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SNK Newsletter

DIRECT TAXES

Judicial pronouncements

CIT v. Brihdaranyak Mandal (Trust) (Allahabad HC) (Appeal No. 4 of 2000)

Charitable trust - Exemption under s. 11 - Business held in trust

Assessee trust had been established to educate public about ancient glory and cultural heritage of the country. Trustees raised funds by organising a coaching institute for the benefit of students seeking admission to various institutions and study material was also published. Exemption denied by AO on the ground that trust was not a valid one and the income was actually earned by AK, the managing trustee, in his individual capacity and that the income was not exempt under s. 11 since it was earned from business and the provisions of s. 11(4A) were applicable. Revenue has not sought reference questioning the validity of the findings recorded by the Tribunal. Tribunal has found that the activities of coaching institute were carried out by the trust as cl. 4 of the trust deed empowered the trust to start educational agencies for earning income to achieve aims and objects of the trust. Tribunal has further found that the surplus was transferred to the trust and utilised in purchase of land and construction of Sabha Bhawan. On the basis of finding recorded by the Tribunal, sub-s. (4A) is not applicable. Exemption under s. 11 was therefore available to the assessee.

Batra Gulati Hotels v. ITO (ITA NO. 655/Mum/2009)

When an assessee-company exploits its property to earn income in form of rent, rental income received by assessee is chargeable to tax under head "income from house property" and not under head "profits and gains of business"

Merely because the property was given on leave or licence for a specific purpose of running restaurant or it was given

along with furniture, fixtures as well as other equipments required for running of restaurant, the same, could not change the character of rental income which is "income from house property" and the same would not become business income even if the hire was inclusive of other assets which were incidental to running a restaurant

DCIT vs. Shreyas S. Morakhia (ITAT Mumbai Special Bench)(ITA No. 3374/Mum/2004)

If brokerage offered to tax, the principal debt qualifies as a “bad debt” u/s 36(1)(vii) r.w.s. 36(2)

The assessee, a broker, claimed deduction for bad debts in respect of shares purchased by him for his clients. The AO rejected the claim though the CIT (A) upheld it. On appeal by the Revenue, the matter was referred to the Special Bench. Before the Special Bench, the department argued that u/s 36 (2), no deduction on account of bad debt can be allowed unless “such debt or part thereof has been taken into account in computing the income of the assessee”. It was argued that as the assessee had offered only the brokerage income to tax but not the value of shares purchased on behalf of clients, the latter could not be allowed as a bad debt u/s 36(1)(vii). HELD rejecting the claim of the department:

(i) In Veerabhadra Rao 155 ITR 152 the Supreme Court held in the context of a loan that if the interest is offered to tax, the loan has been "taken into account in computing the income of the assessee" and qualifies for deduction u/s 36(1)(vii). The effect of the judgement is that in order to satisfy the condition stipulated in s. 36(2)(i), it is not necessary that the entire amount of debt has to be taken into account in computing the income of the assessee and it will be sufficient even if part of such debt is taken into account in computing the income of the assessee. This principle applies to a share broker. The amount receivable on account of brokerage is a part of debt receivable by the share broker from his client against purchase of shares and once such brokerage is credited to the P&L account and taken into account in computing his income, the condition stipulated in s. 36(2)(i) gets satisfied. Whether the gross amount is reflected in the credit side of the P&L A/c or only the net amount is finally reflected as profit after deducting the corresponding expenses or only the net amount of brokerage received by the share broker is reflected in the credit side of the P&L account makes no difference because the ultimate effect is the same;

(ii) The argument that the loss was suffered owing to breach of SEBI Guidelines framed to safeguard the interest of brokers in respect of amount receivable from the clients against purchase of shares is irrelevant. If the broker chooses not to follow the guidelines, it is a decision taken by him as a businessman having regard to his business relations with the client. The loss cannot be equated to expenditure incurred by the assessee for any purpose which is an offence or which is prohibited by law. (CIT vs. Pranlal Kesurdas 49 ITR 931 (Bom) followed where bad debts on account of forbidden vayada transactions were held allowable);

(iii) The contention of the Revenue that the sale value of the shares remaining with the assessee should be adjusted against the amount receivable from the client so as to arrive at the actual amount of bad debt should be raised, if permissible, before the Division Bench.

CIT & Anr. v. Modi Xerox Ltd. (Allahabad HC)

Two criteria of bad debts Bad debts, if satisfied it is allowable

Tribunal having recorded a categorical finding of fact that the assessee has complied with both the requirements of s. 36(1)(vii) namely, the amount has been considered for computation of income in earlier years and the debt has been written off in the books of account, claim for bad debt was rightly allowed.

Scindia Investments Pvt. Ltd. v. ACIT (ITA No. 682/Mum/2009)

It is not necessary that for claiming deduction on account of foreign travel expenses, there has to be some business activity of assessee in foreign countries

Merely because there was no business activity of assessee-company in foreign countries, it cannot be said that claim of assessee for foreign travel expenses has to be disallowed.

Parlight Securities Ltd. vs. ACIT (2010) 3 ITR 628 (Ahd.) (Trib.)

S. 28(1) : Business loss – Non refundable deposit with stock exchange

Deposit given to Calcutta Stock Exchange to become corporate member of exchange was written off as business loss. The assessee entitled to deduction as business loss.

Amount paid for non-compete rights while acquiring business is capital expenditure

Tecumseh USA, a global compressor manufacturer, was interested in entering the Indian market. It entered into a MOU with Whirlpool India & Whirlpool-USA under which Whirlpool-India agreed to sell its compressor business to the assessee, a wholly owned subsidiary of Tecumseh USA, for the total consideration of Rs. 52.5 crores. The agreement also provided that Whirlpool would not compete with Tecumseh. To give effect to the MOU, the assessee entered into an agreement dated 2.7.97 with Whirlpool India. The agreement provided a split of the consideration of up to Rs. 49.85 crores between land, building, inventories etc. The agreement provided that a separate non-compete agreement would be entered into which was entered into on 10.7.1997 and provided for a consideration of Rs. 2.65 crores. The period of non-compete was 5 years. The consideration of Rs. 52.5 crores agreed to in the MOU was accordingly bifurcated between the assets (Rs. 49.85 crores) and the non-compete covenant (Rs. 2.65 crores). The Special Bench had to consider whether the said payment for the non-compete was capital or revenue expenditure. HELD deciding against the assessee:

Judicial pronouncements

(i) The contention that the non-compete agreement should be considered separately from what was paid by the assessee to acquire the business is not acceptable. The terms of the MOU and agreement made it clear that the parties had agreed on the total consideration of 52.5 crores and it was allocated between the assets and the non-compete covenant. Accordingly, the non-compete agreement cannot be considered on a stand alone basis. All agreements form one transaction which are interwoven by a common thread. The agreements are not mutually exclusive as one cannot be fulfilled without fulfilling the other;

(ii) The general proposition of the assessee that in all cases of payment of non-compete fee, the purpose of making such payment is to maintain/protect the profitability of the business by insulating the same from the risk of competition and that it is, therefore, revenue in nature is not acceptable;

(iii) There are several tests formulated by Courts to distinguish between capital and revenue expenditure such as the test of initial outlay of the business, the aim and object of the expenditure, enduring benefit test and the test of fixed and circulating capital. These tests continue to be applicable even in the context of the modern situation. (Case Laws discussed in detail);

(iv) As the 'non-compete agreement' is part & parcel of the entire transaction of acquisition of business, it falls under the first test which is that if the expenditure is made for the initial outlay or for the expansion of business or a substantial replacement of the equipment, then, it is capital expenditure. The incurring of expenditure also brought enduring benefit to the assessee. In Assam Bengal Cement Company a period of five years was regarded as providing enduring advantage to the assessee irrespective of the fact that the payment was to be made annually. The argument that this was a case of acquiring monopoly rights is not right because in Coal Shipment it was held that even payment made to ward off competition from a rival dealer would constitute capital expenditure;

(v) Accordingly, the amount paid under the non-compete agreement is capital expenditure.

Bapushaeb Nanasaheb Dhumal v. ACIT (ITAT Mumbai)(ITA No. 6628/Mum/2009)

Default u/s 194C does not result in s. 40(a)(ia) disallowance if TDS paid before due date of filing ROI

The assessee made payments to sub-contractors during the previous year and though s. 194C requires TDS at the stage of payment/credit, did not do so. The tax was, however, deducted on 31st March and paid over in Sept before the due date for filing the return. The AO took the view that while the payment made to the sub-contractor for March was allowable, the payments for the earlier months was disallowable u/s 40(a)(ia). This was confirmed by the CIT (A). On appeal by the assessee, HELD allowing the appeal:

Failure to deduct or deposit tax as per s. 194C or Chapter-XVII makes the assessee liable to the consequences provided under the said Chapter-XVII. However, s. 40(a)(ia) is in addition to Chapter XVII. S. 40(a)(ia)(A) provides that if tax is deducted during the last month of the previous year and paid on or before the due date of filing of return as per s. 139(1), then such sum shall be allowed as deduction. In cases where tax is deducted other than the last month of previous year but is deposited before the last day of the previous year, then it will be allowed as deduction. Therefore, the conditions for allowability of deduction are prescribed u/s 40(a)(ia) itself and Chapter-XVII and s. 194C are not relevant. If the condition of deduction and payment prescribed u/s 194C / Chapter XVII are held applicable for disallowance of deduction u/s 40(a)(ia), then s. 40(a)(ia) will be rendered meaningless, absurd and otiose. Since the assessee had (belatedly) deducted tax in the last month of the previous year i.e. March 2005 and deposited the same before the due date of filing the return u/s 139(1), deduction had to be allowed u/s 40(a)(ia) (A).

Note: S. 40(a)(ia) has been amended by the FA 2010 w.e.f. 1.4.2010 to provide that in all cases if TDS is paid before the due date of filing the ROI, no disallowance shall be made.

Judicial pronouncements

Abhay Devilal Rathod *v.* DCIT (ITAT Ahd)

Merely by giving evidence of identity and creditworthiness of donor, genuineness cannot be taken to be established automatically

The assessee is required to discharge the onus of submitting complete details of gifts before the AO; merely because money is claimed to have been transferred through banking channel, it is not enough to establish the genuineness of gift; the human probability has to be considered as to why donor is prompted to give gift to the assessee.

CIT vs. Kalpataru Colours and Chemicals (Bombay High Court) (Income Tax Appeal (Lodg.) No. 2887 of 2009)

DEPB sale proceeds cannot be bifurcated into "profits" and "face value". The entire amount is "profits" for s. 80HHC r.w.s. 28(iiid)

S. 28 (iiid) provides that "any profit on the transfer" of the DEPB shall be business profits. Under Explanation (baa) to s. 80HHC, 90% of "the sum referred to in s. 28(iiid)" has to be reduced from the business profits. Under the third Proviso to s. 80HHC (3), in the case of an assessee having an export turnover exceeding Rs. 10 crores, the profits referred to in s. 80HHC (3) can be increased by 90% of "the sum referred to in s. 28 (iiid)" only if two conditions are satisfied. If the said conditions are not satisfied, no relief on account of DEPB can be granted u/s 80HHC. In Topman Exports vs. ITO 318 ITR 87 (Mum)(SB) (AT) the Special Bench of the Tribunal held that "the sum referred to in s. 28 (iiid)" meant only the "profits" on transfer of the DEPB and not the entire sale proceeds. The Tribunal held that the amount received on account of DEPB had to be bifurcated into the "face value" of the DEPB and the "profit" and that while the "face value" was assessable u/s 28(iiib), the "profit" was assessable u/s 28(iiid). The consequence was that only the "profit" suffered the rigors of the third Proviso to s. 80HHC (3) and not the "face value". On appeal by the Department, HELD reversing the Special Bench:

The argument that s. 28(iiid) covers only the "profit" (difference between sale consideration and face value of the DEPB credit) and that the "face value" is assessable u/s 28(iiib) is not correct. The entire amount received on transfer of the DEPB credit is "profits" and falls under s. 28(iiid). There was no basis or justification for the Tribunal to hold that the face value of the DEPB credit can be reduced from the sale consideration. It is not permissible to bifurcate the proceeds of the DEPB into "face value" and "excess of face value". The approach of the Tribunal is misconceived and unsustainable. As the assessee had an export turnover exceeding Rs.10 crores and did not fulfill the conditions set out in the third proviso to s. 80HHC (3), it was not entitled to a deduction u/s 80HHC on the amount received on transfer of DEPB.

CIT v. King Metal Works [2010] 6 taxmann.com 26 (Bom.)

Freight and insurance cannot be regarded as costs directly attributable to trading goods within meaning of clause (b) of Explanation to sub-section (3) of section 80HHC

Freight and insurance attributable to the transportation of goods beyond the customs station does not constitute a part of the direct costs which are defined to mean costs directly attributable to the trading goods exported out of India; the words, "exported out of India" are used in a descriptive sense; in order that the costs can be regarded as direct costs within the meaning of Explanation (b), they must be attributable to the trading goods which are eventually exported out of India.

CIT v. Al-Kabeer Exports Ltd. (ITA No. 2619 of 2010)

For purposes of clause (iv) of Explanation 1 to section 115JB, extent of reduction in respect of deduction available under section 80HHC has to be computed strictly in accordance with provisions of section 80HHC

Tribunal was not justified in coming to the conclusion that the amount to be reduced under clause (iv) of Explanation 1 to Section 115JB in respect of the profits eligible for deduction under Section 80HHC has to be computed with reference to the net profits in the profit and loss account and not according to the profits of the business computed under the head of profits and gains of business or profession.

ITO v. Khyati Financial Services (ITA No.3740/Mum/2008)

Housing project for purpose of section 80-IB(10) does not include construction of commercial establishment carried out by another entity in that area

Claim of the assessee for deduction under section80-IB (10) for the housing project cannot be denied because the commercial project was carried out by its sister concern in the same area.

CIT vs. Walfort Share & Stock Brokers (Supreme Court)(Civil Appeal No. 4927 of 2010)

Pre S. 94(7) dividend stripping loss cannot be disallowed. Transaction cannot be ignored on ground that it is for tax-planning

In respect of AY 2000-01, the assessee bought units of a mutual fund on 24.3.2000 (the record date) for Rs. 17.23 each and immediately became entitled to receive dividend of Rs. 4 per unit. After the dividend payout, the NAV of the unit fell by Rs. 4 to Rs. 13.23. The assessee redeemed the units on 27.3.2000 at Rs. 13.23 per unit and claimed a loss of Rs. 4. The dividend of Rs. 4 was claimed exempt u/s 10(33). The AO & CIT (A) rejected the claim of loss on the ground that the loss was "artificial" and could not be allowed. On appeal by the assessee, a Five Member Special Bench of the Tribunal 96 ITD 1 (Mum) (SB) upheld the claim and this was confirmed by the Bombay High Court 310 ITR 421 (Bom). On appeal to the Supreme Court, HELD, dismissing the appeal:

(i) The argument of the department that the loss (the difference between the purchase and sale price of the units) constitutes "expenditure incurred" for earning tax-free income and was liable to be disallowed u/s 14A is not acceptable. The difference arose as a result of the dividend payout. The said "pay-out" is not "expenditure" to fall within s. 14A. For attracting s. 14A, there has to be a proximate cause for disallowance, which is its relationship with the tax exempt income, which is absent in the present case.

(ii) The argument of the department that the transaction was entered into in a pre-meditated manner and that the loss is not genuine is not acceptable because the transaction was a "sale", the sale-price and dividend was received by the assessee. The assessee made use of the provisions of s. 10(33), which cannot be called an "abuse of law". Even assuming that the transaction was pre-planned, there is nothing to impeach the genuineness of the transaction. With regard to McDowell & Co 154 ITR 148(SC), in the later decision in Azadi Bachao Andolan 263 ITR 706(SC) it has been held that a citizen is free to carry on its business within the four corners of the law. Mere tax planning, without any motive to evade taxes through colourable devices is not frowned upon even in McDowell & Co. Accordingly, the losses pertaining to exempted income cannot be disallowed prior to s. 94(7).

(iii) S. 94(7) was inserted w.e.f. 1.4.2002 to curb claim of such loss. However, the effect of s. 94 (7) is that only losses to extent of dividend have to be ignored by the AO and not the entire loss. Losses over and above the dividend are still allowable even after s. 94(7). This shows that Parliament has not treated the dividend stripping transaction as sham or bogus or the entire loss as a fictitious or fiscal loss. If the argument of the Department is to be accepted, it would mean that before 1.4.2002 the entire loss would be disallowed as not genuine but, after 1.4.2002, a part of it would be allowable u/s 94(7) which can never be the object of s. 94(7).

(iv) As regards the reconciliation of ss. 14A and 94(7), the two operate in different fields. S. 14A deals with disallowance of expenditure incurred in earning tax-free income while S. 94(7) refers to disallowance of loss on acquisition of an asset. S. 14A applies to cases where an assessee incurs expenditure to earn tax free income but where there is no acquisition of an asset. In cases falling u/s 94(7), there is acquisition of an asset and existence of the loss which arises at a point of time subsequent to the purchase of units and receipt of exempt income. It occurs only when the sale takes place. S. 14A comes in when there is claim for deduction of an expenditure whereas s. 94(7) comes in when there is claim for allowance for the business loss. One must keep in mind the conceptual difference between loss, expenditure, cost of acquisition, etc. while interpreting the scheme of the Act. Also, though ss. 14A and 94(7) were inserted by the Finance Act, 2001, s. 14A was inserted w.r.e.f. 1.4.1962 while s. 94(7) was inserted w.e.f. 1.4.2002.

(v) The argument of the department that by virtue of Para 12 of AS 13, the dividend should be regarded as a "return of investment" and go to reduce the cost of the unit is not acceptable. As 13 provides that interest/ dividends received on investments are generally regarded as return on investment and not return of investment and it is only in certain circumstances where the purchase price includes the right to receive crystallized and accrued dividends/ interest, that have already accrued and become due for payment before the date of purchase of the units, that the same has got to be reduced from the purchase cost of the investment. A mere receipt of dividend subsequent to purchase of units, on the basis of a person holding units at the time of declaration of dividend on the record date, cannot go to offset the cost of acquisition of the units. (Reference made to Vijaya Bank 187 ITR 541 (SC) where it was held that where the assessee buys securities at a price determined with reference to their actual value as well as interest accrued thereon till the date of purchase the entire price paid would be in the nature of capital outlay and no part of it can be set off as expenditure against income accruing on those securities).

Rain Commodities vs. DCIT (ITAT Hyderabad Special Bench)(ITA No. 673/Hyd/2009)

Even exempt income is taxable under MAT / s.115JB

The assessee credited its P&L A/c with an amount of Rs. 149.77 crores being the profit on sale of assets to its wholly owned subsidiary. As the said profits were not chargeable to tax u/s 47(iv), the assessee took the view that the same had also to be reduced from the "book profits" u/s 115JB. The Special Bench had to consider whether exempt income could be excluded from the computation of "book profits" u/s 115JB. HELD deciding against the assessee:

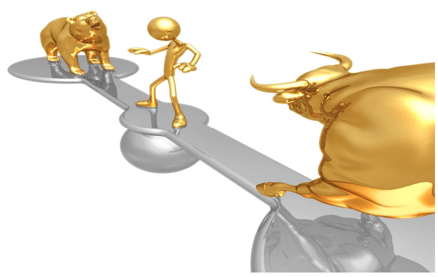
(i) The AO can alter the "book profit" only in two circumstances (a) if the P&L A/c is not drawn up in accordance with Parts II & III of Schedule VI to the Companies Act or (b) If accounting policies & standards, method & rate of depreciation have been incorrectly adopted for preparation of the P & L A/c. Except for the said two cases, the AO has no power to alter the net profit shown in the P&L A/c. Under (a), the AO cannot disturb the Net Profit shown by the assessee where there are no allegations of fraud or misrepresentation but only a difference of opinion as to whether a particular amount should be properly shown in the P&L A/c or Balance sheet;

(ii) Parts II & III of Schedule VI to the Companies Act do not permit the exclusion of capital gain from the P & L A/c. The P & L A/c is required to disclose every material feature including credits or receipts and debits or expenses in respect of non-recurring transactions or transactions of an exceptional nature including capital profits (Veekaylal Investments 249 ITR 597 (Bom) followed). Items referred to in the Notes are a part of the P&L A/c (Sain Processing 221 CTR 493 (Del) followed;

(iii) The assessee had included the said capital gains in the P & L A/c and it was not its' case that same was not includible. The fact that the capital gains was exempt u/s 47(iv) does not mean it can be excluded from the "book profit" because no such exclusion was permitted under the Explanation to s. 115JB. The taxability of capital gain is relevant only for the purpose of computation of income under the normal provisions and has nothing to do with the computation of "book profits". {N.J. Jose & Co 217 CTR 479 (Ker) (capital gains exempt u/s 54E) followed};

(iv) The argument that as s. 115JB (4) provides that "save as otherwise provided in this section all other provisions of the Act shall apply" does not mean that the exemption provisions of s. 47(iv) can be read into s. 115JB. This only means that while the computation has to be as per s. 115JB, anything over and above that will be subject to other provisions of the Act. Frig Sales 4 SOT 376 (Mum) overruled);

(v) Accordingly, in the absence of any provision for exclusion of exempted capital gain in the computation of book profit u/s 115JB, the assessee is not entitled to the exclusion claimed.



Sadbhav Engineering vs. DCIT (Gujarat HC)(Special Civil Application Nos. 5846 & 5847 of 2010)

Reopening beyond 4 years on basis of retrospective amendment not justified if assessee has not failed to disclose material facts

In respect of AY 2003-04, the assessee claimed deduction u/s 80IA (4) which was partly allowed by the AO vide assessment order passed u/s 143 (3). Subsequently, a retrospective amendment was made to s. 80IA by the Finance (No. 2) Act, 2009 w.e.f 1.4.2000 to provide that s. 80IA deduction would not be admissible to an assessee who carries on business which is in the nature of works contract. After the expiry of 4 years from the end of the assessment year, the AO reopened the assessment u/s 147 to deny the deduction u/s 80IA in view of the retrospective amendment. The assessee challenged the reopening by a Writ Petition. The department argued that the by virtue of the retrospective amendment, it had to be deemed that the assessee had submitted untrue facts at the relevant time and that s. 147 was attracted. HELD allowing the Petition:

Under the first proviso to s. 147 where an assessment has been made u/s 143(3), the assessment cannot be reopened after expiry of four years from the end of the relevant assessment year unless if income has escaped assessment by reason of failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment. In the present case, there was no failure on the part of the assessee to make a full and true disclosure of the material facts. The argument that in view of the retrospective amendment of section 80IB, it is deemed that the petitioner has failed to disclose the correct facts is not acceptable. The question whether there is a failure to disclose all material facts is a matter of fact and there can be no deemed failure as contended by the department. Consequently, in the absence of any failure on the part of the assessee to make a full & true disclosure of material facts, the initiation of proceedings u/s 147 was vitiated and could not be sustained.

Hindalco Industries Ltd. v. DCIT (ITA Nos. 3667, 4685 & 4968/M/05 and ITA No. 6923/M/06)

Assessment as a 'Representative Assessee'

The Mumbai Tribunal held that deduction of tax under Section 195 of the Act will not be a bar to pass an order against the payer holding him as an "agent" under Section 163 of the Act. Accordingly, the payer can be taxed as a representative assessee of the recipient. The Tribunal also held that an income, having been taxed in the hands of the non-resident principal, cannot be again assessed in the hands of its representative assessee

Dinesh T. Tailor v. TRO

Reference u/s 179 refers to only tax and not penalty

Sec. 179(1) refers to "any tax due from a private company" and every director of the company is jointly and severally liable for the payment of "such tax", which cannot be recovered from the company. The expression "tax due" and, for that matter the expression "such tax" must mean tax as defined for the purposes of the Act by s. 2(43). "Tax due" will not comprehend within its ambit a penalty. In several provisions of the Act, a distinction has been made by Parliament between a tax and a penalty. Where Parliament has intended to make a specific provision imposing a liability to pay penalty apart from the tax which is due and payable, a specific provision to that effect has been made. Sec. 179 imposes a joint and several liability upon a director of a private company where tax due from the company cannot be recovered. The expression "tax due" cannot comprehend within the meaning of that expression a liability to pay a penalty that may have been imposed on the company.

ITO v. Executive Officer Cum Secretary Marketing Committee (ITA Nos. 1005 & 1006/Delhi of 2009)

When assessee makes a provision of interest in its account, in account of creditor, provisions of section 194A would be applicable

Person liable to pay interest shall be covered by section 194A, even if interest is credited in `Interest Payable Account', `Suspense Account' or by any other name, entered into the books of accounts.

Strides Arcolab Ltd. *v.* ACIT (**ITA No. 6233/Mum/2009**)

Merely because assessee has made some legal claim which has not been accepted by A.O. that will not amount to furnishing of inaccurate particulars of income

There is no justification to support the A.O. for levy of the penalty on the claim of the assessee u/s 80HHC, which was not accepted.

Equest India Pvt. Ltd. v. ITO (ITA No. 1548/Mum/06)

Raising a legal claim, even if it is ultimately found to be legally unacceptable, cannot amount to furnishing of inaccurate particulars of income.

The connotations of expression `particulars of income' do not extend to the issues of interpretation of law and as such making a claim, which is found to be unacceptable in law, cannot be treated as furnishing of inaccurate particulars of income

KSPG Netherlands Holding B.V. (AAR No. 818/2009)

Ultimate Holding Company should not be considered as beneficial owner of gains arising to Subsidiary Company on sale of investments held by such Subsidiary Company

The applicant, a Dutch company was incorporated on 11 August 2008. On 6 November 2008, it acquired all the shares of an existing Indian company from another group company located in Germany. The shares were acquired for a consideration of INR 100 million. Post acquisition, the applicant made a further investment of INR 1100 million in the Indian subsidiary company. Both the companies (Dutch Company and German Company) are ultimately held by another German company with extensive manufacturing operations in Europe. The applicant is now proposing to sell the shares of the Indian subsidiary to another non-resident. The issue before the Authority is whether terms of the India – Netherlands Tax Treaty capital gains arising on transfer of shares of the Indian subsidiary to another non-resident is liable to tax in India.

AAR held that the applicant, though a subsidiary of German holding company, is a distinct legal entity having its own board of directors and management systems. The shares of Indian company were acquired by the applicant company at a price determined under the Indian foreign exchange regulation. Moreover, post the initial acquisition the applicant had made substantial investments to the tune of INR 1,100 million in the Indian subsidiary. It is not possible to assume that the applicant was merely a conduit to siphon off gains to the ultimate holding company by means of colorable device contrary to its corporate status and the stake in Indian company. There is no factual basis to hold that the German company is the real beneficial owner of the shares and the capital gains that accrue. Accordingly, the applicant is not liable to pay tax on the capital gains by virtue of Article 13 (5) of the India-Netherlands tax treaty.

ACIT v. Louis Berger International Inc. (ITA No. 1073 & 1074/Hyd/2004)

Indo-US DTAA: Reimbursable expenditure cannot form part of fee payable for technical services

The payment received by the non-resident foreign company as reimbursable expenditure does not fall within the four corners of clause 4 to Article 12 of the DTAA.

J Ray Mcdermott Eastern Hemisphere Ltd. v. JCIT (ITA No. 8084/2004)

DTAA with Mauritius -art. 5(2)(i) time limit on standalone basis for each project etc.

Even a plain reading of art. 5(2)(i) would show that, for the purpose of computing the threshold time-limit, what is to be taken into account is activities of a foreign enterprise on a particular site or a particular project, or supervisory activity connected therewith, and not on all the activities in a tax jurisdiction as whole. It is important to bear in mind the fact that the expressions used in the relevant definition clause are in singular, and there is no specific mention about aggregating the number of days spent on various sites, projects or activities. In other words, each of the building site, construction project, assembly project or supervisory activities in connection therewith is to be viewed on standalone basis. Broadly, the underlying rationale of this approach is that various business activities performed by one and same enterprise, none of which constitutes a PE, cannot lead to a PE, if combined. The very conceptual foundation of this approach rests on the assumption that various business activities of the enterprise in different locations are not so inextricably interconnected that these are essentially required to be viewed as a coherent whole. In a typical building site, assembly or installation project, or supervisory activities in connection therewith, each of site or project is an independent unit, and the approach to these types of PEs recognize this normal business practice. The unambiguous principle, underlying this approach, seems to be to view these business activities at different locations on standalone basis. It is also interesting to note that in certain treaties entered into by India, there is a specific departure from this rule as evident from the wordings used in definition clauses of corresponding PEs. In all these cases, the relevant PE clauses are so worded that there is a specific mention for application of aggregation principle on all, or even connected, sites, projects or activities for computation of threshold duration test. When aggregation is not specifically provided for in the relevant PE definition clause, as in the present case, normally it cannot be open to infer the application of aggregation principle.

Seabird Exploration FZ, LLC, In re (AAR No. 829 of 2009)

INDO-UAE DTAA: Mere physical presence of non-resident's vessel in territorial waters of India pursuant to hiring of vessel on Bareboat Charter terms by applicant does not, without anything more, constitute a permanent establishment

Where the agreement was executed outside India and the delivery of the vessel also took place outside India, by reason of the mere presence of the vessel in India without the volition of Vessel Providing Companies, the source of income cannot be said to be located in India.

In Re, The Timken Company (AAR) (AAR No. 836 of 2009)

S. 115JB (MAT) not applicable to foreign company without presence in India

The assessee, a foreign company, without a presence or PE in India, earned long-term capital gains which were exempt u/s 10(38). The assessee applied for a ruling on whether it was liable to pay Minimum Alternate Tax (MAT) u/s 115JB on the said gains. HELD ruling in favour of the assessee:

(i) XYZ, In re (234 ITR 335) the AAR held that s. 115JA (akin to s. 115JB) applied to every "company" and as the term "company" was defined in s. 2(17) to include a "foreign company", there was no reason to presume that the legislature did not intend s. 115JA to apply to a foreign company. This ruling is not applicable because:

(a) It was rendered in the case of an assessee who was doing business and had a PE in India. Its income was being assessed under the head "income from business and profession". It was required to maintain accounts under section 44AA of the IT Act and prepare accounts under ss. 591 & 594 of the Companies Act;

(b) S. 591 of the Companies Act applies only to foreign companies who have established a place of business within India and requires the preparation of a balance sheet and P&L A/c as per s. 594. The obligation in s. 115JA(2) to prepare P&L Account in accordance with Parts II and III of Schedule VI can apply only to a foreign company which has a place of business within India. As the applicant does not have a place of business in India, its preparation of P&L Account in accordance with Parts II & III of Schedule VI cannot be complied;

(c) In the ruling, the AAR has not taken into account the Budget Speech, Memorandum & Notes on Clauses explaining the purpose behind introduction of s. 115JA which makes the legislative intent clear that MAT was not intended to apply to foreign companies;

(d) Though s. 2(17) defines a "company" to include a "foreign company", the context of the definition has to be seen. Income, which does not have a source in India, cannot be made part of the book profits. The annual accounts, including the P&L Account, cannot be prepared as per s.115JB(2) in respect of the world income and laid before the company at its AGM in accordance with s. 210 of the Companies Act. The speech of the Finance Minister and the Memorandum explaining the provision also become out of sync if the meaning of "company" appearing in s. 115JB is adopted as 'foreign company". Any other meaning would take away force and life from the true intent of the makers of the Act. The contention of the department that there is no demarcation between a 'domestic company' and a 'foreign company' while applying s. 115JB is not acceptable. As the applicant did not have a place of business in India and was not required to prepare its accounts under s. 594 r.w.s. 591 of the Companies Act, it could not have prepared its accounts in accordance with the provisions of Part II and III of Schedule VI of the Companies Act, 1956.

(ii) Accordingly, s. 115JB is not designed to apply to a foreign company which has no presence or PE in India.

Linklaters LLP vs. ITO (ITAT Mumbai)(ITA No. 4896/Mum/03)

Professional Firms can have a 'service PE'. The words "indirectly attributable to the PE" encompass the "force of attraction" principle and even services rendered offshore for Indian projects are assessable in India

(ii) The assessee, a UK based law firm, rendered services to clients with operations / projects in India. The assessee did not have an office in India and to render the services, its' partners and employees visited India. The assessee took the view that as it did not have a permanent establishment (PE) or fixed base in India, its income was not assessable to tax under Articles 7 or 15 of the India-UK DTAA. The AO took the view that as the assessee had furnished services in India for more than 90 days, it had a PE under Article 5(2)(k) of the DTAA. On the quantum, he held that the entirety of the invoices raised by the assessee was assessable in India. On appeal, the CIT (A) upheld the existence of the PE though he held that only the income attributable to the PE was assessable to tax. On appeal to the Tribunal, HELD:

(a) As regards taxability under the domestic law, the argument on the basis of Ishikawajima 288 ITR 408 (SC) & Clifford Chance 318 ITR 237 (Bom) that only services rendered in India are assessable is not acceptable in view of the retrospective amendment to s. 9(1) by the Finance Act, 2010. The result of the amendment is that utilization of the services in India is sufficient to attract taxability in India. The said judgements are no longer good law. (Concept of territorial nexus and source rule discussed);

(b) As regards the DTAA, the question whether a partnership being a "fiscally transparent entity" is entitled to the benefits under the DTAA is entitled to be raised for the first time by the Tribunal suo moto though not raised by the AO or CIT (A). Under Rule 11 of the Tribunal Rules, while the Tribunal cannot enlarge the scope of 'subject matter of appeal' inasmuch as a disallowance or addition not made by the lower authorities cannot be made by the Tribunal, within the subject matter of appeal, the Tribunal can examine any aspect of the matter irrespective of whether the same has been examined by the lower authorities or not. There are no restrictions on the Tribunal as to on what grounds the Tribunal decides the appeal provided it hears the affected party before doing so. (Tata Telecommunications 121 ITD 384 (SB) & Morgan Stanley 39 DTR 240 followed);

(c) On merits, though a UK partnership is a "person" under Article 3 (2), the question is whether it is a "resident of UK". Article 4(1) defines a "resident of a Contracting State" to mean a person "liable to tax in that State by reasons of domicile, residence, place of management or any other criterion of similar nature". According to the OECD Report on Partnerships, mere computation of income at the level of partnership is not sufficient to hold that the partnership firm is 'liable to taxation' in the residence country. However, this view is not correct and has also been rejected by India. A partnership is eligible to the benefits of the DTAA provided the entire profits of the firm are taxed in UK – whether in the hands of the firm (after determining taxable income in relation to the personal characteristics of the partners) or in the hands of the partners directly. (International law on the subject discussed in detail);

(d) The argument that a PE cannot be constituted under Article 5(2)(k) if the basic conditions of Article 5(1) are not fulfilled is not acceptable. While clauses (a) to (i) of Article 5 (2) are illustrative of the basic rule of a PE (fixed place of business), clauses (j) and (k) are an extension of the basic rule. The items included in the said clauses (j) & (k) are such as would not constitute a PE under the basic rule of Article 5(1), and it is only on account of the deeming fiction provided in Article 5(2)(j)/(k), that it can be treated as a PE;

(e) The argument that the term "furnishing of services" in Article 5 (2)(k) of the DTAA does not cover "rendering of services" by lawyers is not acceptable because both terms are used interchangeably in normal course of business;

(f) The argument that as Article 5 refers to commercial and industrial establishments, it cannot cover the rendition of professional services is not acceptable. The Commentary on the OECD Model Convention shows that income derived from professional services or other activities of independent character have to be dealt with under Article 7 as business profits. Accordingly, even professional services are covered by Article 5(2)(k);

(g) The argument that income from professional services can only be taxed under Article 15 (which applies to individuals and not firms) and in case chargeability under Article 15 fails, it cannot be assessed under Article 7 is not acceptable. While professional services rendered by an individual are governed by Article 15, professional services rendered by an enterprise are governed by Article 5 (2)(k) read with Article 7. This view is supported by the UN Model Convention Commentary;

(h) As regards the quantum of profits attributable to the PE, the argument that by virtue of Article 7(2), the PE must be assessed by taking the value of services rendered by the PE at the market value of such services in India and not the price at which the assessee billed its' clients is not acceptable. The fiction of hypothetical independence in Article 7(2) is confined to a PE's transactions with its head office and branches and does not extend to transactions with third parties. The fiction of hypothetical independence has no role to play in adjusting actual revenues with independent entities. The arms length principle in Article 7(2) is relevant only for intra organization transactions or transactions with associated enterprises. Accordingly, the revenues earned by the assessee are to be taken at actual figures and no adjustments are permissible in the same;

(i) Further, as regards the quantum of profits attributable to the PE, Article 7 (1) provides for the taxability of profits "directly or indirectly attributable" to the PE. The words "profits indirectly attributable to the PE" incorporates the "force of attraction" principle. To give effect to the "force of attraction" principle, in addition to taxability of income in respect of services rendered by the PE in India, any income in respect of the services rendered to an Indian project, which is similar to the services rendered by the PE is also to be taxed in India in the hands of the assessee – irrespective of whether such services are rendered through the PE or directly by the GE. There cannot be any professional services rendered in India which are not, at least indirectly, attributable to carrying out professional work in India. This indirect attribution is enough to bring the income from such services within ambit of taxability in India. The two conditions to be satisfied for taxability of related profits are (i) the services should be similar or relatable to the services rendered by the PE in India; and (ii) the services should be 'directly or indirectly attributable to the Indian PE' i.e. rendered to a project or client in India. The result is that the entire profits relating to services rendered by the assessee, whether in India or outside, in respect of Indian projects is taxable in India.

DDIT vs. SET Satellite (Singapore) (ITAT Mumbai)(ITA No.7349/ Mum/2004)

Royalty paid by non-resident does not "arise" in India if there is no "economic link" between the PE and the royalty

The assessee, a Singaporean company with a PE in India, obtained rights from the Global Cricket Council, Singapore, for telecast of cricket matches in

India. The AO took the view that the payment for the said rights constituted "royalty" in the hands of GCC u/s 9(1)(vi) & Article 12(7) of the India-Singapore DTAA and that it had arisen in India on the ground that the payer had a PE in India and there was a direct nexus between collection of advertisement revenue in India and payment for the rights. The assessee was held liable u/s 201 for failure to deduct tax u/s 195. On appeal, the CIT (A) disagreed with the AO. On appeal by the department to the Tribunal, HELD dismissing the appeal:

Assuming the payment for obtaining cricket telecast rights is "royalty", under the first limb of Article 12(7) of the DTAA, royalties can be said to have arisen in India only if the payer is a resident of India. This condition is not fulfilled as the assessee was a non-resident. Under the second limb of Article 12(7), payments made by a non-resident are deemed to arise in India if the non-resident has a PE in India with which the liability to pay the royalties is incurred and such royalties are borne by the PE. This condition is also not fulfilled because the mere existence of a PE in India does not mean that royalties arise in India. In addition to the existence of PE, it is essential that liability to pay such royalties has been "incurred in connection with" and is "borne by" the PE of the payer in India. There must be an "economic link" between the liability for payment of such royalties and PE. As there was no economic link between the payment of royalties and the PE of the assessee in India, the payments to GCC are not incurred "in connection" with the PE in India. Further, the PE was also not involved in any way with the acquisition of the right to broadcast the cricket matches, nor did the PE bear the cost of payments to GCC. Thus the payments to GCC were not "borne by" the PE in India.

DCIT vs. M/s Starlite (ITAT Mumbai) (ITA No.2279/Mum/06)

Transfer Pricing TNMM must be applied to transaction margins and not to enterprise level margins. Adjustments must be confined to international transactions

The assessee, engaged in the business of manufacture and export of diamonds and jewellery, claimed that having regard to the nature of the product, none of the transfer pricing methods were applicable for benchmarking the international transactions with associated enterprises. The TPO rejected the argument on the ground that the Transactional Net Margin Method (TNMM) was applicable and made an adjustment by comparing the enterprise level operating margins. This was upheld in principle by the CIT(A). On appeal to the Tribunal, HELD:

(i) It is mandatory for an assessee to follow one of the methods prescribed in Rule 10B and demonstrate that the international transactions entered into by it with an associated enterprise are at arms' length. The argument that no method is applicable is unsustainable;

(ii) However, the TPO is wrong in adopting the enterprise level margins as the TNMM. U/s 92F (ii) r.w.s. 10B(e), TNMM requires comparison of net profit margins realized by an enterprise from an international transaction(s) and not comparison of operating margins of enterprises;

(iii) Further, the adjustments arising due to computation of ALP should be restricted only to the international transactions and not to the entire turnover of the assessee. No addition can be made to local transactions under Chapter X of the Act.

Velankani Mauritius vs. DDIT (ITAT Bangalore)(ITA No. 985/Bang/2009)

Profits from supply of 'shrink-wrapped' software is not 'royalty'

The assessee, a Mauritius company, was engaged in supply of software. It supplied "off-the-shelf" "shrink-wrapped" software to Infosys Technologies and took the view that the profits there from was not taxable in India as it did not have a Permanent Establishment in India. The AO assessed the profits as royalty u/s 9(1)(vi) of the Act and this was confirmed by the CIT (A). On appeal by the assessee, HELD allowing the appeal:

(i) In CIT vs. Samsung Electronics 227 CTR 335 the Karnataka High Court has confined its decision to the issue of responsibility of the assessee u/s 195 in deducting tax at source before making remittances to non-residents. Even though the court held in favour of the Revenue on the application of the TDS provisions, the court made it clear in paragraph 78 that it has not examined the question of tax liability of the non-resident assessees in respect of the payments received from assesses in India.

(ii) On the question whether income from supply of software can be assessed as royalty, in Motorola Inc vs. DCIT 95 ITD 269, the Delhi Special Bench held that the crux of the issue was whether the payment was for a copyright or for a copyrighted article. If it was for a copyright, it had to be classified as 'Royalty' under the Act and the DTAA. If it was for a copyrighted article, then it only represented the purchase price of an article and could not be considered as Royalty either under the Act or under the DTAA. This principle was upheld by the AAR in Airports Authority of India and the ITAT in Sonata Software 6 SOT 700 and it was held that the payments partook the character of purchase and sale of goods; and as there is no PE in India, no income accrued or deemed to accrue or arise in India. Immense support can be drawn from Tata Consultancy Services v. State of AP 271 ITR 401 (SC) where it was held that though copyright in a software programme may remain with the originator of the programme, the moment copies are made and marketed, it becomes goods which are assessable to sales-tax. It was held that even intellectual property become "goods" once put to a media whether in the form of books or computer disks or cassettes. Accordingly, profits on sale of software cannot be assessed as royalty either under the Act or under the DTAA.

ACIT v. Dufon Laboratories (2010) 39 SOT 59 (MUM.)

Section 92C - Computation of Arm's length price

Assessee was engaged in business of processing and export of chemicals. It had transaction with associated enterprises (AEs) as well as non-AEs. Method of computation of arm's length price had been stated to be comparable uncontrolled price (CUP) method. Assessing Officer on examination of sales to AEs and to non-AEs averred that assessee was selling goods at higher rate to non-AEs, but it was not selling same to AEs at same rate. He further found that goods sold to AEs were valued at a discount of 5 per cent as compared to goods sold to non-AEs and, accordingly, made certain addition on account of transfer pricing. On appeal, Commissioner (Appeals) held that 97.5 per cent of assessee's turnover was to AEs in USA and Europe and only 2.5 per cent to non-AEs and in order to capture and maximize its profits of big and flourishing market of USA and Europe it had to depend on its AEs only. He held that Assessing Officer had not taken into account these very materials and significant differences while carrying out an ad hoc addition, while he was bold enough to enter chopping seas of CUP method but unable to navigate on account of ignoring core tenets of adjustments in this regard, thus, leading to an erroneous arm's length price. He further held that sale to non-AEs was of 1150 kgs. only, whereas there was a sale of magnitude of 62,000 kgs. to AEs which would have a bearing on prices as volume sold was a significant factor in fixing price and lastly, on calculating simple average there was hardly any profit to assessee. In that view of matter he concluded that transaction with AEs was at arm's length price and there was no case of making adjustment, and, accordingly, deleted addition. Order of Commissioner (Appeals) in deleting addition made on such adjustments was to be confirmed.

M/s Dun & Bradstreet Information Services India Pvt. Ltd. v. ADIT [2010-TII-59-ITAT-MUM-INTL]

Sale of Business Information Report by a non-resident can not be treated as 'royalty' taxable in India. Accordingly, while making payments for the same to non-resident, tax withholding liability does not arises

The Tribunal held that the consideration paid by the taxpayer to foreign affiliates for purchase of Business Information Report (BIR) was not 'royalty' within the meaning of explanation 2(iv) to section 9(1)(vi) of the Income-tax Act, 1961 (the Act). Further, no withholding of tax is required when payment is made to foreign affiliates for purchase of BIR.

DDIT v. TII Team Telecom International Ltd [2010-TII-62-ITAT-MUM-INTL]

The supply of software does not amount to any transfer of copyright but only transfer of copyrighted article. Further, payment received for sale of copyrighted article does not amount to income from royalty within the meaning of the India-Israel tax treaty.

The Tribunal held that the supply of software does not amount to any transfer of copyright but only transfer of copyrighted article. Further, payment received for sale of copyrighted article does not amount to income from royalty within the meaning of the India-Israel tax treaty. Further, the Tribunal held that payment received from sale of software copy does not amount to income from royalty under the tax treaty.

Nimbus Communications Ltd v. ACIT (2010) 38 SOT 246 (Mum.)

S. 92C : Transfer pricing – Arm's Length Price – Interest on Loan

The Tribunal held that arm's length price in relation to an international transaction needs to be determined using one of the most appropriate method mandated in section 92C(1) of the Income-tax Act, 1961(the Act). Further, the Tribunal also held that the rate of interest charged on loan granted cannot be used as a comparable rate for charging interest on outstanding trade receivables.

Cartier Shipping Co Ltd v. DDIT (ITA No. 3036/Mum/07)

Income from sale of an asset of a Permanent Establishment in India as a part of winding up process is taxable in India under the Income-tax Act, 1961 as well as under India-Mauritius tax treaty

The Tribunal has held that income from sale of an asset of an Indian Permanent Establishment (PE), as a part of its winding-up process, is taxable in India under the Income-tax Act, 1961 (the Act) as well as under the India-Mauritius tax treaty (the tax treaty).

Airlines Rotables Limited, UK v. JDIT [2010-TII-52-ITAT-MUM-INTL]

Fixed place PE – 'Power of disposal' test

The 'power of disposal test' is one of the key criteria to evaluate whether a foreign enterprise has a fixed place Permanent Establishment (PE) (a form of business presence) in India. The Mumbai bench of the Income-tax Appellate Tribunal (the Tribunal) analysed this issue in the present case wherein the taxpayer maintained a stock of replacement components at operational bases of airline in India.

The Tribunal in the context of the India-UK tax treaty, held that

- Storage of goods on a consignment basis at specific customer locations in India would not result in a fixed place PE, as such locations were not under the control of the taxpayer. Further, as the business of the taxpayer was not carried out from the customer location, there could be no fixed place PE of the taxpayer in India.
- There is no material to establish that the airlines qualify as a dependent agent permanent establishment (DAPE) of the taxpayer in India. Further, as the airline maintains the consignment stock on behalf of the taxpayer for standby use and not for delivery, the airline will not constitute a DAPE of the taxpayer in India (if at all the agent can be said to be dependent).

Kansai Nerolac Paints v. ADIT (ITAT Mumbai)(ITA No.568/Mum/2009)

Fee for software is NOT royalty & TDS u/s 195 not required

The assessee applied to the AO for a NOC u/s 195(2) for remittance of a fee to IXOS Software, Singapore, to acquire software. The assessee claimed that the fee was commercial profits and not taxable in the hands of the recipient under Article 7 of the India-Singapore DTAA as the recipient did not have a PE in India. The AO & CIT (A) took the view that as *the software was a “copyright” / “secret process” and the assessee had merely acquired a ‘non-exclusive & non-transferable’ license to use the software and as the Singapore Company continued to be the owner of the software, the fee constituted “royalty”* under s. 9(1)(vi) of the Act and Article 12 of the DTAA and that it was chargeable to tax in India. On appeal by the assessee, HELD allowing the appeal:

The effect of the judgements in Tata Consultancy Services vs. State of AP 271 ITR 401 (SC), Samsung Electronics Co 94 ITD 91 (Bang), Motorola Inc 95 ITD 269 (SB) & Dassault Systems 229 CTR 105 (AAR) is that the primary condition for coming within the definition of ‘royalty’ is that the payment must be received as consideration for the use of or right to use any copyright of a literary, artistic or scientific work etc. A ‘right to use the copyright’ is totally different from the ‘right to use the programme embedded in a CD’. In acquiring a ready made off-the-shelf computer programme, no right was granted to the assessee to utilize the copyright of the computer programme. The assessee had merely purchased a copy of the copyrighted article, namely, a computer programme which is called ‘software’. *Computer software when put into a media and sold becomes goods like any other audio cassette or painting on canvas or book*. Accordingly, the amount paid by the assessee towards purchase of the software cannot be treated as payment of “royalty” so as to be taxable in India under Article 12 of the DTAA and the assessee was not liable to deduct tax at source.

LS Cable Ltd. (AAR No. 858-861 of 2009)

Pendency, before a statutory forum, of a similar matter in respect to transaction with a different party is no bar to seek an advance ruling

The Authority held that pendency of a similar matter of the applicant in respect to transaction with a different party, before a statutory forum, is no bar to seek advance ruling in respect of another transaction.

Circulars / Notifications

Notification No. 59/2010, Dated July 21, 2010

SECTION 48, EXPLANATION (V) OF THE INCOME-TAX ACT, 1961 – NOTIFIED COST INFLATION INDEX FOR FINANCIAL YEAR 2010-2011

Cost Inflation Index for the F.Y. 2010-11 notified to be **‘711’**.

Processing of Returns of Assessment Year 2009-10 - Steps to Clear Backlog

Instruction No. 5/2010 [F.No. 225/25 /2010-ITA-II], dated 21-7-2010

The issue of processing of returns for Asst. year 2009-10 and giving credit for TDS has been considered by the Board. In order to clear the backlog of returns, the following decisions have been taken:

(i) In all the returns filed in ITR-1 and ITR-2, for the Asst. Year 2009-10, where the aggregate TDS claim does not exceed Rs. Three lakh (3 lacs) and where the refund computed does not exceed Rs. 25,000; the TDS claim of the tax payer shall be accepted at the time of processing of the return.

(ii) In all the returns filed in forms other than ITR-1 and ITR -2, for the Asst. Year 2009-10, where the aggregate TDS claim does not exceed Rs. Three lakh (3 lacs) and the refund computed does not exceed Rs. 25,000 and there is 10% matching of TDS amount claimed, the TDS claim shall be accepted at the time of processing of the return.

(iii) In all remaining cases, TDS credit shall be given after due verification.

Notification No. 48/ 2010 dated 9th July 2010

Long-term Infrastructure Bonds notified

The Finance Act, 2010 introduced1 a deduction in respect of investment in 'long-term infrastructure bonds' as may be notified by the Central Government.

The deduction can be claimed by an individual or a Hindu Undivided Family (HUF) upto Rs. 20,000 from financial year 2010-11 onwards.

The deduction will be in addition to the existing overall deduction of Rs. one lakh allowed under Section 80C, 80CCC and 80CCD of the Income-tax Act, 1961.

The Central Government has now notified2 the 'Long-term Infrastructure Bonds' eligible for deduction under section 80CCF of the Act. The bonds shall be issued by:

- Industrial Finance Corporation of India;
- Life Insurance Corporation of India;
- Infrastructure Development Finance Company Limited;
- A Non-Banking Finance Company classified as an infrastructure finance company by the Reserve Bank of India.

The tenure of the bonds shall be minimum ten years with a lock-in period of five years. Further, it will be mandatory for the investor to furnish his Permanent Account Number to the issuer for investment in the bonds.

INDIRECT TAXES

Judicial Pronouncements

Maharashtra Chamber of Housing Industry v. UOI (Writ Petition No. 1456 OF 2010)(Bombay HC)

Service Tax – Construction Service – Constitutional Validity of Finance Act 2010 Amendment challenged – No coercive steps till next hearing: Notice issued to Attorney General of India

The Bombay High Court has granted an interim stay on collection of Service Tax levied on buildings under construction, following a writ petition filed by the Maharashtra Chamber of Housing Industry (MCHI). President of MCHI said the chamber had urged the High Court to restrain the respondents (Union Government and others) from taking steps against the members of the Chamber in respect of transactions for construction, development, and sale of immovable property under the various provisions of the Finance Act, 1994 and a new entry as amended by the Finance Act of 2010 in any manner, besides challenging the constitutional validity of the amendment.

According to President of MCHI, the court had said, "No coercive steps shall be taken against the petitioner for the recovery of Service Tax in relation to the provisions in question, but it is clarified that assessment may proceed in accordance with law."

SPM Construction Pvt. Ltd. v. CCE Vadodara [2009(16) STR-763 (Tri.-Ahmd)]

Commercial or Industrial Construction Services

The appellant was registered under "Commercial or Industrial Construction services" and claimed abatement for certain contracts as per the Notification 1/2006 - ST and claimed "NIL" CENVAT Credit and in some other contracts claimed CENVAT Credit. The assessee contented that service tax is a charge on the services rendered and not the person rendering the same and as such, each contract should be viewed independent of each other. The Tribunal agreeing with the contention of the assessee has granted unconditional Stay of demand.

CCE, Ahmedabad v. Fine Care Bios systems [2009 (26) STR 701 (Tri.-Ahmd.)]

CENVAT Credit on outward freight and commission paid on air tickets

The Commissioner (Appeals) allowed CENVAT Credit of service tax on outward freight and commission on air tickets. The Tribunal observed that CENVAT Credit is allowed on outward freight till the place of removal; that is the port from which the goods are loaded for export made on FOB basis. In respect of service tax paid on commission for air tickets, the Tribunal observed that the definition of input service was wide enough to cover all services used directly or indirectly in the manufacture process and thus CENVAT Credit was admissible in this case.

CCE, Vadodara v. Ram Krishna Travels Pvt. Ltd. [2010 (17) STR 487 (Tri.-Ahmd)]

CENVAT Credit and abatement

The assessee availed CENVAT Credit and also availed benefit of abatement under Notification No. 7/2006-ST (as amended). On realizing the mistake, they reversed the credit with interest. The Tribunal observed that the order in favour of the assessee relying on precedents that proportionate reversal for Credit amounts to non-availment of Credit is sustainable.

CCE, Nagpur v. UltraTech Cement Ltd. [(2009 (16) STR 611 (Tri.- Mum)]

CENVAT Credit on Input service analysed

The question for consideration was whether the lower authority rightly allowed CENVAT Credit of service tax paid on security service received at the off-factory residential colony of the assessee, considering the service to be ‘input service’ as per Rule 2(l) of the CENVAT Credit Rules, 2004.

The Tribunal observed that services mentioned in the inclusive part of the definition of input service have also to satisfy the parameters laid down in the main part of the definition as the two parts were not independent of each other and as such, the security service used for residential activity was neither a service received prior to the commencement of manufacture, but the value of which got absorbed in the value of goods, nor was it the case of a service received after the clearance of goods where the service is received up to the stage of clearance of goods. It was also not the case of a service like advertising which was not directly related to manufacture but is related to sale of manufactured goods and as such, the Credit was ineligible.

GHCL Ltd. v. CCE, Bhavnagar [2009 (16) STR 588 (Tri-Ahmd.)]

CENVAT Credit on security agency services

The Tribunal allowed CENVAT Credit of service tax paid on security agency services relating to residential colonies of employees of the appellant, which is in the proximity to their factory. The Tribunal relied on decision in *Manikgarh Cement reported at [2008 (9) STR554 (Tribunal)].*

Circulars / Notifications

Instruction [F.No.267/11/2010-CX8], dated 8-7-2010

Availability of Cenvat Credit on inputs used in the manufacture of capital goods

I am directed to invite your attention to the landmark judgement of the CESTAT Larger Bench in the case of Vandana Global Ltd. V/s CCE, Raipur [2010-TIOL-624-CESTAT-DEL-LB] delivered on 30.04.10, on admissibility of credit on capital goods and inputs and to state that the Tribunal has ruled that ‘capital goods’ defined in the CENVAT Credit Rules, in the context of providing credit of duty paid, have to be excisable goods. Whether a particular plant or structure embedded to earth can be considered as excisable goods or not has to be determined in the light of settled decisions of Supreme Court on the issue. The Tribunal has further ruled that goods like cement and steel items used for laying ‘foundation’ and for building ‘supporting structures’ cannot be treated as either 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. It has also been stated by Tribunal that amendment to Explanation 2 to Rule 2(k) of CENVAT Credit Rules, 2004 inserted vide Notification No. 16/2009-CE (NT) dated 07.07.09, is clarificatory in nature and has **retrospective effect**.

2. Attention is also drawn to the Tribunal’s judgement in the case of Vikram Cement V/s CCE, Indore [2009(242) ELT545(Tri-Del)], where the Tribunal held that credit on welding electrodes used for repair and maintenance, is not available as input. It may also be noted that in the case of Vikram Cements V/s CCE, Indore [2005(187)ELT145(SC)], it has been conclusively held by the Apex Court that the definition of capital goods is not inclusive and only the items covered under the definition and used in the factory of the manufacturer can be treated as capital goods.

3. It thus follows from the above judgements that credit on capital goods is available only on items, which are excisable goods covered under the definition of ‘capital goods’ under CENVAT Credit Rules, 2004 and used in the factory of the manufacturer. As regards ‘inputs’, they have to be covered under the definition of ‘input’ under the CENVAT Credit Rules, 2004 and used in or integrally connected with the process of actual manufacture of the final product for admissibility of cenvat credit. The credit on inputs used in the manufacture of capital goods, which are further used in the factory of the manufacturer is also available, except for items like cement, angles, channels, CTD or TMT bars and other items used for construction of factory shed, building or laying of foundation or making of structures for support of capital goods. Further, credit shall also not be admissible on inputs used for repair and maintenance of capital goods.

4. In view of above stated position, necessary action may be taken to safeguard revenue immediately. Pending cases on the issue may also be taken up immediately for finalisation.

OTHER LAWS

OTHERS

Navi Mumbai Municipal Corporation v. Sargam Foods Bombay High Court

Overdraft facility can't be attached for tax recovery

The taxman does not have claim over the bank overdraft facility of a defaulter since the lender does not owe money, but has promised a loan for business, the Bombay High Court has ruled. By taking an overdraft facility, a taxpayer becomes a debtor to the bank and hence, no authority has the right to attach overdraft facility for recovering tax dues, the court said in an order dated July 8.

The court ruling related to outstanding municipal cess. The court said that Navi Mumbai Municipal Corporation did not have the right to attach the overdraft account of the Thane-based Sargam Foods to recover dues from the company. The overdraft facility was from the Dombivli Nagari Sahakari Bank.

To recover dues from defaulters, authorities issue notices to those who owe money to the defaulter, like in bankruptcy proceedings. While the assets of the defaulter could be sold to recover dues, contracted loans could not be treated as assets. There were precedents to such rulings.

"Where the banker lends money on an overdraft and the customer is always in debit, there is no stage at which the banker is debtor to the customer nor at any point of time he holds any money of the customer or the latter's account," the Madras High court had held. A similar judgement was delivered by the Karnataka High Court in 1999 in a case between Karnataka Bank and the Commissioner of Commercial Tax.

Sargam lawyer Jitendra Jain said such notices for recovery could be sent to "any person from whom money is due or may become due to the assessee or any person who holds or subsequently holds money for or on account of the assessee."

The division bench comprising justice RG Ketkar and justice PB Majmudar agreed with the verdict of Madras and Karnataka High Courts and set aside the order of NMMC. This does not stop the municipal corporation from recovering the money in any other manner.

Shri Ganpati Panchayatan Sansthan Trust v. Union of India (Writ Petition No. 4778 of 2009)

An unregistered private trust cannot open a Demat account in its name and in the name of Gods or Goddesses.

It is true that under Income Tax Act individual income received by a particular trust for a particular deity may be treated as income of said deity, but provisions of Income Tax Act cannot be relied upon so far as opening of Demat account is concerned. Demat account is essential a commercial activity done on a day to day basis and it is not expected that a private trust would bring the Gods and Goddesses in the matter of share trading business.

Garware Polyester vs. State (Bombay High Court)(Writ Petition No.1085 of 2010)

Failure to follow High Court's order is contempt of court

The AO passed an assessment order in which he declined to follow the judgement of the Bombay High Court in CST vs. Pee Vee Textiles 26 VST 281 on the ground that the said judgement "is not accepted by the Sales Tax Department and legal proceeding is initiated against the said judgment". On a Writ Petition filed by the assessee, the High Court has taken the view that as the said judgement in Pee Vee Textiles is not stayed, "the refusal to follow and implement the judgment of this Court by Mr.Dubey in our considered view prima facie amounts to contempt of this Court". The Court directed issue of a show-cause notice to the AO as to why action under the Contempt of Courts Act should not be initiated against him.

PIB press release dated 28 July 2010

India and Czech Republic sign Social Security Agreement

India has recently signed a social security agreement ('SSA') with Czech Republic. The SSA provides for the following benefits, on a reciprocal basis, to Indian nationals working in Czech Republic:

- Indian nationals working in the Czech Republic, on short term contract up to five years, will be exempt from making social security contributions under the Czech laws provided they continue to make social security contributions in India.

- The above benefits shall be available even when an Indian company sends its employees to Czech Republic from a third country.
- Indian nationals shall be entitled to export of social security benefits if they relocate to India or a third country after the completion of their assignment in Czech Republic.
- The above benefit of exportability would also be available to self employed Indian nationals in Czech Republic.
- The period of contribution made in one state will be added to the period of contribution in the second state for determining the eligibility for social security benefits in order to avoid loss of contributions.

The SSA will come into force from the date to be notified separately.

Indian Stamp Act - 1899

The Finance Ministry has released a draft Bill containing proposed amendments to the Indian Stamp Act, 1899. Besides other amendments, it is proposed to amend definition of 'Conveyance' to include in its scope every such order of the High Court/ Tribunal under Section 394 of the Companies Act, 1956, sanctioning the scheme of amalgamation or reconstruction of companies, including banking companies, by which the property is transferred inter vivos. The rate of stamp duty on conveyance is proposed at 5 percent of the market value of the property which is the subject matter of conveyance and no separate rate is prescribed in relation to the High Court Order.

OECD approves the 2010 Transfer Pricing Guidelines

The OECD Council has approved the 2010 version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations on 22nd July, 2010.

Chapters I-III of the Transfer Pricing Guidelines were substantially revised as a result of the review of comparability and profit methods that was undertaken by the OECD, with input from non OECD economies. Building on the experience acquired by tax administrations and taxpayers in the application of the Transfer Pricing Guidelines since they were originally released in 1995, new guidance was developed on the selection of the most appropriate transfer pricing method to the circumstances of the case, the practical application of transactional profit methods (the transactional net margin method and the profit split method) and the performance of comparability analyses.

In addition, the 2010 version of the Transfer Pricing Guidelines contains a new Chapter IX on the transfer pricing aspects of business restructurings. This new Chapter results from the OECD project on business restructurings, which also benefited from significant input from the business community and non OECD economies.

Due Dates of key compliances pertaining to the month of August 2010:

5th August	***Payment of Service Tax & Excise duty for July***
6th August	***Payment of Excise duty paid electronically through internet banking***
7th August	***TDS/TCS Payment for July***
10th August	***Excise Return ER1 / ER2 /ER6***
15th August	***PF Contribution for July***
21st August	***ESIC Payment for July***

The information contained in this newsletter is of a general nature and it is not intended to address specific facts, merits and circumstances of any individual or entity. We have tried to provide accurate and timely information in a condensed form however, no one should act upon the information presented herein, before seeking detailed professional advice and thorough examination of specific facts and merits of the case while formulating business decisions. This newsletter is prepared exclusively for the information of clients, staff, professional colleagues and friends of SNK.