Tax News

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INCOME TAX

Reminder For February '11

Action Due	Due Date
TDS/TCS for the month of Jan 2011	07-02-11
PF for the month of Jan 2011	15-02-11
ESI for the month of Jan 2011	21-02-11

SERVICE TAX

Action Due	Due Date
Service Tax for the month of Jan 2011 in case of company	05-02-2011
Service Tax for the month of Jan 2011 in case of a company for which e-payment is mandatory.	06-02-2011

INCOME TAX

- **Vital Notifications / Changes**

No circular to be reported in this edition.

- **Supreme Court / High Court Judgments**

➢ **Interest u/s 234 B in case of MAT on book profits:** In a landmark decision the Larger Bench of the Apex Court has settled all the disputes relating to the interest liability and the liability to pay advance tax on MAT companies.

The issue before the Apex Court was - whether interest under Section 234B can be charged on the tax calculated on book profits under Section 115JA. In other words, whether advance tax was at all payable on book profits under Section 115JA?

Findings: It was concluded that interest under Sections 234B and 234C shall be payable on failure to pay advance tax in respect of tax payable under Section 115JA / 115JB. *2011-TIOL-02-SC-IT-LB in Income Tax.*

➢ **Tax avoidance by incurring of losses voluntarily**

Assessee had purchased and sold US-64 units of UTI incurring losses. The Assessing Officer did not allow the losses since it was held that it amounted to tax planning and therefore liable to be ignored. The High Court observed that the transactions were genuine and losses should have been allowed. It was held that the legally permissible transaction which was resulting in a loss even with the intention to reduce tax liability could not be disallowed as it was a genuine transaction, not speculative in nature. *Porrits and spencer (Asia) Ltd. V. CIT (2010) 329 ITR 222.*

➢ **Goodwill" is an "intangible asset" u/s 32(1)(ii) & eligible for depreciation**

The assessee engaged in manufacture of non-alcoholic beverages claimed depreciation u/s 32 on "goodwill", being the amounts paid to bottlers for marketing and trading reputation, trading style and name, territory know-how etc. The AO, allowed the assessee's claim u/s 143(3). The CIT revised the assessment u/s 263 on the ground that goodwill was not an "intangible asset" as defined in sec 32(1)(ii). Tribunal also allowed assessee's claim. On appeal by the IT department, High Court held that:

(i) S. 263 cannot be invoked to correct each and every type of mistake or error committed by the AO if it is not "prejudicial to the interests of the revenue". Every loss of revenue as a consequence of the AO's order cannot be treated as prejudicial to the interests of the Revenue.

(ii) It is a fact that the assessee had made full disclosure of the facts of the claim and the AO had examined the claim and taken a view. As a result, the assessment order cannot be termed "erroneous & prejudicial to the interests of the revenue";

(iii) On merits, sec 32(1)(ii) allows depreciation in respect of know-how, patent, copyrights,

trademarks, licences, franchises or any other business or commercial rights of similar nature. The term "commercial rights" are such rights which are obtained for effectively carrying on business and commerce. Goodwill, being the positive reputation built by a person over a period of time is of "similar nature" as the other items enumerated in the definition of "intangible assets, and so depreciation on it should be allowed. *CIT vs. Hindustan Coco Cola Beverages Pvt. Ltd. 2011-TIOL-33-HC-DEL-IT in Income Tax.*

Benefit of Sec. 10 A in case of profits of foreign branch: The assessee, a 100% EOU, was engaged in export of computer software. It was in the business of development of software through its unit located in NEPZ and was entitled to deduction under Section 10A/10B of the Act in respect of profits derived from the said unit. The question related to the profits derived by the assessee's branch in Japan.

The High Court held that as per Explanation 3 of Section 10A, even if the profits were derived from on-site development of computer software outside India, they were also to be treated as profits from the export of computer software outside India. Therefore, it was to be examined whether Japan Office of the assessee would be treated as an onsite development of computer software or was it to be treated as a separate branch functioning independently.

The department submitted that to qualify as an onsite development, it should be only a Liaison Office acting as an intermediary between the foreign principal enterprise and the India customers and vice-versa. However, this foreign office was working as a separate branch carrying on full-fledged marketing operations which could not be treated as onsite development.

Since the matter was not examined in this perspective (Liaison office vs Branch) by the lower authorities, so the High Court referred it back to the lower authority to examine *the case in this view afresh. 2011-TIOL-17-HC-DEL-IT in Income Tax*.

Depreciation in case of units not used for a long time: Assessee had claimed depreciation on its various assets which included the claim of depreciation in respect of a closed unit at Bhopal. Assessee submitted that the depreciation was to be allowed as the said assets of Bhopal unit remained part of the block of assets and were ready for passive use which was as good as real use. AO denied it on the ground that unit of the assessee at Bhopal was closed throughout the year. CIT (A) confirmed this order. But ITAT allowed the appeal of the assessee. On appeal, the **High Court** held that: As per amended Section 32, deduction of depreciation is allowed on block of assets, and the Revenue cannot segregate a particular asset therefrom on the ground that it was not put to use. Individual assets have lost their identity and concept of 'block of assets' has been introduced, which is relevant for calculating the deprecation. In CBDT Circular No.469 dated 23.09.1986, it was observed that keeping the details with regard to each and every depreciable asset was time consuming both for the assessee and the Assessing Officer. Therefore, the law was amended to provide for allowing of the depreciation on the entire block of assets instead of each individual asset. This amendment also strengthens the claim that now only detail for "block of assets" has to be maintained and not separately for each asset. Therefore, to claim depreciation, use of each and every asset is not necessary, when a particular asset forms part of a 'block of assets'. *2011-TIOL-36-HC-DEL-IT in Income Tax.*

Can amount transferred from Revaluation reserve to reduce Depreciation debited to P&L A/c be excluded to calculate book profits : Assessee was a widely held listed company and was engaged in the business of manufacture of yarn and polyester.

During the previous year ending 31.3.2000, it revalued its fixed assets resulting in increase in the net book value of such assets by approx Rs. 2.88 billion which was credited to the Revaluation reserve.

For the previous year ending 31.3.2001, the P&L Account reflected depreciation at approx Rs.1.27 billion. However, this was reduced by transfer from Revaluation reserve to the extent of approx Rs.0.26 billion, resulting in a net debit on account of depreciation of approx Rs. 1.01 billion.

The Assessing Officer, while computing the book profit under Section 115JB of the Act, did not allow reduction of the afore-stated amount of Rs. 0.26 billion on the ground that the Revaluation reserve was created in the assessment year 2000-01 and had not been added back while computing the book profit in that year, which is one of the requirements under Section 115 JB.

This order was upheld by the C.I.T. (A) and by the ITAT and by the High Court. So the assessee appealed to the Supreme Court.

Issue involved in the case

Whether the amount transferred from the revaluation reserve be allowed to be set off against the amount of depreciation debited to P & L Account under the terms of clause (i) of explanation to Section 115 JB (2)?

Could the above-stated approx Rs. 0.26 billion, being the differential depreciation recouped from the Revaluation reserve created during the earlier assessment year 2000-01, be said to be credited in the P & L Account during the assessment year in question under the above clause?

Observations of the Supreme Court

Section 115JB provides that all companies having book profit under the Companies Act, shall be liable to pay Minimum Alternate Tax (MAT) at a specified rate of the book profit. It further provides that every MAT company shall follow same accounting policies and standards as are followed for preparing its statutory account.

For the purposes of the provision, "book profit" means the net profit as shown in the P & L Account in the relevant previous year in accordance with the provisions of Part II and Part III of the Schedule VI to the Companies Act, subject to certain adjustments which increases or decreases the book profit. Thus, even under Section 115J, certain adjustments were to be made to the net profits as shown in the P & L Account. One such adjustment stipulates that the net profit shall be decreased by the amount withdrawn from any Reserves, if any such amount is credited to the P & L Account. Some companies have taken advantage of Section 115J by decreasing their net profit by the amount withdrawn from the Reserve created in the same year itself, though the Reserve, when created, had not gone to increase the book profit. Such adjustments led to lowering of profits and, consequently, the quantum of tax payable got reduced.

Thus, by amending Section 115J, it was provided that "book profit" will be allowed to be decreased by the amount withdrawn from any Reserves only in two cases:

(i) if such Reserve was created in the previous year relevant to the assessment year commencing w.e.f . 1.4.1998

OR

(ii) if the Reserve so created in the previous year had gone to increase the book profit in any year when Section 115J was applicable.

In the present case, the adjustment was primarily in the nature of contra adjustment in the P & L Account and not a case of effective credit in the P & L Account (as contemplated in clause (i) of explanation). The credit in the P & L Account implies that the P & L Account per se has been effectively credited by the said amount. Thus, the amount withdrawn from any reserve must in effect impact the net profit as shown in the P & L Account. As per accounting principles, the contra adjustment does not at all affect any particular account to which it has been carried. Unless an

adjustment has the effect of increasing the net profit as shown in the P & L Account, that entry cannot be said to be a credit to the P & L Account and, therefore, though the amount has been literally credited to the P & L Account, however, in substance there is no credit to P & L Account.

MAT provisions were introduced as number of zero tax companies had grown. It was found that companies had earned substantial book profits and had paid huge dividends but paid no tax. In the present case, had the assessee deducted the full depreciation from the profit before depreciation during the accounting year ending 31.3.2001, it would have shown a loss and in which event it could not have paid the dividends. Therefore, the assessee credited the amount to the extent of the additional depreciation from the Revaluation reserve to present a more healthy balance sheet to its shareholders enabling the assessee possibly, to pay out a good dividend. It is precisely to tax these kinds of companies that MAT provisions had been introduced. The object of MAT provisions is to bring out the real profit of the companies. The thrust is to find out the real working results of the company. Thus, the reduction sought by the assessee under clause (i) to the explanation to Section 115JB (2) in respect of depreciation has been rightly rejected by the AO.

The reduction under clause (i) to the explanation could have been availed only if such Revaluation reserve had gone to increase the book profits. As the amount of Revaluation reserve had not gone to increase the book profits at the time it was created, the benefit of reduction cannot be allowed.

Conclusion

The civil appeal filed by the assessee was dismissed. *2011-TIOL-01-SC-IT-LB in Income Tax.*

- **Tribunal Judgments**

Sec. 80 RR in case payment received in advance following cash system: Assessee was a film actor, and had received professional remuneration for doing stage shows abroad between May 2003 and July 2003. Assessee followed the cash system of accounting and as payments had been received in advance, these were shown as receipts for claim of deduction under section 80RR. The asseessee had provided some documents and letters relating to discussion on payment for the shows. In Form-10H all the payments for the shows were stated to have been received in the month of June, July and August, 2003. The assessee had also claimed a deduction on account of legal expenses incurred towards defending him in various criminal proceedings, arising out of his professional activity. The AO disallowed the claim on the grounds that (i) assessee had not filed all the agreements to show that the payment for the stage show was received in advance and (ii) he was a film actor and not exactly a stage artist. On Appeal, the Tribunal held that the assessee, a film actor, follows the cash system of accounting. So he cannot claim Sec 80RR benefits for the payment received in advance for a stage show to be organised without furnishing any evidence of an agreement. As far as legal expenses are concerned they were incurred to defend the assessee in criminal proceedings, not in relation to his profession, and the assesee had failed to prove any co-relation. So the assessee's appeal was turned down. *2011-TIOL-45-ITAT-MUM in Income Tax.*

Exemption u/s 54 on payments made for reservation and booking of a flat: Assessee sold a property. After availing the benefit of indexation, the assessee declared long term capital gain and claimed exemption u/s 54 for investment in the new property. AO disallowed the exemption claimed on the ground that the assessee had not acquired any residential house but simply reserved a flat with the builder. The amount was not for booking but reservation of a flat which may be converted into booking later on but at the same time the reservation may be cancelled also.

The ITAT held that exemption u/s 54 is available for booking of a flat not for reservation of the flat. Therefore, the issue was set

aside to the AO to calculate correct addition to the tax liability. *2011- TIOL-64-ITAT-MUM in Income Tax.*

Income of US co. from back office operation carried out by Indian subsidiary is liable to tax :

1. The assessee companies - eFunds Corporation, USA ("eFunds USA") and eFunds IT Solutions Group Inc, USA ("eFunds Solutions USA") – were two USA based companies, that were tax residents of USA.

2. eFunds Solutions USA was a wholly owned subsidiary of eFunds USA.

3. eFunds International India (P) Ltd ("eFunds India") was a wholly owned subsidiary of eFunds USA, and was operating in India since 1997. It provided the following IT enabled services to clients of eFunds USA and eFunds Solutions USA:

    a. Call centre service

    b. Financial shared services and data entries

    c. Software development services

4. For these services, eFunds India was being compensated by way of remuneration, which was being assessed duly, and tax paid accordingly, as an Indian resident assessee.

5. Since the two US based companies did not have any business in India, the remuneration paid to eFunds India was not being claimed as a deduction in India. However, this amount was being regularly deducted as an expenditure while computing their income in USA.

Issue before Tribunal

1. According to the assessees, since eFunds India was being remunerated on arm's length basis, therefore, they did not have any PE in India (they quoted an extract from the OECD model for the definition of PE), and so there was no tax liability arising in India.

2. The Commissioner (Appeals) had upheld the Assessing Officer's line that the assessees had a business connection/PE in India. Since core activities of the assessee were carried out in India by subsidiary – eFunds India - and profits were attributable to PE in India, it was liable to tax in India. However, some relief was offered in the method of computation of these attributed profits.

3. The issue before the Tribunal was, whether it could be concluded that the assessee had business connection/ PE in India, and whether, the PE had profits liable to tax in India?

Observations and rulings of Tribunal

1. eFunds USA entered into a contract with its clients for providing certain IT enabled services and then the same contract was either assigned or sub-contracted to eFunds

India for execution. Therefore, both eFunds USA and eFunds India came under legal obligation to provide services to clients of eFunds USA.

2. Considering the functions performed, assets used and risks assumed (FAR analysis) by the assessees and by eFunds India, it was clear that eFunds India was not having requisite material assets – the relevant software and database – needed for providing these services independently. They were made available by eFunds USA to eFunds India, free of any charge.

3. eFunds India did not bear any significant risk as the ultimate responsibility lay with the assesses.

4. eFunds India's office in Mumbai had an International division which reported to eFunds USA, and undertook activities directly for eFunds group entities globally.

5. eFunds India's activities could not be considered as auxiliary or preparatory, as they were core income generating activities. This was supported by the content of the Form 10-I in the case of eFunds USA.

6. It is to be noted that the articles of the Indo-US DTAA are worded differently than the OECD model, and prescribe a lower threshold with respect to existence of the PE. The basic intent of article 5(1) of this DTAA is that there should be a fixed place of business through which an enterprise's business is partly or wholly carried out. This place of business need not be owned, rented or otherwise under possession or control of the enterprise in order to constitute a PE.

7. In view of these observations it could be held that the assessee had business connection in India. Also, assessee's PE existed under article 5(1) of the Indo-US DTAA, in respect of back office operation and software development services being carried out by its subsidiary.

8. It was also held that assessee's income was liable to tax in India for the operations performed by eFunds India on its behalf under provisions of sec 9(1).

Conclusions

1. Due consideration needs to be given to the functions performed, assets used, and risk assumed (FAR analysis), while determining whether business connection exists between two entities.

2. Existence of PE is determined by the provisions of the DTAA between the two countries.

3. Once it is established that a PE exists, the income of the foreign company attributable to this PE, becomes taxable in India.

SERVICE TAX

- **Important circular/ notification**

Fumigation of export cargo in compliance of export obligation– whether taxable under 'cleaning services' – a clarification: It was clarified that the activity of fumigation of export cargo including agricultural/horticultural produce, whether loaded into containers or otherwise, is not taxable service under 'cleaning services'. Government had also issued Notification No. 41/2007-ST dated 6.10.2007, as amended by notification No. 42/ 2007-ST dated 29.11.2007 to exempt specialised cleaning services of containers used for export goods. This was in line with the international practice of making the export consignments free from taxation in the country of its origin. *Circular no. 132/1/2011 dated 12th January 2011.*

Service tax exemption for Janata Personal Accident Policy: Generally, a standard JPAP is an individual oriented policy with a fixed 'sum assured'. The sum assured in these JPAP policies is often as low as Rs. 25000/-, so that even people without regular income can afford to purchase a risk cover for themselves. For the insurers, JPAP offers a vehicle to fulfill the 'rural or social sector' obligation prescribed by the Insurance Regulatory Development Authority (IRDA). It is clarified that customized group JPAP insurance schemes floated by various insurance companies as per the specifications of state governments concerned, to extend risk cover to target populations, and to fulfill the prescribed 'rural or social sector' obligation, are covered by the subject service tax exemption. *Circular no. 133/2/2011 dated 18th January 2011.*

- **SC/HC Judgments**

Taxability of collecting Entry fee at Airport by AAI: The AAI entered into a licence agreement with the assessee by which the appellant was entrusted with the responsibility and the activity of collecting airport admission ticket charges on behalf of AAI Limited at Karipur Airport, Calicut.

As per the said agreement the appellant was permitted to collect Rs. 50/- per visitor as airport admission ticket charges for which the appellant was required to pay an amount of Rs. 2,66,797/- per month as licence fee.

The assessee was granted licence by AAI to collect the admission ticket charges so as to provide amenities and facilities to the passengers and visitors at the Airport. Under the said agreement, the assessee was also required to pay all rates, assessment, out goings and other taxes as leviable on the Licensee as per law. It is also clear therefrom that AAI has only provided bare space and all expenses for providing services to passengers / visitors are to be borne by the assessee.

Issue was whether the assessee, who is a licencee, could be held liable for payment of service tax when actually the service provided by them could and should be said to be provided by the Airport Authority of India ("AAI").

Supreme court held that it is true that the appellant deposits a licence fees of Rs . 2,66,797/- per month to AAI but it collects the required fees from the users of the facility and provide all facilities to such customers. Section 65 Clause 105(zzm) of Finance Act, 1994 defines 'taxable service' to mean any person, by airports authority or any person authorised by it, in an airport or a civil enclave. It is thus crystal clear that the assessee being a person authorized by AAI to provide service in express terms and conditions, it becomes liable to pay such tax as it was an authorized person to provide taxable service and collect the admission ticket charges on a contract basis. *2011-TIOL-06-SC-ST in Service Tax.*

Supply of vessels to ONGC is not covered under mining services: In this appeal the judgment was given against the order dated 23.3.2009 ***2009-TIOL-150-HC-MUM-ST*** passed by the Division Bench of the Bombay High Court.

The Supreme Court considered the provisions and the nature of work that was required to be carried out by the Members of the respondent Association in terms of the contract entered into by them with ONGC, and observed, "None of the aforesaid entry in the Schedule could be strictly

said to be a service rendered in relation to mining of mineral, oil or gas. The nature of work which are set out in the Schedule cannot be said to be even remotely connected and included within the ambit of the aforesaid expression as found in Section 65(105) Entry No. zzzy, therefore, we affirm the order of the High Court to the aforesaid extent by looking into the facts in issue only. We, however, leave the question of law which has been decided by the High Court open to be considered at length in an appropriate case." *2011-TIOL-05-SC-ST in Service Tax.*

- **CESTAT Judgments**

Jungle cutting is to be considered as input service: Assessee claimed credit for following input services: Outdoor Catering Services availed in guest house, Garden maintenance, House keeping at Guest House, House keeping at factory, Picnic and jungle cutting.

It was held by the Tribunal that assessee is entitled to avail input service credit, only for the services availed by the assessee in its business activity of manufacturing. In this case, the guest house has been maintained by the appellant for its business activity and not for any welfare of the society. Hence, the appellant is entitled for input service credit on outdoor catering service/house keeping service except for the portion of their service for which they have recovered some amount from the persons staying in guest house. With regard to garden maintenance service and house keeping service of the factory as they are availed by the appellant in the course of its business, they are entitled for input service credit. With regard to the picnic services, this service does not have any nexus with the business activity of the appellant. Hence, the input service credit on the picnic service is denied. Finally, the jungle cutting service, which is required by the appellant to keep the environment surrounding the factory free of bacteria, it amounts to availing the said service for its manufacturing business. Hence, the appellant is entitled for credit on jungle cutting service as well. *2011-TIOL- 95-CESTAT-MUM in Service Tax.*

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