Tax News

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INTERNATIONAL TAX

- **Judgments**

  - **Reimbursement for finishing the manufacture of unfinished goods:** The assessee-company, a subsidiary of AT&S Austria, was engaged in manufacture and sale of professional grade printed circuit boards. In the relevant assessment year, the assessee entered into an agreement with AT & S Austria whereby, the goods manufactured by the assessee were sold to AT & S Austria, which in turn sold the goods to final customers in European countries. During the course of the manufacture of the product, the assessee could not complete the full manufacturing of the goods. Certain parts of the manufacturing process which were critical for completion of manufacture and saleability of the product could not be done by the assessee. Accordingly the unfinished products were exported to AT & S Austria. Since it was essential to complete the manufacture of finished goods without which the customers would not accept the product AT & S Austria completed the manufacture of the product in Austria by using its manufacturing facilities and for the same it was mutually agreed by the assessee and AT & S Austria that the actual cost incurred by AT & S Austria in performing the aforesaid manufacturing activity to finish the production of PCBs would be reimbursed by AT & S India.

The Assessing Officer took a view that manufacturing cost reimbursed by assessee to its parent company constituted fee for technical services taxable under section 9(1)(vii). Since assessee failed to deduct tax at source under section 195 while making said payment, the Assessing Officer disallowed same by invoking provisions of section 40(a)(ia). The Commissioner (Appeals) confirmed said disallowance. Upon appeal, the Tribunal held that:

- The parent company has not made available to the assessee the technology or the technological services which was required to provide the distribution, management and logistic services. Admittedly AT & S Austria does not have a PE in India.
- AT & S Austria was carrying out re-working of products of assessee at its own manufacturing plant at Austria and there was no connection between manufacturing activities done by AT & S Austria with manufacturing process done by the assessee at its manufacturing facility in India. Consequently the income, if any, generated by AT & S Austria on account of the repairing operations or manufacturing operations at its manufacturing facility outside India cannot be held to any income taxable in India under the

Act.

- As the income of AT & S Austria is not chargeable to tax under the Act, the requirement of deduction of tax at source under section 195 would not be applicable and consequently no disallowance under section 40(a)(ia) can be made. In the result, the disallowance made by the Assessing Officer and as confirmed by the Commissioner (Appeals), stands deleted. *DCIT Kolkata vs. AT & S India (P) Ltd. [2015] 58 taxmann.com.*

➢ **Commission paid to foreign agents:** The assessee was a manufacturer of shoes, handbags and key chains. It paid commission to its foreign agents for carrying out exports outside India but it did not deduct TDS on the same on the ground that services had been rendered outside India. The Assessing Officer invoked section 40(a)(i) and made disallowance. The Commissioner (Appeals) held that:

- There is no evidence placed on record proving any 'technical services' element in procurement of export orders.
- It is evident that the assessee's overseas export agents have merely collected export orders in lieu of direct remittances.
- 'Export Sales Commission' payment to the non-residents for procuring export orders, were not assessable to tax in India and consequently, the assessee-company was not under any obligation to deduct the TDS on the above commission payments under section 195. *ACIT Chennai vs. India Shoes Exports (P) Ltd.[2015] 57 taxmann.com.*

➢ **Expenditure on salaries of International Assignees:** The assessee was engaged in the business of software development and required expertise of personnel of Cisco affiliates abroad. Therefore, the assessee had entered into cross border secondment arrangements with such overseas group affiliates. As per the assessee, their salaries, for the period in which they were holding the work of the assessee in India, as well as their expenditure had to be met by the assessee. The assessee was aggrieved that the foreign currency expenditure in relation to reimbursement of international assignee cost were considered as technical service fee and disallowed for want of deduction of tax at source.

The assessee submitted that there were two elements for the reimbursements; 75 per cent of the salary cost was paid to the concerned seconded personnel directly by the assessee and 25 per cent of their salaries were paid by their employer abroad and such amount was in turn reimbursed by the assessee to such employer. Expenditure incurred by the affiliates abroad in relation to such seconded personnel was also reimbursed by the assessee. As per the assessee, there were 4 individuals who were rendering their services to the assessee in India. The assessee had not received any technical services from such affiliate companies.

The assessee submitted that tax was deducted by the assessee for the whole of the salary, including the 25 per cent reimbursed by the assessee to the affiliate. Thus, the payments were subject to tax deduction at source in India. According to the assessee, the amounts reimbursed to these persons through their employers abroad if considered as technical services, rendered by the employers, it would result in double taxation since amount was already subject to tax deduction at source. The assessee submitted that reimbursement of salary paid under the secondment agreement did not constitute fee for technical services.

The Revenue contested that the payments to the affiliates abroad was not limited to salary, but even 'out of pocket' expenditure and other miscellaneous expenditures were reimbursed. Miscellaneous expenditures reimbursed were not for business travel alone. Though the assessee was claiming that all persons had been sent to India based on secondment agreements, the fact was that no such secondment agreement was available on record. According to Revenue, through the services of their employees, assessee was actually receiving technical services from its affiliates. Therefore, the assessee was bound to deduct tax at source as set out under section 195. Having not done so, the Assessing Officer was justified in making a disallowance under section 40(a)(ia). Upon appeal, the Tribunal held that:

- Whether the employees of the affiliates abroad were rendering services to the assessee-company, as a part of any technical services agreed to be rendered by such affiliates to the assessee, has to be seen based on the verification of actual services rendered by them.
- The assessee should also be given an opportunity to show that the employees came to India only on a secondment and had not rendered any technical services on behalf of the affiliates abroad. Therefore, the issue is sent back to the file of the Assessing Officer for fresh consideration.

➢ **Arm's Length Pricing:** The assessee-company was primarily engaged in providing software research and development services to its AE as per the design, production orders, plans, process specification and production schedules provided by its American parent company. In its transfer pricing study, assessee had benchmarked its international transactions relating to the provision of software design and development services entered with its associated enterprises by adopting the Transactional Net Margin (TNM) method. The assessee compared its PLI with the arithmetic mean of the margins of the comparable cases selected, and as assessee's PLI was found to be higher than the arithmetic mean of the margins of the comparable cases, stated value of international transaction was claimed to be at arm's length price.

The TPO disagreed with the assessee on the selection of the comparable cases and selected the fresh comparables and on basis of arithmetic mean of the PLI of said comparables

made certain adjustment to the stated value of international transaction. On appeal, the assessee challenged action of the TPO/Assessing Officer in inclding certain comparables and/or in rejecting certain comparables while benchmarking the international transactions. The Tribunal held that:

- The assessee was justified in seeking exclusion of two firms from the final set of comparables, on the ground that the said concerns were functionally different from the assessee inasmuch as the majority of services rendered by it.
- TPO's decision to exclude one firm from the final set of comparables for the reason that the PBIT/cost ratio of said concern in the current assessment year was quite low in comparison to the preceding and succeeding years, was not sustainable, as the TPO had not demonstrated that the lower profit margin of the said concern in that year was attributable to any abnormal business condition.
- TPO's decision to exclude one firm from the final set of comparables on ground that it had undertaken business restructuring, was found unsustainable, as the business restructuring was not carried out in the business segment which was compared by the assessee, but in some other business segment of the firm.
- TPO's decision to exclude 3 firms from the final set of comparables on the ground that the said concerns were predominantly engaged in providing onsite services whereas assessee was providing services to his clients as an offsite service provider, was upheld.
- TPO's decision to exclude a firm from the final set of comparables on the ground that the annual accounts of the said concern covered a period of 18 months whereas the comparable data should be for 12 months from reliable comparability, was upheld.
- The assessee sought exclusion of a firm from the final set of comparables on the ground that the said concern was an abnormally high profit making concern. It was held that a concern which has earned abnormally high profit margin cannot be excluded straightway but it would require further investigations to ascertain the reasons for the high profit margin. In this background, the assessee had furnished the operating margin trends of the said concern over six financial years, *i.e.,* for three preceding years, current and two succeeding financial years. As there existed wide fluctuation in profit margins fir these 6 years, it was clear that it was not a normal business phenomenon. Thus assessee's appeal to exclude this firm from the final set of comparables, was upheld.
- The assessee had contested that the TPO had given no opportunity to the assessee before applying the turnover filter. So, the Tribunal sent the matter back to the Assessing Officer/TPO for fresh consideration.
- In the result, the Assessing Officer/TPO was directed to recompute the arm's length price of the international transactions after considering aforesaid decision on various aspects of the matter.*TIBCO Software (India) (P.) Ltd. vs. DCIT Pune, [2015] 58 taxmann.com.*

- **Foreign Exchange Gain:** The assessee-company was engaged in the business of providing Information Technology Enabled Services ('ITES') to its Associated Enterprises. While computing ALP of said transactions, the TPO opined that Foreign exchange gain was not derived from the ITES service and, thus, had to be excluded while computing operating margin of the assessee and accordingly, computed T.P. adjustment. The Commissioner (Appeals) held foreign exchange loss/gain to be operating in nature. On appeal, the Tribunal held that:

  - It has not been disputed that foreign exchange gain has arisen as a consequence of the realization of the consideration for rendering ITES services and, therefore, there is no reason for its exclusion from the operating revenues for the purpose of calculating the operating margin of the assessee.
  - Operating revenue should be computed by including the foreign exchange gain. *DCIT Bangalore v. Amba Research India (P.) Ltd. [2015] 58 taxmann.com.*

- **India Singapore DTAA:** The assessee was a tax resident of Singapore. It had undertaken installation and construction activity in respect of certain projects. Revenue held that the presence of assessee in India in excess of 90 days constituted PE in India, under Article 5(6) of India-Singapore DTAA ('treaty'). The assessee submitted that it was purely into installation and construction activity, which would fall within Article 5(3) of the treaty. Thus, activities of assessee would not constitute PE due to its presence in India for less than 183 days under Article 5(3) of DTAA. Upon appeal, the Tribunal held:

  - Article 5(3) of DTAA provides that - "A building site or construction, installation or assembly project constitutes a permanent establishment only if it continues for a period of more than 183 days in any financial year."
  - Article 5(6) of DTAA provides that - "An enterprise shall be deemed to have a permanent establishment in a contracting State if it furnishes services, other than services referred to in paragraphs 5(4) and 5(5) of this Article and technical services as define in Article 12, within a contracting State through employees or other personnel, but only if….."
  - If the activities related to construction or installation are specifically covered under Article 5(3), then one need not to go in for Article 5(6). Thus, the activity of the assessee which is purely installation services has to be scrutinized under Article 5(3) only and not under

Article 5(6). *Kreuz Subsea Pte. Ltd.v. Deputy Director of Income-tax (International Taxation) 3 (1), Mumbai , [2015] 58 taxmann.com.*

SERVICE TAX

- **CESTAT Judgments**

➢ **Reversal of CENVAT credit along with interest at later date also amounts to non-availment of credit**: The appellant was providing tour operator service, and had availed CENVAT credit on input services. Upon realizing that it was not entitled for the benefit of the notification 1/2006-ST, the appellant immediately deposited the amount of credit availed during the period April, 2006 to March, 2007 along with interest on 03.10.2007 and intimated the Department on 04.10.2007. The Department raised a Service Tax demand against the appellant on the ground that the assessee had availed CENVAT credit of the duty/tax paid on inputs/capital goods and input service. Also, also another demand was raised for payment of interest under Section 75 of the FA, 1994 for delayed payments of service tax. The Department contested that the appellant had not paid ST on due dates - for the intervening period from the date of deposit of cheque into the credit of treasury till its realisation. Before the CESTAT, the appellant submitted that the reversal of CENVAT credit amounted to non-availment of credit and consequently it was entitled for the benefit of the notification 1/2006-ST. The Tribunal held that:

- The argument by the Department that if reversal is made before point of taxation, only then the tax exemption is available is not acceptable.
- The appellant is entitled for the benefit of exemption Notification No.1/2006-ST.
- The demand of Service Tax was set aside along with the interest and equivalent penalty. *2015-TIOL-1259-CESTAT-DEL, June 28, 2015.*

➢ **Coaching Service:** Sinhagad Technical Education Society was issuing certificate of Diploma/ Degree of various courses conducted by them. Revenue authorities were of the view that the constituent institutes of the appellant, and some courses conducted by it, were not recognized by law and also there was no documentary proof regarding recognition of its institutes by statutory body established for the said purposes. So a show cause notice was issued and service tax demand was raised for approximately Rs.15 crores. The appellant contested that the courses/degrees/post graduation degrees were recognized by various Universities as well as by All India Council for Technical Education (AICTE). The Adjudicating Authority held that most of the courses conducted by the appellant would not fall under the

category of "Commercial Training or Coaching Services", hence not liable to tax. However, other courses which were not recognized by any statutory authority, like Post Graduation diploma in Business Administration (PGDBA), would get covered under the definition of "Commercial Training or Coaching services". Upon appeal, the Tribunal held that:

- Only education in the field of sports, pre-school coaching and training centres, institutes or establishments which issue any certificate, diploma or degree or any education qualification recognized by law for the time in force are excluded from the service tax net.
- The appellant has maintained that the courses conducted by it are recognized by University of Pune and Tilak Maharashtra Vidyapeeth and the courses are approved by AICTE, and the adjudicating authority has also confirmed this fact.
- It was found that statement of marks as well as provisional passing certificates issued by the appellant are recognized by Tilak Maharashtra Vidyapeeth and University of Pune, so it cannot be doubted that the courses conducted by the appellant are recognized by law. The Revenue's appeal was rejected and that by the assessee was allowed. *2015-TIOL-1213-CESTAT-MUM, June 23, 2015.*

➢ **Second Level Distributors liable to Service Tax:** Amway, a company engaged in marketing and sale of consumer products through direct selling appointed persons as distributors. These distributors bought the products to be marketed from Amway at Distributors Acquisition Price (DAP) and were required to sell the same at the price not exceeding the MRP fixed by Amway, thereby earning a margin. Besides this, a distributor was entitled to commission based on the monthly volume of purchases made by him from Amway for direct sale to the consumers or for personal consumption. The distributors appointed by Amway could also sponsor/enroll other persons for marketing of the Amway products. These second level Distributors enrolled through a particular Distributor could directly purchase the products from Amway for selling the same. Based on the volume of the Amway products purchased by such second level distributors, the Distributors through whom they were enrolled, were paid commission and other incentives by Amway. This commission was also paid on monthly basis.

According to the Department, the activity of the Distributor was covered by the definition of Business Auxiliary Service as given in Section 65(105)(zzb) read with Section 65 (19) (i) of the Finance Act, 1994, as it was same as promotion or sale of goods belonging to the client. On the other hand, the contention of the assessees was that its activity was not covered by the definition of Business Auxiliary Service. Upon appeal, the Tribunal held that:

- The activity of the Distributors, cannot be treated as promotion, marketing or sale of the goods produced or provided by or belonging to the client (Amway). Once the products have been purchased by a Distributor from Amway, those products cease to belong to Amway. Sale of these goods by the Distributor would not constitute service to Amway. Similarly, any incentive or commission received by a Distributor from Amway for buying certain quantum of goods during a month cannot be treated as the consideration received for promotion or sale of goods. This commission is not linked to the goods sold by the Distributor, but is linked to the goods purchased by the Distributor from Amway during a month and is in the nature of volume discount. Therefore, the Tribunal held that no service tax is chargeable from the distributors.
- The activity of a Distributor of identifying other persons, who can be roped in for sale of the Amway products/marketing of the Amway products and who on being sponsored by that Distributor are appointed by Amway as second level of distributors is the activity of marketing or sale of the goods belonging to Amway and the commission received by the Distributor from Amway, which is linked to the performance of his sales group (group of the second level of distributors appointed on being sponsored by the Distributor) would have to be treated as consideration for Business Auxiliary Service of sales promotion provided to Amway. Therefore, service tax would be chargeable on the commission received by a Distributor from Amway on the products purchased by his sales group.
- Also, merely because the assesse (distributors) did not apply for Service Tax Registration or did not file ST-3 Returns or did not declare their activities to the jurisdictional central excise authorities, it cannot be inferred that this was a wilful act with intent to evade payment of service tax. The orders passed by the Commissioner (Appeals) are set aside and the matters are remanded to the Original Adjudicating Authority for fresh consideration. *2015-TIOL-1205-CESTAT-DEL, 23 June 2015.*

➢ **Health and Fitness Services**: The appellants were Osho International Foundation & Neo Sannyas Foundation. The appellants submitted that to fall under the "Health and Fitness Services" category, the activity must be shown to have been undertaken for physical well-being. However, the meditation courses conducted by the appellant were spiritual meditation and had nothing to do with the physical well-being of an individual undergoing the meditation courses.

The department submitted that the definition of "health and fitness services" is very clear and unambiguous inasmuch as the word "meditation" is included

specifically, and there is no scope to exclude the activities undertaken by the appellant from the definition. The department concluded that the services of yoga, meditation and massage to the customers/participants on payment of specified charges/fees would fall under the category of "Health and fitness services". Service Tax demand for the period 1/04/2008 to 17/03/2009 was confirmed by the adjudicating authority. Upon appeal, the CESTAT held:

- The definition of "health and fitness services" clearly includes the word "meditation" in the ambit of charging service tax. The arguments put forth by the appellants are unacceptable as the meditation courses offered by the appellant may be for spiritual balance in life, but fundamentally contributes towards the physical well-being and the physical benefits of an individual.
- The correspondence between the department and the appellants show that the appellant was first informed as to there being no tax liability on the meditation courses conducted by them. Subsequently on 18-Mar-2009, there was a change in view of the Board and it was opined that service tax liability arises on the meditation courses. In our considered view, revenue authorities cannot demand service tax liability from the appellants for the period prior to 18 March 2009, as a change in view by the highest body of the indirect taxes can be applied only from the date when the change of view took place.
- The order of the CCE, Pune-III was set aside and the appeals were allowed. *2015-TIOL-1081-CESTAT-MUM, 10 June 2015.*

➢ **Transportation of Gas through Pipeline**: The applicant rendered transportation of gas through pipeline which is a taxable service. For that purpose, the applicant has to set up pipelines from Kakinada in Andhra Pradesh to Bharuch in Gujarat. The applicant appointed various contractors on jobwork basis who were assigned the work of laying pipeline. The applicant imported raw materials under EPCG scheme and those materials were issued to the contractors. For laying the pipeline, the applicant also availed certain services namely design and engineering of the pipeline to be laid, GTA services, rent-a-cab services, CHA services, Business Auxiliary services. A show cause notice was issued to the applicant to deny CENVAT Credit availed on the ground that the services rendered by the contractors resulted in creation of an immovable property. The applicant sought waiver of pre-deposit along with interest and various penalties imposed by way of denial of CENVAT Credit on inputs, input services and capital goods. The department opposed the contention of applicant by submitting that the service tax paid by the contractor was for laying pipeline which was capital asset, therefore, service tax paid by the contractors did not fall in the category of tax paid on capital goods, input and input services used in

providing services. Similarly pipe and other equipment and services procured and supplied by the applicant to contractors were used in laying of the pipeline by the contractor hence these were inputs or input service for the contractors and not for the applicant, therefore, applicant was not entitled to credit of these taxes and duty. Upon appeal, the Tribunal held:

- It is undisputed that the appellant is rendering the services of transportation of gas through pipeline services, the said activity of the appellant falls under the head of "transport of goods (other than water) through the pipeline or conduit services".
- The pipeline laying contractors, who lay the pipes, undertake the entire job of pipeline and bill the appellant as for providing the services of "commercial or industrial construction services". There is no dispute that contractors' classification of service is not accepted. The services rendered by the contractors for laying the pipeline is towards bringing into existence a system which is the back bone for rendering the services of the appellant i.e., "transport of goods (other than water) through the pipeline or conduit services". Thus, the services rendered by the pipeline laying contractors would be eligible for Cenvat credit, as laid down by the Hon'ble High Court in the case of CCE Vs. Sai Samhita Storages (P) Ltd. - 2011-TIOL-863-HC-AP-CX .
- Other input services which were availed prior to commissioning of the pipeline, in respect of consulting engineer services, rent-a-cab services, CHA services, BAS for coating pipes, supply of tangible goods services, were rendered by the service providers for bringing into existence, pipeline through which the appellant transported the goods and discharged services tax liability. If any service was rendered for the purpose of providing taxable output services, Cenvat credit, prima facie could not be denied.
- As regards the Cenvat credit of the Central Excise duty paid on valves, compressor pump, pipes, etc, it was found that these items were procured by the appellant directly from the manufacturers. Undisputedly, these items are covered under the definition of "capital goods". If the items which are covered under the definition of capital goods are procured for bringing into existence a pipeline and are used for rendering output services on which the service tax is discharged, then, prima facie Cenvat credit of the duty paid could not be denied.
- Hence waiver of the requirement of pre-deposit of service tax, interest and penalty was granted during the pendency of the appeal. *2015-TIOL-1068-CESTAT-MUM, 9-June-2015.*

- **Input services used for trading**: The appellant was providing "Business Auxiliary Services" (BAS) and IT Software Services as well as trading of scrap. It availed Cenvat Credit of service tax paid on common services received for providing output services as well as in trading activities. As the trading activity is not taxable under Central Excise law or Service Tax law, the benefit of allegedly wrongly availed Cenvat Credit on input services used in trading activity was denied by the adjudicating authority. The credit was disallowed in proportion of trading turnover (i.e. sales price of traded goods) to the total turnover (i.e. trading plus value of output service). The Commissioner (Appeals) held that since with effect from 01/04/2011 the definition of exempted services was amended to include Trading and "method of computation of value" of input services used for trading was prescribed in Rule 6(3A), the same formula could be adopted for the period of dispute to arrive at the quantum of Cenvat Credit used in the trading activities. He accordingly reduced the amount of Cenvat Credit demand.

  Against this order, the appellant as well as Revenue were in appeal, appellant against confirmation of demand and Revenue against reducing the demand as confirmed by the adjudicating authority. The Tribunal held:

  - The amount of credit to be disallowed was correctly computed by the adjudicating authority.
  - The department is not imposing a condition which is not in the Rules. Department is merely saying that input credit is available under Service Tax law for providing output services in terms of the definition of input service in the Cenvat Credit Rules whereas the Trading activity is outside the purview of service tax law .
  - The appellant did not declare in its ST-3 returns that the input service credit was used in relation to trading. This amounted to suppression of facts. Therefore, the extended period of limitation was correctly invoked as the appellants were following self-assessment procedure and taking credit on their own against the provisions of law.
  - The reduction in penalty to 50% of amount confirmed under Section 78(1) is not acceptable because Rule 6(3A) became effective from 08/04/2011 whereas the period in the present case is from 2006-2007 to 2010-2011. The appeal filed by the assessee was dismissed and that by Revenue was allowed. *2015-TIOL-1036-CESTAT-MUM, 5 June, 2015.*

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