT exemption in respect of transfer of two independent units.

The taxpayer entered into business transfer agreement for sale and transfer of its Agro Engine and Light Engineering business, as a going concern. The taxpayer while filing its revised returns claimed exemption on the consideration received for transfer of business. The Assessing Officer rejected the claim of the taxpayer on the ground that as per the agreement, separate values were agreed upon for the immovable assets and movable assets. The Commissioner (Appeals) and the Tribunal upheld the demand for tax and penalty.

On a revision petition, the Madras High Court observed that the terms of the agreement clearly indicate that the intention of the parties was to sell units and the Tribunal committed serious error in holding that there was separate sale of immovable and movable assets. The Madras High Court further observed that since the transfer of these units included all assets and liability, all employees, pending contracts, licenses, plant and machinery, furniture, fixtures, etc and the manufacturing activity was already in progress, given the time gap between the effective date of transfer and the agreement, parties agreed to the pricing of certain items and in such framework, the agreement was executed in such manner. Therefore, what was sold was undertaking in entirety by the taxpayer to the purchaser with non-compete clause available in the agreement. Therefore, the High Court concluded that, the taxpayer was entitled to claim exclusion of consideration received from turnover and set aside the demand and penalty.

Eicher Motors Limited [TS-219-HC-2013(MAD)-VAT]

Computation of turnover for VAT levy

Value of free issue materials received from customer not includible in gross turnover for sales tax payment

The issue involved was whether the value of free issue materials supplied by the customer and used in the manufacture of railway sleepers would form part of the turnover for the purpose of calculating sales tax. The taxpayer manufactured mono block pre-stressed concrete sleepers for broad gauge as per the drawings and specifications issued by the South Central Railways. The customer had supplied fastenings, cast iron inserts and HTS wires free of cost to the taxpayer which were used by the taxpayer for manufacturing the concrete sleepers. The contention of the revenue was that the activity of manufacture and supply of concrete sleepers was a sale and not works contract. Hence, the taxpayer is liable to pay tax on the value of materials supplied by South Central Railways. The demand was also confirmed by the Tribunal.

On a revision petition, it was held that the sale price is the actual consideration received and sales tax can be levied only on sale price. The Andhra Pradesh High Court had observed that the cost price that is being paid to the taxpayer does not include the value of the free issue material and the taxpayer had not collected any sales tax and the railways had not paid any amount on the value representing the free issue material. Hence, value of free issue materials used in manufacture would not form the part of turnover of the manufacturer and would not be liable to sales tax.

V.S. Engineering (P) Ltd [TS-224-HC-2013(AP)-VAT]

Quantity discount provided in invoice towards past performance not deductible in computing taxable turnover

In the instant case, the issue involved was whether discount granted as incentive to dealers for past performance mentioned in sale invoice is deductible from the total turnover, to determine the taxable turnover.

The taxpayer had claimed scheme / quantity discounts offered to its distributors (as regular trade practice) as deduction from total turnover. The same was disallowed on the ground that such discount was not relatable to the sale affected by relevant tax invoices. The taxpayer solely argued on the point that the discount allowed was reflected in the tax invoice and was granted per regular practice and the consideration received by them was net after deduction of discount.

The Karnataka High Court observed that the taxpayer sought deduction of value representing quantity/scheme discount allowed in the tax invoices in view of distributors' performances during 3-6 months and not in respect of the goods sold by the said tax invoices, mentioning gross value. It defied

the condition of the relevant rule, which clearly required tax invoice to be in respect of sales relating to such discount. In view of the above, it was held that discounts in the invoices were not relatable to sales affected by those tax invoices and deduction in respect of the same shall not be allowed.

Maya Appliances Pvt. Ltd v. Commissioner of Commercial Taxes and Ors. [TS-112-HC-2014(KAR)-VAT]

Determination of sale

Airtime charges and license fees charged under contract for selling activated pager not part of sale price and not liable to sales tax

In the instant case, the issue before Bombay HC was whether airtime charges and license fees charged under a contract for selling activated pager would form part of sale price as per the Erstwhile Bombay Sales Tax Act.

The taxpayer, importer and reseller of hardware in general and radio pagers in particular, collected sales tax only on the value of hardware, viz. the pagers and no sales tax was collected on the amount of license fees or airtime charges. Revenue proceeded against the taxpayer on the ground that gross sales value should include license fees and airtime charges. On second appeal, the Mumbai Tribunal allowed taxpayer appeal and held that airtime charges and license fees would not form part of the sale price for the purpose of sales tax. Aggrieved thereby, Revenue filed the present appeal.

The Bombay High Court ('HC') observed that the airtime charges collected by way of annual fees and purchase of pager unit by subscriber was of no use unless there was corresponding paging service. It observed that the airtime charges were collected as part of the service. Therefore, HC held that the cost of hardware was separate from the cost of airtime and that of the cost of license fees. HC also held that the taxpayer had merely collected airtime charges and license fees in respect of airtime radio paging services which were activated after the pager was purchased and/or after its delivery of the pager. It observed that nothing was required to be done in respect of pager unit at the time of activation. In view of this, it was held that activation of pager was a service in respect of pager sold to the purchaser. It observed that sale of pager was a standalone transaction and activation of the pager was subsequent to the incidence of sale. Accordingly, airtime charges and license fees charged under the contract for selling activated pager did not form part of the sale price.

Commissioner of Sales Tax, Maharashtra v. Page Point Service (P) Ltd. [TS-438-HC-2014(BOM)-VAT]

Supply of explosives to contractor for use in mining operations constitutes as 'sale'

In the instant case, the issue was whether supply of explosives to contractor for use in mining operations constitutes as sale.

The taxpayer awarded various mining contracts to contractors wherein cement and steel were required to be used. Taxpayer was required to use explosives for extracting minerals from its mines and explosions were done on job work basis under strict control and supervision of explosive experts. As per the statutory condition of license obtained under Explosive Act, 1884, taxpayer could not re-sell the explosives purchased for its own use. In view of this, the taxpayer purchased the explosives against declaration on payment of concessional tax at 4 percent.

However, Revenue issued notices on the ground that supply of material such as cement, iron, steel and explosives to various contractors was 'sale'. The taxpayer replied that the ownership of goods had never been transferred to the contractor and therefore, such transaction does not amount to 'sale' to be liable

to sales tax. Aggrieved thereby the taxpayer preferred separate appeals before the Commissioner (Appeals). On dismissal of the appeals, the taxpayer approached the Rajasthan Tax Board, who confirmed the assessments. Consequently, the taxpayer filed revision petition before the Rajasthan High Court.

The HC held that the transaction in question is a sale on the ground that all ingredients of sale are present in the transaction. HC rejected taxpayer's contention that the said explosives have been consumed in the works contract and the transaction cannot be a sale. It observed that consumable items are only the items used ancillary in works contract and those can be water, electricity and fuel etc., as these items are not goods transferred to the contractor in execution of works contract and providing above or like items, the contractor is given some facilities by the Principal engaged in works contract. It also observed that in mining operation, explosive is an item like cement, iron etc. on which tax is leviable. Therefore, the explosives are not consumable items which can be equated with water, electricity or fuel. Accordingly, Revenue was justified in levying the tax. HC dismissed the petition filed by the assessee. Aggrieved by such order, appeals were filed before the SC, which dismissed the same and upheld the HC order.

Hindustan Zinc Ltd. v. Commercial Taxes Officer, Udaipur [TS-406-SC-2014-VAT]

Use of stents / valves during surgical procedures such as angioplasty, not 'sale' for VAT liability

In the instant case, the issue involved was whether VAT would be applicable on the medical stents used during angioplasty operation in a hospital.

The taxpayer at its hospital provided various medical services including medical surgery for implantation of stent / valve such as angioplasty to its patients. The Deputy Commissioner, Commercial Tax, treated the valves / stents used by the taxpayer during angioplasty as purchases made from unregistered dealers and imposed VAT at the rate 12.5 percent on its implant, on the ground that it constitutes as sale. Aggrieved by the same, the taxpayer filed a Writ petition before the Allahabad High Court.

The taxpayer contended that stents formed an integral part of the medical procedure involved in Angioplasty. As such it could not be separated from the rest of the contract. However, Revenue contended that contract between the patient and the hospital was a divisible contract and sale of stent /valve was distinguishable from surgical procedure. Consequently, the hospital was thereby liable to pay VAT at 12.5percent on the sale of stents through its use in the angioplasty procedure.

The Hon'ble High Court observed that six clauses in Article 366(29-A) envisaged that State had the powers to divide the contract into two separate contracts (involving sale of goods and supply of labour or service) and tax the sale element involving the sale of goods in contracts which fell within the description of one of the six clauses of the Article. Also, it specifically observed that in the case of BSNL, with respect to hospital services, it has been held that sub-clauses of Article 366(29-A) did not cover hospital services and Article 366 (29-A) had no application unless the transaction in truth represented two distinct and separate contracts and was perceivable. Further, the High Court observed that in BSNL's case, the Supreme Court laid down the 'dominant nature' test for deciding the substance of the contract.

Further, the High Court held that there was no intention between the hospital and the patient for sale of stent / valve but that the contract in substance was an agreement for treatment in the form of a medical procedure. It observed that implantation of stent / valve in the heart of a patient was an intrinsic and integral element of that procedure.

Based on above facts, the High Court allowed the petition and held that that mere recovery of charges towards drugs and other consumables by the hospital from the patient would not render the transaction of the implantation of a stent or valve a 'sale' for the purpose of VAT levy.

International Hospital Pvt Ltd. v. State Of U.P. and others [TS-49-HC-2014(ALL)]

Equipment provided on BOOT basis for use not "sale" hence VAT not applicable

In the instant case, the issue involved was whether the activities carried out for Government under Build, Own Operate and Transfer basis would be treated as a project involving only service or as project for sale of equipments under 'works contract'.

The taxpayer had entered into an agreement with Meghalaya Information Technology Society (MITS) for providing network services throughout Meghalaya state on Build, Own, Operate, Transfer (BOOT) basis which was to be implemented in 5years on payment of minimum guaranteed amount by the State Government. As per the agreement, the taxpayer was required to transfer the entire system with equipments to the State Government on nominal payment of Re. 1, at the end of 5 years. Subsequently, the taxpayer submitted an application for no deduction certificate before the Commissioner on the ground that no transfer of right to use goods was involved as personnel of taxpayer was still controlling the entire operation. But the application was rejected by the Commissioner. Hence, the taxpayer filed a writ before the High Court ('HC').

The Hon'ble HC observed that since under the BOOT basis, the taxpayer was not only in control and possession of equipment imported, but also was the owner of the same, neither sale / supply of material nor transfer of right to goods could be said to have taken place. Therefore, the above transaction does not fall within the ambit of 'tax on sale or purchase of goods' and taxpayer not liable to pay tax under Meghalaya VAT Act in respect of goods which assessee still owned and is in possession thereof.

Tata Consultancy Services Ltd. & Anr. v. State of Meghalaya & Ors. [TS-288-HC-2014(MEGH)-VAT]

Works Contract

Supply, erection, installation and commissioning of lifts/elevators constitute as "works contract" and not "contract for sale"

The issue involved in the present case was whether supply, erection, installation and commissioning of lifts/elevators constitute as "works contract" or "contract for sale".

The taxpayer is engaged in the manufacture, supply and installation of lifts involving civil construction. For the Assessment Year 1995-96, the Sales Tax Appellate Tribunal, Andhra Pradesh held that the supply, erection, installation and commissioning of lifts/elevators is in nature of works contract. On a revision filed, the High Court of Andhra Pradesh affirmed the view of the Tribunal. Aggrieved by the High Court decision, the State of Andhra Pradesh filed a special leave petition before the Supreme Court wherein it was held that the above transaction is a sale. Being aggrieved by the said order, the petitioner filed a writ petition before the Supreme Court (5 Judge Bench).

The 3 Judge Bench of Supreme Court had earlier held that the activity of supply and installation of lifts constitutes sale of goods. However, now by way of a majority view, the Constitution Bench (consisting of 5 members) has overruled the said judgment and held that composite contract for supply and installation of lifts has to be treated as a works contract and not as a sale of goods / chattel.

The observations of the Constitution Bench are as follows:

- The Constitution bench referred to the decision given in the case of Otis Elevators wherein it was held that the contract for the manufacture, supply, installation and commissioning of lifts were an indivisible contract for execution of the works contract and there was no sale of goods.
- Upon installation of the lift in the building, it becomes a permanent fixture in the premises and that the

involvement of technical skill and experience pertain to the precision in execution for rendering satisfactory service and the obligation to maintain which are integral to the supply and installation.

- The bench then referred to the earlier 3 Judge Bench decision, whereby the Constitution bench observed that once there is a composite contract for supply and installation, it has to be treated as it is not chattel sold as chattel.
- In the present case the contract itself speaks of obligation to supply goods and materials as well as installation of the lift. Hence, fundamental characteristics of works contract are satisfied.

Kone Elevators India Pvt Ltd v. State of Tamil Nadu and Others [TS-142-SC-2014-VAT]

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