July 2016

TAX UPDATES

(containing recent case laws, notifications, circulars)

Prepared in association with

KPMG
cutting through complexity

Foreword

I am pleased to enclose the June issue of FICCI's Tax Updates. This contains recent case laws, circulars and notifications pertaining to direct and indirect taxes.

The draft model Goods and Services Tax (GST) law including the Integrated Goods and Services Tax Bill has been released by the Government and placed in public domain for obtaining feedback from the trade and industry. FICCI had circulated the draft Model GST Law to all its members and sought their feedback on the draft legislation. We have received a number of responses from the members providing their comments and observations on the various provisions. After deliberations by the FICCI's Task Force on GST, we will submit appropriate feedback to the Government on the model law.

In the direct tax regime, the Central Board of Direct Taxes has introduced a provision (Rule 37BC) clarifying that in the case of a non-resident, not being a company, or a foreign company and not having a permanent account number (PAN), the provisions of higher rate of tax under Section 206AA of the Act shall not apply in respect of payments in the nature of interest, royalty, fees for technical services and payments on transfer of any capital asset, if the deductee furnishes the details and the specified documents to the deductor. The prescribed details obtained from the deductee need to be reported in the TDS statements filed by the deductor in Form 27Q mentioning that PAN is not available.

In an important judgment pertaining to service tax the Delhi High Court has ruled that a provision in the Service Tax Rules empowering departmental officers and officers of the Comptroller and Auditor General of India (CAG) to demand documents from the taxpayers was ultra vires of the provisions of the Finance Act 1994 levying service tax. It noted that the Rule requiring documents such as Cost Audit Reports was beyond requirement mentioned in the Act. It also held that the rule making powers provided under the Finance Act 1994 do not include power to conduct audit [Mega Cabs Pvt Ltd. vs Union of India and Ors. (2016-TIOL-1061-HC-DEL-ST)].

We do hope that this newsletter keeps you updated on the latest tax developments.

We would welcome any suggestions to improve the content and the presentation of this publication.

A. Didar Singh

Recent Case laws

I. DIRECT TAXES

High Court Decision

Consideration from offshore construction contract for installation of 'Single Point Mooring' is not taxable as royalty as well as FTS in India

The taxpayer is a leading solutions provider of offshore construction, engineering, project management, and support services to the oil and gas industry worldwide. Indian Oil Corporation Ltd (IOCL) invited tenders for 'Residual Offshore Construction work' at the Paradip port. IOCL was setting up an offshore crude oil receiving facility with Single Point Mooring (SPM) terminal about 20 km off the coast of Paradip port on the east coast of India. The said facility would enable unloading of crude oil from Very Large Crude Carriers (VLCCs) to meet the crude oil requirement of its refineries located in the eastern part of India. The work involved installation of IOCL supplied SPM including anchor chains, floating and subsea hoses. The taxpayer signed a contract with IOCL for the above offshore construction work involving installation of IOCL supplied SPM including anchor chains, floating and subsea hoses.

As per the contract, the contractor was to provide all marine spread, specialised manpower, and equipments, installation tools and tackles, consumables, labour, logistic supplies, planning, engineering, documentation, etc. to fulfil the project specifications up to the commissioning stage. The contractor was responsible for taking over all the owner supplied project materials from the place designated by the owner, required for installation of a complete SPM system including their sub systems. Further, it is required to depute an installation engineer during the entire installation period of the SPM system for assisting and advising the installation contractor in the installation of the SPM system. IOCL sent to the taxpayer a 'Letter of Acceptance' in which it inter alia set out the 'contract value and price schedule'. It was stated therein that the contract value would be USD18,598,140. The letter also indicated the amount in US dollar agreed to be paid for each item of work. Broadly the break up was (i) Mobilisation and demobilisation of Marine Spread (ii) Pre and post erection work (iii) Actual installation work (iv) Documentation, misc.

The taxpayer stated that it did not have any project office or any other premises in India for executing the work under the above contract. The taxpayer's obligations under the contract were fulfilled by deputing men and materials at the offshore site where the activity was performed. The taxpayer filed an application before the AAR for determination of certain questions regarding its tax liability in respect of the services rendered by it under the above contract.

The Authority for Advance Ruling (AAR) held that the payment made for use of equipment, i.e. the barges, and stated mobilisation and demobilisation expenses which comprised a substantial part of the payment, fell within the definition of royalty under Article 12(3)(b) of the tax treaty. Further, installation was considered by AAR to be ancillary and subsidiary to the use of equipment or enjoyment of the right for such use. Consequently, the payment for the installation was held to be falling under the definition of FTS in terms of Article 12(4)(a) of the tax treaty.

The Delhi High Court reversed the AAR's decision and held that IOCL (service recipient) did not have dominion or control over the equipment. The High Court observed that the clauses of the contract make it clear that at all times during the execution of the contract the control over the equipment brought by the taxpayer was to remain with the taxpayer. It is held that there is a difference between the use of the equipment by the taxpayer 'for' IOCL and the use of the equipment 'by' IOCL. Since the equipment was used for rendering services to IOCL, it could not be converted to a contract of hiring of equipment by IOCL. Therefore, consideration received by the taxpayer from IOCL for mobilisation/demobilisation is held to be not constituting royalty.

Consequently, the installation of SPM supplied by IOCL, which was considered as ancillary and subsidiary to the use of equipment, was also held to be not taxable as FTS.

Technip Singapore Pte. Ltd. vs DIT [W.P (c) No. 7416/2012](Delhi High Court)

Whenever the provision of an opportunity for hearing is actually turned into an empty formality by the Officer, the opportunity provided by the show cause notices become meaningless opportunities

The appellant filed a writ petition before the Madras High Court challenging the order passed by the TPO under Section 92CA of the Income Tax Act, 1961 (the Act) for AY 2012-13 seeking an interim grant of stay of all further proceedings pending disposal of the writ petition. The appellant filed another writ petition wherein it challenged the constitutional validity of Section 92B(2) of the Act which was admitted and posted in the usual course.

High Court's ruling

- The High Court noted that they were unable to decipher from the second show cause notice, whether the TPO arrived at the list of six comparables after mining information from a huge database or on the basis of the information already available in his/her office. Further, the Court noted that the TPO has also stated that he/she did not have time to go through the entire data furnished by the taxpayer as seen from the second show cause notice and the impugned order. The High Court held that since the order was passed after a period of two full months, after the issue of the show cause notice, the plea of non-availability of time and resources to search the database was not correct.

- The High Court held that total lack of opportunity is only one facet of the principle of natural justice. Whenever the provision of an opportunity is actually turned into an empty formality by the officer withholding the necessary information or refusing to consider certain things citing lack of time or resources, the opportunity provided by the show cause notices, becomes meaningless opportunities.

- The High Court without going into greater details and reserving the liberty to the department to come up with a positive stand in the form of a counter, granted an interim stay of further proceedings and clarified that this order was only based on prima facie findings and posted the appeal after two weeks for filing the counter.

Sutherland Global Services Pvt. Ltd. vs UOI, Ministry of Finance - Department of Revenue, JCIT, DCIT, CBDT (WMP.No.9140 of 2016 in WP.10335)

Tribunal Decisions

35 per cent of net global profits are attributed to an Indian permanent establishment of a Chinese company in respect of both hardware and software supplied to Indian customers

The taxpayer is a Chinese company engaged in the business of providing telecom equipment. The taxpayer was engaged in supply of telecom equipment to Indian telecom operators. The taxpayer was also engaged in supply of mobile handsets to various customers in India. During the year under consideration, the taxpayer did not file its return of income in India on the ground that it did not have a Permanent Establishment (PE) in India under the India-China tax treaty.

The Assessing Officer (AO) held that the taxpayer had a business connection in India and its business had been carried through its PE in India. The AO held that the taxpayer had fixed a place PE, an installation PE and dependent agent PE in India and therefore, the revenues from the supply of telecom equipment and mobile handsets were to be taxed in India as business profits. The AO held that the profits of the PE in India have to be computed separately in respect of hardware and software components of the telecom equipment and the mobile handsets. The payments for the supply of software embedded in the telecom equipment should be treated as royalty under Section 9(1)(vi) of the Act and also under Article 12(3) of the tax treaty. As regards the attribution of profits to the PE in India in respect of hardware component, the AO invoked Rule 10 of the Rules and determined the income of the taxpayer's PE at 20 per cent of the net global profits from Assessment Year (AY) 2004-05 to 2008-09. However, for AY 2009-10, the AO has attributed 45 per cent of the operating profit.

The Commissioner of Income-tax (Appeals) [CIT(A)] held that the taxpayer had a fixed place PE and dependent agent PE in India. However, it did not accept the AO's plea of having an installation PE in India. The CIT(A) held that software embedded in the telecom equipment was taxable as business profits, and not royalty. As regards the computation of profits attributable to the PE, 2.5 per cent of total sales made by a foreign company in India were held to be attributed as business profits of the PE (including the value of software). The Delhi Tribunal observed that the taxpayer agreed for attribution of profits to a PE without prejudice to its claim that there was no PE in India. The Tribunal held that almost the entire sales functions, including marketing, banking and after sales, were carried out by the taxpayers' PE in India and, therefore, 35 per cent of net global profits as per published accounts are attributed to the PE in India in respect of hardware and software supplied to Indian customers. The Tribunal observed that for the purpose of attribution of profits to the PE, the most important aspect to be kept in mind is the level of PE's participation in the economic life of the source country. It is primarily nexus between source country and the PE's activities which produce the taxable income to the taxpayer. In the present case, since the taxpayer has not maintained books of accounts relating to PE in India, indirect method prescribed in Rule 10 of the Rules for attribution of profits was resorted. The Tribunal observed that the issue of attribution of profits depends on the facts of the case and is fully dependent on the level of operations of the activities carried out in India.

ZTE Corporation vs ADIT (ITA No.5870/Del/2012)

Payment received by a UK company under the management and administration services agreement is taxable as royalty under the Act as well as the India-UK tax treaty

The taxpayer is a U.K. based company engaged in the business of international express distribution of freight, parcels and documents. The taxpayer entered into management and administration services (MAS) agreement with TNT (India) Pvt. (TNT India) under which the taxpayer provided services to TNT India. In terms of the MAS agreement, the taxpayer was rendering services such as business policy advice, management information and other automated system services, new process information, assistance in evaluation of the development in the international market, market research/analysis, evaluation of business opportunities, drawing up finance plans, assistance with strategic management, statistical evaluations, liaison with professional advisers, etc.

The taxpayer invoiced TNT India for providing the services under the agreement. TNT India deducted tax at source under Section 195 of the Act, before making remittance of the said amount. Subsequently, the taxpayer filed its return of income declaring nil taxable income and claimed refund for the tax deducted at source. The taxpayer claimed that since it was not having any presence in India, income earned from the provision of MAS would not be taxable in India under Section 9(1) of the Act as well as under Article 13 of the tax treaty. The AO held that services rendered by the taxpayer under the MAS agreement involved the provision of know-how, and such services would fall within the purview of royalty. The Dispute Resolution Panel (DRP) confirmed the order of the AO.

The Bangalore Tribunal held that the payment received by the U.K. resident from its Indian affiliate under a management and administrative services agreement is taxable as royalty under the Act as well as the India-U.K. tax treaty. The Tribunal observed that to bring the case within the definition of royalty, imparting of experience, information by the taxpayer to the Indian company is necessary. In the case of the taxpayer, it appears to be a composite agreement for providing various services, some of which are purely business / commercial services and others are in the nature of imparting the knowledge, and experience, which concern commercial or business experience. In such a situation, since the taxpayer has failed to produce the relevant information, which is necessary to segregate part of the payment which may not be falling under the purview of royalty, the entire consideration received by the taxpayer, would be treated as royalty.

TNT Express Worldwide (U.K.) Limited vs DDIT (IT(TP)A No.6/Bang/2011)

Payment to toll collecting agencies is liable for deduction of tax under Sec-

tion 194C and not under Section 194H of the Act

National Highway Authority of India (NHAI) is engaged in carrying out the development and maintenance of highways across the country. It availed the services of toll agencies for collection of toll fees. It deducted tax at 2.266 per cent under Section 194C of the Act in respect of payment for above services. The AO observed that the contract between NHAI and agencies is a contract of agency i.e. agents appointed on behalf of NHAI to collect toll fee. Therefore, any payment made in pursuance of the said contract of agency partakes the nature of commission within the meaning of Section 194H of the Act. The CIT(A) held that it is a simple work contract on principle to principle basis and not on principle to agent basis. Therefore, such payments would be covered under Section 194C and not under Section 194H of the Act.

The Visakhapatnam Tribunal observed that the collecting entity is liable to provide the services of toll fees collection work under its own organizational structure and on deployment of personnel, without binding NHAI for its employees. Normally, the commission is paid in terms of value of the transaction, whereas in the given case, consideration is paid in terms of salary payable to the personnel deployed plus the service charge of 14 per cent. The contract between the taxpayer and the agencies is a mere contract for the supply of labour for execution of work contract as defined under the provisions of Section 194C of the Act. It has all the ingredients of a contract of principle to principle basis and it is not a contract of an agency as defined under Section 194H of the Act. Accordingly, the Tribunal held that payment to toll collecting agencies is liable for deduction of tax under Section 194C and not under Section 194H of the Act.

DCIT vs Project Director, NHAI (ITA No.69 & CO No. 60/Vizag/2013)

Contribution of land to AOP for joint development is not transfer of capital asset and therefore not taxable as capital gain

During the year under consideration five persons had entered into a development agreement with different land owners and all the parties had further transferred and assigned development rights in the taxpayer and his family's favour. They had started development of the said properties with M/s. Estate Enterprises and M/s. Shriram Constructions and had formed the AOP in the name and style M/s. Gajanan Associates by deed of joint venture on 26 May 2008. The said Joint Venture was entered into with M/s. Estate Enterprises, Kriplani Brothers (taxpayer) and M/s. Shriram Constructions. The first two parties were to make available the land for joint development and the third party was to bring in the capital required for the construction of project. The taxpayer stated that it had taken sum of INR2.5 million as a security deposit to avoid any losses and the same does not become part of sale consideration. The AO held that the interest-free deposit received from M/s Shriram Construction was nothing but assignment of development rights to the AOP through M/s Shriram Construction. The difference between the deposits and the development rights acquired in the above properties is to be taxed as capital gains and added to the total income.

The Pune Tribunal held that on a perusal of joint venture agreement it indicates that it was not the case of transfer of land to the

AOP, but was the case of joint pooling of resources by three different parties. In such scenario where the asset held by the taxpayer has not been transferred to the AOP, there is no question of charging any income from capital gains in the hands of the taxpayer in this regard under Section 45(3) of the Act. The security deposit received by the taxpayer is not chargeable to tax. Even otherwise, the said security deposit has been refunded by the taxpayer to M/s. Shriram Constructions. The taxpayer has also placed the copy of bank account on record, wherein there is debit INR2.5 million. The assessment of Parmanand A. Kirpalani (Kriplani Brother), who had received 16.67 per cent as against 8.33 per cent received by the taxpayer, was completed by the AO vide order passed under Section 143(3) of the Act and though during the course of assessment proceedings, submissions were made with regard to the purchase of property and the joint venture agreement, no addition was made in this regard. Where the transaction as such has been accepted in the hands of one of the co-owners, no adverse view could be taken in the hands of other person.

Ashok Gordhandas Kirpalani vs ITO (ITA No.1647/PN/2014) (Pune)

Money received by a taxpayer from various trusts as a beneficiary could not be considered as amounts received without consideration and hence it is not in the nature of income taxable under Section 56(2)(vi) of the Act

During AY 2008-09, the taxpayer received income from twelve trusts floated by Lintas Employees Financial Assistance Trust (LEFAT). The taxpayer claimed the same as exempt on the ground that the trust concerned had paid taxes on the income declared by it and the payment received by the taxpayer was distribution of the surplus among the trust beneficiaries who were employees of LEFAT. However, the AO held that such payment is taxable under Section 56(2)(vi) of the Act.

The Tribunal upheld the AO's power to assess the amount received by the taxpayer (an individual) from various trusts as a beneficiary of such income. The Tribunal rejected the taxpayer's stand that the tax department had exercised the option to assess income in hands of trusts, referring to the Supreme Court ruling in the case of ACIT vs Rajesh Jhaveri Stock Brokers (P) Ltd [2007] 291 ITR 500 (SC).

The Tribunal rejected the tax department's treatment of assessing the amount received by the taxpayer as income under Section 56(2)(vi) of the Act. It has been observed that in a trust, the trustees hold the property and income for the benefit of the beneficiaries. What was received by the taxpayer as a beneficiary from the thirteen trusts was nothing but her own income in her status as a beneficiary of the said trust. What has flown from the trustee to the beneficiary is the income the trustee collected on behalf of the beneficiaries. Accordingly, the Tribunal held that money received by the taxpayer from various trusts as a beneficiary could not be considered as amounts received without consideration as the character of income in the hands of trusts were under the heads capital gains and dividends/interest and not the type of income falling under Section 56(2) (vi) of the Act.

Mrs. Sharon Nayak vs DCIT (ITA No. 1594/Bang/2014) – Taxsutra.com

Even though in earlier years, the taxpayer itself had accepted the department's stand in MAP proceedings, this should not be considered as consent of the taxpayer for the adjustment proposed by the department in earlier years

The taxpayer is engaged in the business of distribution of satellite TV channels and soliciting advertisement to be telecasted on TV channels. Taxpayer aggregated its transactions pertaining to the distribution functions and benchmarked them by comparing its operating margin with companies engaged in distribution of retail products. The Transfer Pricing Officer (TPO) ignoring the FAR (functions performed, assets utilized and risks assumed) analysis, used service providers as comparables for the distribution segment of the taxpayer and proposed an adjustment. Before the CIT(A), the taxpayer contended that if comparables as selected by the TPO which are service providers, are considered, then Operating Profit/Value Added Expenses (OP/VAE) should be considered as the Profit Level Indicator (PLI) as the total operating cost of the taxpayer under the distribution segment also included the cost of purchase of distribution/ advertisement rights as paid to its AEs while the companies selected by the TPO do not have input costs in their cost base. The CIT(A) agreed with the taxpayer's contention for using OP/VAE as the PLI and since the OP/VAE of the taxpayer was higher than the average OP/VAE of the comparables companies considered by the TPO, Transfer Pricing (TP) adjustment was accordingly deleted.

Tribunal's ruling

- The Tribunal relied upon the decisions of the Delhi Tribunal in the case of Cheil Communication1 wherein PLI of OP/ VAE was approved; and Mitsubishi Corporation India Pvt. Ltd.2 which upheld the use of Berry Ratio as PLI for trading segment. It also referred to OECD (Para Nos. 2.100 to 2.102) and UN Guidelines (Para Nos. 6.3.7.5 and 6.3.7.6) wherein berry-ratio has been discussed.

- The Tribunal held that TP addition made was not tenable due to difference in functional profile of the taxpayer and companies selected by the TPO and stated that the TPO, rejecting the economic analysis of the taxpayer, had merely relied on service companies considered as comparable by his predecessor.

- The taxpayer was characterised as distributor that assumed normal risk in undertaking distribution activities and had identified companies engaged in distribution of retail products as comparables. The TPO ignored the same and erred in selecting service companies as comparables for the distribution segment of the taxpayer. The TPO was also not justified in ignoring the companies presented by the taxpayer in TP documentation and the fresh search submitted during the proceedings.

- For benchmarking a distributor like the taxpayer, only distributors should be selected as comparables and since distributors of channels were not available in public domain, distributors of broadly comparable products/services should have been selected. In the appeals pertaining to AYs 2007-08 and 2008-09 in the case of taxpayer itself on similar issues, the Tribunal had upheld that the comparables selected by both the Revenue and the taxpayer were not appropriate and the matter was remitted back to the AO to undertake fresh search of comparable companies.

- In earlier years also, the taxpayer had taken distributors as comparables whereas the department used service providers as comparables. The taxpayer itself had accepted this stand during MAP proceedings. The Tribunal held that the TPO failed to appreciate the fact that for the earlier years, on behalf of AEs, an application was made under Article 27 of India USA Double Taxation Avoidance Agreement to settle the disputes arising from their assessments and it was pointed out that assessments in India resulted in double taxation especially in view of TP adjustment made in the case of the taxpayer. In the settlement reached between CAs of India and USA, USA agreed to provide corelative relief in the assessments of AEs for the TP adjustment made in the hands of the taxpayer to avoid double taxation.

- The Tribunal thus held that such act of taxpayers should not be considered as consent of the taxpayer about the adjustment proposed by the department in earlier years as the taxpayer, in good faith had not pressed for any appeal. A due functional and economic analysis has to be carried out every year to reflect changes in the market or changes in the nature of its intra-group transaction.

- In view of the above and the findings of the Tribunal in the appeal for AYs 2007-08 and 2008-09 in the case of taxpayer on an identical issue, the Tribunal set aside the matter to the file of the AO to decide the issue afresh after undertaking fresh search of comparable companies.

ACIT vs Turner International India Pvt. Ltd. (ITA No. 3080/Del/2011- AY: 2005-06, ITA No. 5981/Del/2010- AY: 2006-07, Cross Obj. No. 246/Del/2011 (In ITA No. 080/Del/2011) - AY: 2005-06)

Royalty received from franchisee remitted to an overseas AE without value-addition to be treated as a 'pass-through' cost for computation of operating profit margin

The taxpayer is engaged in the business of providing management services for fast foods. It entered into a master license agreement with its Associated Enterprise (AE) i.e. McDonald Corporation, U.S. for a non-exclusive marketing and operational license of McDonald's system granted to the taxpayer, for which it made a royalty payment of 5 per cent on its gross sales in India (to be remitted by the taxpayer to its AE within five days of the end of the month). The taxpayer also created two Joint Ventures (JVs) who in turn are the sub-licensees and paid royalty at the rate of 5 per cent to the taxpayer. The taxpayer was further obliged to pay a franchisee fee for each of the new restaurants taken on franchise, the obligation of which was also been passed on to the JVs.

During the AY 2003-04, the taxpayer entered into international transactions with its AE in the nature of provision of consultancy services, payment of royalty and franchise fees. The taxpayer applied the Comparable Uncontrolled Price (CUP) method to benchmark the impugned international transactions of payment of royalty and franchisee fees.

The TPO rejected the taxpayer's approach and applied Transactional Net Margin Method by aggregating all the aforesaid three transactions and proposed an adjustment. While computing the operating profit margin, the TPO included the royalty income received from the JVs and subsequently paid to AE as operating income and operating expenses respectively based on the ground that agreement provided that in case of default in payment of royalty by the JVs, the taxpayer would make good the AE to the extent of such an amount.

Further, the TPO excluded part of the franchise fee received during the year from the operating income as it was not remitted to the AE in the absence of necessary RBI approvals as it was not recognised as expenses in the books of the taxpayer. The CIT(A) upheld the TPO's action.

Tribunal's ruling

- The Delhi Tribunal interpreted 'pass through costs' as costs which are incidental to the main business activities and no significant function or significant risk is assumed in relation to such costs.

- The Tribunal observed that the taxpayer's risk to make good the AE in the event of a default by the JVs cannot be viewed in isolation of actual conduct of the parties as no actual default has occurred. Further, no instance has been pointed out by the TPO or CIT(A) to show that risk of non-payment by a franchisee is imminent and a real risk. Therefore, the Tribunal concluded that no risk is assumed by the taxpayer in collection and onward remittance of royalty.

- Taking cognizance of the fact that the taxpayer is required to remit the royalty amount within five days of the end of each month, the Tribunal observed that taxpayer has also not commercially exploited or availed of any benefit on account of the credit or retaining money.

- Based on the above, the Tribunal held that the royalty payment by the taxpayer to its AE is to be treated as a 'pass through cost' and should not be considered as operating in nature while computing the operating profit margin.

Mc Donald's India (P) Ltd vs DCIT (ITA No. 961/DEL/2010)(AY 2003-04)

Chennai ITAT rules that the residential status is relevant while exercising option and not during the vesting period for taxability of Stock Appreciation Rights

Recently, the Chennai Tribunal, in the case of Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy, has ruled that the value of Stock Appreciation Rights (SARs) received by taxpayers (employees of an Indian company having a U.S. parent) is taxable either as benefit in lieu of salary or as a perquisite under Section 17 of the Act. The Tribunal also rejected the taxpayers' claim that SARs was a capital asset and cannot be treated as income. The Tribunal also held that since the assessees were residents in India at the time of exercise of SARs, they are liable to tax on the same irrespective of the fact that they were non-residents during the vesting period.

Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy vs DCIT (ITA No. 390/Mds/2016)

Notifications/Circulars/ Press Releases

The CBDT notifies Equalisation Levy Rules, 2016

The Finance Act, 2016 has introduced an 'Equalisation Levy' in line with the recommendation of the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project to tax e-commerce transactions. The Act provides that the Equalisation levy is to be charged on specified services (online advertising, provision of digital advertising space, etc.) at 6 per cent of the amount of consideration for specified services received or receivable by a non-resident payee not having a PE in India.

The CBDT has now issued the Equalisation Levy Rules, 2016 to lay down the compliance procedure to be followed for such levy. The Rules will come into force from 1 June 2016.

Key summary of the rules is as follows:

- Equalisation Levy is to be deducted and paid to credit of central government by remitting to Reserve Bank of India or in any branch of the State Bank of India or any authorized bank accompanies by an equalisation challan.
- The deductors of Equalisation Levy during a financial year are required to furnish a 'Statement of specified services' in Form 1, electronically (either digital signature or verification code), on or before 30 June Immediately following that financial year.
- Rules prescribe the process for issuance of notice by the AO in the event of non-furnishing of Form 1 by the deductors.
- Rules also prescribe various forms – Form 2 for notice of demand by the AO; Form 3 for filing appeal before CIT(A); Form 4 for filing appeal before the Income Tax Appellate Tribunal.

Notification No. 37 and 38/2016, dated 27 May 2016

CBDT notifies amendments to Rule 8D of Income-tax Rules

The CBDT has notified amendments to Rule 8D of the Rules.

The erstwhile sub-rule (2) to Rule 8D provided for computing the expenditure in relation to earning of exempt income as an aggregate of the following:

- expenses directly incurred to earn exempt income;
- interest expenditure incurred by the taxpayer (not directly attributable to any particular income) computed as a proportion of the average value of investment earning exempt income to average total assets; and

- 0.5 per cent of the average value of investment income from which is exempt.

The CBDT has amended the formula for computing the expenditure relatable to earning of exempt income contained in Rule 8D. The amendment has done away with the inclusion of proportionate indirect expenses in computing the expenditure relatable to earning exempt income, as against the earlier formula. However, the new formula provides for aggregation of expenses directly identifiable to earning exempt income with a value computed at a presumptive rate of 1 per cent (as against earlier 0.5 per cent) to be applied to the annual average of monthly averages of the value of investments. The new rule further provides for an overall capping on the disallowance to the total expenditure claimed by the taxpayer.

Notification No. 43/2016 [F.No.370142/7/2016-TPL] dated 2 June 2016

CBDT clarifies on taxability of income from the transfer of unlisted shares

The CBDT has issued a clarification that the income arising from the transfer of unlisted shares would be considered under the head 'capital gain', irrespective of the period of holding, with a view to avoid disputes/litigations and to maintain uniform approach. Further, the clarification would not be necessarily applied in the following situations:

- The genuineness of transactions in unlisted shares itself is questionable or
- The transfer of unlisted shares is related to an issue pertaining to lifting of the corporate veil; or
- The transfer of unlisted shares is made along with the control and management of the underlying business.

The AO would take the appropriate view in such situations.

CBDT Clarification F No. 225/12/2016/ITA.II, dated 2 May 2016

II. SERVICE TAX

Decisions

Composite construction contracts involving sale of land not liable to Service tax

The issue in the instant case was whether service tax is applicable on the service component of a composite construction contract and preferential location charges. While the Delhi High Court upheld the levy of service tax on preferential location charges, it has struck down service tax levy on construction contracts including sale of land on the basis of the following:

- service tax is levy on services only and no tax can be levied on the elements representing transfer of goods or immoveable property; and
- The Central Government does not have legislative competence to levy service tax on composite contracts in the absence of a mechanism to ascertain the value of service component in such contracts and the existing abatement mechanism cannot substitute lack of machinery provisions to ascertain value of services in a composite contract.

Suresh Kumar Bansal vs Union of India & Ors [2016-TIOL-1077-HC-DEL-ST]

Services provided by a corporate entity on behalf of the government is liable to service tax

The issue in the instant case was whether maintenance and repair services provided by the taxpayer (which is a corporate entity) would be liable to service tax on the basis that such services are performed under statutory duty/function on behalf of the state government. The Delhi High Court upheld the levy of service tax on such services on the basis of the following

- The service tax law does not provide for any exemption for services rendered as part of statutory duties or merely on the ground that service provider/service receiver is 'Government'/'Governmental agency'; and
- Erstwhile Circular No. 89/7/2006 – ST, exempting activities performed by sovereign or public authority would not be applicable in the instant case since the taxpayer was a corporate entity.

Chhattisgarh State Industrial Development Corporation Ltd vs C.C.E. & S.T., Raipur [2016-VIT -385-CESTAT -DELST]

Payment processing services to foreign customers qualifies as export as they are not 'intermediary services'

The issue in the instant case was whether the payment processing services proposed to be provided by the taxpayer to a service recipient located outside India would be liable to service tax. The AAR held that since the services are to be provided on a principal to principal basis and the taxpayer would be providing services on its own account, it would not qualify as 'intermediary services'. Therefore, the AAR held that the place of provision of the said services would be outside India in terms of the service tax law and accordingly, the said services would qualify as 'export' of service.

M/s Universal Services India Pvt Ltd vs Commissioner of Service tax, Ruling No. AAR/ST/07/2016

Rule empowering departmental and other officers to demand documents is ultra vires to that extent

The issue in the instant case was whether the Service tax Rule which empowers departmental officers/ officers of Comptroller and Auditor General to demand documents from assessees, was in conflict with the provisions of the Chapter V of the Finance Act, 1994 (Service tax Act) itself. The Delhi High Court held that the impugned Rule of Service tax law is ultra vires the provisions of the Act on the basis of the following observations –

- Certain aspects mentioned in the impugned Rule such as cost audit reports goes beyond the requirements mentioned in the Service tax Act and the Central Government cannot exceed its powers by using the rulemaking powers;
- Since the concerned officers can demand production of documents from assessees without recording any reasons and there is no requirement that the officers should be duly authorised, the powers under the impugned rule could lead to harassment of assesses; and
- The rule-making powers provided under the Service tax Act, do not include power to conduct audit.

Mega Cabs Pvt Ltd vs Union of India and Ors. [2016-TIOL-1061-HC-DEL-ST]

Notification/Circulars/ Press Releases

Withdrawal of service tax exemption on specified services provided by the government/local authority to business entities

With effect from 20 May 2016, the exemption on certain specified services provided by the government/ local authority to business entities (with turnover less than Rs.10 lakh in the preceding financial year) such as services provided by the Department of Posts by way of speed post, services in relation to aircraft/ vessel, services by way of renting of immoveable property, life insurance services, etc., has been withdrawn.

Notification No. 26/2016-ST, dated 20 May 2016

Levy of Service tax on legal services provided by senior advocates

The Central Government has exempted legal services provided by senior advocates to a person other than a business entity or a business entity with a turnover of up to Rs.10 lakh in the preceding financial year from service tax. Further, it has been notified that legal services provided to a business entity (with turnover above Rs.10 lakh) would be liable to service tax under reverse charge mechanism.

Notification No. 32/2016-ST, 33/2016-ST and 34/2016-ST all dated 6 June 2016

Speedy disbursal of pending refund claims of service exporters

With respect to the scheme for speedy disbursal of refund claims of service exporters (vide Circular No. 187/6/2015 dated 10 October 2015), CBEC has further clarified that the statutory auditors are allowed to indicate the manner in which audit was conducted, assumptions taken, limitation in scope, etc. Furthermore, the certificates issued by statutory auditors indicating the aforesaid remarks or disclaimers owing to guidance notes issued by ICAI, should not be rejected so long as it is not inconsistent with the contents specified in the erstwhile Circular No. 187/6/2015 dated 10 October 2015.

Circular No. 195/05/2016 – ST dated 15 June 2016

III. CENTRAL EXCISE Decisions

Time limit of 180 days not applicable for inputs sent to job work which turns into scrap after repeated use and used for making intermediate product which is cleared

The taxpayer engaged in the manufacture of CTD bars, MIS roll, wire coil, wire rods and wire nails had sent inputs and CI Ingot moulds to their job worker, who manufactured MS Ingots and sent the same, back to the taxpayer. The MS Ingots manufactured by the job worker was an intermediate product, which was used in the manufacture of CTD bars in the factory of the taxpayer. The CI Ingot moulds were not returned in as much as the same was used in the manufacture of MS Ingots repeatedly as moulds. Finally, the CI Ingot moulds after repeated use, became worn out and it was also consumed in the manufacture of MS Ingots by the job worker treating the same as scrap. Such MS Ingots were also returned to the taxpayer, who used it in the manufacture of finished goods namely CTD bars in their factory. As the CI Ingot moulds were finally consumed in the manufacture of finished goods, the same was declared by the taxpayer as scrap though it is capital goods in terms of Rule 2(a) of Cenvat Credit Rules, 2004. During a visit by the authorities, it was found that the appellant had availed CENVAT credit on CI Ingot moulds falling under Chapter heading 8454.2020 as inputs and had sent them to the job worker for manufacture of iron ingots. In the job workers unit, it gets melted to make ingots.

The Madras Tribunal observed that the understanding of law by the lower authorities is contrary to the provisions of CENVAT Credit Rules, 2004, if the goods are allowed to be sent to a job worker's premises, where further manufacturing process is carried on behalf of the principal, CENVAT credit cannot be denied. There can be no doubt that the spirit behind the CENVAT scheme, which is a beneficial one, would be lost, if a statutory benefit is denied by wrong interpretation. Therefore, the denial of credit is clearly an error. The failure to receive back the moulds within the specified period was due to full utilisation and consumption of the moulds in the course of manufacture resulting in the same emerging as scrap and thus the appeal was allowed.

Tower Steels Ltd vs CCE (2016-TIOL-1362-CESTAT-MAD)

Cross-utilisation of inputs for job-work and manufacturing activity

The taxpayer manufactured goods on job work basis for Bayer Industries Limited (BIL). BIL supplied inputs for the job work. The inputs were common for manufacture on the taxpayer's own account and for manufacture by them on job work. The inputs are stocked together and usually the taxpayer uses the materials supplied by BIL for manufacturing the goods on job work basis, while for manufacturing goods on its own behalf, it uses its own inputs. However, if there is an urgent requirement of the inputs, the taxpayer borrows the inputs supplied by BIL and this movement is duly recorded in Goods Receipt Notes (GRN). The stock taken was subsequently replaced. The revenue issued notice for alleged diversion of such inputs.

The lower authorities confirmed the demand on the ground that the inputs supplied to the job worker and those procured on their own account for manufacture have been inter utilised. Such removal according to revenue would be construed as diversion of inputs or removal outside the factory for home consumption inviting reversal of credit or payment of duty. Against the said allegation, the taxpayer contended that there is no provision in the Excise Act or Excise Rules or in CENVAT Credit Rules treating such inter utilisation of inputs as prohibited. On the other hand, CENVAT Credit Rules, 2004 permits utilisation of inputs for any final product of the manufacturer.

Further, the taxpayer contended that under the rules there is no requirement of one to one correlation of inputs and output so long as inputs are not used for manufacture of exempted goods. Considering the arguments, tribunal allowed the appeal in favour of the taxpayer.
Covestro (India) Pvt Ltd vs CCE (2016-TIOL-1363 - CESTAT-MAD)

Notification/Circulars/ Press Releases

Scope of 'Brand Name'

With regard to the scope of excise duty levy on 'readymade garments and made articles of textiles' bearing a brand name or sold under a brand name with retail sale price of Rs.1000 or more, it has been clarified that excise duty shall not be levied on all readymade garments and made-ups however, it shall be restricted only to readymade garments and made-up articles of textiles bearing a brand name or sold under a brand name and having retail sale price of Rs.1000 or above. Further, it has also been clarified that affixing a brand name on the product, labelling or relabeling of its containers or repacking from bulk packs to retail packs or the adoption of any other treatment to render the product marketable to the consumer, shall amount to manufacture.

Further, merely because the outlets of a retailer, from where readymade garments or made-ups are sold, has a name, say, M/s XYZ and Sons, the readymade garments or made ups sold from such outlet cannot be held as branded readymade garments or made ups and become liable to excise duty. Accordingly, deemed manufacture and excise duty liability will arise only if such retailer affixes a brand name on the readymade garments and affixes a label bearing the RSP on the packages containing the readymade garments of Rs.1000 or above.
Circular No. 1031/19/2016-CX, dated 14 June 2016

IV. VAT
Decision

Declaration issued to a selling dealer in Form C cannot be cancelled due to retrospective cancellation of purchasing dealer's registration

The taxpayer is engaged in the trading of DEPB scrip and registered under the Central Sales Tax Act, 1956 (CST Act). The taxpayer had made an interstate sale to a dealer, who was duly registered under the CST Act as on the date of the transaction, at a concessional rate of 2 per cent. The purchasing dealer subsequently obtained Form C from the department and issued to selling dealer.

Subsequently, the taxpayer came to know that due to retrospective cancellation of the CST registration of the purchasing dealer, Form C issued by such purchasing dealer had been cancelled by the department. Being aggrieved by this, the taxpayer filed a writ petition before the High Court. The taxpayer contended that, Form C was cancelled only because the registration of a purchasing dealer was cancelled retrospectively, although there was no power under the CST Act or rules thereunder to cancel Form C issued by the department. Further, subsequent cancellation of registration would not affect the validity of Form C since on the date of the issuance, purchasing dealer was validly registered.

Against this, revenue submitted that the taxpayer had no locus to question the cancellation of the CST registration of a purchasing dealer. It also, submitted that a transaction between the taxpayer and purchasing dealer were under a cloud as the details of the payer's bank account did not match with the details as available with the department. In other words, the revenue submitted that the entity which paid the sums to the taxpayer against the invoices, was not the entity to which C-Forms were issued by the department. Accordingly, the department was justified in cancelling the Form C. Also, in the present case, the purchasing dealer does not have a valid registration, hence, it is not open to the selling dealer to question the cancellation of the C-Form issued.

The Delhi High Court held that there was no provision in the CST Act which enables an authority issuing Form C to cancel the same. HC agreed that if the purchasing dealer does not possess such registration on the date of the transaction of sale, then the assessee cannot insist on being issued Form C. However, in the present case, on the date of the transaction, the purchasing dealer possessed a valid CST registration. The cancellation of the CST registration took place subsequent to the issuance of the C-Form and the taxpayer had no means to suspect that the payments made by it were not by a purchasing dealer but by some other entity with the same name.

Given the above, the High Court set aside the order of the department cancelling the Form C issued to the taxpayer and stated that, the taxpayer will continue to treat the said C-Form issued to it as having been validly issued.

Jain Manufacturing (India) Pvt. Ltd vs Commissioner Value Added Tax & Anr (TS-233-HC-2016(DEL)-VAT)

Notifications/Circulars/ Press Release

Maharashtra - The procedure of new SAP based registration, billing software under Maharashtra VAT Act has been provided by the Commissioner of Sales Tax. Further, the new functionalities other than registration and billing software, such as filing of returns, refund applications, requisitions for CST declarations, audit/ assessments, etc. will be provided in a phased manner. Actual dates about implementation of these phases will be notified as and when these functionalities become ready for deployment.
Trade circular no. 18T of 2016 dated 24 May 2016

Jharkhand - With effect from 8 June 2016, in case where an application for registration is made and the same has been subject to verification by the authorities, the time duration for issuing the registration certificate has been reduced from five days to one day from the date of satisfactory verification of records and information furnished and accordingly registration number shall be allotted.
Notification No. S.O-27 dated 8 June 2016

Kerala - The due date for filing Annual VAT Returns along with enclosures for FY 2015-16 has been extended from 30 April 2016 to 31 July 2016. It has also been stated that no further extension shall be granted.
Circular No. 06/2016 dated 1 June 2016

Telangana - In order to ensure a taxpayer friendly regime and thereby ensuring ease of doing business, the application for a new registration under VAT/CST/TOT acts shall be made only through an online mode.
Circular-CCT's Ref No. CS(1)/18/2015 dated 23 May 2016

Tamil Nadu - The last date for issuance of manual 'C' and 'F' forms for interstate transactions already reported and properly accounted for, has been extended from 31 March 2016 to 31 July 2016. It has also been stated that no further extension shall be granted in this regard.
Circular No.6/2016 CC4/678/2012 dated 13 June 2016

Haryana - With effect from 1 June 2016, in order to facilitate business and to enhance 'Ease of Doing Business', the Excise and Taxation Department has developed and implemented single ID system for various Acts. A dealer who is registered under multiple Acts can make use of his single ID i.e. VAT TIN for the purpose of login.
Circular Memo No. 940 /ST-1 dated 14 June 2016

DGFT – Trade Notice

Clarification on modification of Importer Exporter Code

With regard to modification of provisions relating to Importer Exporter Code (IEC), it has been provided that henceforth the Regional Authority shall consider applications seeking modification in IEC, involving change in PAN, by ensuring that liabilities of the previous applicant/ applicant firm are transferred to the new applicant/applicant firm whose PAN will be reflecting in the modified IEC.
Trade notice No. 6/2016 dated 23 May 2016