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DIRECT TAXES

Judicial pronouncements

RSM & Co. v. ACIT (2010) 38 DTR (Mumbai)(Trib) 246

Diversion by overriding title - Payment to a retired partner as per terms of deed

As per the terms of the partnership deed, any partner who retires after the age of 50 years is entitled to 25 per cent of his average earnings of three completed financial years prior to his retirement. Assessee firm has to pay the same for a period of five years. In terms of said clause there is a charge on the profits of the assessee firm. There is a diversion of income to the extent of the retirement benefits paid by the assessee firm as per the terms of the said clause. Therefore, retirement benefit paid by the assessee firm to the retired partner cannot be included in the total income of the assessee.

Dr. Rahul Tugnait v.ITO (ITA No. 197/CHD/2008)

Scholarship/ stipend received by a student for pursuing higher studies cannot be treated as salary

Sections 15, 16 and 17 of the Income-tax Act, 1961 nowhere includes scholarship/ stipend which have been mentioned in section 10(16) of the Act; therefore, it can be said that the stipend/scholarship has been specifically precluded from the mischief of sub-clause (1) & (2) of section 17.

Sponge Iron India Ltd. v. DCIT (ITAT No. 410 & 411/ Hyd/2007)

Assessee is not entitled to depreciation on a plant which is not in operation since its capitalization

Even after introduction of concept of block assets, identity of the individual assets are not lost and the Assessing Officer can restrict the depreciation having regard to the usage of a plant.

Bosch Ltd. v. CIT [2009-TIOL-736-ITAT-BANG]

Depreciation is allowable on payments made to acquire skill and know-how of incoming employees as 'business information' classified under other intangibles (Goodwill)

The Tribunal has held that the taxpayer company was entitled to claim depreciation on the skill and the know-how brought by the employees of the transferee company classified as 'business information' under the category of 'other identifiable intangibles' (goodwill) under section 32(ii) of the Income-tax Act, 1961.

Dr. Aswath N. Rao v. ACIT (ITA No. 2900/2005) (Karnataka HC) [2010] 5 taxmann.com 63 (Kar.)

Second hand machinery purchased for use as spare parts for existing old machineries has to be considered as an allowable expenditure on revenue side

When an assessee purchases the spare parts for the existing machineries, same cannot be treated as capital expenditure and it has to be treated as revenue expenditure since these spare parts are purchased for the maintenance of the existing equipments.

ACIT vs. Mahindra Holidays & Resorts (ITAT Chennai Special Bench) (ITA Nos.2412 to 2416/Mds/2005)

Timeshare membership fee is taxable only over the term of contract

The assessee, a time-share company having resorts at tourist places granted membership for a period of 33/25 years on payment of certain amount. During the currency of the membership, the member had the right to holiday for one week in a year at the place of his choice from amongst the resorts of the assessee. The membership fee was received either in lump sum or in installments to the prospective member. In addition to the membership fee, the member was liable to pay maintenance charges or subscription fees irrespective of whether he made use of the resort or not. If the resort was utilized, additional payment towards utilities like electricity, water, etc was payable. Though the assessee was following the mercantile system of accounting and treated the membership fee as revenue receipt, only 40% of the amount received was offered for taxation in the year of receipt. The balance was equally spread over the period of membership of 25 or 33 years on the ground that it was relatable to the services to be offered to the members. The AO took the view that as per the accrual system of accounting, the entire receipt had to be assessed as income in the year of receipt. The CIT (A) upheld the stand of the assessee. On appeal by the department, the matter was referred to the Special Bench. HELD by the Special Bench:

(i) In E.D. Sassoon & Co. Ltd. v. CIT 26 ITR 27, the Supreme Court held that two conditions are necessary for income to have "accrued to" or "earned by" an assessee viz. (i) the assessee has contributed to its accruing or arising by rendering services or otherwise, and (ii) a debt has come into existence and he must have acquired a right to receive the payment. In the present case, though a debt is created in favour of the assessee immediately on execution of the agreement, it cannot be said that the assessee has fully contributed to its accruing by rendering services because the assessee has a continuing obligation to provide accommodation to the members for one week every year till the currency of the membership. Till the assessee fulfils its promise, income has not accrued to it;

(ii) The argument of the assessee that the balance amount of membership fees has to be spread over the tenure of membership on the ground that heavy expenditure for the upkeep and maintenance of the resorts has to be incurred is not acceptable because separate charges are collected for maintenance and use of utilities and therefore the matching concept cannot be pressed into service with regard to the membership fee. The principles laid down in Calcutta Co. Ltd 37 ITR 1 (SC) and Rotork Controls India 314 ITR 62 are not applicable because though there is a liability, it is difficult not only to quantify but also to reasonably estimate it on a scientific basis. If the assessee had chosen to provide for the liability every year to comply with the matching concept, it would have been wholly unscientific and arbitrary;

(iii) Recognizing the entire receipt as income in the year of receipt can lead to distortion. Following the principles laid down in Madras Industrial Investment Corporation 225 ITR 802 (SC), where it was held that allowing the entire expenditure in one year might give a distorted picture of the profits of a particular year, recognizing the entire receipt in one year can also lead to distortion;

(iv) Consequently, the entire amount of timeshare membership fee receivable by the assessee up front at the time of enrollment of a member is not chargeable to tax in the initial year on account of contractual obligation that is fastened to the receipt to provide services in future over the term of contract.

ACIT v. Core Healthcare Ltd. Core Towers (ITA Nos. 573/Ahd/2003 and 1195/Ahd/2004)

Deferred revenue expenditure should be allowed entirety in the year in which it was incurred

For the purpose of allowability of any expenditure under the Act, what is material is the classification between the capital and revenue and the same does not recognise any concept of deferred revenue expenditure.

Smt. Sadhana Nabera vs. ACIT (ITAT Mumbai)(ITA No. 2586/ Mum/2009)

Tests laid down to determine whether income from shares is "business" income or "capital gains"

The assessee, a director and shareholder in a company engaged in share trading, returned income of Rs. 78,89,499 earned by her on transfer of shares as a "short-term capital gain". The AO took the view that as there were voluminous transactions, the assessee was engaged in share trading and the income was assessable as "business income". This was upheld by the CIT (A). On appeal, HELD dismissing the appeal:

(i) The legal principles are well settled viz. that:

  (a) Whether a transaction of sale and purchase of shares is a trading or investment transaction is a mixed question of law and facts,

  (b) It is possible for an assessee to be both an investor as well as dealer in shares,

  (c) Whether a particular holding is by way of investment or of stock-in-trade is a matter within the knowledge of the assessee and it is for the assessee to produce evidence from the records as to whether he maintained any distinction between shares held as investment and those held as stock-in-trade,

  (d) The treatment in the books by an assessee is not conclusive and if the volume, frequency and regularity at which transactions are carried out indicate systematic and organized activity with profit motive then it becomes business profit not capital gain,

  (e) Purchase with intention to resale can constitute capital gains or business profit depending on circumstances like quantity of purchase and nature of activity,

  (f) No single fact has any decisive significance and the question must be answered depending on the collective effect of all relevant material brought on record.

(ii) These principles have to be applied to the following facts:

  (a) The assessee entered into transaction of purchases and sale of shares of about 32 companies totaling Rs.1,87,83,440 which were sold for Rs.2,69,71,368. Though most transactions were effected by actual delivery, the holding period was less than 6 months. Most of the gain was earned in shares held for a period for short periods;

  (b) In the earlier years the assessee has nil or small long term capital gain which indicates that holding investments for a longer period is not the main intention except few scrips which are carried over without any transactions year after year. Accordingly to the extent of investment activity in shares one can see that the assessee has invested in some 5 to 6 companies scrips which have been carried over from year to year in which there are no frequent or large number of transactions and these investments in shares can be considered as assessee's proper "investments";

  (c) Purchase and sale of shares in short period indicates that the assessee purchased the shares with a motive to earn profit in short period;

  (d) The assessee undertook daily transactions without delivery in a few select scrips;

  (e) The assessee borrowed funds to purchase shares;

  (f) The dividend received was meager;

  (g) The assessee's group companies were involved in share trading.

(iii) These facts indicate that the intention of the assessee was to gain profits by dealing in short term period only. Consequently, the income from sale of shares was assessable as "income from business" and not "short-term capital gains";

(iv) The decision in Gopal Purohit 122 TTJ 97 (affirmed in 228 CTR 582 (Bom)) is distinguishable because there the assessee had consistently been investing in shares and the ratio of sales to investment was very less and the LTCG was more than the STCG. Similarly Janak S. Rangwalla 11 SOT 627 (Mum) is also distinguishable on facts.

Management Structure & Systems vs. ITO (ITAT Mumbai) (ITA No.6966/ Mum/2007)

Tests laid down to determine whether income from shares is "business" income or "capital gains"

The assessee, engaged in management consultancy, offered profits of Rs. 1.03 crores earned by it on sale of shares as long-term and short-term "capital gains" depending on the period of holding. The AO took the view that as the assessee was regularly dealing in shares throughout the year, the assessee was engaged in the "business" of trading in shares and that the profits were assessable as "business income". This was confirmed by the CIT (A). On appeal by the assessee, HELD allowing the appeal:

(i) Though there is no fixed formula to determine whether the activity of purchasing and selling shares can be treated as a trading activity or as investment activity, certain guiding principles have been laid down in CBDT's Circular No. 4/2007 dated 15.6.2007 as well as in Gopal Purohit 122 TTJ 87 (Mum) (affirmed in 228 CTR 582 (Bom)), Saranath Infrastructure 120 TTJ 216 (Luck) and other judgments. These principles of law have to be applied to the following facts:

(a) As per the books of account, the assessee has treated the entire investment in shares as an "investment" and not as "stock-in-trade";

(b) The assessee is not a share broker nor he is having a registration with any Stock Exchange;

(c) Almost 83% of the capital gain is from shares that were held for a long period of time;

(d) There were no derivative transactions by the assessee;

(e) There were no transactions without delivery;

(f) The assessee used his own surplus funds for investing in shares and not borrowed any money;

(g) In the preceding years, the assessee consistently declared the gain/profit on the sale of the shares as 'Capital Gains' and the same has been accepted by the A.O. Though the rule of res judicata is not applicable to income-tax proceedings, in the absence of change in facts, there should be consistency in the approach of the Revenue;

(h) The assessee received substantial dividend on the investments.

(ii) The intention of the assessee cannot be read from his mind but it reflects in his conduct and the way he treats the transactions. Considering the totality of the facts, the transactions of sale and purchase of shares cannot be treated to be trading in shares nor as an adventure in the nature of the trade but is assessable as 'capital gain'.

ACIT vs. Dinesh K. Mehta HUF (ITAT Mumbai)(ITA No. 976/Mum/2009)

S.43(5): Derivatives are speculative transactions if not for bona fide hedging - A.Y. 2005-06

In respect of AY 2005-06, the assessee, a dealer in shares, entered into transaction of purchases of Nifty Futures, which being a derivative instrument, was settled by payment of differences and not actual delivery of shares. The assessee argued that the transactions were hedging transactions meant to minimize the loss due to fluctuation of price of shares held as stock-in-trade and could not be regarded as speculative transactions u/s 43(5) so as to disallow the loss from being set off against other income. The AO took the view that a derivatives transaction could be regarded as a hedging transaction u/s 43(5)(b) only to the extent of the inventory of shares held by the assessee and that the excess would be regarded as a speculative transaction. As, on the date the Nifty Futures were purchased, the inventory of shares held by the assessee was less that the value of the Futures, the loss was treated as a speculation loss. The CIT (A) allowed the appeal on the ground that the s. 43(5)(d) inserted by FA 2005 w.e.f. 1.4.2006 (which provides that derivatives are not speculation transactions) was clarificatory). On appeal by the Revenue, HELD reversing the CIT (A):

(i) In Shree Capital Services 121 ITD 498 (Kol) it has been held by the Special Bench that the amendment to s. 43(5)(d) is neither clarificatory nor retrospective in operation. Consequently, derivatives can be considered non-speculative u/s 43(5)(b) only to the extent they are for hedging purposes;

(ii) The argument of the assessee that to constitute a hedging transaction u/s 43(5)(b), a transaction need not be in the same shares held by the assessee as inventory or that the value of hedging transactions should be equal to or less than the value of inventory held by the assessee is not acceptable. Circular No. 23D dated 12-9-1960 makes it clear that bona fide hedging transactions shall not be regarded as speculative provided that the hedging transactions are up to the amount of his holdings and confined to shares in his holding. The value and volume of hedging transactions should be in equal proportion and the hedging transaction should be in respect of the same scripts held by the assessee;

(iii) If the arguments of the assessee are accepted, it will lead to a situation where all speculative transactions will be claimed as hedging transactions and the purpose behind s. 73 of not permitting set off of speculative loss against business income will become redundant. The fact that in Nifty futures and index futures there cannot be any identification of shares does not change the position in law till the insertion of s. 43(5)(d);

(iv) As the AO has gone by the overall value of inventory without individual script wise tally (though required to be done), the plea of the assessee that the loss in purchase of Nifty Futures should not be considered as speculative to the extent of the value of inventory held by the Assessee on a particular day is acceptable.

[Note: From 2006-07 such transactions would be non-speculative due to section 43(5)(d)]

CIT v. Kumbazha Tourist Home (Dissolved) (2010) 38 DTR (Ker) 166

Distribution of assets on dissolution of firm - Applicability of s. 45(4)

At the time of constitution of the firm the partners brought land and respective portions of building thereon as their capital contribution, and the firm claimed depreciation in respect of the building all along. On dissolution of the firm the properties reverted back to the partners at book value in the same way it was brought by them to the firm as their capital. Retransfer of properties to the partners on dissolution of firm involves transfer of properties and, therefore, s. 45(4) is attracted. Finding of the Tribunal that s. 55A has no application to the facts of the case also is not correct. Sec. 55A authorises the AO to refer any capital asset to find out its fair market value for the purpose of assessment of capital gains. AO was free to refer the assets for valuation as the transfer value shown is the book value. Further, the finding of the Tribunal that the transfer of building in the course of dissolution of the firm is assessable as short-term capital gain under s. 50(1), and since the transfer was made at book value, there is no capital gain is not sustainable. Distribution of assets at book value among the partners in the course of dissolution of the firm is to be assessed under s. 45(4), and the same is not covered by s. 50(1).

Kishori Sharad Gaitonde vs. ITO (ITAT Mumbai)(ITA No. 1561/M/09)

S. 50C does not apply to "rights" in land & building like tenancy rights

The assessee, a tenant in a flat, sold tenancy rights for Rs. 30 lakhs and offered long-term capital gains on the basis that the said sum was the consideration. The AO took the view that as the market value adopted the Sub-Registrar was Rs. 33,11,200, the said market value had to be adopted as the consideration u/s 50C. This was confirmed by the CIT (A). On appeal by the assessee, HELD allowing the appeal:

(i) S. 50C is a deeming provision and incorporates a legal fiction that if the consideration received on transfer of land or building is less than the stamp duty value, the said stamp duty value shall be deemed to be the full value of consideration for purposes of computing capital gains;

(ii) It is trite law that a legal fiction cannot extend beyond the purpose for which it is enacted. As long as there is no ambiguity in the statutory language, resort to any interpretative process to unfold the legislative intent is impermissible. The statute has to be interpreted on the basis of the language used. No words can be added and only the language used can be considered so to ascertain the proper meaning and intent of the legislation. (Law on interpretation discussed in detail);

(iii) S. 50C does not apply to all capital assets but only to "land or building". A tenancy right is not "land or building" (It is "rights" in building). Consequently, s. 50C has no application and the capital gains have to be computed on the basis of the actual consideration and not the stamp duty value.

Velayudhaswamy Spinning Mills (P) Ltd. v. ACIT (2010) 38 DTR (Mad) 57

Computation of Deduction u/s. 80-IA - Adjustment of brought forward losses and depreciation set off in earlier years

As per sub-s. (5) of s. 80-IA, profits are to be computed as if such eligible business is the only source of income of the assessee. When the assessee exercises the option, only the losses of the years beginning from the initial assessment year are to be brought forward and not the losses of earlier years which have been already set off against the income of the assessee. Revenue cannot notionally bring forward any loss of earlier years which has already been set off against other income of the assessee and set off the same against the current income of the eligible business. Fiction created by sub-s. (5) of s. 80-IA does not contemplate such notional set off. In the instant case, admittedly, losses incurred by the assessee have already been set off and adjusted against the profits of the earlier years. There is a positive profit during the relevant year. Therefore, loss or depreciation in the year earlier to initial assessment year already absorbed against the profit of other business cannot be notionally brought forward and set off against the profits of the eligible business. All the authorities below have given a categorical finding that the first year of assessee's claim for deduction under s. 80-IA is 2004-05 and the same has reached finality. There is no error or illegality in the order of the Tribunal warranting interference.

DCM Shriram Consolidated Ltd. v. ACIT (ITA No. 4299/Del/2009) [2010] 5 taxmann.com 32 (New Delhi - ITAT)

From assessment year 2001-02, provision for bad debts is to be added in book profit while computing book profit u/s 115JB

The ratio laid down by the Supreme Court in the case of HCL Comnet System & Services Ltd. [305 ITR 409] is no more applicable in view of the amended provisions of section 115JB brought in the statute with retrospective effect.

ITO v. Vintage Distillers Ltd. (2010) 130 TTJ (Del) 79

Admissibility of Additional ground in appeal before CIT(A)

If all the facts are available on record, a legal question can be raised at any stage. Hence, CIT(A) was justified in admitting the additional ground raised by the assessee relating to quantification of book profit under s. 115JB vis-a-vis provision for fringe benefit tax.

Book profit under s. 115JB - Provision for fringe benefit tax

As per cl. (a) of Explanation to s. 115JB, provision for income-tax has to be added back if it was debited to the P&L a/c. Definition of the term "tax" in s. 2(43) proves beyond doubt that the term "tax" includes both "income-tax" as well as "fringe benefit tax" and hence the term "income-tax" cannot include the term "fringe benefit tax". When amendment was made in s. 2(43) by Finance Act, 2005 no amendment was made in cl. (a) of Explanation to s. 115JB by either including the term "fringe benefit tax" in addition to the term "income-tax" or by substituting the words "income-tax" by the term "tax". Thus, as per cl. (a) of Explanation to s. 115JB, payment or provision for "fringe benefit tax" is not required to be added back for the purpose of computing book profit under s. 115JB.

Asstt. CIT vs. M.N. Rajendhran (Chennai)(TM) (2010) 130 TTJ (Chennai)(TM) 15

Search and seizure - Computation of undisclosed income - Cheques found during search

These cheques were issued by various parties as security to whom advances were made by the assessee in cash admittedly out of undisclosed income. On similar facts, the Tribunal has accepted the plea of the assessee's brother that no income accrued as the cheques remained unencashed and allowed telescoping of the un-recovered amount against the undisclosed income assessed on the basis of cheques. There is no difference in the facts of the two cases. On the same set of facts, a Co-ordinate Bench of the Tribunal cannot come to a diametrically opposite conclusion than that arrived at in the earlier case. Impugned addition is therefore liable to be deleted.

Fabula Trading Co. (P.) Ltd. v. ITO [2010] 123 ITD 557 (MUM.)

Transfer pricing - Section 92 r.w.ss 92CA and 143 of the Income-tax Act, 1961

Assessee-company was engaged in business of importing rough diamonds. On a perusal of details of sales and purchases, Assess-ing Officer found that assessee-company was making imports and exports mainly from its sister concern and

and India based companies with whom it had close connection. Assessing Officer further taking a view that gross profit rate disclosed by assessee was low, invoked provisions of section 92 and made an addition of one per cent of total sales to assessee's income. Commissioner (Appeals) confirmed said addition. On instant appeal, it was seen that Assessing Officer had failed to bring on record any discrepancy in sales and purchase documents maintained by assessee, except for contention that purchases/sales had been made to related concerns at lower rates. It was also noted that in succeeding year i.e., assessment year 2002-03, an order under section 92CA(3) had been passed wherein it was held that arm's length price of international transactions could be taken up as transactional value recorded in books of account of assessee. On facts, it was held that there was no basis for invoking provisions of section 92 and, therefore, impugned addition was to be deleted.

Audco India Ltd. v. ITO (ITA No. 6305/M/2007) [2010] 5 taxmann.com 14 (Mum. - ITAT)

Assessing Officer cannot take any action under section 147 merely because he happened to change his opinion or to hold an opinion different from that of his predecessor on same set of facts

Where it was clear from the original assessment orders as well as order made by the appellate authority that the Assessing Officer was well aware about the primary facts, viz., the claim made by the assessee, the circumstances under which the claim was made, and the provisions of law which could be applied while granting the benefits, and the Assessing Officer consciously considered the facts and arrived at a decision, the assessment cannot be reopened merely because subsequently the Assessing Officer changes his opinion or some other officer takes a different view.

Jai Pulse Mills v. ITO (ITA Nos. 1317-1319/Ahd/2004) [2010] 5 taxmann.com 42 (Ahd. - ITAT)

Once book results are not rejected, AO has no alternative except to accept the book results

No assessment under the first proviso to section 145(1) or under section 145 (2) can be sustained if the Assessing Officer has not considered and recorded a finding against the assessee as to whether he has been regularly employing a method of accounting or whether his income, profits or gains can properly be deduced from his method of accounting if he has been regularly employing a method of accounting or whether the accounts are correct and complete.

Prudential Assurance Company Ltd. v. DIT (Int'l Taxation) (Writ Petition No. 866 of 2010)[2010] 5 Taxmann.com 21 (Bom.)

Assessment order which gives effect to a binding precedent cannot be regarded as being erroneous or as being prejudicial to interests of Revenue

When the Assessing Officer has followed a binding ruling of the AAR, the Jurisdictional Commissioner cannot come to the conclusion that the view of the Assessing Officer was erroneous or that it was prejudicial to the interests of the Revenue.

Prudential Assurance Company Limited (Writ petition no.866 of 2010)(Bom. HC)

Order passed by the Tax Officer after applying the AAR ruling in petitioner's own case cannot be revised by the Commissioner based on the some other AAR ruling

The Company (Petitioner), a sub-account duly registered with the Securities and Exchange Board of India ('SEBI') filed a writ petition with the Bombay High Court against the show-cause notice issued by the Commissioner of Income-tax (Commissioner). The Commissioner was seeking to revise an assessment order determined on the basis of a ruling of the Authority for Advance Ruling ('the AAR') in the case of Fidelity Northstar Fund.

The Bombay High Court has quashed a show-cause notice issued by the Commissioner and held that the assessment order passed by the Assessing Officer (AO) after applying the AAR ruling in petitioner's own case, cannot be regarded erroneous or prejudicial to the interests of the tax department.

Further, the High Court also observed that as per section 245S of the Income-tax Act, 1961 (the Act), the ruling in the case of Fidelity Northstar Fund cannot displace the binding character of the advance ruling rendered between the Petitioner and the tax department.

ACIT v. Tej Diam [2010] 37 SOT 341 (MUM)

Computation of arm's length price - Section 92C of the Income-tax Act, 1961, read with rule 10B, of the Income-tax Rules, 1962 - Transfer pricing

Assessee had entered into an international trans-action. It adopted CUP method for computing arm's length price of international transaction. TPO had rejected CUP method on ground that assessee had not provided any comparables. He had thereafter used 'Trans-action Net Margin Method' (TNMM) and had suggested adjustment of Rs. 44 lakhs while adopting TNM method. Assessing Officer had considered 'operating margin to sale' of various enterprises and arrived at a conclusion that an adjustment was called for under 'Transfer Pricing Regulations' and he, accordingly, made an addition. It was held that TNM method requires comparison of net profit margins realized by an enterprise from an international transaction and not comparisons of operating margins of enterprises as a whole and therefore, TPO as well as Assessing Officer had committed an error by wrongly applying transaction net margin method.

Royal Bank of Canada, In re (A.A.R No 816 of 2009)

Profits / losses on futures and options contracts (derivative transactions) would be in the nature of 'Business Income'

The Authority for Advance Rulings (AAR) has held that the profits / losses on futures and options contracts (derivative transactions) carried out by Canadian entity would be in the nature of 'Business Income'. Further since the entity did not have a Permanent Establishment (PE) in India, as per Article 5 of the India-Canada tax treaty (the tax treaty), the Business Income of the applicant would not be taxable in India. Morgan Stanley & Co. [2004] 142 Taxman 630 (AAR) followed.

While pronouncing the ruling, the AAR has also made some important observations on the taxation of income earned by Foreign Institutional Investors (FII) in India, which are given below:

- Tax department's contention that there is a prohibition of trading in Derivatives under the FEMA or SEBI Regulations is unsustainable.
- Investment in Derivatives does not necessarily exclude trading transactions.
- Giving an undertaking for abiding by SEBI Rules and Regulations, would have no bearing on the characterization of income.
- The purpose and purport of section 11 5AD of the Act is to provide for special or concessional rate of taxation in relation to securities received or arising from the income of FIIs. The contention of the tax department that for FIIs there cannot be any income outside section 11 5AD is not sustainable.
- The observation of AAR in Fidelity North Star that there was no prohibition in law as far as the exchange traded derivatives were concerned cannot be faulted.
- Irrespective of the provisions of the Act, the applicant can seek the benefit of tax treaty provisions. If the income derived can be characterized as business income, such income cannot be taxed in the absence of a PE in India.
- A special provision in the Act cannot be pressed into service to deny the benefit which is otherwise due to FII under the tax treaty provisions notwithstanding their conflict with the domestic law of income tax.

Ashapura Minichem v. ADIT (ITAT Mumbai)(ITA No. 2508/Mum/08)

Fees for Technical Services, even if rendered outside India, are Taxable

The assessee, an Indian company, entered into an agreement with a Chinese company for bauxite testing services in its laboratories (outside India) and for preparation of test reports.

The assessee filed an application u/s 195(1) in which it argued that as the services were rendered outside India and the recipient did not have a permanent establishment in India, the payments were not chargeable to tax under the India-China DTAA and no tax was required to be withheld at source. The AO took the view that the payments constituted "fees for technical services" u/s 9(1)(vii) and Article 12 of the DTAA and tax was required to be withheld at 10%. This was upheld by the CIT (A). The assessee appealed to the Tribunal. HELD dismissing the appeal:

(i) As regards taxability u/s 9(1)(vii), in Ishikawajima-Harima Heavy Industries 288 ITR 408 and Clifford Chance 318 ITR 237 (Bom) it was held that "fees for technical services" were not chargeable to tax in India if two conditions were not satisfied viz. that the services were (a) rendered in India and (b) were utilized in India. However, these judgments are no longer good law in view of the retrospective amendment to the Explanation to s. 9(1)(vii) by the Finance Act, 2010. The effect of the amendment is that "fees for technical services" are chargeable to tax in India even if rendered outside India. Except in a situation in which a territorial method of taxation is followed, which is usually also a lowest common factor in taxation policies of tax heavens, source rule is an integral part of the taxation system. It is thus fallacious to proceed on the basis that territorial nexus to a tax jurisdiction being sine qua non to taxability in that jurisdiction is a normal international practice in all tax systems. (The concepts of "territorial nexus" and "source rule" discussed);

(ii) As regards taxability under the DTAA, Article 12(4) defines "fees for technical services" as "the provision of services of .. technical .. nature by a resident of a Contracting State in the other Contracting State". Article 12(6) provides that such technical services shall be deemed to arise in a Contracting State when the payer is a resident of that State;

(iii) The argument that in using the words "in the Contracting State", Article 12(4) incorporates the "place of performance test" and negates the "source rule" and that services rendered offshore are not taxable is not acceptable for two reasons. Firstly, because the expression "provision for services" is wider than the term "provision for rendering of services" and covers services rendered in the one State but used in the other State. Secondly, because the interpretation will render Article 12(6) redundant. A literal interpretation to a tax treaty which renders a treaty provision unworkable should be avoided. (Principles of treaty interpretation reiterated);

(iv) Consequently, the payment was chargeable to tax under s. 9(1)(vii) as well under Art. 12 of the DTAA and tax had to be withheld at source u/s 195.

Airlines Rotables vs. JDIT (ITAT Mumbai)((ITA No. 3254/Mum/06)

No PE under DTAA if three criteria are not fulfilled

The assessee, a UK company, entered into an agreement with Jet Airways under which it agreed to provide Jet Airways with two segments of services, first, to carry out repairs and overhauling of aircraft components outside India and, second, to provide spares and components in the period the components were being repaired. To ensure that the spares and replacement components were readily available, the assessee maintained a stock of the components at the operating base of the airline in India. Though the stock was under the direct control of the assessee, it was in the possession of the airline as a bailee. The AO took the view that as the stock was kept in India with Jet Airways, Jet Airways constituted an "agent" and a "permanent establishment" in India under Article 5(4)(b) of the India-UK DTAA and that 10% of the receipts was liable to tax in India. This was upheld by the CIT (A). On appeal by the assessee, HELD allowing the appeal:

(i) In order for a PE to come into existence under Article 5(1) ("the basic rule"), three criteria have to be satisfied viz. (a) the physical criterion (existence of physical location) (b) subjective criterion (right to use that place) and (c) functional criterion (carrying on business through that place). It is only when the three conditions are satisfied that a PE under the basic rule can be said to have come into existence. The onus is on the Revenue to show that the assessee has a PE;

(ii) On facts, though the stock was stored at specific locations in India, such locations were not at the disposal of the assessee and the assessee could not carry out its business from that place. There was consequently no PE under Article 5(1). Further, even if there was a PE, the consideration relatable to the repairs done outside India was not taxable as it was not "attributable" to the PE. The existence of a PE does not justify taxation of all profits as one cannot infer the force of attraction principle. As regards the consideration for the right to use the components, the business element thereof is over when the component is handed over to the airline. There is no "carrying on of business" from that location. Consequently, there is no PE under article 5(1);

(iii) The argument of the Revenue that there is a “Dependent Agent PE” under Article 5(4)(b) is also not correct. The rationale of a Dependent Agent PE is that the foreign enterprise carries on business through a dependent agent, who is integrated into the principal’s business to a substantial extent. However, on facts, as Jet Airways was neither the dependent agent of the assessee and nor was the assessee carrying on business through Jet Airways, there was no PE under Article 5(4)(b);

(iv) When a PE exists, even such a consideration, which may otherwise be taxable in the source country under Article 13, is taxable on net basis under Article 7. Therefore, merely because an amount is not taxable under Article 7 in the source country, it is not end of the road so far taxability for that item in the source country is concerned. As evident from a plain reading of the consideration clause in the agreement between the parties, consideration for use of replacement components is distinct and separate and the same can perhaps be neatly segregated from the overall receipts. In this view of the matter, non taxability under Article 7 will still mean that application of Article 13 is to be considered and adjudicated upon. As the authorities had not examined whether the consideration for use of the replacement components was “for the use of industrial, commercial or scientific equipment” and taxable as “royalty” under Article 13(3)(b), the matter was remanded for that purpose.

ACIT Vs M/s Chrys Capital Investment Advisors India Pvt Ltd (2010-TII-11-ITAT-DEL-TP)

Exclusion of interest, dividend, income from investment operations, trading in bonds and capital market operations, etc. while determining profit margin under the Transactional Net Margin Method (TNMM)

The Tribunal has upheld the exclusion of non-operating incomes like interest, dividend, income from share trading etc. while determining profit margin under the Transactional Net Margin Method TNMM). The Tribunal also concluded that in case expenses incurred by a taxpayer on behalf of associated enterprises (AEs) are included in operating cost, any reimbursement pertaining to such expenses must be included in operating revenue while computing profitability under the TNMM method.

ITO (IT) v. Rameshkumar Goenka (ITA No. 3562 / Mum / 2009)

The expression ‘liable to tax’ in the contracting State as used in Article 4(1) of India-UAE tax treaty does not necessarily imply that person should actually be liable to tax in that contracting state

The Tribunal has held that the expression ‘liable to tax' as used in Article 4 (I) of India-UAE tax treaty (the tax treaty) does not mean that the person should actually be liable to tax in that contracting state by virtue of an existing legal provision. It will also cover cases where the other contracting state has the right to tax such person, whether or not such a right is exercised.

J Ray McDermott Eastern Hemisphere Ltd. (Taxpayer) [2010- TII-41-ITAT-MUM-INTL]

Receipts of NRI for contract executed outside India cannot be taxed under the special provisions if the same is not taxable under the general provisions of the Indian Tax Law

The ITAT held that receipts pertaining to transportation and installation contract executed by the Taxpayer outside India cannot be taxed under the special provisions, which provide for taxation of certain income of a non-resident on presumptive basis, if the income is not chargeable to tax under the general provisions of the Indian Tax Law (ITL).

M/s Intervet India Private Limited (2010-TIOL-240- ITAT-MUM)

Transfer Pricing Provision: ITAT underscored the importance of taxpayers making accurate transaction adjustments on account of different conditions in varying locations

The ITAT observed that when there is a sale of identical product to an unrelated party, it (CUP) will form the basis of determining the ALP in respect of sales to an AE, but one of the essential prerequisite is that reasonably accurate adjustments are to be made to eliminate material factors affecting price, cost or the profit arising from such transaction. But at least all material factors should be considered in arriving at the adjustments.

The ITAT found that the TPO and the CIT (A) have assumed similarity of markets and economic conditions and have made adjustments only for the volume discount, credit offered and a small adjustment of credit risk. They have, completely ignored the disparate economic land market conditions of Thailand and Vietnam and have made no adjustment for the same. Mere geographical contiguity of two countries need not mean similarity in economic or market conditions. How can the sale prices to wholesale agents in two different countries be comparable, when the sale price to the final user in one country is less than the sale price to the wholesale agent in another country, unless adjustment for the same has been considered. Thus, the adjustments merely for volume offtake, credit period and credit risk, though material are not sufficient to make the sale price to AE in Thailand comparable with the sale to unrelated party in Vietnam.

Thus, the ITAT has set aside the matter to the file of the CIT (A) for deciding the matter afresh after giving reasonable opportunity to the appellant (Intervet – India) to present their case.

Circulars / Notifications

Circular No.4/2010 [F.No.178/14/2010 -ITA.I], dated 18-5-2010

Section 80-IA(4)(i) of the Income-tax Act, 1961 – Deductions – In respect of profits and gains from infrastructure facility – Clarification regarding widening of existing road

References have been received by the Board as to **whether widening of existing roads constitutes creation of new infrastructure facility** for the

purpose of Section 80-IA(4)(i) of the Income-tax Act, 1961.

Section 80-IA(4)(i) provides for a deduction to an undertaking engaged in developing, or operating and maintaining, or developing, operating and maintaining any infrastructure facility subject to satisfaction of the conditions laid down in the Section. The Explanation to sub-section 80-IA(4)(i) states that for the purpose of this clause, infrastructure facility means inter alia:-

"(a) a road including toll road, a bridge or a rail system;

(b) a highway project including housing or other activities being an integral part of the highway project;"

The issue has been examined by the Board. It has been decided that **widening of an existing road by constructing additional lanes as a part of a highway project by an undertaking would be regarded as a new infrastructure facility** for the purpose of Section 80-IA(4)(i). However, simply relaying of an existing road would not be classifiable as a new infrastructure facility for this purpose.

Instruction No. 4/2010, dated 25-5-2010

Section 197 of the Income-tax Act, 1961 – Deduction of tax at source – Certificate of lower deduction or non-deduction of tax at source – Instructions for issue of certificate u/s 197 mandatorily through ITD system

1. I am directed to bring to your notice on the subject of issue of certificates u/s 197 that by Instruction No. 8/2006 dated 13/10/2006, it was laid down that certificates for lower deduction or nil deduction of tax at source u/s 197 are not to be issued indiscriminately and for issue of each certificate, prior administrative approval of the concerned Range Head shall be obtained by the AO. Subsequently, Instruction No. 7/2009, dated 23/12/2009 read with letter F.No.275/23/2007-IT(B), dated 8/02/2010 has laid down monetary limits for prior administrative approval of the CIT-TDS or DIT-Intl. Taxation, as the case may be. Such certificates are normally being issued at present, manually rather than through the ITD system.
2. To maintain centralized data of issue of such certificates and facilitate better processing of the TDS returns filed by the deductors and in continuation to the above instructions, I am directed to communicate that henceforth w.e.f…………the certificates u/s 197 shall be generated and issued by the AO mandatorily through ITD system only.
3. In case due to certain reasons, it is not possible to generate the certificate through the system on the date of its issue, the AO shall upload the necessary data on the system within 7 days of the date of issue (manually) of the certificate.

4. The manner of issue of certificate u/s 197 through the system, uploading of data in situation covered in para 3 above and the prior administrative approval by the Range Head and by the CIT-TDS / DIT-Intl. Taxation is given in the enclosed Annexure for guidance of all concerned.
5. The content of the above Instruction may be brought to the notice of all officers working in your charge for strict compliance.

Notification No. 36/2010. F. No. 501/13/1980-FTD-I, dated 20-5-2010

Section 90 of the Income-tax Act, 1961 – Double Taxation Agreement – Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion with Finland

An Agreement and the Protocol between the Government of Republic of India and the Government of the Republic of Finland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed at New Delhi on the 15th day of January, 2010 and all the provisions of the said Agreement and the Protocol shall be given effect to in the Union of India with effect from 1st day of April, 2011.

Notification No. 41/2010; SO No. 1261(E) dated 31-05-2010

The Central Board of Direct Taxes (CBDT) have amended the Rules relating to TDS provisions, date and mode of payment of tax deducted at source (TDS), TDS certificate and filing of 'statement of TDS' (TDS return). The amended rules will apply only in respect of tax deducted on or after 1st day of April 2010 01.04.2010 means applicable from financial year 2010-11.

Notification No. 22/2010 [F.NO.142/5/2010-SO(TPL)], dated 8-4-2010

Section 90 of the Income-tax Act, 1961 - Double taxation agreement - Agreement for Avoidance of Double Taxation and Prevention of Fiscal Evasion with Foreign Countries - Specified territories notified under section 90, Explanation 2

In exercise of the powers conferred by Explanation 2 to section 90 of the Income-tax Act, 1961 (43 of 1961) the Central Government hereby notifies the following areas outside India as the 'specified territory' for the purposes of the said section, namely:-

(i)	Bermuda	a British Overseas Territory
(ii)	British Virgin Islands	--- do ---
(iii)	Cayman Islands	--- do ---
(iv)	Gibraltar	--- do ---
(v)	Guernsey	--- do ---
(vi)	Isle of Man	--- do ---
(vii)	Jersey	--- do ---
(viii)	Netherlands Antilles	an Autonomous Part of the Kingdom of Netherlands
(ix)	Macau	a Special Administrative Region of The People's Republic of China

INDIRECT TAXES

Judicial Pronouncements

Vandana Global Ltd. v. CCE [Appeal No. E/1036/2008] [2010] 5 taxmann.com 13 (NEW DELHI - CESTAT)

No credit of duty paid on cement and steel items used for laying foundation and for building supporting structures can be allowed under Cenvat Credit Rules

Goods like cement and steel items used for laying 'foundation' and for building 'supporting structures' cannot be treated either as inputs for capital goods or as inputs in relation to the final products and therefore, no credit of duty paid on the same can be allowed under the CENVAT Credit Rules for the period prior to 7-7-2009.

Kbace Tech Pvt. Ltd. *v.* CCE/CST (Appeal No. ST/304/09)

Refund or CENVAT credit on input services allowed only if services are consumed in output service

The CESTAT ruled that the refund or CENVAT credit on input services is allowed only if the services are consumed in the output service. It is held that the Board's Circular No. 120/01/2010-ST, dated 19-1-10 does not have the effect of amending the statute and cannot be seen as authorizing sanction of refund if the credit of service tax does not relate to services consumed for providing the output service. The Order has initiated the new battle between the tax administration authorities and judicial organs over legislative intentions behind the grant of refund of Cenvat credit on input services to the service exporter.

Central Excise (N.T.) Notification No. 21 / 2010

Online filing of Excise Return & Statement mandatory from 1st June 2010

W.e.f. 01-06-2010, where total duty paid is of rupees ten lakh or more including the amount of duty paid by utilization of CENVAT credit in the preceding financial year, declaration / monthly return shall be filed electronically.

OTHER LAWS

RBI

RBI/2009-10/465
A. P. (DIR Series) Circular No. 52 dated May 13, 2010

Current Account Transactions – Liberalisation

Attention of Authorised Dealer Category-I (AD Category-I) banks is invited to Foreign Exchange Management (Current Account Transactions) Rules, 2000 notified vide Notification No.G.S.R.381(E) dated 3rd May 2000, as amended from time to time.

2. In terms of Rule 4 of the Foreign Exchange Management (Current Account Transactions) Rules 2000, prior approval of the Ministry of Commerce and Industry, Government of India, is required for drawing foreign exchange for remittances under technical collaboration agreements where payment of royalty exceeds 5% on local sales and 8% on exports and lump-sum payment exceeds USD 2 million [item 8 of Schedule II to the Foreign Exchange Management (Current Account Transactions) Rules, 2000]. The Government of India has reviewed the extant policy with regard to liberalization of foreign technology agreement and it was decided to omit item number 8 of Schedule II to the Foreign Exchange Management (Current Account Transaction) Rules, 2000, and the entry relating thereto.

3. Accordingly, AD Category-I banks may permit drawal of foreign exchange by persons for payment of royalty and lump-sum payment under technical collaboration agreements without the approval of Ministry of Commerce and Industry, Government of India.

4. The amendment to the Foreign Exchange Management (Current Account Transactions) Rules, 2000, in this regard has been notified by the Government of India vide Notification No.G.S.R.382 (E) dated May 5, 2010 (copy enclosed).

5. AD Category-I banks may bring the contents of this circular to the notice of their constituents and customers concerned.

6. The directions contained in this Circular have been issued under Section 10(4) and 11(1) of the Foreign Exchange Management Act, 1999 (42 of 1999) and is without prejudice to permissions / approvals, if any, required under any other law.

RBI/2009 - 10/449

RPCD.SME & NFS. BC.No. 79 /06.02.31/2009 - 10 dated May 6, 2010

Credit upto Rs.10 lacs to MSEs without collateral security

As you are aware, a Working Group was constituted by the Reserve Bank of India to review the Credit Guarantee Scheme (CGS) of the Credit Guarantee Fund Trust for Micro and Small Enterprises (Chairman: Shri V.K. Sharma, Executive Director, RBI) and suggest measures to enhance its usage. The Report of the Working Group was released on March 6, 2010, which is available on our website (www.rbi.org.in). The Working Group has, inter alia, recommended that

"the limit for collateral free loans to the MSE sector be increased from the present level of Rs. 5 lakh to Rs.10 lakh and it be made mandatory for banks. Banks, in turn, can take cover for the collateral free credit facilities under CGS. In order to upscale the CGS, it is necessary to create widespread awareness about the key features and benefits of the Scheme. As the branch level functionaries have a predilection to lend against collaterals, the Group recommends that the Chief Executive Officers (CEOs) of banks assume complete and total ownership in the matter of strongly encouraging the branch level functionaries to avail of the CGS cover, including making performance in this regard a criterion in the evaluation of their field staff."

The above recommendations have been accepted by the Reserve Bank of India. Accordingly, in modification of our circular RPCD.SME & NFS.BC.No. 16/ 06.02.31 (P)/ 2009 - 10 dated August 24, 2009, banks are mandated not to accept collateral security in the case of loans upto Rs 10 lakh extended to units in the MSE sector.

2. Banks may also strongly encourage their branch level functionaries to avail of the CGS cover, including making performance in this regard a criterion in the evaluation of their field staff.

The Managing Director, Hassan Co-operative Milk Producer's Society Union Limited v. The Assistant Regional Director Employees State Insurance Corporation MANU/SC/0293/2010 (Decided on 26.04.2010)

Principal is not liable to pay ESI of workers of contractor

The Appellant had awarded the contract for transportation of milk for specified period to contractors. Contractor neither the agent of the principal employer under Section 2(9)(ii) nor his employees worked under the supervision of Appellant. Contractors separately engaged workers for the work and workers were neither directly nor indirectly employees of the Appellant. Wages or salary of such workers were not paid by the appellant but by the contractor. Thus, in the present case and the persons employed by the contractor for loading and unloading of milk cans are not the persons employed on the premises of the Appellants' establishment. Appellants not liable to pay ESI contribution in respect of the workers employed by the contractors.

K. A. Abbas H.S.A. v. Sabu Joseph [CRIMINAL APPEAL NO. 1052 OF 2010] [2010] 5 taxmann.com 47 (SC)

Imprisonment for offence punishable u/s 138 of NI Act, 1881

Essentially section 357 of Cr. PC empowers courts, not to just impose a fine along or fine along with sentence of imprisonment, but also when situation arises, direct accused to pay compensation to person who has suffered any loss or injury by reason of act for which accused person has been sentenced - Not imposing a sentence of imprisonment would mean allowing the accused to get away without paying the compensation and imposing another fine would be impractical as it would mean imposing a fine upon another fine and therefore would not ensure proper enforcement of the order of compensation; while passing an order under section 357(3), it is imperative for the courts to look at the ability and the capacity of the accused to pay the same amount otherwise the very purpose of granting an order of compensation would stand defeated.

CCE vs. Bharat Petroleum Corporation (Supreme Court)(Civil Appeal Nos. 1903 of 2008)

Supreme Court doubts law requiring PSUs to obtain COD approval; directs review

In ONGC vs. CCE 104 CTR (SC) 31, the Supreme Court directed the Central Government to set up a 'Committee on Disputes' to monitor disputes between the Government and Public Sector Enterprises and give clearance for litigation. It was held the no litigation could be proceeded with in the absence of COD approval. This was followed in ONGC vs. CIDCO (2007) 7 SCC 39 and it was held that even disputes between PSUs and State Governments would require COD approval. HELD doubting the correctness of this law and referring the matter to a larger bench for reconsideration:

"In our experience, the working of the COD has failed. Numerous difficulties are experienced by the COD which are expressed in the letter of the Cabinet Secretary, dated 9th March, 2010. Apart from the said letter, we find in numerous matters concerning public sector companies that different views are expressed by COD which results not only in delay in filing of matters but also results into further litigation.

In the circumstances, we find merit in the submission advanced before us by learned Attorney General that time has come to revisit the orders passed by the three Judge Bench of this Court in the case of Oil & Natural Gas Commission vs. Collector of Central Excise (supra)".

General Circular No. 1/2010 (F. No. 2/7/2010-CLV) dated May 26, 2010

MCA Introduces Company Law Settlement Scheme 2010 for Defaulting Companies

It has been observed that a large number of companies are not filing their due documents timely with the Registrar of Companies. Due to this, the records available in the electronic registry are not updated and thereby are not available to the stakeholders for inspection. Further, due to not filing the documents on time, companies are burdened with additional fee and facing the prosecutions also.

There are many companies, who have also not increased their paid up capital up to the threshold limit provided in sub-section (3) and sub-section (4) of Section 3 of the Companies Act, 1956.

3. In order to give an opportunity to the defaulting companies to enable them to make their default good by filing belated documents and to become a regular compliant in future, the Ministry, in exercise of the powers under Section 611(2) and 637B (b) of the Companies Act, 1956 has decided to introduce a Scheme namely, "Company Law Settlement Scheme, 2010," condoning the delay in filing documents with the Registrar, granting immunity from prosecution and charging additional fee of 25 percent of actual additional fee payable for filing belated documents under the Companies Act, 1956 and the rules made there under.

This scheme shall come into force on the 30th May, 2010 and shall remain in force up to 31st August, 2010.

General Circular No. 1/2010 (F. No. 2/7/2010-CLV) dated May 26, 2010

Easy Exit Scheme, 2010

It has been observed that certain companies have been registered under the Companies Act, 1956, but due to various reasons some of them are inoperative since incorporation or commenced business but became inoperative later on and are not filing their due documents timely with the Registrar of Companies. These companies may be defunct and are desirous of getting their names strike off from the Register of Companies.

In order to give an opportunity to the defunct companies, for getting their names strike off from the Register of Companies, the Ministry has decided to introduce a Scheme namely, "Easy Exit Scheme, 2010" under Section 560 of the Companies Act, 1956.

This Scheme shall come into force on the 30th May, 2010 and shall remain in force up to 31st August, 2010.

Payment of Gratuity (Amendment) Act, 2010 (No. 15 of 2010), dated 17-5-2010

In section 4 of the Payment of Gratuity Act, 1972, in sub-section (*3*), for the words "three lakhs and fifty thousand rupees", the words "ten lakh rupees" shall be substituted.

Notification No. S.O. 1217(E), dated 24-5-2010

In exercise of the powers conferred by sub-section (2) of Section 1 of The Payment of Gratuity (Amendment) Act, 2010 (15 of 2010), the Central Government hereby appoints the 24th day of May, 2010, as the date on which the said Act shall come into force.

5th June	*Payment of Service Tax & Excise duty for May*
6th June	*Payment of Excise duty paid electronically through internet banking*
7th June	*TDS/TCS Payment for May*
10th June	*Excise Return ER1 / ER2 /ER6*
15th June	*PF Contribution for May*
15th June	*Due date for payment of Advance Income Tax*
15th June	*Filing of last quarter TDS return for the year 2010*
21st June	*ESIC Payment for May*

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