Tax News

PKF SRIDHAR & SANTHANAM
Chartered Accountants

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INCOME TAX

Reminder For January '11

Action Due	Due Date
TDS/TCS for the month of Dec.2010	07-01-11
PF for the month of Dec .2010	15-01-11
ESI for the month of Dec .2010	21-01-11
Form 24C qtr ending 31.12.2010	15-01-11

SERVICE TAX

Action Due	Due Date
Service Tax for the month of Dec.2010 in case of company	05-01-2011
Service Tax for the month of Dec .2010 in case of a company for which e-payment is mandatory.	06-01-2011
Service Tax for the month of Dec .2010 in case of assessee other than company that makes payment electronically.	06-01-2011
Service Tax for the month of Dec .2010 in case of assessee other than company that does not make payment electronically.	05-01-2011

INCOME TAX

Vital Notifications / Changes

No circular to be reported in this edition.

SUPREME COURT / HIGH COURT DECISIONS

- **Taxability in case of sum paid for transfer of on-going business**

  Assessee, a partnership firm, was a manufacturer of transformers. The business of the assessee firm was taken over as a going concern by a limited company known as "Indo Tech Transformers Limited". The partners of the assessee firm were also directors in the acquiring company. The company made payments to the partnership firm for technical knowhow and compensation by way of non-compete fee, for not competing and indulging in transformer business.

  ITAT considered that since assessee had not transferred any patented process, trade mark etc. therefore the amount received as the payment for technical know-how was nothing but a goodwill amount which was a way to evade tax. It was held that in view of the taking over of the going concern, the assessee firm had come to an end, more so, when the partners were also the directors in the acquiring company. Therefore, there was no possibility of the assessee firm doing the very same business again. The High Court held that:

  a) the assessee firm had been taken over as a going concern. The receipts for technical know-how and the non-compete fee were nothing but a part of composite receipt to diminish the value of the assets of the assessee firm. The assessee had termed the said amount as technical know-how in order to escape from the provisions of Section 55(2) of the Income Tax Act, under which a goodwill amount is taxable;

  b) there was no explanation as to why no amount had been received towards the goodwill considering the undisputed fact of the good performance of the assessee firm over the years. It was not the case of the assessee that it had been selling the technical know-how to any other third party. The assessee had merely changed from being a partnership firm into one of a private company due to business and com mercial expediency;

  c) the question of payment to be made as compensation by way of non-competing fee also would not arise, considering the fact that the assessee firm had been taken over as a going concern in its entirety by the new company. The partners of the assessee firm were the new Directors of the company and the consideration was paid to the assessee firm and not to the partners. There was no competition as alleged between the assessee firm and the new private limited company. Therefore, the finding of the tribunal is correct.

2011-TIOL-04-HC-MAD-IT in Income Tax.

Expenses incurred for modernization of the plant:

The High Court held that the expenses incurred for modernization of the plant and to replace particular machinery used for a particular process out of various processes, are not current repairs. If the assessee neither claimed investment allowance in the return, nor created any investment allowance reserve, the ITAT is not correct in giving an opportunity to the assessee to create the reserve as per Explanation to Section 32A(4).

It was held that, it is only after a profit and loss account is prepared, can it be ascertained whether the assessee has suffered a loss or has made profits in the said accounting period. The book entries, both with regards the debit of Investment Allowance and credit of the Investment Allowance Reserve account, would precede the determination of whether the assessee has incurred a loss or has made profit in the accounting period in question. In the present case, the necessary book entries for debiting the investment allowance to the Profit and Loss Account, and crediting 75% thereof to the Investment Allowance Reserve account have not been made. Therefore in reference to the case of *Shri Shubhlaxmi Mills Ltd v. Addl. CIT, adjudged by the Supreme Court*, what is contemplated by Section 34(3)(a) of the Act is the creation of a Reserve Fund in the relevant previous year irrespective of the result of the profit and loss account disclosed by the books of the assessee; book entries would suffice for creating such a Reserve Fund; the debit entries, and the entries relating to the Reserve Fund, have to be made before the Profit and Loss account is finally drawn up; that is a condition for securing the benefit of development rebate; and, if that condition is not satisfied, the deduction on account of development rebate cannot be claimed at all. *2010-TIOL-815-HC-AP-IT in Income Tax.*

Waiver of loan taken for fixed assets:

The issue was whether the principal loan amount taken for the purchase of fixed assets, waived by the bank under the One Time Settlement Scheme (OTS), and credited by the assessee to its Capital Reserve Account in its Balance Sheet, is assessable to tax as a revenue receipt u/s 28(iv) of the Act.

The assessee took a loan from State Bank of India, for the purpose of acquiring capital assets. The assessee paid part of the principal and interest amount for the earlier years. An OTS was arrived at between the Bank and the assessee, whereby the assessee made an adhoc payment of Rs 5 cr towards the outstanding principle and interest amount, whereas the actual due (including overdue interest) was in excess of Rs 7 cr. The assessee credited the waiver of principle amount to the "Capital Reserve Account" in the balance sheet treating it as capital in nature and the waiver of interest in its P&L a/c.

The High Court held that the transaction in the present case being a loan transaction having no application with respect to Section 28(iv) of the Income Tax Act, cannot be termed as an income within the purview of Section 2(24) of the Act. Such a receipt which does not have any character of an income, being that of a loan, cannot be made taxable. Also, Section 41(1)(a) of the Income Tax Act is not applicable, as it is applicable only to a trading liability.

It was held that section 36(1)(iii) of the Income Tax Act deals with the amount of interest paid in respect of capital borrowed for the purpose of business. Therefore, this section has no relevance to the case on hand. A receipt cannot be taxed unless it is a revenue

receipt. Since in this case the receipt involved is a capital receipt, it cannot be taxed. Further Section 37(1) of the Income Tax Act specifically deals with the capital expenditure which cannot be allowed in computing income. Therefore on consideration of the facts involved and applying the legal principle discussed above, the decision went in favor of the assessee. *2010-TIOL-776-HC-MAD-IT in Income Tax.*

TRIBUNAL JUDGMENTS

Compensation received on termination of joint venture with non-resident:

On the matter of receiving compensation on termination of joint venture with a non resident, Tribunal held that, through a joint venture, no separate source or apparatus for earning a separate income was created. It was a simple case of doing the business in a particular way and the whole business was carried on even after the termination of the Joint Venture Agreement. The assessee company was engaged in the business of manufacturing and selling of water treatment equipments and chemicals before entering into the joint venture and continued to do the same even after termination of the joint venture.

It was held that, if the receipt of compensation for cancellation of a contract does not affect the trading structure of business of the assessee, nor deprive him of what in substance is his source of income, and termination of contract being a normal understanding, then such compensation has to be treated as revenue receipt. In this case, the assessee has not been deprived of his business and, in fact, the same business continued before the joint venture and after the termination of the joint venture. Therefore the compensation received by the assessee company has been rightly treated by the lower authorities as revenue receipt. *2011-TIOL-04-ITAT-MUM in Income Tax.*

Taxability of the payment for roaming services:

The issue was, when assessee makes payments to service providers for facilitating national roaming service to its mobile subscribers, whether TDS liability arises u/s 194I for use of equipment or u/s 194J to be treated as fees for technical services.

- **The Tribunal held that:**

section 194-I would not apply to rate-contract agreements. The Board itself has recognized that rent is something which is paid for earmarked premises. In the case of roaming charges, a subscriber does not get any earmarked service provider and the assessee also does not commit itself to the subscriber to provide for any particular service provider. The choice of the service provider who will provide the roaming facility to the subscriber is left to the subscriber. The message which is flashed on the cell phone of the subscriber gives the names of the service providers which have a roaming agreement with the service provider with whom he is registered and he can choose any of them during the period of his stay at other place. This shows that there is no commitment either by the assessee or by the other service provider with whom it has entered into a roaming agreement, to make the space available to the subscriber whenever demanded. This is why the payment made by the subscriber through the assessee as roaming charges cannot be considered to be rent. Therefore, the payment of

assessee to the other service providers cannot be considered as rent within the meaning of the Explanation under sec 194-I and there was no liability on the part of the assessee to deduct tax under that section;

the CIT(A) has not decided the issue of applicability of sec 194J. Therefore, the matter should receive fresh consideration at the hands of the Assessing Officer on the applicability of section 194J to the payment of national roaming charges, keeping in view the observations of the Supreme Court in CIT vs. Bharti Cellular Ltd. *2010-TIOL-789-ITAT in Income tax.*

Sec. 10B

Assessee was engaged in the business of development of software both onsite as well as offshore. It had set up a branch in USA for which separate accounts were maintained. Assessee being 100% EOU, claimed deduction u/s 10B of IT Act in respect of the exports of software. It was submitted by the assessee that the profits of the USA branch were eligible for double taxation relief under India-USA DTAA. The AO observed that the assessee had total export turnover of about Rs.28 cr, out of which the assessee had utilized the export proceeds of about Rs.15 cr in the USA for the purpose of carrying on export activities, and since the said amount had not been received in convertible foreign exchange in India within the prescribed time u/s 10B(3) of IT Act, the said amount cannot be treated as a part of export turnover for computing deduction u/s 10B of IT Act. The AO also excluded the expenses of about Rs. 3.33 cr incurred outside India in foreign exchange in providing technical services from the export turnover, while computing deduction u/s 10B of IT Act. The CIT(A) allowed the appeal in respect of the export turnover utilized in the USA but dismissed the claim in respect of foreign expenditure incurred for technical services to be included while computing the deduction u/s 10B.

The Tribunal held that:

It was not brought on record by the department that the company was involved in providing the technical services to other personnel or any outside agency. All the services rendered by the company were to its staff located at New Jersy for the fulfillment of objects namely development of software. A person can not provide services to self. The circular No. 621 dated 19.12.91, and circular No. 694 dated 23.11.94, also specify that the expenditure incurred on site abroad is eligible for deduction u/s 10B of the IT Act. The above expenditure has been incurred on foreign soil in connection with development of software by the employees of the assessee company at foreign branch and nothing has been incurred on managerial or technical services rendered to any outsider in foreign soil, therefore, it should not be excluded from the export turnover for computing deduction u/s 10B of IT Act.

In respect of the turnover retained in USA, Section 10B of the Act requires that foreign exchange in lieu of the exports should be brought to India within the prescribed time. However, the RBI allows the assessee to retain the said foreign exchange in foreign countries for the specific purposes and due approval is also granted for that purpose. The RBI and FEMA also monitor the utilization of such foreign exchange and the assessees are required to file periodic reports to those authorities. In such situation, the

circulars of the RBI allowing its retention, utilization or capitalization abroad cannot be ignored. This becomes more important when provisions of Section 10B(3) are considered which provide that the sale proceeds of the articles or computer software exported out of India are required to be brought in India in convertible foreign exchange within a period of six months from the end of the previous year or within such further time as the competent authority may allow in this behalf. As required by Explanation (1) to Section 10B, the competent authority involved is RBI under whose schemes and circulars the appellant has capitalized the foreign exchange earning and invested the same in approved joint ventures in USA. Therefore, the said reinvestment of export earning is deemed to have been received in India. No specific instance have been brought on record by the Assessing Officer to prove that the said foreign exchange had not been realized by the appellant within the due date abroad from the contracting parties. Once the appellant receives the export proceeds in foreign exchange abroad within due dates and the same are utilized by the appellant for the purpose of its own business through its branch office abroad, the said sale proceeds are required to be considered as deemed receipts in India. *2010-TIOL-779-ITAT-MAD-SB in Income Tax.*

SERVICE TAX

- **Important circular/ notification**

➢ **Electricity meter installed in consumers' premises and hire charges collected; whether covered under exemption for transmission and distribution of electricity:**

A doubt has been raised whether renting of electricity meter by a service provider rendering the service of transmission or distribution of electricity, is covered by the exemption available under Notification No. 11/2010-ST dated 27.02.2010 and/ or 32/2010-ST dated 22.06.2010.

The matter has been examined. It is a general practice among electricity transmission/ distribution companies to install electricity meters at the premises of the consumers, to measure the amount of electricity consumed by them and 'hire charges' are collected periodically. Supply of electricity meters for hire to the consumers being an essential activity having direct and close nexus with transmission and distribution of electricity, the same is covered by the exemption for transmission and distribution of electricity, extended under the relevant notifications. *Circular no. 131/13/2010 dated 7th December 2010.*

Exemption for packaged or canned software:

The Central Government hereby exempts the taxable service referred to in sec 65(105)(zzzze)(v) of the said Finance Act for packaged or canned software, from the whole of service tax, subject to the condition that-

(i) the value of the said goods domestically produced or imported, for the purposes of levy of the duty of Central Excise or the additional duty of customs leviable under sub-section (1) of section 3 of the Customs Tariff Act, 1975 (51 of 1975), if imported, as the case

may be, has been determined under section 4A of the Central Excise Act 1944 (1 of 1944) (hereinafter referred to as 'such value'); and

(ii) (a) the appropriate duties of excise on such value have been paid by the manufacturer, duplicator or the person holding the copyright to such software, as the case may be, in respect of software manufactured in India; or

(b) the appropriate duties of customs including the additional duty of customs on such value, have been paid by the importer in respect of software which has been imported into India;

(iii) a declaration made by the service provider on the invoice relating to such service that no amount in excess of the retail sale price declared on the said goods has been recovered from the customer. *Notification No. 53/2010 - Service Tax dated 21st December, 2010.*

Management, maintenance or repairs of roads:

Through the notification no. 24/2009 dated 27th July 2009, services related to management, maintenance and repair of roads was declared as exempted from service tax and now the word management, maintenance and repair of roads has been substituted with the word "management, maintenance or repair of roads, bridges, tunnels, dams, airports, railways and transport terminals" through the issue of current notification. *Notification no. 54/2010 dated 21st December 2010.*

Period of exemption extended to services related to transport of goods by rail:

Sec 65(105)(zzzp) of the Finance Act, 1994 – Transport of goods by rail service – Amendment has been made to Notification No. 7/2010-ST, dated 27-2-2010 by extending the exemption till April 2011. *Notification no. 55/2010-ST, dated 21-12-2010.*

Period of exemption extended to services related to transport of goods by rail including transport of hides and skins and leather:

The Service Tax Notification No. 8/2010 dated 27th February 2010 provided service tax exemption in respect of transport of certain goods by rail, including transport of **hides and skins and leather** with effect from 1st April 2010. Subsequently, the date of applicability of exemption was amended and as per last amendment the date was fixed as 1st January 2011. However, now a Service Tax *Notification no. 56/2010 dated 21st December 2010* has been issued in which it is stated that the provisions of Service Tax Notification No.8/2010 will come into effect from 1st April 2011 instead of 1st January, 2011.

Transport of goods by rail

Service Tax Notification No. 9/2010 dated 27th February 2010 notified "Transport of goods by rail" as an eligible service for availing Service Tax exemption to certain extent, with effect from 1st April 2010. Earlier, the Service Tax Notification No.20/2006 dated 25th April 2006 has provided the aforesaid exemption, from so much of the service

tax leviable thereon, as is in excess of the service tax calculated on a value which is equivalent to 30%, of the gross amount charged by the service provider for providing the said taxable service. However, now a Service Tax Notification no. 57/2010 dated 21st December 2010 has been issued in which it is stated that the provisions of *Service Tax Notification No.9/2010* will come into effect from 1st April 2011 instead of 1st Jan, 2011**.**

Exemption of general insurance service:

The Central Government, hereby exempts the taxable services in relation to general insurance business provided under the Weather Based Crop Insurance Scheme or the Modified national Agricultural Insurance Scheme, approved by the Government of India and implemented by the Ministry of Agriculture, from the whole of service tax leviable thereon under section 66 of the said Act. *Notification No.58/2010-Service Tax , the 21st December, 2010.*

- **SC/HC Judgments**

Construction of Housing Complex, a deemed Service under explanation to section 65(zzzh):

Assessee was engaged in development and sale of residential flats and enters into agreement for construction of flats with the contractors. The said flats are ultimately sold to the customers.

Service tax is leviable as per the provisions of the Act on taxable services as defined under Section 65. Section 65 (zzzh) includes service in relation to construction of a complex. Definition of construction of a complex under Section 65(30a) refers to construction of a new residential complex and other activities mentioned therein. Residential complex is defined under Section 65(91a) as comprising of buildings, common areas and other facilities. As per the impugned circular, service tax is leviable on the builders even when they enter into an agreement for sale and receive payment without issuance of completion certificate. As per explanation added to Section 65(zzzh), vide Finance Act, 2010, construction of complex by a builder or any person authorized by the builder, is deemed to be service by the builder to buyer.

According to the petitioner, the explanation widens the scope of levy beyond the concept of service by including therein sale. Taxing of sale and purchase was beyond the legislative competence of the Union Legislature. If construction activity is not undertaken by a builder, then the builder cannot be considered to be a service provider in relation to service of construction activities.

The High Court held that:

Assessee's case does not fall under Entry 54 List-II relating to sale and purchase of goods. What has been subjected to levy, in the present case, is element of service of construction. In this view of the matter, the imposed levy cannot be held to be beyond the legislative competence. Service and sale may both be included in a transaction. Considering the scope of entry 54 List II, it has been held that the said entry was a source of levy of tax only on transaction of sale and not in a composite transaction of sale and service or transaction of service.

This being the legal position, contention that there is no element of service of construction involved in a builder selling a flat cannot be accepted. Whether or not service is involved has to be seen not only from the point of view of the builder but also from the point of view of the service recipient. What is sought to be taxed is service in relation to construction which is certainly involved even when construction is carried out or got carried out before construction and before flat is sold. Therefore levy of service tax is correct in law. *2010-TIOL-813-HC-P&H-ST in Service tax*.

- **CESTAT Judgments**

Deputation of trained software personnel:

Assessee had recruited certain graduates and then had trained them in the field of software development and software consultancy and maintained a roll of all such trained graduates and based on the requirements of the clients as per the mutual agreement between the assessee and the clients, used to depute such software professionals to the locations specified by the clients. Those software professionals undertook various projects of the assessee clients and worked for them under the directions as per the requirements of the clients. Therefore CIT (A) ordered that the activity was clearly covered by the category of "Manpower Recruitment or Supply Agency's Service" within the meaning of the said expression under the Act and therefore, the tax liability.

The main contention of the assessee was that the service rendered was in the nature of software development and maintenance activity and not the manpower supply activity as has been held by the Adjudicating Authority. In that regard apart from the agreement and bills, attention was also drawn to the fact that since 2008, the assessee had also obtained certificate in relation to the Information Technology software services and had been paying the service tax only in relation to such services which have been accepted by the Department. Considering the same, there is no case for holding that assessee had been rendering "Manpower Recruitment Agency's Services". It was sought to be argued that once the Department accepts that the assessee had been rendering Information Technology software services, it was not open for the Department to contend that the assessee had been rendering totally different service.

The Tribunal observed that:

The bills issued by the assessee in relation to the services rendered clearly refer to the services of Senior Consultant and Consultant being made available to the clients. It was clear that requisite software was developed by the assessee's own employees based on the directions of the clients at various premises specified by the clients, and after completion of projects, persons were deputed to another projects and remained on assessee' rolls'.

The contention that since the assessee has been registered with the Department for providing Information Technology Software services and has been paying service tax accordingly, so it can be justified that for the earlier period it should be presumed that the assessee was rendering similar type of services only, cannot be accepted. The nature of service rendered by an assessee for a particular period is not a matter of mere inference based on registration obtained by the assessee or service tax paid by the assessee in relation to a particular service for a totally different period. The nature of service rendered by the assessee is a question of fact decided on the basis of actual nature of service to be ascertained on the basis of the evidence collected in that regard.

As regards the issue of classification, certainly the dispute in that regard can be dealt with while dealing with the appeal on merits. Nothing has been shown that on account of any such issue, there could be any difference in the calculation of the value of the services rendered and the tax liability as such. Tribunal asked the assessee to pre-deposit some of the demand raised. *2010-TIOL-1652-CESTAT-BANG in Service tax.*

Export of Services - Marketing and Sales promotion for foreign company in India is export:

CIT found that FIPL had rendered services classifiable under the category 'Business Auxiliary Services' (BAS for short) and 'Maintenance or Repair Services' (MRS for short) during the respective material period mentioned. FIPL had entered into two Agreements with M/s. FANUC Ltd., Japan. In terms of the first agreement, FIPL was to provide marketing and sales promotion in respect of the

specified products of FANUC, Japan, in India. FANUC, Japan, manufactured and sold CNC systems, Cell controllers and CNC automatic programming systems in India. FIPL received commission for the services rendered. FIPL also rendered MRS in respect of the specified products.

CIT raised some demand under BAS rejecting the claim of the assessee that the impugned services were exported. As regards the MRS, the Commissioner held that during the material period 15.03.2005 to 17.04.2006, to qualify for export, services had to be delivered outside India and used outside India. In the instant case, MRS was delivered and consumed in India.

The Tribunal observed, As regards the marketing and sales services rendered in India in respect of products manufactured and exported by a foreign client, the CBEC had clarified that such services had to be treated as export since the beneficiary of such services was based abroad.

The Tribunal had dealt with a similar dispute relating to BAS in Stay Order No.1737 /2009 dated 14.12.2009 in the case of M/s. IBM India (Pvt. Ltd.) Vs. *CCE* , Bangalore (***2009-TIOL-2441-CESTAT-BANG***), in which it was held: When services are similarly provided to a foreign enterprise by Indian agents, it cannot be held that export of services is not involved. Therefore there is no logic in the view that in the instant case export of marketing services (BAS) was not involved. Benefit of service accrued to the manufacturer of computer systems and peripherals based abroad. In any case, Commissioner cannot validly hold a view contrary to that held by the *CBEC* and communicated for implementation by the officers in the field.

The case laws cited also support the claim of the assessee on export of services. Therefore, prima facie, the appellants are not liable to pay service tax and interest thereon and penalty imposed on them. Following the above order, Tribunal held that prima facie, the impugned BAS have to be treated as exports and the impugned demand denying the benefit of export to those services involved is not sustainable.

As regards MRS, the demand pertains to the period 15.03.2005 to 17.04.2006. During this period, for services to constitute export, the following conditions had to be satisfied :-

Services physically performed outside India partly or completed; Such services delivered outside India; Such services used in business or for any other purpose outside India; and Payment for such service provided is received by the service provider in convertible foreign exchanges.

In the instant case, MRS involved were performed entirely in India. Moreover, such services were also delivered in India. In the circumstances, the MRS involved do not prima facie qualify for benefit of services exported. *2010-TIOL-1645-CESTAT-BANG in Service Tax.*

Our Offices:

Head Office
" KRD Gee Gee Crystal"
7th floor
91 - 92 Dr. Radhakrishnan Salai
Mylapore
Chennai 600 004
Phone # + 91 44 28112985/86/87/88
Fax # + 91 44 2811 2989

Branches:

Bangalore
Unit G1, 'Ebony'
No.7, Hosur Road
Langford Town
Bangalore – 560 025
Phone : +91-80-22110512

Mumbai
No.406, Madhava Building
4th floor, Bandra Kurla complex
Bandra (E), Mumbai – 400 051
Phone : +91-22-26591730/
26590040

Delhi
No.35, Hauz Khaz Apartments
Hauz Khaz
New Delhi
Phone : +91-11-65814982

Hyderabad
6-3-609/140/A
No.402, Annapurna Enclave
Ananda Nagar Colony
Khairatabad
Hyderabad – 500 004
+Mobile:+91-9490189743

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