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India Tax Konnect

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Editorial

Post election results, as the Bharatiya Janata Party came into power, it has been witnessed that, the benchmark stock index soared over six per cent to a record high and the INR touched an eleven month high cutting below 59 per USD.[1] Another positive development was the announcement of India being ranked at the third position in the International Comparison Program ranking for 2011, conducted by the World Bank. The ranking is based on the Gross Domestic Product measured in purchasing power parity terms.[2] However, the new government needs to address certain important economic aspects like, taming of inflation, increasing growth, generating employment, providing impetus to infrastructure and creating a conducive atmosphere to attract foreign direct investment to India.

On the judicial front, the Delhi High Court in the case of Linde AG, Linde Engineering Division and Anr. (Linde) held that the consortium between Linde and Samsung was not forming an association of persons and the contract between them was divisible. The High Court held that offshore supply was not taxable in India since the property was transferred outside India and the contract was not resulting in a business connection in India. In relation to the taxability of offshore services under the Income-tax Act, 1961 (the Act), it was held that if such services are linked with the manufacture and fabrication of the material and equipment to be supplied overseas, formed an integral part of the said supplies, it was not taxable in India.

The Delhi High Court in the case of Centrica India Offshore Pvt. Ltd. held that the secondment of employees by foreign group companies to an Indian company constitutes a service Permanent Establishment (PE) in India, since there was no employment relationship between the taxpayer and the seconded employees and the taxpayer had no right to terminate the employment of the seconded employees. Further, services provided by seconded employees are 'technical or consultancy' in nature, since employees possessed the necessary technical knowledge and skills which were 'made available' to the employees of the Indian company till the necessary skill set was acquired by the employees of the Indian company.

The Authority of Advance Rulings (AAR) in the case of Steria (India) Ltd (applicant) ruled that payment for management services would be taxable as 'Fees for Technical Services' as the benefit of 'make available' clause under the India-U.K. tax treaty cannot be imported to interpret the provisions of the tax treaty with France. The AAR observed that a protocol cannot be treated as the same with the provisions of the tax treaty itself, though it may be an integral part of the tax treaty. As per the protocol, the restrictions are on the rates and 'make available' clause cannot be read into it.

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

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[1] Rajesh Kumar Singh and Aditi Shah, 'India's pro-business Modi storms to historic election win,' Reuters Edition, 16 May 2014.
[2] 'India displaces Japan to become third-largest world economy in terms of PPP: World Bank,' The Economic Times, 30 April 2014.

International tax

Decisions

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

An Indian company (the Company) entered into a Master services Agreement (the Agreement) with a non-resident partnership firm (the service provider) formed in France to receive various management services.

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

The company contended that the benefit of the 'make available' clause in the India-U.K. tax treaty, which was signed after 1 September 1989 should be available under the India-France tax treaty (the tax treaty) by virtue of the protocol signed between India and France. Thus in absence of the technical knowledge, experience, skill, know-how or processes being 'made available' by the service provider to the company, the services ought not qualify as Fees for Technical Services (FTS) under the tax treaty.

The AAR ruled that payment for management services will be taxable as FTS as the benefit of 'make available' clause under the India-U.K. tax treaty cannot be imported to interpret the provisions of the tax treaty with France, inter alia, for the following reasons:

- A protocol cannot be treated in the same way as the provisions [Most Favoured Nation (MFN)] contained in the tax treaty itself, though it may be an integral part of the tax treaty;
- As per the protocol, the restrictions are on the rates and the benefit of 'make available' clause cannot be read into it;
- The Notification No. GSR 681(E), dated 7 September 1994 and Notification No. 11438 [SO 650(E), (F.No.501/16/80-FTD)], dated 10 July 2000 do not cover the 'make available' clause. Had the intention been to include the 'make available' clause in the India-France tax treaty, it should have been included in the notification.

Steria (India) Ltd. [2014] 45 taxmann.com 281 (AAR)

A consortium formed for the limited purpose of acquiring a contract does not lead to the constitution of an association of persons under the provisions of the Act

An Indian company floated a tender inviting bids for executing a turnkey project in India. A German company (the Company) and a Korean company (collectively called 'the Companies') entered into a Memorandum of Understanding (MOU) for jointly submitting a bid for the project. The Indian company accepted the proposal made by the Companies. The project involved the offshore and onshore supply of services and equipment.

On a petition filed by the company before the AAR, it was held that the Companies constituted an Association of Persons (AOP) under the provisions of the Act and that the profit/income of the AOP was taxable in India.

Aggrieved by the AAR ruling, the Companies filed a writ petition before the High Court.

The High Court held that the consortium formed between the Companies was only for acquiring the project/contract and no AOP was formed, inter alia, for the following reasons:

- An AOP is one in which two or more persons join together for a common purpose or a common action and there is joint management or joint action by the said two or more persons. A mere cooperation of one person with another in serving one's business objective would not be sufficient to constitute an AOP merely because the business interests are common;
- The consortium was established for the limited purpose of representation and dealing with the Indian company with independent and a separate scope of work as set forth explicitly in the MOU;
- The Companies were independent of each other and were responsible for their own deliverables under the Contract, without reference to each other;
- The fact that a third party is desirous to deal with the members as one consortium cannot be the determinative factor in considering whether the members constitute an AOP.

Further, the High Court held that the offshore supply of equipment/materials was not taxable in India since the property, equipment/materials was transferred to the buyer outside India. In relation to the taxability of offshore services, the High Court held that if such services form an integral part of the offshore supply of equipment/materials, such services would not be taxable in India under the provisions of the Act.

Linde AG, Linde Engineering Division v. DDIT [2014] 44 taxmann.com 244 (Del)

Employees seconded to provide business support services constitute a service PE in India

The taxpayer, an Indian company, was established as a wholly owned subsidiary of a U.K. based company to overlook and manage certain back office functions outsourced to Indian vendors by two subsidiaries (one in U.K. and other in Canada) of the U.K. based parent (overseas entities).

To seek support during the initial years of the operations, the taxpayer sought some employees on secondment from the overseas entities. The seconded employees were to work under the supervision and control of the taxpayer. The taxpayer reimbursed the salary cost of the seconded employees to the overseas entities on a cost-to-cost basis and also withheld and paid tax in India on the salary paid to the seconded employees.

The taxpayer filed an application before the AAR, seeking a ruling on the issue of taxability of the sums reimbursed in the hands of the overseas entities and consequential withholding tax obligations on the taxpayer. The AAR ruled that the overseas entities constituted a Service PE in India under the tax treaty, and hence the taxpayer was obliged to withhold tax at source.

Aggrieved by the ruling given by the AAR, the taxpayer filed a writ petition before the High Court seeking to quash the ruling of the AAR.

The High Court ruled that the services rendered by the seconded employees qualified as 'technical services', inter alia, for the following reasons:

- The overseas entities have provided 'technical services' to the taxpayer, since, inter alia, the expression FTS/Fees for Included Services (FIS) in the tax treaty includes the provision of the service of personnel;
- The payment is not, in nature, a reimbursement, but rather a payment for rendering services. The nomenclature or less than expected charge for such services cannot change the nature of the service;
- The seconded employees possessed the necessary technical knowledge and skills which were 'made available' to the employees of the Indian company till the necessary skill set was acquired by the employees of the Indian company.

Further, the High Court upheld the ruling of the AAR that the seconded employees create a service PE of the overseas companies. While reaching its conclusion the High Court noted, inter alia, the following:

- There was no employment relationship between the taxpayer and the seconded employees since the assessee had no right to terminate the employment of the seconded employees;
- The seconded employees could not sue the taxpayer for default in the payment of their salary;
- The seconded employees retained their entitlement to participate in the retirement and social security plans of the overseas entities.

Centrica India Offshore (P.) Ltd. v. CIT [2014] 44 taxmann.com 300 (Del)

Transponder fees are taxable as royalty under the Act as well as under the India-USA tax treaty

The taxpayer, Viacom 18, is primarily engaged in the business of broadcasting television channels from India. The taxpayer was provided with satellite signal reception and re-transmission services (transponder services) by Intelsat Corporation, US (Intelsat). In consideration for transponder services, the taxpayer paid a transponder service fee to Intelsat.

The taxpayer approached the Assessing Officer (AO) for an order under Section 195(2) of the Act for nil withholding tax on payments to be made to Intelsat. The AO held that the transponder fee payable by the taxpayer to Intelsat was, in nature, 'royalty' income under the Act and also under the India-USA tax treaty, and accordingly the payments were liable to withholding tax.

The Tribunal, based on the facts of the case, held as follows:

- The definition of royalty is common under the tax treaty as well as under the Act to the extent of 'payment of any kind received as consideration for the use of, or the right to use… any process, industrial, commercial or scientific equipment'.
- The term 'process' is defined in Explanation 6 to Section 9(1)(vi) of the Act. The retrospective introduction of Explanation 6 to Section 9(1)(vi) from 1 June 1976 is clarificatory in the nature and it did not amend the definition of 'royalty' per se.
- The use of a transponder by the taxpayer falls within the expression 'process' under Explanation 6 of Section 9(1)(vi) of the Act. Further, the term 'process' is not defined in India-USA tax treaty. Therefore, the meaning of such a term under the Act shall apply to the India-USA tax treaty.
- Hence, the payments made for use/right to use of process falls in the ambit of expression 'royalty' under the India-USA tax treaty as well as the provisions of the Act.

The decision of the Delhi High Court in the case of Asia Satellite Communication Co. Ltd. [2011] 197 taxman 263 (Del) is not applicable in view of the insertion of an explanation below sub-section (2) of Section 9 (inserted vide the Finance Act, 2010) and Explanation 6 to Section 9(1)(vi) of the Act (inserted vide the Finance Act, 2012). The Tribunal also relied on the decision of the Madras High Court in the case of Verizon Communications Singapore Pte. Ltd. [2014] 361 ITR 575 (Mad) which had distinguished the decision of the Delhi High Court in case of Asia Satellite Communication Co. Ltd.

Viacom 18 v. ADIT [2014] 44 taxmann.com 1 (Mum)

Corporate tax

Decisions

TDS under Section 194-I of the Act attracted on employee's car hire and Section 194C of the Act for chauffeur's services for the purpose of deduction of tax at source

The taxpayer is in the business of providing telecommunication network and services across the country. For the smooth functioning of its business, it enters into maintenance contracts with various contractors. For AYs 2007-08 to 2009-10, the taxpayer deducted tax at source for payments to contractors. The taxpayer inter alia made payments toward 'vehicle hiring' and deducted tax under Section194C of the Act. However, the AO considered it to be covered under Section 194-I of the Act dealing with Tax Deducted at Source (TDS) on rent payments. On appeal, the Commissioner of Income-tax [CIT(A)] held that the nature of services contracted were not towards car hiring but for the facility of transportation from one place to another, with the rates fixed for a particular vehicle with reference to distance and timing. Further, the cars were not at the disposal of the taxpayer. Being aggrieved, the tax department preferred an appeal before Mumbai Tribunal.

The Mumbai Tribunal observed that as per Section 194-I of the Act, rent means a payment, under any lease, sub-lease, tenancy or any other agreement or arrangement for the use of (either separately or together) any land; building; land appurtenant thereto; machinery; plant; equipment; furniture; or fittings. Thus, a vehicle or motor car would come within the purview of the words 'plant' or 'machinery' which are generic terms and accordingly, the arrangement for providing cars to the taxpayer's personnel for their work would stand to be covered by Section 194-I of the Act. The Tribunal further clarified that the chauffeur's services included in the vehicle hiring arrangement as well as meeting the fuel cost of transportation, could not be considered toward car rental and would attract TDS under Section 194C of the Act.

ITO v. Bharat Sanchar Nigam Ltd. [2014] 45 taxmann.com 124 (Mum)

Proceeds generated from scrap sales should not be included in 'total turnover' for the purpose of deduction under Section 80HHC of the Act

The taxpayer is a manufacturer and exporter of stainless steel utensils. In the process of manufacturing stainless steel utensils, some portion of the steel, which cannot be used or reused, is treated as scrap. The taxpayer disposes of the said scrap in the local market and the income arising from the said sale is also reflected in the profit and loss account, separate from the turnover. For the purpose of availing deduction under section 80HHC of the act, the taxpayer was not including the sale proceeds of scrap in the total turnover. According to the tax department, the sale proceeds from the scrap should have been included in the 'total turnover' as the scrap was also part of the sale proceeds. The taxpayer objected to the said inclusion of scrap sales in total turnover as it would reduce the amount deductible under Section 80HHC of the Act. The High Court decided the said issue in favour of the taxpayer. Aggrieved by this, the tax department filed an appeal before the Supreme Court.

The Supreme Court noted that the term 'turnover' was neither defined in the Act nor was it explained by any of the Central Board of Direct Taxes (CBDT) circulars; therefore, the meaning of the term in ordinary accounting or commercial parlance had to be examined. The Supreme Court held that, the word 'turnover' would mean only the amount of sale proceeds received in respect of the goods in which a taxpayer is dealing. It would not include the amount received, if any, from the sale of scrap of metal pieces or sale proceeds of old or useless things sold during that accounting year. The Supreme Court also noted that the buyer of such scrap would, however, treat the same as turnover for the simple reason that the buyer would be a person who is primarily dealing in scrap. The Supreme Court also referred to the 'Guidance Note on Tax Audit Under Section 44AB of the Income Tax Act' published by the Institute of Chartered Accountants of India, which has explained the meaning of the words 'sales', 'turnover' and 'gross receipts', and held that in normal accounting parlance the word 'turnover' would mean 'total sales'. The Supreme Court also observed that the intention behind Section 80HHC enactment was to encourage export and earn more foreign exchange and once the government decides to give the benefit, tax department should also make all possible efforts to encourage such traders/manufacturers by giving such businesses more benefits as contemplated under law.

CIT v. Punjab Stainless Steel Industries (Civil Appeal No. 5592 of 2008)

Gains arising from PMS transactions are capital gains and not business profits

The taxpayer offered long-term capital gains (LTCG) and short term capital gains (STCG) on the sale of shares, which had arisen through a Portfolio Management Scheme (PMS) of Kotak and Reliance. The investments were shown under the head 'investments' in the books and were made out of surplus funds. The purchase and sale of shares were done through actual delivery, The AO, CIT (A) and the Tribunal held that as the transactions by the PMS Manager were frequent and the holding period was short, the income is assessable as business profits.

The Delhi High Court allowing the appeal of the taxpayer held that the PMS Agreement in this case was a mere agreement of the agency and could not be used to infer any

intention to make profit. The intention of the taxpayer must be inferred holistically, from the conduct of the taxpayer, the circumstances of the transaction, and not just from the seeming motive at the time of depositing the money. Along with the intention of the taxpayer, other crucial factors like the substantial nature of the transactions, frequency, volume, etc. must be taken into account to evaluate whether the transactions are adventure in the nature of trade. The block of transactions entered into by the portfolio manager must be tested against the principles laid down, in order to evaluate whether they are investments or adventures in the nature of trade. In the instant case, the sources of funds of the taxpayer were its own surplus funds and not borrowed funds. About 71 per cent of the total shares had been held for a period longer than six months, and had resulted in an accrual of about 81 per cent of the total gains to the taxpayer. Only 18 per cent of the total shares were held for a period less than 90 days, resulting in the accrual of only four per cent of the total profits. This shows that a large volume of the shares purchased were, as reflected from the holding period, intended towards the end of investment. The fact that an average of four to five transactions were made daily, and that only eight transactions resulted in a holding period longer than one year is not relevant because the number of transactions per day, as determined by an average, could not be an accurate reflection of the holding period/frequency of transactions. Moreover, even if only a small number of transactions resulted in a holding for a period longer than a year, the number becomes irrelevant when it is clear that a significant volume of shares was sold/purchased in those transactions.

Radials International v. ACIT (ITA No.485/2012 dated 25 April 2014)

Payment for provision of passive infrastructure by the petitioner, an owner of a network of telecom towers, to telecom service providers, amounts to 'rent for the use of machinery, plant or equipment'

The taxpayer provided passive infrastructure services to its customers, i.e., major telecom service providers in the country which, inter alia included, tower, shelter, diesel generator sets, batteries, air conditioners, etc. The petitioner applied for issue of a lower deduction certificate on its projected receipts under Section 194C of the Act. The AO however issued a lower deduction certificate treating receipts under Section 194-I. Aggrieved by that certificate, the taxpayer filed a writ petition before the Delhi High Court, which by its order directed the taxpayer to prefer a revision petition before the CIT who was to dispose it of expeditiously. The CIT by its impugned order under Section 197 of the Act declined its request for determination of a lower rate of tax deduction at source. Thus, the crucial question to be decided in the instant case was whether the activity, i.e., provision of passive infrastructure by the taxpayer to the mobile operator, constituted renting within the extended definition under Explanation to Section 194-I or whether the activity was service, pure and simple without any element of hiring or letting out of premises. The taxpayer urged that there was no intention to rent or lease the premises or facilities or equipment and what was contemplated by the parties was a service. On the other hand the tax department contended that the use of the premises, and the right to access it, amounted to renting the premises.

The Delhi High Court held that the dominant intention in these transactions between the taxpayer and its customers was use of equipment or plant or machinery, hence, the operative intention here, was use of equipment. Since the use of premises was incidental, in that sense the transaction was inseparable, therefore the submission of the taxpayer that the transaction involved no 'renting' at all, was incorrect. Equally, the tax department's contention that the transaction was one where parties intended renting of land because of right to access being given to mobile operators was also incorrect. The underlying object of the arrangement or agreement was use of machinery, plant or equipment, i.e. passive infrastructure services to mobile operators which amounted to 'rent' for use of machinery, plant or equipment, and thus tax deductions were to be at a rate directed in Section 194-I for use of any machinery or plant or equipment at two per cent.

Indus Towers Ltd. v. CIT [2014] 44 taxmann.com 3 (Del)

Deduction under Section 35 on account of raw material purchased for research and development to be allowed in the year of purchase of raw materials, though they remained unused/unconsumed during the year

The taxpayer is engaged in the business of manufacture and sale of specialty chemicals and intermediates. It purchased certain raw materials for research and development (R&D) activities. It claimed the expenditure for raw materials of INR27.5 million under Section 35 of the Act for AY 2007-2008. The AO observed that the taxpayer failed to furnish the relevant supporting details like the nature of the expenditure in detail, evidence for the purchase of raw material, stock register of raw material consumed etc. Further, the AO noted that expenditure of raw materials for R&D was over and above the total expenditure claimed on raw materials reported in the statutory audit report. Thus, the AO concluded that the taxpayer could not establish that R&D expenditure was incurred over and above the expenditure on raw material already debited in the audited profit and loss account and so disallowed the expenditure. The CIT(A) upheld the order of the AO. Aggrieved by the same, the taxpayer preferred an appeal before the Pune Tribunal.

The Pune Tribunal held that when a material is purchased for R&D purposes, it is immaterial whether the material is consumed during the year or held as closing stock, and the entire expenditure incurred on raw material for the purpose of R&D qualifies for deduction under Section 35 of the Act irrespective of the accounting treatment of the same in the books of account. The Tribunal referred to certain decisions wherein R&D expenditure was allowed in respect of capital expenditure and it was observed that the Revenue should not deprive the taxpayer of the benefit of deduction under Section 35 even if the asset was not put to use for R&D.

Balaji Amines Pvt. Ltd. v. ACIT (ITA No.1448/PN/2011)

Municipal Committee, a tax exempt entity is also subject to disallowance of expenditure if tax is not deducted on the same

During AY 2010-11, the taxpayer, a municipal committee, made a payment of INR3.46 million towards supply, erection, testing and commissioning of lights. As per the AO, TDS provision under Section 194C of the Act for contract payment was applicable in taxpayer's case. Since the taxpayer failed to deduct tax at source, the AO disallowed the payment under Section 40(a)(ia) of the Act and did not grant the exemption

under Section 10(20) of the Act on such amounts added to the income. The CIT(A) further confirmed the AO's order. Aggrieved, by the order of the CIT(A), the taxpayer filed an appeal before the Amritsar Tribunal.

Before the Amritsar Tribunal, the taxpayer argued that being a municipal corporation, its income was exempt under Section 10(20) of the Act and therefore, it was submitted that its income was not covered under the head 'Profit & Gains of Business and Profession' and accordingly provisions of Section 40(a)(ia) of the Act were not applicable. The Tribunal held that the provisions of Section 40(a)(ia) of the Act are deeming provisions and such deeming provisions were applicable notwithstanding anything otherwise provided under the Act. Since the taxpayer had violated the provisions of Section 194C of the Act, provisions of Section 40(a)(ia) of the Act were triggered. Further, the Tribunal also held that no benefits in the form of deduction or exemption could be allowed on violating the provisions of the Act. Separately, the Tribunal relying on the co-ordinate bench ruling in Mahabir Cotton Traders [ITA No. 326(Asr)/2010] rejected the taxpayer's contention that since no amount was payable as on balance-sheet date, no disallowance under Section 40(a)(ia) of the Act can be made.

Municipal Committee v. ITO (ITA No. 34(Asr)/2014)

Payments made for the use of database and human skill transfer are revenue in nature though the benefit may be enduring

The taxpayer is a newly incorporated company due to the division of software and hardware business by the erstwhile TATA IBM. During the year under consideration, the taxpayer made a payment of i) INR53 million towards transfer of domestic customer database ii) payment of INR93.8 million (cost belonging to non STP unit) towards transfer of human skills which was claimed as revenue expenditure by the taxpayer. The AO disallowed the aforesaid claim on the grounds that same were capital in nature and incurred enduring benefit. The CIT(A) confirmed the AO's order. The Tribunal reversing the order of the AO and the CIT(A) decided the said issue in favour of the taxpayer. Aggrieved by the same, the tax department appealed before the High Court.

The Karnataka High Court after perusing the agreement between IBM and TATA held that the amount paid by the taxpayer towards the domestic customer database was only for the right to use that database and not for the acquisition of such database. The transferor company was not precluded from using the database. Relying on the judgment of the Karnataka High Court in the case of Wipro Ge Medical System Ltd, it held that the payment made for access to the database is revenue in nature. With respect to the payment made for the transfer of human skills, the High Court observed that TATA IBM had spent lot of money to give training to the employees who were transferred to the taxpayer. The High Court noted that the expenditure was incurred for the employees' past services in TATA IBM and it cannot be said that payment has been made for expenses incurred by TATA IBM on training given to employees transferred to the taxpayer, and hence the same are revenue in nature. The High Court held that the concept of payment made once and for all and of the enduring benefit respond to the changing economic realities of business, and hence the expenditure incurred on processing domestic customer database and transfer of human skill is a revenue, though the benefit may be enduring in nature.

CIT v. IBM Global Services India Private Limited (ITA NO.735/2007)

Mergers and acquisition

Decisions

Transfer of undertaking not involving monetary consideration is an exchange transaction and not a slump sale

The Bombay High Court upheld the finding of the Tribunal that the transfer of an undertaking in exchange for the issue of preference shares and bonds without any mention of monetary consideration for the transfer was a case of exchange and not a sale, and therefore, provision of Section 50B of the Act was inapplicable and dismissed the appeal filed by the tax department.

CIT v. Bharat Bijlee (Appeal No. 6401/MUM/ 2008)

The Supreme Court held that carried forward losses of amalgamating co-operative societies cannot be claimed by amalgamated co-operative societies

The Supreme Court held that since there is no specific provision for set off of carried forward losses of amalgamating co-operative society by an amalgamated co-operative society, an amalgamated co-operative society cannot claim the carried forward losses of amalgamating co-operative societies. The Supreme Court observed that Section 72A of the Act provides for setting off losses on amalgamation of companies only. Also if one class of legal entities is given some benefit which is specifically stated in the Act, it does not mean that the legal entities not referred to in the Act would also get the same benefit. Thus the Supreme Court held that the amalgamated co-operative society cannot claim set-off of losses of amalgamating co-operative societies.

Rajasthan R.S.S. & Ginning Mills Fed. Ltd. v. CIT (Civil Appeal No.3880 of 2003)

Transfer pricing

Decisions

The Delhi Tribunal upheld the taxpayer's residual Profit Split Method over the TPO's Transactional Net Margin Method and held that the allocation of residual profits was to be based on contributions from each entity

The taxpayer is a company incorporated in India which is a subsidiary of EGN BV, Netherlands and is engaged in providing internet and related network services to the group's customers in India. An upward adjustment was made to the Arm's Length Price (ALP) for Assessment Year (AY) 2007-2008 and 2008-2009 by the Transfer Pricing Officer (TPO) by adopting the Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM) and rejecting the Profit Split Method (PSM) adopted by the taxpayer. The Dispute Resolution Panel (DRP) upheld the conclusion drawn by the TPO.

The taxpayer contended that as the group operations are highly integrated, interconnected and intrinsically linked, wherein multiple entities are engaged in the transaction and where one group entity incurs expenditure and one group entity records revenue, only PSM can be the MAM, and if not correctly applied, the remedy is to correct the same rather than concluding to change the method itself.

The Tribunal held that:

- The nature of the taxpayer's group operations is integrated, interconnected and interdependent as the transaction passes through various Associated Enterprises (AE's) and their contribution and revenue is also shared.
- Agreed with the taxpayer's contention that TNMM cannot be used for benchmarking returns earned by the number of complex entities/entrepreneurs, where each make valuable unique contributions. The TPO, while adopting the TNMM, considered operating profit at the entity level whereas TNMM contemplates benchmarking at the transactional level.
- Guidance to determine the ALP can be taken from the OECD commentaries, the UN guidelines and other such literature.
- When the transaction involves contributions of multiple entities and is integrated and interrelated, the PSM is the MAM and presence or use of unique intangibles is not a must for adopting the PSM.
- The Tribunal, rejecting the tax department's contention that the residual PSM cannot be applied as reliable external market data necessary for the same was not available, held that the basic routine rate of returns determined by the taxpayer was based on external benchmarking.
- A harmonious interpretation of the provisions is required to make the Rules workable as any benchmarking at this stage may not be practicable as comparables having similar, multiple, interrelated and integrated transactions, would be difficult to find. The Tribunal upheld the allocation of residual profits on the basis of contribution made by each entity.
- The legislature has introduced Rule 10AB by the Income-tax (Sixth Amendment) Rules, 2012 with effect from 1 April 2012 under the sub head 'Other method of determination of ALP'. When a new method is allowed, with the objective of enabling determination of the proper ALP, such a provision operates retroactively, and can be used to determine the ALP in the earlier AYs also.
- The Tribunal remitted the matter back to the file of the AO for fresh adjudication in line with the observations made by the Bench.

Global One India Pvt. Ltd. v. ACIT [ITA No. 5571/Del/2011 and ITA No.5896/Del/2012]

Indirect tax

Service tax - Decisions

After 31 December 2013, the option to discharge the first installment under the Voluntary Compliance Encouragement Scheme (the scheme) along with interest, is unavailable

In the instant case, the issue was that in case the declarant has defaulted in discharging 50 per cent of the tax declared under the scheme (on or before the due date i.e. 31 December 2013), can the same be discharged till 31 December 2014.

The Tribunal held that the option of payment of the first installment (which was payable till 31 December 2013) along with interest till 31 December 2014 is not available under the provisions of the scheme. Further, in the event of any default under the scheme the authority can only take recourse as specified under the scheme (i.e. sending notice, seize any immovable property of the declarant, etc.). However, the authorities cannot initiate prosecution on the declarant.

Parijat Vyappar Private Limited & ANR v. UOI [2014-VIL-107-CAL-ST]

The constitutional validity of service tax on a service portion involving the supply of food/other articles of human consumption was upheld

In the instant case, the issue was whether levying service tax on a service portion involving the supply of food/other articles of human consumption is constitutionally valid.

The High Court observed that the Constitution of India [under Article 366 29(A) (f)] does not indicate that the service portion is subsumed in the sale of food, rather it separates the sale of food and drinks from service and therefore, the Parliament was constitutionally competent to charge service tax on a such service portion.

It also held that no Value Added Tax (VAT) should be charged on the service portion which has already been subjected to tax and hence, has advised the state governments to issue a clarification/direction to ensure that the consumers are not unnecessarily doubly taxed.

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

Services provided by FICCI to its members are not liable to service tax

In the instant case, the issue was whether the activities undertaken by the Federation of Indian Chamber of Commerce & Industry (FICCI) for its members, with an objective of common good of the Indian business, would be liable to service tax under the taxable service category of 'Club or Association services'.

The Delhi Tribunal held that the transaction was not liable to service tax on the basis of the following:

- The services provided by FICCI to its own members would be construed as a provision of service to itself;
- The activities undertaken were public services, which are specifically excluded from the definition of taxable services;
- FICCI being a registered company in India falls under the exclusionary clause of the definition of 'Club or Association'.

Federation of Indian Chamber of Commerce & Industry and Ors. v. CST [TS-136-Tribunal-2014-ST]

Cancellation and VISA charges collected by the air travel agents from end customers are not liable to service tax

In the instant case, the following issues were under consideration:

- Whether service tax would be levied on the cancellation charges collected by an air travel agent from end customers;
- Whether service tax paid on cancelled air tickets would be adjustable against service tax liability on other bookings;
- Whether charges collected for arranging VISA would be leviable to service tax under 'Business Auxiliary Services'

The Tribunal held as under:

- Since, cancellation charges were not collected from airlines but from the end customers, and no commission was received from the airlines on such receipts therefore, such cancellation charges would not be liable to service tax;
- Excess service tax paid on cancelled air tickets can be adjusted against service tax liability on other bookings;
- The activity of arranging VISA was not covered under any of the sub-clause of 'Business Auxiliary Services' and hence, not subjected to service tax levy.

Global Forex & Travels Ltd. v. CCE [TS-135-Tribunal-2014-ST]

Central Excise - Decisions

A job worker cannot claim exemption with respect to the goods manufactured on their own account, but subsequently supplied to the principal manufacturer

In the instant case, the job worker had received raw materials from the principal manufacturer for carrying out job work. The job worker, instead of clearing goods manufactured out of the said raw materials, cleared their own manufactured finished goods under the cover of job work challans to the principal manufacturers. The Central Excise authorities have demanded excise duty on such finished goods. The job worker contended that, subsequently excise duty has been paid on the finished goods cleared by them, which were manufactured out of job worked items.

The Ahmedabad Tribunal held that, the lower authorities were correct in holding that the job worker should discharge the duty liability on the finished goods manufactured out of his own raw materials.

National Conductors v. CCE [2014-TIOL-553-CESTATAHM]

At the time of receipt of capital goods, the manufacturer is not required to be the owner of such goods for availing the credit

In the instant case, the taxpayer for the purpose of setting up of a refinery plant has entered into composite lump sum turnkey contracts for various Engineering, Procurement, Construction and Commissioning (EPCC) Contracts with different contractors. The contractors purchased the capital goods and installed the same in the plant. The taxpayer had availed CENVAT credit on these capital goods.

However, the Central Excise authorities denied the credit on the grounds that, at the time of receipt of capital goods in the refinery where the same had been installed for setting up the plant, the taxpayer was not the owner of capital goods, as the same had been brought by their contractor for setting up the plant.

The Delhi Tribunal held that 'capital goods' as defined under Rule 2(a) of the CENVAT Credit Rules, 2004, are those goods which are specified under the said Rule and which are used in the factory of the manufacturer of the final products and there is absolutely no requirement that the capital goods at the time of receipt be owned by manufacturer. Accordingly, CENVAT credit could be claimed even if at the time of receipt of capital goods the manufacture is not its owner.

Indian Oil Corporation Limited v. CC [2014-TIOL-579-CESTAT-DEL]

Discounts pertaining to a particular product cannot be provided to another product, for the purpose of claiming reduction in assessable value

In the instant case, the taxpayer was a manufacturer of cars. The Model A cars attracted a lower rate of excise duty, and whereas Model B cars attracted a higher rate. The taxpayer had paid incentive amounts attributable to Model A as well as Model B cars to the dealers based on their performance as per the sales incentive schemes. However, the incentives attributable to Model A as well as Model B cars were paid to the dealers by reducing the value of 'only' Model B cars sold to the dealers in the succeeding month, as a special discount.

The Central Excise authorities demanded duty on the special discount provided on Model B cars, on the ground that the taxpayer has reduced the transaction value of Model B cars even though the incentive pertained to both Model A and

Model B cars, as Model B cars attracted a higher rate of Central Excise duty than Model A Cars.

The Mumbai Tribunal held that in this case the special discounts under the sales incentive schemes were passed on to the dealers not as reduction in the prices of the goods to which they related to, but as a reduction in the prices of some other goods cleared in the subsequent month. Further, there was also no evidence on record to show that the goods on which the discounts were given while effecting sales to the dealers were passed on to the ultimate customer. Accordingly, the duty demanded was upheld.

Tata Motors Limited v. CCE [2014-TIOL-619-CESTAT-MUM]

The amount claimed as refund shall not be expensed out in the profit and loss account

In the instant case, the Central Excise authorities denied the refund claim on the ground that the amount claimed as refund was not shown as 'receivables' in the books of accounts but was expensed out in the profit and loss account.

The Mumbai Tribunal held that writing off the amount claimed as refund in the profit and loss account signifies that the taxpayer has adjusted the amount in his income while arriving at the net profit, thereby implying that the incidence of duty had been passed on to third parties and accordingly, the refund claim represented unjust enrichment.

CCE v. Raymond Limited [2014-TIOL-617-CESTAT-MUM]

Customs Duty - Decisions

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

In the instant case, the taxpayer has imported recorded media containing feature films/programmes on payment of a licence fee (fixed amount or minimum guaranteed amount), for exploiting the intrinsic content of the said media. The duty liability was discharged only on the cost of media.

The Customs Authorities have included the value of license fee paid to the assessable value of media and demanded duty on the same.

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

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

The price of raw materials in India is not relevant for assessing the value of final products imported

In this case the Customs Authorities are of the view that the declared price of the imported goods is less than the price of the raw materials required for manufacturing such goods and accordingly, the declared price cannot be accepted for the purpose of assessment of customs duty.

The Delhi Tribunal held that for making the allegation of under-valuation and rejecting the declared transaction value, the department cannot adopt the price of raw materials of the goods in India and allege that the declared price of the goods is less than the average price of the raw materials. In any case, the price of the raw materials and manufacturing cost for this purpose has to be of the country in which the goods had been manufactured. Therefore, as in this case, the department has not clarified whether the prices of the raw materials considered are the price in India or the prices in the country of manufacture and if so, what is the source for this information and also what is the cost of manufacture of these items in the country of manufacture, the declared valued cannot be rejected.

Imperial Glass Emporium & Others v. CCE [2014-TIOL-621-CESTAT-DEL]

VAT

Notifications/Circulars/Press Release

Delhi

Registered dealers filing the returns online using a digital signature are not required to file a return verification in Form DVAT – 56.

Circular No. 2 of 2014-15 F.3/(377)/VAT/2013/PF/16-23 Dated 23 April 2014

Karnataka

Every dealer whose total turnover is INR 5 million and above, during the tax period ending on 31 March 2014 or whose cumulative total turnover is INR 5 million and above in the tax periods of any subsequent year, shall furnish details of purchases made, receipt of goods otherwise than by way of purchases from registered dealers outside the state, sale of goods and transfer of goods otherwise than by way of sale to other registered dealers outside the state electronically from tax period May 2014 onwards.

Notification No. CCW/CR44/2013-14 Dated 29 April 2014

Kerala

With effect from 26 April 2014, the use of manual Form No. 15 (Delivery Note) along with online Form No. 15 shall be permitted only for rubber and cement. For all other commodities, use of online Form No. 15 is mandatory.

Circular No. 08/2014 No. C1-12107/12/CT Dated 22nd April, 2014

Madhya Pradesh

With effect from 26 April 2014, the rate of VAT on telephone, cellular hand set and tablets has been increased from 5 per cent to 13 per cent.

Notification No. F.A-3-11-2014-1-V (17). Dated 26 April 2014

Dadra Nagar & Haveli

All the registered dealers are required to submit their utilisation details of manually issued statutory forms (Form C, F, H and EI), from AY 2008-09 to 2013-14, for further uploading on TINXSYS website. Failure to comply with these directions would attract penalty. The utilisation statement is to be furnished in a prescribed pro forma in the form of a CD or pen drive, which may be handed over to the single window or the help desk of the department.

Circular No. DC//VAT/IT/2014/653 Dated 19 April 2014

VAT Decisions

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

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

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

The Karnataka High Court observed that the taxpayer sought deduction of value representing quantity/scheme discount allowed in the tax invoices in view of distributors' performances during three to six months and not with respect to the goods sold by the said tax invoices, mentioning gross value. It defied the condition of the relevant rule, which clearly required a tax invoice to be with respect to sales relating to such a discount. In view of the above, it was held that discounts in the invoices were not relatable to sales affected by those tax invoices and deduction with respect to the same shall not be allowed.

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

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