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India Tax Konnect

Contents

Editorial

The International Monetory Fund reiterated that India would remain one of the fastest growing major economies in the world citing reasons such as policy reforms, increase in investments and lower commodity prices. India's Wholesale Price Index (WPI) fell for the eleventh straight month in September, and declined by 4.54 per cent from a year ago. A steep 17.71 per cent fall in fuel prices kept the WPI in the negative zone[1].

Showing signs of recovery, India's industrial output rose to nearly a three-year high to 6.4 per cent in August on account of an improvement in manufacturing and capital goods while retail inflation remained within the comfort zone. The manufacturing sector, which constitutes over 75 per cent of the industrial output index, grew by 6.9 per cent in August, while the capital goods output rose by 21.8 per cent in the month indicating a recovery[2].

On the international tax front, the Authority for Advance Rulings (AAR) in the case of Guangzhou Usha International Ltd. held that service fees received for providing services in connection with procurement of goods are taxable as Fees for Technical Services (FTS) under the India-China tax treaty. The AAR observed that the applicant has knowledge in the specialised field of evaluation of credit, organisation, finance and production facility of an organisation, market research, etc. The nature of these services in a specialised field would fall within the ambit of the term 'consultancy services'. The AAR observed that the expression 'provision of services' under the FTS Article in the India-China tax treaty is much wider in scope than the expression 'provision of rendering of services' used in the Pakistan-China tax treaty. Based on this distinction, it is observed that the expression 'provision of services' will cover the services even when these are not rendered in the source state as long as these services are used in the source state.

The Delhi Tribunal in the case of Cincom System Inc. held that the consideration received by a foreign company for providing access to its internet, email and networking facilities by which it provides a gateway that will facilitate call centers for incoming and outgoing calls from India to the USA and vice-versa is taxable as royalty under the Income-tax Act, 1961 (the Act) and under the India-USA tax treaty.

On the corporate tax front, the Supreme Court in the case of Victory Aqua Farm Ltd. held that ponds which are specially designed for rearing/breeding of prawns are treated as tools of the business of the taxpayer. Therefore, such ponds are plant which are eligible for depreciation under Section 32 of the Act.

We at KPMG in India would like to keep you informed of the developments on the tax and regulatory front and its implications on the way you do business in India. We would be delighted to receive your suggestions on ways to make this Konnect more relevant.

Source - 1. Economic times
2. www.dnaindia.com

International tax

Decisions

Services in connection with the procurement of goods are taxable as FTS under the India-China tax treaty

The applicant is a company registered under the Chinese laws. The share capital of the applicant is held by Usha International Limited (UIL), having its registered office in India. The applicant has been set-up to carry out the business of import and export and also to provide services relating to the business of household electrical appliances and equipments, household goods and accessories, etc. to the Indian company. The applicant had entered into a Memorandum of Understanding (MOU) with UIL for providing services in connection with the procurement of goods by UIL from vendors in China. Subsequently, the MOU was converted into a service agreement. As per the agreement, the applicant has to render services to UIL in the form of new supplier's development, new products development, market research, price, payment terms, safety/performance/endurance test, review of the quality system, inspection through SGS, interaction with vendors and information sharing with UIL. While making the payment of service fees to the applicant company, UIL had deducted tax at source at the rate of 10 per cent, considering the payment was in the nature of FTS under the tax treaty. The applicant filed an application before the AAR on the issue of whether service fees received for providing services in connection with procurement of goods are taxable in India.

The AAR referred to the India-China tax treaty and the China-Pakistan tax treaty and observed that it is necessary to point out the distinction between the two. In the India-China tax treaty, the expression used is 'provision of services of managerial, technical or consultancy nature' while in the China-Pakistan tax treaty the expression used is 'provision of rendering of any managerial, technical or consultancy services'. The AAR observed that the expression 'provision of services' is not defined anywhere in the tax treaty. It is concerned only with the India-China tax treaty. Any other tax treaty either between India and an other country or between China and an other country cannot influence the scope of the India-China tax treaty. This distinction clearly points out that the scope of 'provision of services' as in the India-China tax treaty is much wider than that of 'provision of rendering of services' as in the Pakistan-China tax treaty. Based on this distinction, the AAR in the case of Inspectorate (Shanghai) Limited [AAR No.1005 of 2010] held that 'provision of services' will cover the services even when these are not rendered in the other contracting state (i.e. India in this case) as long as these services are used in the other contracting state (i.e. India in this case).

On perusal of the list of services provided in the service agreement, it indicates that the applicant is not only identifying the products but also generating new ideas for UIL after conducting market research. It is also evaluating the credit, organisation, finance, production facility, etc. and based on advice in the form of a report to UIL. Such an evaluation can only be given by an expert in the specific area. The applicant is also providing information on new developments in China with regard to technology/product/process upgrade. These are specialised services requiring special skill, acumen and knowledge. These services are definitely in the nature of

consultancy services. Accordingly, it has been held that the amount of service fees received by the applicant from UIL for providing consultancy services is taxable in India.

Guangzhou Usha International Ltd. (AAR No 1508 of 2013) – Taxsutra.com

Consideration for providing access to internet, email and networking facilities which provides a gateway to call centres for incoming and outgoing calls is taxable as royalty under the Act and under the India-USA tax treaty

The taxpayer is a foreign company engaged in the business of providing software solutions including creating personalised documents, management of solutions, etc. The taxpayer entered into a 'Communication Agreement' with Cincom Systems (India) Pvt. Ltd. wherein it was agreed that the taxpayer shall provide access to Cincom Systems (India) Pvt. Ltd. to the internet and other email and networking facilities along with other group concern. As a consideration for providing these services, the taxpayer was paid a certain sum. For the Assessment Year (AY) 2002-03, the taxpayer company offered such an amount as Fees for Included Services (FIS). However, before the Commissioner of Income-tax (Appeal) [CIT(A)], the taxpayer contended that the amount was not taxable in India. The CIT(A) held that the payment was not in the nature of FIS, however, held that it was in the nature of royalty.

The Tribunal observed that the AAR in the case of Abc [1999] 238 ITR 296 (AAR) held that the definition of the expression 'royalty' under Section 9(1)(vi) of the Act read with clause (vi) of the Explanation includes rendering of any services in connection with any activities for the use of any patent, invention, secret formula or process, etc. In the instant case, the concept of 'source' against 'residence' becomes more significant as the issue relates to cyberspace activities. The transmission of information was through encryption as the data relates to clients and strict confidentiality was observed. It was for downloading of the software that the royalty is paid. In this context, the source rule becomes relevant which requires that royalty is sourced in the state of the payer. According to the agreement between the American and Indian company, the facilities were to be accessed only by the Indian company. The consideration payable was for the specific programme through which the Indian company was able to cater to the needs of the group companies located in Japan and other places. The transaction would be related to 'scientific work' and would partake the character of intellectual property and therefore, in the character of royalty. The software was customised and a secret. From the facilities provided by the American company to the Indian company, which were of the nature of online, analytical data processing, it would be clear that the payment was received as 'consideration for the use of, or the right to use design or model, plan, secret formula or process'. The use

of the CPU and the consolidated data network of the taxpayer by the Indian company was not merely 'use of or the right to use any industrial, commercial or scientific equipment' as envisaged in Article 12(3)(b) of the tax treaty but more than that.

It was the use of an embedded secret software (an encryption product) developed by the American comapny for the purpose of processing raw data transmitted by the Indian company, which would fall within the ambit of Article 12(3)(a) of the tax treaty. The reliance placed by the taxpayer on the decision of the Delhi High Court in the case of Asia Satellite Telecommunication Co. Ltd. vs DIT [2011] 332 ITR 340 (Del) is totally misplaced. Accordingly, the ratio of the ruling of the AAR in the case of Abc was applicable in the present case and the consideration paid was in the nature of royalty within the meaning of Article 12(3) of the tax treaty.

Cincom System Inc. vs DDIT [ITA No. 952/Del/2006, AY: 2002-03] (Del) – Taxsutra.com

Payments of ISO certification and audit services are not FTS under the Act or under the India-Germany tax treaty

The taxpayer is a German company having a branch in India. The Indian branch is engaged in the business of audit and procedure of norms for ISO 9000 certification wherein a quality system auditor of the taxpayer visits the company which wants an ISO 9000 certification. These auditors shall carry out a pre-assessment audit after which a certification audit is conducted. Consequently, a report is prepared which is checked and verified by the taxpayer in Germany.

During the year under consideration, the taxpayer received a payment towards ISO certification and audit services. The taxpayer was of the view that the ISO certification and audit services do not fall under Article 12 of the tax treaty. It was taxable as business income under Article 7(1) of the tax treaty since business was carried out through a Permanent Establishment (PE) in India. The Assessing Officer (AO) held that the services rendered by the taxpayer were FTS under the tax treaty and therefore taxable as per Article 12 of the tax treaty. The CIT(A) upheld the order of the AO. The Mumbai Tribunal held that in an audit work there may be some incidence of advice given at the time of evaluation but it cannot be termed as a pure consultancy service since in the audit work, the auditor has to only evaluate the quality as well as environmental system. Accordingly, such services were not in the nature of in the nature of FTS.

The High Court upheld the order of the Tribunal and held that there is a finding which is rendered after examination of the taxpayer's records. Having analysed all this, the Tribunal concluded that the taxpayer's services are not of the nature that fall within the statutory provision. Therefore, the Tribunal's order cannot be termed as perverse or vitiated by any error of law apparent on the face of the record. Accordingly, such fees were not FTS falling within the provisions of Section 9(1)(vii) of the Act and Article 12 of the tax treaty.

DIT vs TUV Bayren (India) Ltd. (ITA No. 1304 of 2013) – Taxsutra.com

Corporate tax

Decisions

Ponds specially designed for breeding of prawns are treated as a plant which is eligible for depreciation under the Act

The taxpayer, a company engaged in the business of aqua culture, grows prawns in specially designed ponds. In the return of income, the taxpayer had claimed depreciation in respect of these ponds by raising a plea that these prawn ponds are tools for the business of the taxpayer and, therefore, they constitute as a 'plant' within the meaning of Section 32 of the Act. However, the AO disallowed the claim of the taxpayer. Earlier, the Division Bench of the Kerala High Court in the taxpayer's own case held that it is not a 'plant'. However, another Division Bench did not agree with the earlier decision and rendered a contrary decision. In the present case, the Supreme Court observed that the Division Bench of the High Court of Kerala which had given the latter decision should have referred the matter to a larger Bench, as otherwise it was bound by the earlier decision of the Co-ordinate Bench.

Appeals were filed against both the decisions and the validity of the decision rendered in the first case was also questioned by the taxpayer. The question before the Supreme Court was whether a 'natural pond', which as per the taxpayer is specially designed for rearing of prawns, would be treated as a 'plant' within Section 32 of the Act for the purposes of allowing depreciation thereon.

If ponds are 'plants', then they are eligible for depreciation at the rates applicable to plant and machinery and the case would be covered under the provisions of Section 32 of the Act. The decision of the Supreme Court in the case of CIT vs Karnataka Power Corporation [2002(9) SCC 571] decided this issue wherein the Court had taken into consideration the earlier judgments and suitably dealt with them. The tax department had contended that the pond in question was natural and not constructed/specially designed by the taxpayer. The Supreme Court did not agree with the same. The Kerala High Court's decision which was in favour of the taxpayer had specifically mentioned that the prawns are grown in specially designed ponds, which are not natural ponds. The court's decision rightly rests this case on a 'functional test' and since the ponds were specially designed for rearing/breeding of the prawns, they have to be treated as tools of the business of the taxpayer and depreciation was admissible on these ponds.

ACIT vs Victory Aqua Farm Ltd. [2015] 61 taxmann.com 166 (SC)

Service tax collected shall not be included in the gross receipt while computing presumptive income under Section 44BB of the Act

The taxpayer is a company engaged in the business of providing equipment on hire and manpower, etc. for exploration and production of mineral oil and natural gas. The taxpayer filed its income tax return for the relevant year, declaring its income as per the provisions of Section 44BB(3) of the Act. In computing the gross receipts, the taxpayer did not include service tax received from its customers. However, the AO included service tax in the gross receipts for computing the taxable income under Section 44BB of the Act.

The High Court observed that Section 44BB of the Act begins with a non obstante clause that excludes the application of Sections 28 to 41 and Sections 43 and 43A to assessments under it. It states that 10 per cent credit of the amounts paid or payable or deemed to be received by the taxpayer on account of 'the provision of services and facilities in connection with, or supply of plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils in India' shall be deemed to be the profits and gains that are chargeable to tax. The purpose of this provision is to tax what can be legitimately considered as income of the taxpayer earned from its business and profession. The expression 'amount paid or payable' in Section 44BB(2)(a) of the Act and the expression 'amount received or deemed to be received' in Section 44BB(2)(b) is qualified by the words 'on account of the provision of services and facilities in connection with, or supply of plant and machinery.' Therefore, only such amounts which are paid or payable for the services provided by the taxpayer can form part of the gross receipts for the purposes of computation of gross income under Section 44BB(1) read with Section 44BB(2) of the Act. Based on the decision of the Supreme Court in the case of CIT vs Lakshmi Machine Works [2007] 290 ITR 667 (SC), the present appeal is decided in favour of the taxpayer. The service tax collected by the taxpayer does not have any element of income and therefore cannot form a part of the gross receipts for the purposes of computing 'presumptive income' of the taxpayer under Section 44BB of the Act.

In this case, the High Court concurs with the decision of the Uttarakhand High Court in the case of DIT vs Schlumberger Asia Services Ltd. [2009] 317 ITR 156 (Utt). Service tax is not an amount paid or payable, or received or deemed to be received by the taxpayer for the services rendered by it. The taxpayer is only collecting the service tax for passing it on to the government. This position has been made explicit by the CBDT through two of its circulars. In Circular No. 4/20086, it was clarified that service tax paid by the tenant does not partake the nature of 'income' of the landlord. The landlord only acts as a collecting agent of the government for the collection of service tax. Therefore, Tax Deduction at Source (TDS) under Section 194-I of the Act would be required to be made on the amount of rent paid/payable, without including the service tax. In Circular No. 1/20147, it has been clarified that service tax is not to be included in the fees for professional or technical services and no TDS is required to be made on the service tax component under Section 194J of the Act. Accordingly, the amount of service tax collected by the taxpayer from its various clients shall not be included in the gross receipts while computing its income under the provisions of Section 44BB of the Act.

DIT vs Mitchell Drilling International Pvt Ltd [ITA 403/2013] (Del) – Taxsutra.com

Section 14A of the Act does not come into operation automatically. The AO must record that he/she is not satisfied with the correctness of the claim of the taxpayer

The taxpayer is engaged in the business of providing legal and other support services to law firms. These services are specifically related to search of trademark, patent and design out of the unique database created and owned by the taxpayer. During the year under consideration, the taxpayer had earned dividend income. The taxpayer claimed that since no expenses have been incurred for earning of such dividend income, Section 14A disallowance was not applicable.

The AO observed that the invocation of Section 14A is automatic and comes into operation, without any exception, as soon as the dividend income is claimed as exempt. The AO disallowed the payment under Section 14A read with Rule 8D of Income-tax Rules, 1962 (the Rules) and added the said amount to the total income of the taxpayer. The CIT(A) held that the taxpayer had sufficient funds and no interest expenditure was incurred which generated exempt income. Therefore, payment could not be disallowed under Section 14A of the Act.

High Court's ruling

The Delhi High Court observed that the AO has proceeded with the erroneous premise that the invocation of Section 14A of the Act is automatic and comes into operation as soon as the dividend income is claimed exempt. In Maxopp Investment (P) Ltd. vs CIT [2012] 347 ITR 272 (Del) the High Court held that:

- The requirement of the AO embarking upon a determination of the amount of expenditure incurred in relation to exempt income would be triggered only if the AO is not satisfied with the correctness of the claim of the taxpayer in respect of such expenditure. Therefore, the AO must accordingly record that he/she is not satisfied with the correctness of the claim of the taxpayer.
- It is only if the AO is not satisfied with the correctness of the claim of the taxpayer, that the AO gets jurisdiction to determine the amount of expenditure incurred in relation to such income, which does not form part of the total income under the said Act in accordance with the prescribed method.
- While rejecting the claim of the taxpayer with regard to the expenditure or no expenditure, as the case may be, in relation to exempt income, the AO would have to indicate cogent reasons for the same.

In the case of CIT vs Taikisha Engineering India Ltd. [2015] 370 ITR 338 (Del), the High Court disapproved of an AO's finding invoking Section 14A read with Rule 8D(2) of the Rules without recording his satisfaction and noted that the recording of satisfaction as to why 'the voluntary disallowance made by the taxpayer was unreasonable and unsatisfactory' is a mandatory requirement of the law. Accordingly, the disallowance under Section 14A of the Act cannot be made.

CIT vs I. P. Support Services India Ltd. (ITA No. 283/2014) – Taxsutra.com

Lease rentals capitalised in the books of account is as an allowable expenditure under Section 37 of the Act

The taxpayer is a public limited company engaged in the business of manufacturing automobile lock sets. During the year under consideration the taxpayer acquired vehicles on finance lease. In terms of Accounting Standard 19 (AS 19) issued by the Institute of Chartered Accountants of India (ICAI), the assets acquired under financial lease were capitalised in the books of accounts and a consequent liability thereon was also created. However, under the Act lease rentals paid by the taxpayer was claimed as deduction under Section 37 of the Act. The AO disallowed the aforesaid claim of deduction on the ground that since the payments made by the taxpayer was in the nature of a 'finance lease', the same was required to be capitalised and not allowable as deduction under Section 37 of the Act. Further, depreciation was also not allowed on the purported cost of the fixed asset. The CIT(A) confirmed the disallowance under Section 37 of the Act.

The Tribunal held that AS19 i.e. accounting for leases issued by the ICAI is only applicable for accounting lease transaction in the books. The treatment in the books of accounts is not the determining factor of the liability towards income-tax for the purpose of the Act. For this proposition, the Tribunal relied on the decision of the Supreme Court in the case of Sutlej Cotton Mills Ltd. vs CIT [1979] 116 ITR 1 (SC), Kedarnath Jute Mfg. Co. Ltd. vs CIT [1971] 82 ITR 363 (SC). The Tribunal observed that, AS19 classifies lease transactions for accounting purposes as finance lease and operating lease. Finance lease, in AS19, is described as a lease that transfers substantially all the risks and rewards in respect of ownership of an asset; title may or may not be transferred under such lease. However, an operating lease is described as a lease other than a finance lease. AS19 provides that under the finance lease, the lessee should recognise the asset in its books and should charge depreciation on the same. In the case of operating lease, AS19 provides that the lessee should recognise lease payments as an expense in the profit and loss account and the lessor should recognise the asset given on lease and charge depreciation in respect of the same. The aforesaid distinction between finance lease and operating lease is not recognised under the Act.

Under the provisions of the Act, depreciation is admissible under Section 32 of the Act only to the 'owner' of the asset. Lease charges paid for the use of the asset, without acquiring any ownership rights in the same, are allowable as revenue expenditure under Section 37 of the Act. The Circular No.2 of 2001 dated 9 February 2001 issued by the CBDT provides that AS19 issued by the ICAI , which creates a distinction between finance lease and operating lease will have no implications under the provisions of the Act. Thus, the CBDT's view on the treatment of finance lease is not aligned to an accountant's perspective. For accounting purposes, although the lessee shows the asset in his balance sheet, charges depreciation in books of accounts and even makes an impairment provision, yet the taxpayer is not eligible to claim depreciation under the Act, which is allowed to the legal owner of the asset. Not only is the interest/finance/other charges component in the lease payments, but the entire lease payments are treated as a deductible expense and no deduction is allowed for the impairment provision. In the hands of the lessor, the entire 'lease rentals' and not merely the finance charges component thereof is taxed as income. The lessor, who is the legal owner

of the asset, is entitled to claim depreciation under the provisions of the Act. The aforesaid legal position finds support from the decision of the Supreme Court in the case of ICDS Ltd. [2013] CIT 350 ITR 527 (SC).

The Rajasthan High Court in the case of Rajshree Roadways vs UOI [2003] 129 Taxman 663 (Raj) upheld the taxpayer's claim of allowability of lease rentals paid as a lessee of the trucks as a revenue expenditure under Section 37(1) of the Act, even though the lease was categorised as finance lease. Relying on the decision of CIT vs Banswara Synthetic Ltd. [2013] 216 Taxman 113 (Raj), Banashankari Medical & Oncology Research Centre Ltd [2009] 316 ITR 407 (Kar), CIT vs Tata Robins Fraser Ltd [2012] 253 CTR 227 (Jhar), it has been held that a disallowance on account of lease rentals is not justified.

Minda Corporation Limited vs DCIT (ITA No. 1962/Del./2012) – Taxsutra.com

Notifications/Circulars/Press Releases

The CBDT has introduced a new procedure for filing for self declaration in the case of nil withholding of tax

The CBDT issued a Notification No. 76/2015, wherein it substituted the Rules with respect to a declaration to be furnished by specified persons in Form 15G or 15H while claiming the receipt of certain incomes without deduction of tax at source.

In order to overcome the discrepancies faced by the earlier procedure for filing of a declaration, the CBDT introduced a new procedure for filing a nil withholding tax declaration with effect from 1 October 2015 which is follows:

- The declaration may be furnished in a paper form or electronically after duly verifying through an electronic process in accordance with the prescribed procedures, formats and standards.
- The payer shall be allotted a unique identification number to each declaration received by him in 15G and Form No. 15H respectively during every quarter of the financial year in accordance with the procedures, formats and standards specified by the Principal Director-General of Income Tax (Systems).
- The payer shall furnish the particulars of the declaration received by him during any quarter of the financial year along with the unique identification number allotted to him in the statement of deduction of tax of the said quarter in the case of the amount paid/credited on which tax was not deducted.
- The payer shall furnish the statement of deduction of tax containing the particulars of the declaration received to him/her during each quarter of the financial year along with the unique identification number allotted to him/her, irrespective of the fact that no tax has been deducted in the said quarter.
- The Income Tax authority may, before the end of seven years from the end of the financial year in which the declaration has been received, require the payer to furnish or make available the declaration for the purposes of verification or any other proceeding under the Act.
- The Principal Director General of Income-tax (Systems) shall specify the procedures, formats and standards for the purpose of furnishing and verifying the declaration, allotment of a unique identification number and furnishing or making available the declaration to the Income Tax authority and shall be responsible for the day-to-day administration in relation to the furnishing of the particulars of the declaration.
- The new Rule has also amended Form No. 15G and 15H with respect to furnishing of a nil declaration.

CBDT Notification No. 76/2015/F.No. 133/50/2015-TPL, dated 29 September 2015

CBDT ordered to use email based communication for paperless assessment proceedings

The Central Board of Direct Taxes (CBDT) issued an order wherein it introduced email based communication for paperless assessment proceedings which can enhance the efficiency and usher in a paperless environment. The tax officer may use email as a mode of communication for sending the questionnaires, notice, etc. at the time of scrutiny proceedings and getting responses using the same medium on a pilot basis. This could eliminate the necessity of taxpayers visiting the income tax offices, particularly in smaller cases, involving limited issues and where the taxpayer is able to provide details required by the AO without necessitating his/her physical presence.

The CBDT has taken steps to set-up a standardised platform for making such email based communications between the taxpayer and the income tax department seamless and user friendly. It has decided to launch a pilot project in this regard in five non-corporate charges at Delhi, Mumbai, Bengaluru, Ahmedabad and Chennai stations. Initially, 100 cases for e-hearing could be identified in each of these charges and major part of the assessment processing could be conducted in an electronic mode. Also, the cases covered under the aforesaid pilot project should be those which have been selected for scrutiny on the basis of Annual Information Return/Central Information Branch information or non-matching with 26AS-data. A consent from the taxpayers should also be obtained in the beginning and cases of only willing taxpayers should be considered under the pilot project. The department officers, through their official emails, can interact with the taxpayers through emails as mentioned in the respective returns of income.

CBDT Order [F. No. 225/267/2015-ITA-II], dated 19 October 2015

Transfer pricing

The AO erred in adding back a transfer pricing adjustment to book profits under Section 115JB of the Act

The taxpayer rendered software development and business support services to its Associated Enterprise (AE) on a cost plus basis. The Arm's Length Price (ALP) of the said transaction was determined by considering the Transactional Net Margin Method (TNMM). The Transfer Pricing Officer (TPO), rejecting the Transfer Pricing (TP) study, carried out a fresh benchmarking analysis and made an adjustment. The Dispute Resolution Panel (DRP) upheld the adjustment made by the TPO, subject to: a) exclusion of the two comparables, b) granting a working capital adjustment as per the OECD Methodology c) furnishing the annual report of Wipro Technology Services Ltd. to the taxpayer and d) recomputing the operating margin of the taxpayer as well as comparable companies as per the guidelines provided by the Safe Harbor Notification dated 18 September 2013. The AO determined the total income under Minimum Alternate Tax (MAT) provisions after including the TP addition.

Tribunal ruling

Dispute on comparables: The Tribunal directed to exclude Persistent Systems Limited and Wipro Technology Services from the comparables set. For Zylog Systems Limited (Zylog), the Tribunal set-aside the issue back to the file of the TPO for reconsideration, subject to the availability of the audited segment data of Zylog's software development services segment and it qualifying all the filters applied by the TPO.

Nature of foreign exchange gain/loss (operating or not) : Relying on the decisions in the case of Westfalia Separator India Pvt. Ltd. vs ACIT (ITA No. 4446/D/02) and Fiserv India Pvt. Ltd. vs DCIT (ITA No. 6737/Del/2014), the Tribunal directed the AO/TPO to treat foreign exchange gain/loss as an operating item.

Addition of TP adjustment by the AO, to the income assessed under Section 115JB (MAT): The Tribunal, stated that except for adjustments provided in Explanation 1 to Section 115JB(2) of the Act, no other adjustment can be made to book profits under Section 115JB and held that the TP adjustment could not have been added back to the book profits under Section 115JB of the Act. The case law relied upon by the Revenue was that of Rain Commodities vs DCIT (2010) 40 SOT 265 (Hyd) is not applicable in the present case as the Special Bench, following the decision the Apex Court in Apollo Tyres vs DCIT [2010] 40 SOT 265 (Hyd) and HCL Comnet (2008) 305 ITR 409 (SC), held that the AO cannot travel beyond the net profits declared by the taxpayer unless (a) it is discovered that the profit and loss account is not drawn in accordance with Part II and Part III of Schedule VI of the Companies Act or (b) incorrect accounting policies and accounting standards have been adopted for preparing such accounts and the method/rate of depreciation has been adopted incorrectly. In the present case, there is no such allegation or any such finding by the AO in the assessment order. The Tribunal directed the AO to exclude the TP adjustment from the book profits computed under Section 115JB of the Act.

Cash Edge India Private Limited vs ITO (ITA No. 102/2015)

The TPO is not an expert on valuation and is bound to refer to the valuation report of the Departmental Valuation Officer as per the procedure laid down in the statute

During the assessment proceedings for AY 2006-07, the TPO observed that the taxpayer has incurred certain expenditure towards the purchase of fixed assets (including two second hand machineries). The taxpayer submitted a report from the approved valuer in the U.S. to justify the ALP of these two machineries. The TPO was of the view that the valuer has not provided the basis for arriving at the valuation and proceeded to make an adjustment to the extent of 50 per cent of the value of the second hand machinery. Further, the taxpayer paid certain amounts on account of a cost sharing arrangement wherein the AE was reimbursed the actual cost incurred. The TPO determined the ALP of the transaction at nil, stating that the information submitted by the taxpayer is incomplete. The DRP upheld the aforesaid disallowances.

Tribunal ruling

Purchase of second hand machineries

- The TPO was duty bound to refer the valuation of the machineries to the Departmental Valuation Officer (DVO) as per the procedure laid down under the statutory provisions, before rejecting the valuation report from the approved valuer indicating the fair market value of machineries purchased. The TPO not being an expert in determining the value of machineries, could not have quantified the value of the machineries at 50 per cent of the value shown by the taxpayer in the absence of any enquiry made by him to ascertain the fair market value of such machineries.
- The TPO is bound to determine the ALP by applying any of the methods prescribed under Section 92C of the Act. However, the TPO has determined the ALP on an adhoc basis.
- The TPO failed to refer the valuation to the DVO and proceeded to quantify the value of the machineries at 50 per cent, in violation of the statutory provisions of the Act. Therefore, the matter could not be restored back to the TPO. The Tribunal deleted the adjustment on account of disallowance of 50 per cent of the purchase value of second hand machineries.

Cost sharing arrangement

- The TPO failed to demonstrate what information was required from the taxpayer to establish that the payments made were for availing of services from the AE. The determination of ALP at nil without applying the method prescribed under the statutory provisions is legally unsustainable.
- The Tribunal observed that the TPO in the AY 2007-08, disallowed 20 per cent of the total cost incurred by the taxpayer towards such services which demonstrated that the TPO had accepted that the AE has provided certain services to the taxpayer and that the taxpayer has availed such services in the subsequent year. Thus, the Tribunal deleted the adjustment.

Koch Chemical Technology Group (India) Limited vs ACIT (ITA No. 7236/Mum/2010 - AY 2006-07) & ACIT vs Koch Chemical Technology Group (India) Limited (ITA No. 8091/Mum/2011 - AY 2007-08)

Indirect tax

Service tax - Decisions

Buying and selling of lottery tickets does not fall within the meaning of 'service' and is not subject to service tax

In the instant case, the constitutional validity of levy of service tax on the activity of buying and selling of lottery tickets was challenged. The Sikkim High Court struck down the constitutional validity of the said amending provisions on the basis of the following:

- The activity of buying and selling of lottery tickets does not fall within the meaning of 'service' which is explained as 'any activity carried out…by a lottery distributor or selling agent in relation to promotion, marketing, organising, selling of lottery or facilitating in organising lottery of any kind…'.
- The service tax payment mechanism provided for lottery distributors/selling agents under the service tax law, is under a subordinate piece of legislation (i.e. the service tax rules) which only provide an optional composite scheme for the payment of tax and does not create a charge of service tax.
- Lotteries fall within the meaning of 'betting and gambling' as provided in the State List of the Constitution of India and therefore by virtue of the entry 'taxes on betting and gambling' in the State List, taxing power lies in the exclusive domain of the State Legislature.

M/s Future Gaming & Hotel Services (Private) Limited and Another vs Union of India [2015-VIL-449-SIK-ST]

Circulars/Notifications/Press Releases

Services provided by Indian banks/agents in relation to remittance of foreign currency from outside India is not liable to service tax for the specified period

The central government notified that for the period from 1 July 2012 to 13 October 2014, service tax is not payable on services provided by Indian banks and agents to Money Transfer Service Operators (MTSO) in relation to remittance of foreign currency from outside India into India.

Notification No. 19/2015-ST dated 14 October 2015

Ancillary services such as loading, packing, unpacking etc. provided by Goods Transport Agencies (GTA) in the course of transportation of goods are a part of GTA services and are eligible for abatement of 70 per cent

The Central Board of Excise and Customs (CBEC) clarified that ancillary services such as loading, unloading, packing, unpacking, transshipment, etc. (when provided in the course of transportation of goods) provided by GTAs would form part of the GTA services and the charges for such services would be included in the invoice issued by the GTA. Further, it has been clarified that such ancillary services would also be eligible to an abatement of 70 per cent as applicable to GTA services.

Circular No. 186/5/2015 – ST dated 5 October 2015

Central excise - Decisions

Whether printing amounts to 'manufacture' and attracts excise duty

In the instant case, the issue was whether printed GI paper is classifiable under Chapter 4811.90, as claimed by the Revenue or Chapter 4901.90 as classified by the taxpayer. The other issue was whether printing on duty paid GI paper amounts to manufacture.
The Tribunal decided the first issue in favour of the Revenue, which was not challenged by the taxpayer and therefore, the issue of classification attained finality. However, with regard to the other question, the Tribunal held that the process of printing on GI paper does not amount to manufacture. Aggrieved by such a conclusion, the Revenue appealed before the Supreme Court.

The Apex Court observed that the paper in-question was meant for wrapping and the end use remained the same even after printing. However, a blank paper can be used as a wrapper for any kind of product; after the printing of logo and name of the specific product, the end use was now confined only to that specific product. The printing, therefore, is not merely a value addition but has now been transformed from a general wrapping paper to a special wrapping paper. Therefore, the Supreme Court mentioned that the process of printing has resulted into a product i.e., paper with distinct character and use of its own, which it did not bear earlier. Thus, it is covered within the definition of the term 'manufacture' and is subject to excise duty.

CCE vs Fitrite Packers (2015-TIOL-235-SC-CX)

Transit insurance is not to be included in assessable value

In the present case, the issue was whether by virtue of a transit insurance policy in the name of the manufacturer, excise duty is liable to be recovered on freight charges incurred for transportation of goods from the factory gate to the buyer's premises, treating the buyer's premises as the place of removal.

Intelligence revealed that the taxpayer was indulging in the evasion of central excise duty by mis-declaration that their factory gate was the place of removal, and not the buyer's premises, consequent to which freight charges recovered from their buyers was sought to be added in transaction value to determine the amount of excise duty payable. Show Cause Notices (SCN's) were issued stating that the property in the goods manufactured remained with the respondent while the goods were in transit, as the respondent had taken an insurance policy to cover the risk of loss or damage to the goods. The purchase orders as well as agreements with the transporters did not suggest that the transporters were taking delivery on behalf of the buyers. It was thus stated that the buyer's place should be treated as the place of removal and the freight charges paid by the buyers ought to be included in the excise duty payable by the taxpayer.

Considering the submissions, the Apex Court dismissed the appeal filed by the Revenue, observing that the prices were 'ex-works'. The goods were cleared from the factory on the payment of sales tax, thereby indicating that the goods are sold at the factory gate. The invoices were prepared at the factory in the name of the customer, in which, the name of the insurance company as well as

the details of the transit insurance policy were mentioned. When the goods were handed over to the transporter, the manufacturer had no right to the disposal of the goods nor did it reserve such rights inasmuch as title had already passed to its customer.

CCE vs Ispat Industries Ltd (2015-TIOL-238-SC-CX)

Notifications/Circulars/Press Releases

A notification issued notifying conditions, safeguards and procedures for clearance from an EOU to DTA

The CBEC notified the conditions, safeguards and procedures for the supply of tags, labels, printed bags, stickers, belts, buttons and hangers produced or manufactured in an Export Oriented Undertaking (EOU) and cleared without payment of duty to a Domestic Tariff Area (DTA) unit in terms of Para 6.09 (g) of the Foreign Trade Policy, 2015-20, for the purposes of their exportation out of India.

Notification No 20/2015 – Central Excise (N.T.) dated 24 September 2015

Clarification regarding a binding nature of 'Circular and Instructions'

It has been clarified that the circulars contrary to the judgements of the Supreme Court become non-est in law and should not be followed. A reference of such circulars should be made to the CBEC, so that action of rescinding the circulars can be expeditiously taken up. The CBEC may also initiate the action suo-moto. All pending cases on the issue, including those in the Call Book, decided after the date of the judgement should conform to the law laid down by the Supreme Court or High Court, as the case may be, irrespective of whether the circular has been rescinded or not.

The above direction would also apply to the judgements of the High Court, where the CBEC decided that no appeal would be filed on merit. However, where the appeal has been filed by Revenue against the High Court's order, pending adjudication, should be transferred to the Call Book and such appeals should be kept alive.

Circular No. 1006/13/2015-CX dated 21 September 2015

Foreign Trade Policy – Public notice

Declaration of intent under the MEIS Scheme

The Directorate General of Foreign Trade (DGFT) clarified that for exports made between 1 April 2015 to 31 May 2015, where the declaration of intent of claiming the MEIS benefit has not been marked inadvertently in the 'reward item box' while filing the shipping bill in the customs for exports, such exporters can avail of the MEIS benefit for such exports. The exporters who are wishing to seek the MEIS benefit shall submit physical copies of their free shipping bills after an electronic filing of application to the RA at the time of submission of application for MEIS rewards in such cases. The RA shall grant MEIS rewards after examination of such shipping bills in accordance with other provisions of FTP/HBP. From 1 June 2015, only those shipping bills, which are transmitted by the Custom Authorities to the DGFT, shall be considered under MEIS.

Public Notice 40/2015-20 dated 9 October 2015

Customs - Decisions

Refund of additional duty of customs under Notification 102/2007

The taxpayer made an application for SAD refund with the Assistant Commissioner of Customs (Refunds) who rejected the same on the ground that the claim was not filed with proper jurisdictional officer. Aggrieved by the same, the taxpayer filed an appeal in the High Court.

The taxpayer submits that both the authorities i.e. the Assistant Commissioner of Customs House and the Air Cargo Complex have concurrent jurisdiction over the ports as well as the airport under Notification15/2012-Cus (NT). The said facts could have been established, if an opportunity was granted. Further, the taxpayer mentioned that if the Assistant Commissioner of Customs (Refunds) has no jurisdiction to entertain the refund claim, he ought to have pointed out the same to the taxpayer by issuing a deficiency memo, which was not done.

On considering the submissions made, the High Court held that the impugned order passed by the adjudicating authority is liable to be set aside. The respondent is directed to send the original refund application submitted to the Assistant Commissioner of Customs (Airport and Air Cargo). The taxpayer is also permitted to submit a copy of the refund application with the copy of the order; within a period of two weeks from the date of receipt of a copy of the order; and on receipt of the same, the Assistant Commissioner shall consider the same and pass appropriate orders, on merits and in accordance with law, within a period of four weeks thereafter.

DS Denmed P Ltd vs CC & ACC (Refunds) (2015-TIOL-2343-HC-MAD-CUS)

VAT - Decisions

Input credit on purchase of DEPB scrips allowed; HC draws an analogy with CENVAT scheme

In the present case, the issue before the Delhi High Court was whether the input tax credit on the purchase of Duty Entitlement Pass Book (DEPB) scrips was eligible to the dealers.

The taxpayer is engaged in the business of import and sale of goods. They had purchased DEPB scrips from registered dealers on payment of VAT under the Delhi Value Added Tax Act, 2004 in the course of their regular business activity. The DEPB scrips were utilised for the payment of customs duty on the imports made by them which were subsequently sold in the local market after charging output VAT. The taxpayer adjusted the input tax paid by them on the purchase of the DEPB scrips against the output tax liability and the balance tax was deposited by them. However, the Revenue disputed that the input tax credit in respect of VAT paid on purchase of DEPB scrips. The taxpayer filed an appeal before the VAT Tribunal which dismissed the objections of the taxpayer. Aggrieved by the same, the taxpayer filed an appeal before the Delhi High Court.

The High Court observed that that the price of the goods imported has an element of customs duty paid on such goods. The component of customs duty is reduced to the extent of the usage of the DEPB scrips. Further, the reduced customs duty is embedded in the resale price of the imported goods. Thus, the use of the DEPB scrips is for the purpose of the taxpayer selling the imported goods. 'Usage' in this context has to be seen as a use that affects the price of the goods although it may not be used tangibly in the goods themselves. The High Court also drew an analogy with the CENVAT/MODVAT credit scheme, the purpose of which, like VAT, was to mitigate the cascading effect of taxes at various stages of trade. The High Court also clarified that there are a number of intangibles which have an impact on the value of final products in respect of which input tax credit may be availed; which goes on to show that such input tax paid goods contribute to the sale of the final product, either directly or indirectly.

The High Court also rejected the contention of the Revenue that credit cannot be availed unless the taxpayers themselves are dealing in DEPB scrips, as such an interpretation would defeat the purpose of introducing the system of value added taxes to reduce the cascading effect of multiple taxes and at various stages. As long as it can be shown that the use of DEPB scrips had impacted the cost of the products sold, the input tax credit on purchase of DEPB scrips shall be made available to the taxpayer. Given the above, the HC allowed the appeals.

Jagriti Plastics Ltd. & Another vs Commissioner of Trade & Taxes [TS-539-HC-2015(DEL)-VAT

Smart cards supplied to the RTO under a computerised system service agreement are not liable to VAT

The taxpayer entered into an agreement with The transport Department of Karnataka for supply, installation and maintenance of computer systems, supply and printing of smart cards, provision of data entry services and incidental activities at respective transport offices throughout State of Karnataka. Further, the said agreement provides that the entire project, including the smart cards, obtained by the appellant were always the property of the transport department. According to the appellant, the entire project was a service contract and the provision of smart cards was only incidental to the contract.

The Commercial Tax Officer (CTO), Bengaluru issued a SCN proposing to levy tax, penalty and interest in respect of the smart cards sold for the periods commencing from June to October 2009.

In this regard, the taxpayer contended that the smart cards prepared by it are a property of the transport department. The transport department has paid the consideration towards the services rendered by them which included the incidental consumption of materials such as smart cards. However, the assessing authority passed an order stating that the taxpayer supplied the goods to the transport department and therefore is a sale of goods. Aggrieved by the said order, the taxpayer filed an appeal before the Joint Commissioner of Commercial Taxes, wherein it is held that the taxpayer is not liable to pay VAT on the said transaction. The revisional authority without appreciating the contentions of the taxpayer set-aside the order of the Appellate Authority and restored the order passed by the assessing authority. Aggrieved, the taxpayer filed an appeal before the Karnataka High Court.

The Revenue contended that under the agreement the taxpayer had to sell the smart cards with the requisite information. The information embedded in the smart card is in the nature of intellectual property which is intangible but the state has the power to levy VAT on the sale of such goods. Further, if the transaction is not considered as a sale of goods, then it falls within the ambit of a 'works contract' and thus attracts VAT.

The High Court observed that the essential test to be satisfied before an article is said to be 'goods' is the test of marketability. The smart cards have no utility or value to any other person than the department who paid for the appellant's services and hence it is not a commodity saleable in the open market. Further, unless the transaction represents two distinct and separate contracts and is apparent as such, the state does not have the power to separate the agreement to sell from the agreement to render services and impose tax on the sale. Given the above, the High Court held that the smart cards specifically developed and designed for the RTO for providing computerised service delivery system are not liable to VAT.

Zylog Systems Pvt. Ltd. vs Addl. Commissioner of Commercial Taxes (TS-549-HC-2015(KAR)-VAT)

Notifications/Circulars/Press Release

Maharashtra

With effect from 1 October 2015, a refund under the Maharashtra Value Added Tax Act, 2002 shall be credited to the registered dealer's bank account by way of the National Electronic Funds Transfer (NEFT) of the Reserve Bank of India. Further, the department of sales tax has also provided certain instructions/guidelines for the eligible dealers to comply with the NEFT system.

Notification No. VAT. 1515/ C.R. 100/Taxation-1 Dated 18 September 2015 and Trade Circular no. 14T of 2015 dated 30 September 2015

Goa

The due date of filing returns for the quarter ending 30 September 2015 for dealers registered under the Goa Value Added Tax, 2005, other than those who have opted for the composition of tax, has been extended to 29 November 2015 from 30 October 2015.

Order No. CCT/12-2/11-12/2903 dated 7 October 2015

Himachal Pradesh

With effect from 1 October 2015 all registered dealers under the Himachal Pradesh Value Added Tax Act, 2005, except dealers paying a lumpsum tax by way of composition, are required to compulsorily deposit tax electronically. Once, payment of tax is made, the authorised bank shall generate an e-challan in Form VAT-II-A.

Notification No. EXN-F(10)-7/2011 dated 16 September 2015

Rajasthan

The payment of tax in respect of transfer of property in goods involved in the execution of a works contracts, is exempted if the same is executed within the territory of a Special Economic Zone (SEZ) and has been awarded by the units being established in the SEZ or co-developers or developers of the SEZ. The exemption is available with immediate effect up to 31 March 2016. Further, where the SEZ is established entirely in backward areas specified by the state government, such an exemption shall be available up to 23 August 2017.

Notification No. F.12(43)FD/Tax/05-Pt-88 dated 24 September 2015

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