# TAX NEWS

December & January 2012

HEMANT ARORA & CO.
Chartered Accountants

For private circulation only.

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## International Tax & Transfer Pricing.

### Agreement with State of Georgia for avoidance of double taxation and prevention of fiscal evasion.

*Notification No. 4/2012 [F. No. 503/05/2006-FTD-I] dated 06.1.2012.*

The Government of the Republic of India and the Government of Georgia at New Delhi on the 24th day of August, 2011 has entered into an agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital. Now in exercise of the powers conferred by S. 90 of the Act, the Central Government has directed that all the provisions of the said Agreement, shall be given effect to in the Union of India with effect from 1st day of April, 2012.

### Transfer of shares of foreign company by non-resident to non-resident does not attract Indian tax even if the underlying assets are located in India.

*Vodafone International Holdings B.V Vs. UOI (Supreme Court)*

A Cayman Island company called CGP Investments held 52% of the share capital of Hutchison Essar Ltd, an Indian company engaged in the mobile telecom business in India. The shares of CGP Investments were in turn held by another Cayman Island company called Hutchison Telecommunications. The assessee, a Dutch company, acquired from the second Cayman Islands company, the shares in CGP Investments for a total consideration of US $ 11.08 billion. The AO issued a show-cause notice u/s 201 in which he took the view that as the ultimate asset acquired by the assessee were shares in an Indian company, the assessee ought to have deducted tax at source u.s 195 while making payment to the vendor. This notice was challenged by a Writ Petition but was dismissed by the Bombay High Court. In appeal, the Supreme Court remanded the matter to the AO to first pass a preliminary order of jurisdiction which the AO did. This order was challenged by the assessee by a Writ Petition which was dismissed by the High Court. On appeal by the assessee, the Supreme Court, HELD:

Per S. H. Kapadia J.

(i) Department's argument that there is a conflict between Azadi Bachao Andolan 263 ITR 706 (SC) & McDowell 154 ITR 148 (SC) and that Azadi Bachao is not good law is not acceptable. While tax evasion through the use of colourable devices and by resorting to dubious methods and subterfuges is not permissible, it cannot be said that all tax planning is impermissible;

(ii) In the taxation of a Holding Structure the burden at the threshold is on the Revenue to establish abuse in the sense of tax avoidance in the creation and/or use of such structure(s). The Revenue may invoke the "substance over form" principle or "piercing the corporate veil" test only after it is able to

establish that the transaction is a sham or tax avoidant (e.g. structures used for circular trading or round tripping or to pay bribes) or if the Holding Structure entity has no commercial or business substance and has been interposed only to avoid tax. A strategic foreign direct investment coming to India should be seen in a holistic manner and keeping in mind certain factors like the period of business operations in India etc. On facts, the Hutchison structure was in place since 1994 and could not be said to be created as a sham or tax avoidant. The holding companies were not a "fly by night" operator or short time investor;

(iii) The Revenue's argument that u.s 9(1)(i) it can "look through" the transfer of shares of a foreign company holding shares in an Indian company and treat the transfer of shares of the foreign company as equivalent to the transfer of the shares of the Indian company on the premise that S. 9(1)(i) covers direct and indirect transfers of capital assets is not acceptable. S. 9(1)(i) (unlike the DTC Bill, 2010) does not use the word "indirect transfer";

(iv) The argument that CGP, the intervened entity, had no business or commercial purpose and that its situs was not in the Cayman Islands but in India (where the assets were) is also not acceptable. The situs of the shares of a company is where the registered office is;

(v) The High Court's finding that, applying the "nature and character of the transaction" test, the transfer of the CGP share was not adequate in itself to achieve the object of consummating the transaction between HTIL and VIH and that there was a transfer of other "rights and entitlements" which were "capital assets" is not correct because the transaction was one of "share sale" and not an "asset sale". It had to be viewed from a commercial and realistic perspective. As it was not a case of sale of assets on itemized basis, the entire structure, as it existed, ought to have been looked at holistically. A transfer of shares lock, stock and barrel cannot be broken up into separate individual components, assets or rights such as right to vote, right to participate in company meetings, management rights, controlling rights, control premium, brand licences and so on as shares constitute a bundle of rights. The sum of US$ 11.08 bn was paid for the "entire package" and it was not permissible to split the payment and consider a part of it towards individual items (Mugneeram Bangur 57 ITR 299 (SC) followed);

Per Radhakrishnan, J (concurring):

(i) On the conflict between McDowell & Azadi, It is a cornerstone of law that a tax payer is enabled to arrange his affairs so as to reduce the liability of tax and the fact that the motive for a transaction is to avoid tax does not invalidate it unless a particular enactment so provides. However, for the arrangement to be effective, it is essential that the transaction has some economic or commercial substance;

(ii) On facts, CGP's interposition in the corporate structure and its disposition, by way of transfer, for exit, was for a commercial or business purpose and not with the ulterior motive for evading tax. It cannot be considered to be an

artificially interposed device and the principle of "fiscal nullity" will not apply. For the principle of "fiscal nullity" to apply, there should be a pre-ordained series of transactions and there should be steps inserted that have no commercial purpose. In that case, the inserted steps can be disregarded for fiscal purpose and one can look at the end result. However, the sale of the CGP shares was a genuine business transaction, not a fraudulent or dubious method to avoid capital gains tax. The situs of the shares was in the Cayman Islands;

(iii) The argument that s. 9(1) should be given a purposive interpretation so as to cover even indirect transfers is not acceptable. On the transfer of shares of a foreign company to a non-resident off-shore, there is no transfer of shares of the Indian company, though held by the foreign company and it cannot be contended that the transfer of shares of the foreign holding company, results in an extinguishment of the foreign company control of the Indian company and it also does not constitute an extinguishment and transfer of an asset situate in India. Transfer of the foreign holding company's share off-shore, cannot result in an extinguishment of the holding company right of control of the Indian company nor can it be stated that the same constitutes extinguishment and transfer of an asset/ management and control of property situated in India;

(iv) S. 195 applies only if payments are made from a resident to another non-resident and not between two non-residents situated outside India. The transaction was between two non-resident entities through a contract executed outside India, consideration passed outside India and the transaction had no nexus with the underlying assets in India. In order to establish a nexus, the legal nature of the transaction has to be examined and not the indirect transfer of rights and entitlements in India.

## Activities of seismic survey, processing of 3D seismic data and submission of its report in desired media as also providing services of personnel will fall under the definition of 'fee for technical services'.

*CGG Veritas Services, SA v. Additional Director of Income-tax, (International Taxation) (ITAT- Delhi)*

The, assessee company, a tax resident of France, engaged in providing geological and geophysical services for exploring mining potential, derived income in India from execution of exploration projects for prospecting mineral oil deposits in the offshore waters under four contracts with ONGC and one contract with Eni, U.K. The scope of work involved conducting seismic survey of large area consisting of thousands of sq. km. of sea bed and acquisition of 3D seismic data, onboard processing thereof and the analysis thereof was to be delivered to ONGC and Eni, in the form of CD/diskette in the manner stipulated in respective agreements.

The assessee in its return of income offered its income u.s 44BB(1) of the Act. In view of s. 90(2) of the Act, it opted to be taxed under domestic tax law as against the DTAA, the same being more beneficial to it.

Though the AO accepted the assessee's contention w.r.t. to taxability under the Act, he proposed to tax the assessee's income u.s 115A of the Act, treating the same as FTS u.s 9(l)(vii), thereby rejecting the assessee claim of being covered u/s 44BB(1). The DRP concurred with view of AO. Hence, the assessee filed appeal before the Tribunal. Held,

In exclusionary clause of Explanation 2 to s. 9(1)(vii) the words used are "undertaken by the recipient" whereas in s. 44BB(1) the words used are "in connection with………"; the scope and import of both the expressions is different and does not mean the same; the necessary condition to be satisfied for bringing the income u.s 44BB (1) is that the services or facilities should be rendered in connection with prospecting for or extraction or production of mineral oils; however, in order to fall under exclusionary clause of Explanation 2 to s. 9(1)(vii), the activities of "mining" or a project similar to that should be undertaken by the assessee himself; hence, the services rendered 'in connection with…….' cannot be read as 'undertaken by the recipient'; therefore, in a case where an assessee is engaged in the business of providing services or facilities in connection with for prospecting for or extraction or production of mineral oil, such services or facilities cannot be equated to 'mining or like projects' undertaken by the assessee himself.

## S. 9 of the Profits from offshore supply of equipment & software not taxable in India

*DIT vs. Ericsson AB (High Court- Delhi)*

The assessee, a Swedish company, entered into contracts with ten cellular operators for the supply of hardware equipment and software. The contracts were signed in India. The supply of the equipment was on CIF basis and the assessee took responsibility thereof till the goods reached India. The equipment was not to be accepted by the customer till the acceptance test was completed (in India). The assessee claimed that the income arising from the said activity was not chargeable to tax in India. The AO & CIT (A) held that the assessee had a "business connection" in India u.s 9(1)(i) & a "permanent establishment" under Article 5 of the DTAA. It was also held that the income from supply of software was assessable as "royalty" u.s 9(1)(vi) & Article 13. On appeal, the Special Bench of the Tribunal held that as the equipment had been transferred by the assessee offshore, the profits therefrom were not chargeable to tax. It was also held that the profits from the supply of software was not assessable to tax as "royalty". On appeal by the department to the High Court, HELD dismissing the appeal:

(i) The profits from the supply of equipment were not chargeable to tax in India because the property and risk in goods passed to the buyer outside India. The assessee had not performed installation service in India. The fact that the contracts were signed in India could not by itself create a tax liability. The nomenclature of a "turnkey project" or "works contract" was not relevant. The fact that the assessee took

"overall responsibility" was also not material. Though the supply of equipment was subject to the "acceptance test" performed in India, this was not material because the contract made it clear that the "acceptance test" was not a material event for passing of the title and risk in the equipment supplied. If the system did not conform to the specifications, the only consequence was that the assessee had to cure the defect. The position might have been different if the buyer had the right to reject the equipment on the failure of the acceptance test carried out in India. Consequently, the assessee did not have a "business connection" in India. The question whether the assessee had a "Permanent Establishment" was not required to be gone into.

(ii) The argument that the software component of the supply should be assessed as "royalty" is not acceptable because the software was an integral part of the GSM mobile telephone system and was used by the cellular operator for providing cellular services to its customers. It was embedded in the equipment and could not be independently used. It merely facilitated the functioning of the equipment and was an integral part thereof. The fact that in the supply contract, the lump sum price was bifurcated is not material. There is a distinction between the acquisition of a "copyright right" and a "copyrighted article".

## AO's self-determination of ALP without referring to TPO is "erroneous & prejudicial to interests of revenue".

*Ranbaxy Laboratories Vs. CIT (High Court- Delhi)*

The assessee entered into international transactions with its AEs, the value of which exceeded Rs. 5 crores. The AO passed an order u.s 143(3) in which he recorded the finding that he had examined the transactions and found them to be at arms' length and no transfer pricing adjustment was required to be made. The CIT thereafter passed an order u.s 263 on the ground that in view of Instruction No. 3 of 2003 dated 20.5.2003, the AO ought to have referred the issue to the TPO instead of himself determining the arms' length price of the transactions and that the assessment order was consequently "erroneous and prejudicial to the interests of the revenue". On appeal, the Tribunal (114 TTJ (Del) 1) upheld the revision order. On further appeal by the assessee, HELD dismissing the appeal:

Though s. 92CA enables the AO to refer an international transaction to the TPO if he considers it "necessary or expedient" to do so, Instruction No. 3 dated 25.5.2003 makes it mandatory for the AO to make a reference to the TPO if the aggregate value of the international transaction exceeds Rs. 5 crores. This Circular, having been issued u/s 119, is binding on the AO. The AO ought to have referred the matter to the TPO having regard to the fact that Specialized Cell was created to deal with complicated and complex issues arising out of the transfer mechanism. The AO's omission to follow

the binding Circular amounted to making assessment without conducting proper inquiry and investigation and resulted in the order becoming "erroneous and prejudicial to the interest of the Revenue". The observations in Sony India 288 ITR 52 (Del) (while upholding the constitutional validity of the aforesaid Circular) that the said Circular was a "Guideline" which did not take away the discretion of the AO was made in a different context.

## TPO is duty bound to eliminate differences in comparables' data.

*Demag Cranes & Components (India) vs. DCIT (ITAT- Pune)*

In a Transfer Pricing matter, the Tribunal had to consider whether for purposes of making adjustment under Rule 10B (1)(e)(iii) 'working capital' constituted a 'difference between the international transactions and the comparable uncontrolled transactions of between the enterprises entering into such transactions' and if so whether the said difference 'could materially affect' the amount of net profit margin of relevant transactions in the open market. HELD by the Tribunal:

Rule 10B(e)(iii) provides that "the profit margin arising in comparable uncontrolled transactions has to be adjusted to take into account the differences, if any between the international transaction and the comparable uncontrolled transactions, or between the enterprises entering into such transactions, which could materially affect the amount of net profit margin in the open market". While the "differences" are not specified, it covers "any differences" which could materially affect the amount of net profit margin. The litmus test to be applied is if the 'difference, if any, is capable of affecting the NPM in open market? If yes, then the TPO is under statutory obligation to eliminate such differences. The revenue cannot say that difference is likely to exist in all accounts and so the demands of the assessee should be ignored. The revenue's stand that the assessee is ineligible for any adjustments if he provides the set of comparable is not correct because under Rule 10(3) it is the duty of the AO/TPO/DRP to minimize/eliminate the difference which is likely to materially affect the price. It is the settled proposition that 'working capital' adjustment is an adjustment that is required to be made in TNMM. The revenue's contention that the 'differences' specified should refer to only (i) the factor of demand and supply; (ii) existence of marketable intangibles i.e. brand name etc; (iii) geographical location and the like is not acceptable. Further, as the difference in the Arm's length Operating Margin of the Comparables before and after making the adjustment for working capital was up to 3.77%, it was "material" and had to be eliminated

## Onus on AO to show foreign co has a PE in India. Under India-France DTAA, even dependent agent is not PE in absence of finding that transactions are not at ALP.

*Delmas France Vs. ADIT (ITAT Mumbai)*

The assessee, a French company, engaged in the operation of ships in international traffic, claimed that it did not have a PE in India and that no part of its income was chargeable to tax

in India. The AO & DRP held that as the assessee had an agent in India which concluded contracts, obtained clearances and did the other work, there was a PE in India under Articles 5(5) & 5(6) of the DTAA. On appeal by the assessee, HELD allowing the appeal:

(i) In order to constitute a PE under Article 5(1) & 5(2), three criteria are required to be satisfied viz; physical criterion (existence), functionality criterion (carrying out of business through that place of physical location) & subjective criterion (right to use that place). There must exist a physical "location", the enterprise must have the "right" to use that place and the enterprise must "carry on" business through that place. An "agency" PE will not satisfy this condition because the enterprise will not have the "right" to use the place of the agent. Under Article 5(6) of the India-French DTAA (which is at variance with the UN & OECD Model Conventions), even a wholly dependent agent is to be treated as an independent agent unless if it is shown that the transactions between him and the enterprise are not at arms' length. The Department's argument that as the AO had not examined whether the transactions were done in arm's length conditions, the matter should be restored to him is not acceptable because the onus was on the Revenue to demonstrate that the assessee had a PE. The onus is greater where the very foundation of DAPE rested on the negative finding that the transactions between the agent and the enterprise were not made under at arms length conditions. A negative finding about transactions with the dependent agent not being at ALP is sine qua non for existence of a DAPE under the India-France DTAA. The AO could not be granted a fresh inning for making roving and fishing enquiries whether the transactions were at arm's length conditions or not.

(ii) If as a result of a DAPE, no additional profits, other than the agent's remuneration in the source country – which is taxable in the source state anyway de hors the existence of PE, become taxable in the source state, the very approach to the DAPE profit attribution seems incongruous. Further, before accepting the DAPE profit neutrality theory, as per Morgan Stanley 292 ITR 416 (SC), the arm's length remuneration paid to the PE must take into account 'all the risks of the foreign enterprise as assumed by the PE'. In an agency PE situation, a DAPE assumes the entrepreneurship risk in respect of which the agent can never be compensated because even as DAPE inherently assumes the entrepreneurship risk, an agent cannot assume that entrepreneurship risk. To this extent, there may be a subtle line of demarcation between a dependent agent and a dependent agency PE. The tax neutrality theory, on account of existence of DAPE, may not be wholly unqualified at least on a conceptual note.

## AO's decision to refer to TPO must be based on material & not be arbitrary.

*M/s Veer Gems vs. ACIT (High Court- Gujarat)*

The assessee entered into transactions with a party named Blue Gems BVBA. In the preceding year, the assessee treated the transactions as an "international transaction" for transfer pricing purposes. However, in the present year, the assessee claimed that though the said party was a "related

party", it was not an "affiliated entity" as defined in s. 92CA. However, instead of deciding the issue, the AO made a reference to the TPO to determine the ALP and the TPO asked the assessee to show-cause why the transaction with the said party was not subject to transfer pricing proceedings. The assessee filed a Writ Petition to challenge the action of the AO/TPO. HELD by the High Court:

The AO has jurisdiction to make a reference to the TPO only if there is an "international transaction". **Though the question as to whether there is an "international transaction" may be disputed, the AO is not obliged to grant hearing to the assessee, invite and consider the objections with respect to the question whether there was an "international transaction" before making a reference to the TPO**. The AO's opinion has to be based on available material and would have "ad-hoc" finality. The power cannot be exercised arbitrarily or at whims or caprice. S. 92C (1) has inbuilt safeguards to ensure that the reference is made only in appropriate cases with approval of the higher authority. At the stage of framing the assessment in terms of the TPO's report the AO is entitled (despite the amendment to s. 92CA (4)) to consider the objections of the assessee that in fact there had been no "international transaction". If the assessee succeeds in establishing such fact, the AO would have to drop the entire transfer pricing proceedings. Even the DRP has the power to consider whether there was an international transaction or not and it can annul the computations proposed on the basis of the TPO's order. ***However, the TPO has no jurisdiction to decide the validity of any such reference and his task is only to determine the ALP.*** On facts, as the parties were closely related and the assessee had accepted in the preceding year that the transactions were subject to transfer pricing, the AO's reference could not be interfered in writ proceedings.

## S. 9(1)(vi): Income from license of software assessable as "royalty"

*CIT Vs. Samsung Electronics Co. Ltd (High Court-Karnataka)*

The assessee imported "shrink-wrapped"/ "off-the-shelf" software from suppliers in foreign countries and made payment for the same without deducting tax at source u.s 195. The AO & CIT (A) held that the payments were assessable to tax as "royalty" u.s 9(1)(vi)/ Article 12 and that the assessee was liable to pay the tax u.s 201. On appeal, the Tribunal held that the assessee had acquired a "copyrighted article" but not the "copyright" itself and so the amount paid was not assessable as "royalty". On appeal by the department, HELD reversing the Tribunal:

(i) U.s 9(1)(vi) of the Act & Article 12 of the DTAA, "payments of any kind in consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work" is deemed to be "royalty". Under the Copyright Act, 1957, a software programme constitutes a "copyright". A right to make a copy of the software and use it for internal business by making copy of the same and storing it on the hard disk amounts to a use of the copyright u.s 14 (1) of that Act because in the absence of such a licence, there would have been an infringement of the copyright. Accordingly, the argument that there is no transfer of any part of the copyright

and the transaction involves only a sale of a copyrighted article is not acceptable. The amount paid to the supplier for supply of the "shrink-wrapped" software is neither the price of the CD alone not software alone nor the price of license granted. It is a combination of all. In substance unless a license was granted permitting the end user to copy and download the software, the CD would not be helpful to the end user;

(ii) There is a difference between a purchase of a book or a music CD because while these can be used once they are purchased, software stored in a dumb CD requires a license to enable the user to download it upon his hard disk, in the absence of which there would be an infringement of the owner's copyright.

## Domestic tax

### Form No. 29C is required to be furnished by the Limited Liability Partnership (LLP) in case of payment of "Alternate Minimum Tax".

*Notifications No.60/2011 dated 01.12.2011*

S.115JC of the Act which provide for payment of "Alternate Minimum Tax" by certain Limited Liability Partnerships (LLP), which was introduced by the Finance Act, 2011. As per s. 115JC (3) every LLP to which S. 115JC applies is required to obtain a report from an accountant in such form as may be prescribed. Accordingly, the CBDT has through this notification, notified Income – tax (9th Amendments) Rules, 2011. The said Amendments rules have inserted Rule 40BA after Rule 40B which provides that the report of an accountant which is required to be furnished by the assessee u.s 115JC (3) shall be in Form 29C. Further. In Appendix II of the said rules, Form 29C has been inserted after Form 29B. These Rules will come into force on 1st April, 2012.

### Process carried out by assessee on raw grounded blades purchased from market and made same ready to use in commercial market amounts to manufacture.

*DCIT Vs. N.V. Exports (P.) Ltd. (ITAT – Kolkota).*

The assessee - company was engaged in the business of exporting of safety razor blades and twin track shaving system. It was engaged in purchasing semi-finished ground blades not suitable for shaving and the said unfinished blades were being processed further in the assessee's factory from grinding till the final packing. The assessee claimed additional depreciation u.s 32(1)(iia) of the Act at 20 per cent on actual cost of machinery and plant acquired and installed after 31-3-2005. The AO taking a view that processes undertaken by assessee did not amount to manufacture and rejected the assessee's claim. On filing an appeal by the assessee, the CIT(A) allowed the claim of the assessee after considering the facts that the assessee has employed sophisticated techniques of packing in view of delicate items involved in handling. Even the samples and photographs supplied by assessee bears testimony to assessee's claim.

Several processes are done at each stage from the stage of semi-finished ground blades to the final stage of release of goods after packing. The process carried out by the assessee on raw grounded blades purchased from market and made the same ready to use in commercial market or consumers, certainly called manufacturing done by assessee. The raw grounded blades cannot be used for the purpose of shaving and cannot be called a commercially viable product, which is sellable in the market. The final product manufactured by assessee is commercially new and different article having a distinctive name, character and use.

Accordingly, the assessee is a manufacturer and is entitled for additional depreciation u.s 32(1)(iia) of the Act. Accordingly, the order of the CIT(A) was also confirmed by ITAT and decided in the favour of assessee.

## Where generation of scrap had direct link with manufacturing process carried out by assessee, income arising from sale of scrap was also eligible for deduction u.s 80-IC of the Act.

*CIT Vs. Micro Turners (High Court – Punjab)*

The assessee - company has a manufacturing unit at Parwanoo, it claimed deduction u.s 80-IC of the Act to the tune of transfer sales of Rs.24,887,941 and scrap sales of Rs.1,249,436. The AO at the time of assessment found that the scrap sales and stock transfer to sister concern at Gurgaon is not an income derived from the manufacturing process and therefore not liable to deduction as contemplated u.s 80-IC of the Act. On filing an appeal to ITAT by the revenue against the impugned order of CIT(A), it was held by the Tribunal in respect of stock transfer that the Gurgaon unit of the assessee has no manufacturing activity as such unit does not have any plant and machinery but only facility of packaging and then transfer of the shaft assembly to Maruti Udyog Limited was there. It was thus concluded that the entire manufacturing process takes place at Parwanoo unit therefore deduction claimed in respect of that income was derived from manufacturing process.

In respect of second question of law, the Tribunal has relied upon judgment of Fenner India's case (supra) and held that the assessee is engaged in the manufacturing of automobile shafts accessories. In such process, scrap is generated. Such scrap has direct link with the manufacturing process, i.e., manufacturing of shafts is bound to be generated. In view thereof, no substantial question of law arises for consideration of this court. Consequently, the appeal was dismissed and decided in the favour of assessee.

## When jurisdictional preconditions are missing, assessee can question reopening of assessment in appellate proceedings also.

*CIT Vs. Expeditors International India (P.) Ltd (High Court – Delhi)*

The assessee - company in the course of appellate proceedings before the Tribunal challenged the validity of reassessment proceedings for the first time. The Tribunal accepted the assessee's objection and accordingly set aside

reassessment proceedings. The revenue thus filed instant appeal contending that the Tribunal had erred in entertaining and deciding the additional ground, questioning the validity of re-opening u.s 147/148. It was held that it is not necessary or mandatory that an assessee should file a writ petition. The assessee can also object to re-opening in the appellate proceedings. Whether or not the preconditions for re-opening are satisfied is a matter of jurisdiction or lack of jurisdiction. If the jurisdictional preconditions are missing and are absent, the assessee can object and question the re-opening in the appellate proceedings. It is not necessary that the assessee must file a writ petition and question the reassessment proceedings. In the present case the ITAT has recorded that in the original assessment proceedings, the AO had examined whether the communication expenses were based upon mere estimate of the management pending finalization of the agreement or as ascertained liability. It has been held by the ITAT that this aspect was duly deliberated upon during the course of the original assessment proceedings. The ITAT has referred to the questionnaire issued by the AO and the reply of the assessee. In the said letter, the assessee had enclosed details of communication expenses. The assessee had also filed copy of the some of the invoices to demonstrate and establish validity and justify the claim. In the return of income, the assessee had disclosed the nature of communication expenditure in the audited accounts. In addition, the assessee has specifically stated that communication expenses were computed and treated as expenditure on the basis of management's estimate pending finalization of agreement with the service provider. The ITAT has observed that no fresh material had come to the knowledge or information of the AO after passing of the first assessment order. The ITAT has, therefore, rightly come to the conclusion that this is a case of change of opinion as this issue in question was examined in the original assessment proceedings. It is not alleged that the said finding is wrong. In the grounds of appeal/during the course of hearing, revenue could not controvert and demonstrate that said findings are erroneous and contrary to record. So the appeal was dismissed.

## For claiming deduction u.s 80-IB, audit report in Form 10CCB can be filed before assessment is completed, if same has not been filed along with return of income.

*Commissioner of Income-tax Vs.AKS Alloys (P.) Ltd (High Court – Madras)*

The assessee company is engaged in the business of manufacture of steel ingots. In respect of the assessment year 2005-06, the assessment order dated 26.12.2007 was passed u.s 143(3) of the Act, in which he has disallowed the claim of the assesee made u.s 80IB of the Act and has also made addition of Rs. 1,20,00,000 as unexplained credit u.s 68 of the Act, on the ground that for the purpose of claiming deduction, the assessee did not file necessary certificate in Form 10CCB of the Act along with the return of income which was filed on 18.7.2005 declaring the income as Rs. 1,02,11,036. As against the disallowance of the claim, the assessee filed an appeal before the CIT (A). The appellate authority has allowed the appeal, thereby granting the claim of the assessee

made u.s 80IB of the Act. Then against the said order, the Revenue has preferred appeal before ITAT which came to be dismissed under the impugned order. Being aggrieved by the said order, the present appeal has been filed on the above substantial questions of law. It was held that the filing of audit report in Form 10CCB is mandatory, it is well settled by a number of judicial precedents that before the assessment is completed, the declaration could be filed.

In fact, the said issue came to be decided by the Karnataka High Court in the case in CIT Vs. ACE Multitaxes Systems (P.) LTD. [2009], wherein it was held that when a relief is sought for u.s 80IB of the Act, there is no obligation on the part of the assessee to file return accompanied by the audit report, thereby, holding that the same is not mandatory. Therefore, it is clear that before the assessment is completed if such report is filed, no fault could be found against the assessee. That was also the view of the Delhi High Court in the case in CIT Vs. Contimeters Electricals (P.) Ltd. [2009], wherein the Delhi High Court, by following the judgements of the Madras High Court in CIT Vs. A.N. Arunachalam [1994] and in CIT Vs. Jayant Patel [2001] held that the filing of audit report along with the return was not mandatory but directory and that if the audit report was filed at any time before the framing of the assessment, the requirement of the provisions of the Act should be held to have been met. By virtue of hierarchy of judgements which are against the Revenue, the substantial question of law would not arise at all for consideration. The above appeal stands dismissed and decided in the favour of assessee.

## Bar as provided u.s 80-IA(3) is to be considered only for first year of claim for deduction u.s 80-IA of the Act.

*CIT Vs. Tata Communications Internet Services Ltd. (High Court –Delhi)*

The company was engaged in the business of providing fax mail services. The Department of Telecommunication granted licence to the company on 5-1-1999 for carrying on business activities for Internet Services and Internet Telephony Services from October, 2000. The business of fax and email services which was being carried out earlier was discontinued and in the financial year 2003-04, the assessee was solely carrying on the business of internet service provider and internet telephony services. The company had claimed that since the first invoice was cut on 17-10-2000 and it filed income-tax regularly and as per the provisions of s. 80-IA(4), it was entitled to deduction right from the assessment year 2001-02. It was claimed that as per the provisions of s. 80-IA(2), the assessee could claim deduction under s. 80-IA(4) for ten years out of 15 years starting from the year in which the assessee started its business being assessment year 2001-02. Since the assessee did not claim deduction u.s 80-IA(4) for the assessment years 2001-02, 2002-03 and 2003-04, the first year of claim u.s 80-IA(4) was 2004-05 and as it had been granted deduction u.s 80-IA(4) for the assessment years 2004-05 and 2005-06, it was entitled to deduction for relevant assessment year i.e. 2006-07. The AO rejected the claim of the assessee holding that it had not fulfilled the conditions laid down in s. 80-IA(3). On appeal, the CIT (A) upheld the order of the AO. On further appeal, the Tribunal allowed the

deductions as claimed by the assessee. On revenue's appeal to High Court it was held that:

There is no dispute with regard to the fact that clause (ii) of section 80-IA(4) was inserted in section 80-IA(3) by the Finance Act II of 2004 with effect from 1-4-2005 and that this was not with retrospective effect. It became applicable only after its insertion with effect from 1-4-2005. The Circular issued by CBDT explaining the provisions of Finance Act II of 2004 testifies the fact that this insertion took effect from 1-4-2005 and is to apply in relation to the assessment year 2005-06 and subsequent years. The first claim of the assessee for deduction u.s 80-IA indisputably was for assessment year 2004-05. The Tribunal has rightly recorded that the business of fax and email has been started by the assessee in 1997 and the business of providing internet services during the year 2000 being from 17-10-2000, the relevant assessment year 2001-02. The question for consideration would be as to whether there was any violation of provisions in the claim of deduction under section 80-IA(4)(ii) for assessment year 2001-02 or at the maximum for the first year of deduction under section 80-IA being the assessment year 2004-05. Admittedly, the assessee was granted deduction u.s 80-IA for the assessment year 2004-05. The Tribunal was right in holding that the revenue could not pick up the assessment year granting claim holding that there was violation of provisions of section 80-IA(3) on the ground that the business was formed by splitting up and reconstruction of business already in existence or that it was formed by transfer of plants and machinery to the new business. The bar as provided under section 80-IA(3) is to be considered only for the first year of claim for deduction under section 80-IA. Once the assessee is able to show that it has used new plants and machinery which has not been previously used for any purpose and the new undertaking is not formed by splitting up or reconstruction of business already in existence, it is entitled to the deduction under section 80-IA for subsequent years. Since the assessee had been granted claim of deduction right from the assessment year 2004-05 under section 80-IA, consequently it cannot be denied deduction for the subsequent years inasmuch as restraint of section 80-IA(3) cannot be considered for every year of claim of deduction, but can be considered only in the year of formation of the business. In view of the above, it was to be held that the Tribunal was justified in allowing,

# Service tax

## Taxability of Revenue Sharing arrangement in case of distribution of films and exhibition of movies.

*{Circular No. 148/17/2011 –ST dated 13 December, 2011}*

CBEC has issued a clarification on the taxability of profit/revenue sharing arrangement in case of distribution of films and exhibition of movies. Following is the manner in which the liability accures:-

1. Where the arrangement between distributor and the movie exhibitor, exhibiting the movie produced by the producer is on Principal to Principal basis the liability of Service tax falls as under depending on :-

(i) if the copyrights are temporary transferred to the cinema exhibitor then the Service tax would be levied on copyright service to be provided by the distributor or sub-distributor or producer as the case may be

(ii) if no copyrights are transferred but the movie is exhibited on behalf of distributor or sub-distributor or producer then the liability of Service tax would be levied under business support service /renting of immovable property, to be provided by the theater owner/ exhibitor.

2. Where the arrangement between the distributor and the movie exhibitor is on unincorporated Partnership basis or joint collaboration basis services provided by each of the parties would be liable to service tax based on the nature of transaction under applicable service head.

## Service Tax Refund to exporters through the Indian Customs EDI System.

*{Circular No. 149/2011 - dated 6 December,2011}*

So far Service Tax Refund (STR) was made available to exporters (other than SEZ Units/Developers) on specified services used for export of goods covered in Notification 17/2009-ST dated 07.07.2009 (as amended) subject to certain conditions. Keeping in mind the above the Government has proposed to introduce a simplified scheme for electronic refund of service tax to exporters, on the lines of duty drawback. With the introduction of this new scheme, exporters now have a choice: either they can opt for electronic refund through ICES system, which is based on the 'schedule of rates' or they can opt for refund on the basis of documents, by approaching the Central Excise/Service Tax formations.

To obtain benefit under the new electronic STR scheme, which is based on the 'schedule of rates', an exporter: (i) should have a bank account and also a central excise registration or service tax code number and the same should be registered with Customs ICES (ii) should declare his option to avail STR on the electronic shipping bill while presenting the same to the proper officer of Customs.

In the 'schedule of rates', to be notified shortly, rates are specified for goods of a class or description. An exporter, who wishes to obtain electronic STR, should express his option by mentioning in the shipping bill. Eligible refund amount of service tax paid on the specified services used for export of goods declared in the shipping bill will be calculated electronically by the ICES system, by applying the rate specified in the schedule against the said goods, as a percentage of the FOB value.

Exporters who do not like to obtain electronic STR on the basis of 'schedule of rates', but wish to opt for claiming STR on the basis of documents, through the Central Excise/Service Tax field formations should declare chapter/subheading number as 9801 in the electronic Shipping Bill. Minimum STR will be Rupees Fifty for an electronic shipping bill.

## Service Tax paid to Commission Agents for sales promotion is admissible as Cenvat Credit.

*M.K. IndustriesVs. Commissioner of Central Excise, Daman*

The assessee availed Cenvat credit of service tax on commission paid towards services received from selling agents. The credit was denied on ground that impugned service could not be considered as input service since service received has no nexus with manufacturer and clearance of final product from place of removal. The CIT (A) also upheld the demand. It was held in the impugned order that, the CIT (A) has taken a view that service tax credit for commission agent services is not admissible because it has been given to the dealers and such commission has been claimed as a discount. However, it was found that even in the show-cause notice, issued by the department, this fact has not been stated. According, to the show-cause notice, the demand was made on the ground that the services received from selling agents did not have any nexus with the manufacture and clearance of final product from the place of removal and service was beyond stage of manufacture and clearance of goods and, therefore, cannot be considered as input service.

The question as to whether the commission was in the nature of discount or not was not at all discussed or brought out in the show-cause notice. Further, it was found that in the appeal memorandum also, the assessee had clearly stated that the demand of service tax credit has arisen in respect of service tax paid by it for the service received from its selling agents. It has clearly stated that the selling agents are providing the service of sales promotion of its finished excisable goods and they are charging service tax on their commission charges. It has also been stated that the assessee had engaged commission agents to procure orders and forward the same to it so that it can dispatch the finished excisable goods. It could not be ascertained as to how or on what basis the CIT (A) reached the conclusion that the commission was nothing but the discount passed on to the dealers and it had been deducted from the transaction value and claimed as a deduction. It has been held that without sales promotion, the business activity cannot be said to have taken place and sales promotion is necessarily a part of business activity. Therefore, the cenvat credit on service-tax paid to commission agents for sales promotion was made admissible.

## Snippets

### 28th February 2012 shall not be the 'Union Budget Day'.

The Union Budget will be presented after the completion of elections in five states, but the government has not yet decided the final date of presentation.

### DTC set to miss April 2012 deadline.

The new Direct Tax Code which is to replace the existing Income Tax Act is unlikely to come into effect from April 2012 as announced by the Finance Minister earlier.

## Direct tax collection rise in April –December.

Direct tax collections rose 14.54 per cent to Rs. 3,96,529 crore during April-December this financial year, against the same period last year, mainly due to an increase in corporate tax mopup. The gross direct tax collection in the first three quarters of 2010-11 was Rs.3,46,182 crore.

## No need to respond to tax notices for below Rs 100

The Income Tax Department has asked assessees not to respond to notices of arrears of paltry amounts like Re 1, Rs 4 and Rs 6 as demands of less than Rs 100 would be adjusted against future refunds. The Department has issued the clarification in response to reports that the Central Processing Centre (CPC), Bangalore, is sending notices for payment of tax arrears as small as Re 1, Rs 4 and Rs 6 and thus causing hardship to assessees. "As per extant procedure, demand of less than Rs 100 is not enforced but is liable for adjustment against future refunds," said the Central Board of Direct Taxes (CBDT) in a release. The communication from the CPC for partly amounts to tax payers, it said, "is not a demand notice. This measure is, in fact, an assessee-friendly exercise".

## Income Tax Department directed to launch special drive for verifying high value transactions.

The Central Board of Direct Taxes has directed the Income Tax department has launched a special drive, from 20th January to 20th March 2012, for verifying high value transactions (investments / deposits / expenditure) from persons who are not assessed to income tax or who have not furnished their PAN while entering into such transactions.

## Transfer pricing wing raises additional Rs.40k-Cr tax demand.

The transfer price wing of the income tax department has made an additional tax demand of.Rs.40, 000 crore for fiscal 2011-12, double of last year. Out of the.Rs.40, 000 crore additional tax demand, more than.Rs.20, 000 crore was from the assessment of 11 multinationals, including foreign banks and telecom companies.

## Statutory Compliance calendar

- Deposit TDS from Salaries paid for January, 2012- ***February 07, 2012***
- Deposit TDS from Contractor's Bill, Payment of Commission or Brokerage, Rent, Professional/ Technical Services bills/ Royalty made in January, 2012 ***- February 07, 2012***
- Pay Service Tax in Form TR-6, collected during January 2012 by persons other than individuals, proprietors and partnership firms - ***February 5, 2012***
- Pay Central Excise duty on the goods removed from the factory or the warehouse during January 2012 **–** ***February 5, 2012***
- Payment of Monthly Employees' Provident Fund (EPF) dues -***Within 15 days from close of every month***
- Payment of Monthly Employees' State Insurance (ESI) dues -***Within 21 days from close of every month***
- Monthly return of Provident Fund for the previous month (other than international workers) - ***Within 15 days from close of every month***
- Monthly return of Provident Fund for the previous month w.r.t. international workers - ***Within 15 days from close of every month***

## Disclaimer

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