Tax News

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INCOME TAX

Reminder for Dec-2012

Action Due	Due Date
TDS/TCS for Nov 2012	07-12-12
PF for Nov 2012	15-12-12
ESI for Nov 2012	21-12-12
Advance Tax	15-12-12

SERVICE TAX

Action Due	Due Date
Service Tax for Nov 2012 in case of company	05-12-2012
Service Tax for Nov 2012 in case of a company for which e-payment is mandatory.	06-12-2012

INCOME TAX

SC / HC Judgments

Non-compete fee: The assessee, a joint venture of Sharp Corp, Japan, and L&T Ltd, paid non-compete fee to L&T as consideration for the latter not competing with the assessee for 7 years. The assessee claimed that the non-compete fee was revenue in nature. It also claimed, that the rights under the non-compete agreement were an 'intangible asset' u/s 32(1)(ii) eligible for depreciation. The AO and CIT(A) rejected the assessee's claim. On further appeal, the Tribunal held:

The advantage derived by the assessee from the non-compete agreement entered into with L&T is for a substantial period of 7 years and ensures a certain position in the market by keeping out L&T. The advantage cannot be regarded as being merely for facilitation of business and ensuring greater efficiency & profitability. So, the advantage falls in the nature of capital field (**Eicher** 302 ITR 249 (Del). *Sharp Business System vs. CIT (Delhi High Court), Nov 8, 2012.*

Tribunal Judgments

Disallowance of TDS: The assessee had made payments under the head "freight and cartage", exceeding the prescribed limit of Rs.50,000, on which no tax was deducted at source. According to the AO, since no tax was deducted at source, the said expenditure was not allowable as per provisions of section 40 (a)(ia). The CIT(A) deleted the addition after observing that there was no violation of provisions of section 194C and therefore provisions of section 40 (a)(ia) could not be invoked. Upon appeal, the Tribunal held that though the assessee did not deduct TDS from the payments made to the payee, it had deposited TDS before the end of the financial year. Therefore, disallowance u/s 40(a)(ia) cannot be made in the light of the order of the Special Bench of the Tribunal in Merilyn Shipping & Transports. *2012-TIOL-651-ITAT-LKW.*

India-Swiss DTAA: Shipping profits not taxable in India even if there is a PE: The assessee, a Swiss company, earned shipping profits. Article 7 of the India-Swiss DTAA excluded shipping profits from its ambit. Article 22 of the DTAA provided that any other income not specifically dealt with, would be taxable only in Switzerland and not in India.

The assessee claimed that in accordance with Article 22, its shipping profits were taxable only in Switzerland. However, the department held that as shipping profits had been 'dealt with' in the DTAA, Article 22 would not apply and the income would be assessable u/s 44B of the Act. It was also held that even if Article 22 (1) applied, as the assessee's agent in India constituted a PE, the shipping profits were assessable to tax in India under Article 22(2). The CIT(A) accepted the assessee's stand that Article 22 of the DTAA applied to it. He further held that though the assessee's agent was its PE, the income from the ships was not "effectively connected" with the PE as the ships were owned by

the assessee and not by the agent. On appeal by the department, the Tribunal held:

- The expression "dealt with" contemplates a positive action and it is necessary that the relevant article must state whether Switzerland or India or both have a right to tax such item of income. Since Article 7 has not 'dealt with' the shipping profits, hence Article 22 is applicable.
- The agent did constitute a PE as it (the agent) was legally and economically dependent on the assessee and the assessee was managing some of its business operations in India through the said agent. Since the economic ownership of the ships was not allocated to the PE but always remained with the assessee, the ships were not 'effectively connected' with the PE in India. Hence the shipping profits could not be assessed to tax under Article 22(2).

Impact of non reconciliation of accounts: The assessee was a foreign company incorporated in Thailand and engaged in the business of construction. The assessee was awarded contracts by NTPC and NHAI for civil works in India, and it had awarded contracts to various sub-contractors. But there was no documentation on reconciliation of capital advances and capital work-in-progress. Also, records of inventories were not updated regularly. The assessee had also written off certain advances to employees under a Board resolution. The assessee had filed its return declaring nil income. The company's auditors had stated in their report that several advances and balances had not been confirmed and reconciled and the impact of such non-reconciliation was not ascertainable.

According to the assessee, all the payments were made through banking channels. These accounts were regular in nature and the non-availability of reconciliation and confirmation statements did not impact the reliability of the accounts. Also, it had maintained its books of accounts as per guidelines laid down in the Accounting Standards, and proper records of purchases and expenses were kept. The AO held that it was difficult to determine the appropriateness of depreciation in the absence of reconciliation of capital advances and capital work-in-progress. It was also not clear if the capital advances were recoverable. Therefore, the books of accounts of the assessee were held to be not reliable. The AO rejected the book results of the assessee under section 145(3) and completed the assessment as provided under section 144. The AO thus determined the assessee's income at the rate of 10 per cent of the total receipts from NTPC and completed the assessment. Upon appeal by the assessee, the Tribunal held that:

- The AO had nowhere recorded any finding that the books of accounts maintained by the assessee were incorrect. There was no deviation in the method of accounting employed by the assessee from the accounting standards. The Revenue could not explain how the observations of the auditors affected the profitability of the assessee. There was no apparent basis for estimating the profitability at the rate of 10 per cent by the AO.

- The Gujarat High Court had held that if there was no challenge to the transactions represented in the books then it was not open to Revenue to contend that the entries did not depict the real state of affairs.
- In the past also, the books of the assessee were maintained in the same manner which had been accepted. The AO was thus, not justified in rejecting the assessee's book results.
- There being no explanation by the assessee in respect of its claim of expenditure, as recognized in the profit and loss account, the amount was required to be added back. Accordingly, to that extent, the CIT(A) order was modified and the AO was directed to disallow the claim of these expenses. *ADIT Vs Italian Thai Development Public Co. Ltd. 2012-TII-193-ITAT-Del-Intl.*

India –US –DTAA: The assessee, engaged in the business of e-publishing, had filed its return, in which it had shown a significant outsourcing cost that was charged to the P&L account but no tax was deducted from the same. The assessee explained that the outsourcing charges paid to M/s Tex Tech Inc. USA, did not fall within the definition of 'technical services'. Tex Tech was a subsidiary company of the assessee and its role was limited to collection of input materials or manuscripts from assessee's customers in USA, scanning them, and uploading them for the assessee to retrieve them in India. Assessee, thereafter, downloaded such data, did typesetting thereof and then uploaded it back to the subsidiary in USA. The subsidiary was to download the typeset pages, print such pages, and return it to the ultimate customers. Assessee also mentioned that Tex Tech was receiving certain input materials electronically from the clients, which were also uploaded to the assessee in India and assessee had to do the typesetting work and send it back to M/s Tex Tech Inc. USA, for ultimate delivery to the clients.

The role of its subsidiary in USA was related to production, co-ordination and shipping of materials from the customers to assessee in India and back, and coordinate issues regarding quality, scheduling of delivery etc. Tex Tech was also advising the assessee on business prospects in USA, and monitoring the orders on behalf of assessee's customers in USA. Tex Tech was paid their costs as per bills raised by them for the services rendered by them. Further, Tex Tech did not have any branches or offices outside USA and did not have any permanent establishment in India. So, the services rendered by subsidiary in USA were outside India and was not chargeable to tax in India, and so not liable for any deduction of tax at source.

The AO however held that the subsidiary in USA was rendering technical services within the definition given in Explanation 2 u/s 9(i)(vii) of the Act. Further, in view of Explanation introduced u/s 9(2) of the Act by Finance Act, 2000 with retrospective effect from 1.6.1996, it was not necessary for an entity abroad to have a business connection or territorial nexus in India. In any case, if the assessee was of the opinion that no tax was required to be deducted at

source for the payments effected to the US company, it should have approached the AO for obtaining a certificate as required u/s 195(2) of the Act or u/s 195(3) of the Act.

The Tribunal held that:

- If the assessee is able to show that the services rendered by the entity abroad, would not fall within the meaning of "fees for included services" as defined under Article 12.4 of DTAA between USA and India, then it can take advantage of such definition and will be justified in not deducting tax on payments effected by it to US company.
- There was no technical knowledge or service made available by the US entity to the assessee in any of the work with regard to the Marketing Agreement, and Overseas Services Agreement, and so no part thereof was having income element which was chargeable to tax.
- However, for the agreement, namely, "Offshore Development (Facilitation) Agreement", one of the items of services rendered by Tex Tech could have an element of income chargeable to tax in India, since it could involve making available technical services to the assessee in India. But, this aspect has not been examined meticulously by any of the authorities below. We are, therefore, of the opinion that the matter requires a re-visit by the A.O. *2012-TII-184-ITAT-MAD-INTL*.

SEZ units exempt from MAT: The assessee had two undertakings, one of which was a SEZ unit and the other which was a STPI unit. Both units were eligible for deduction u/s 10A. By the Special Economic Zone Act, 2005, s. 10AA was inserted to provide deduction in respect of units established in SEZs. By the same Act, sub-sec (6) was inserted in s. 115JB to provide that the profits of an SEZ unit would not be liable to MAT. By the Finance Act, 2007, s. 115JB (2) was amended so as to delete the words "sections 10A or 10B", though sub-sec (6) of s. 115JB was retained. The AO & CIT(A) held that the effect of the deletion of the reference to s. 10A & 10B meant that the units which were eligible for s. 10A & 10B deduction were no longer exempt from s. 115JB and only units which were eligible for s. 10AA deduction would be exempt from s. 115JB. On appeal by the assessee, the Tribunal held:

- S. 115JB (6) does not refer to either s. 10A or s. 10AA but simply provides that the MAT provisions shall not apply to income arising from any business carried on in an unit located in a SEZ.
- Consequently, despite the fact that an amendment was made in s. 115JB(2) to provide that MAT shall apply to units eligible for s. 10A or 10B, a unit which is situated in a SEZ will continue to be exempt from MAT by virtue of s. 115JB(6). *Genesys International Corpn. Ltd vs. ACIT (ITAT Mumbai), November 5th, 2012.*

Taxability of payments to secondment persons: Assessee - Petroleum India International -was engaged in the business relating to Technical consultancy and Operational services. Assessee claimed deduction u/s 80-O. AO

disallowed the claim stating that the assessee was supplying manpower and not comprehensive technical services. AO made disallowance u/s 40(a)(iii) stating that assessee had not deducted tax at source u/s 192 in respect of payment to secondment persons.

AO disallowed the relief claimed by the assessee u/s 91(1) stating that assessee had not paid the taxes in Kuwait before the end of the previous year. Assessee contended that in accordance with mercantile system of accounting, it was entitled to deduction of taxes not paid during the relevant period. AO treated the gain on foreign exchange fluctuation as income from other sources as against claimed by assessee as business income.

Assessee filed cross objection after a delay of 1529 days. The reason for the same was that oversight in not having filed the cross-objections was noticed recently during the conference with the counsel which was a reasonable cause and prayed for condonation. Revenue contended that the 'oversight' mentioned should be construed as assessee's negligence in filing the CO in time and the same does not amount to 'sufficient cause' within the meaning section 253(5) of the Act. The ITAT held:

- The assessee was supplying comprehensive technical services for designing and development of Refinery, which included deputing a competent team of professionals. Therefore, the assessee was entitled to deduction.
- There was no employee-employer relationship between the seconded persons and the assessee. Secondment is a terms used generally for deputing employees of one organization to another for a fixed period generally not more than one year as a part of contract / service agreement for rendering specialized services. The secondment undertaken by the assessee was an external secondment from a member organization to a foreign organization with whom the assessee had entered into agreement. The assessee did not take them as their employees and secondee continued to be on the rolls of the parent organization even though their services were temporarily placed with the other organization. Therefore, the seconded personnel were not employees of the assessee company and so the foreign allowance paid to them by the assessee company could not be considered as part of salary and so provisions of section 40(a)(iii) were not applicable.
- In assessee's own case, the ITAT had held that Sec 91(1) of the Act provided that where the assessee proved that in respect of his income which accrued or arose during the previous year outside India and he had paid in any country with which there was no agreement u/s 90 for the relief or avoidance of double taxation, he shall be entitled to deduction from the Indian Income Tax payable by him of a sum calculated on such doubly taxed income.

- Nowhere in the provision of sec. 91(1) of the Act, it was provided that the payment of tazxes outside India shall be during the relevant previous year itself. The assessee had discharged its onus of proving that it had in fact made the payment of taxes in Kuwait in subsequent periods. Thus, the assessee was entitled to relief u/s 91(1).
- If the exchange fluctuation was on the export proceed stage itself, then it had to be treated as gain in business, and if the gains on exchange fluctuation occured on the funds lying parked in EEFC account, then in that case, it had to be treated as income from other sources.
- Section 253(4) of the Act mandated that the assessee should file Cross Objections within 30 days from the date of receipt of the notice, unless permitted by the under certain conditions. In the present case, assessee failed to explain sufficient cause of delay of 1529 days in filing the Cross Objection. There was a negligence on part of the assessee. Thus the application for condonation of delay is dismissed. ***2012-TIOL-694-ITAT-MUM***.

Payments made to Parent company eligible for Sec 10A: Assessee was engaged in the business of purchase and sale of software. It claimed deduction on account of service charges paid to its holding company 'S', for rendering the services of advise and assistance, training, liaisioning with various government departments, etc. All out of pocket expenses were billed separately taking the turnover as basis with reference to expenditure incurred by 'S' on account of insurance, salaries, allowances, directors' remuneration's, electricity & charges, printing & stationery, professional charges, repairs & maintenance, rent for offices, etc. and also depreciation.

Assessee contended that its agreement with 'S' was on commercial grounds executed in the best interests of business between two independent corporate entities. AO held that these payments were mere diversion of income without services rendered by 'S', so as to reduce taxable profit and claim more deduction u/s 10A, and these receipts should have been offered to tax. CIT (A) confirmed the order of AO.

Secondly, the assessee made a payment for purchase of software from resident Indians, and did not deduct tax at source while making such payments. AO held that as the Assessee as a purchaser of the software had a right to use the software and the payment was for such right to use software, which was in the nature of a royalty, assessee was required to deduct tax at source and since tax was not deducted disallowance was made u/s 40(a)(ia). Assessee contended that it was in the business of purchase and sale of software and that it did not have a right to use the software and that it was akin to purchase and sale of goods and therefore the payment in question was not in the nature of royalty and there was no obligation to deduct at source. CIT (A) confirmed the disallowance made by AO.

The Tribunal held that:

- Assessee had given detailed statement of various expenditures of 'S' and how these were allocated. Out of

the total expenditure, less than 10% was allocated and recovered from a subsidiary i.e. assessee company. Further there was levy of service tax also in each month's bill at 12.5%. If only tax avoidance was main issue in allocation of expenditure to assessee, there was no need for allocating the expenditure to assessee paying service tax at 12.5% directly on the gross amount.

- The total expenditure allocated to holding company was 1/3rd of total expenditure. AO did not examine the balance 2/3rd of the expenditure. Assessee was a 100% subsidiary of 'S' and there was exchange of personnel depending on the field of operation and the agreement clearly provided for distribution of service charges on the basis of turnover. The Revenue contention that expenditure was passed on to assessee company was also not a valid argument as the recovery amount was also shown as income in the other company, and this exercise was going on from 2001 onwards. Thus, addition was deleted.

- In assessee's own case the Hon'ble Karnataka High Court in appeal on orders u/s 201 and payments made to non-residents had held that the amounts were royalty in nature. AO was directed to examine the issue afresh in the light of facts before the Hon'ble High Court of Karnataka. ***2012-TIOL-721-ITAT-MUM*.**

SERVICE TAX

Important Circular / Notification

- **Restoration of service specific accounting codes for payment of service tax:** After the Negative List based comprehensive approach to taxation of services came into effect from 1st July, 2012, suggestions were received from the field formations that the service specific old accounting codes should be restored, for the purpose of statistical analysis. Also it was suggested that list of descriptions of services should be provided to the taxpayers for obtaining registration.

  These suggestions were examined and a decision has been taken to restore the service specific accounting codes. Accordingly, a list of 120 descriptions of services for the purpose of registration and accounting codes corresponding to each description of service for payment of tax is provided in the annexure to this Circular. Descriptions of taxable services given in the annexure are solely for the purpose of statistical analysis.

  Registrations obtained under the positive list approach continue to be valid. New taxpayers can obtain registrations by selecting the relevant description/s from among the list of 120 descriptions of services given in the Annexure. Where registrations have been obtained under the description 'All Taxable Services', the taxpayer should file amendment

application online in ACES and opt for relevant description/s from the list of 120 descriptions of services given in the Annexure.

If any applications for amendment of ST-1 are pending with field formations, seeking the description 'all taxable services', such amendment may not be necessary and the officers in the field formations may provide necessary guidance to the taxpayers in this regard. Directorate General of Systems will be making necessary arrangements for display of the list of 120 descriptions of services and their corresponding Accounting Codes in Form ST-1 and Form ST-2 as may be necessary. Details are in Notification *F.No.341/21/2012-TRU, dated 20-Nov-2012.*

HC JUDGMENTS

Franchise service relating to schools: The petitioner was a Society established solely for educational purposes. It had been running international renowned schools namely Mayo College, Mayo College Girls School and Mayoor School in Ajmer. The object of the petitioner Society was to establish schools/colleges in India on the lines of the progressive independent schools/colleges established in England and other countries. Based on these objectives, the petitioner entered into an agreement with four institutions for the purpose of establishment of schools in different parts of India. Revenue contended that the petitioner was engaged in providing 'franchise service' to various parties/schools, who were running their institutes using its school name "Mayoor School". On scrutiny of the books of account it came to notice that the petitioner had received franchise fee/collaboration fee from various parties/schools. Accordingly, a demand was raised. Upon appeal, the High Court observed –

- The petitioner not only permitted and granted a revokable license to these schools to use the name 'Mayoor School', its logo and motto, but in consideration of the grant of said license, it also realized an initial one time non-refundable payment from the said four schools for the services.
- The petitioner also realized annual fees in advance for the stipulated service for first three years, which was liable to be reviewed after every three years.
- The petitioner was therefore, duty bound to pay the service tax. *Holding so, the petitioner's Writ Petition was dismissed. 2012-TIOL-878-HC-RAJ-ST.*

CESTAT JUDGMENT

- **Renting of Immovable Property Service:** The applicant owned premises which had several units that were given on rent to various persons. On the rent collected, the applicant was paying Service Tax under the category of 'Renting of Immovable Property Service'. The applicant was also involved in the activity of maintaining and

repairing of the building and was paying Service Tax on this activity also.

Revenue was of the view that electricity charges recovered by the applicant from its tenants were also a part of the service of 'Renting of Immovable Property Service' and so, service tax should have been paid on this service as well.

The CESTAT Bench observed - The contention of the applicant that electricity is 'goods' and the same shall not form part of taxable service is clarified by the Notification no. 12/2003. Therefore, the applicant has made out a prima facie case for 100% waiver of the service tax confirmed and penalty imposed. Accordingly, the requirement of pre-deposit of the service tax, interest and penalty, is waived. *2012-TIOL-1688-CESTAT-MUM.*

- **Security service at pump house:** The issue was whether the appellant was eligible for CENVAT credit on the security service availed by it at its pump house for pumping water from the *Kundalika* river, which was required as a coolant in their manufacturing operations or not.

Revenue was of the view that since 'security service' had been consumed outside the factory premises it was not eligible for CENVAT credit. The appellant argued that without water the manufacturing operations could not be carried out and the water had to be pumped from *the* river which was situated away from the factory. The security service provided at the pump house was integrally connected to the manufacturing activity at the appellant's factory and therefore, entitled for the credit.

The CESTAT Bench observed - The pumping of water from the banks of river Kundalika is integrally connected to the manufacturing process and the security services used therein becomes an input service in terms of the definition of input service under Rule 2(l) of the CENVAT Credit Rules, 2004. The appellant is rightly entitled for the credit of input service tax paid on security guard services at their pump house. *2012-TIOL-1662-CESTAT-MUM***.**

Arranger fee for Syndicated loans: The appellant borrowed money by way of 'syndicated loans' from various overseas Banks for the purpose of international acquisitions and capital expansions. For this, the appellant appointed various Banks abroad as Mandated Lead Arrangers (MLAs) and paid arrangement fee, which is the fee paid to procure lender/lender syndicate. The department was of the view that the appellant was liable to pay Service Tax on the fees paid to the MLAs. The Commissioner of Service Tax, Mumbai-I confirmed the demand. Upon appeal to the CESTAT, it was held:

- Regarding the appellant's contention that the arrangement of services was only intermediary services and was different from lending, it was found that out of the 16 lenders who provided the syndicated loan, 10 lenders

were also arrangers and these 10 lenders provided almost 95% of the loan to the appellant. In other words, the lenders themselves had acted as arrangers in bulk of the transactions and, therefore, it could not be stated that the 'arrangement' was different from 'lending'. Therefore, activity undertaken by the appellant could be classified as 'Banking and Financial Services' as defined under Section 65(105) of the Finance Act, 1994.

- If the appellant had any doubt regarding the liability to pay Service Tax on the activity of arranging, they should have sought clarification from the department in the matter. Therefore, withholding of information from the department would tantamount to suppression of facts especially in the context of a tax regime based on self-assessment and voluntary compliance.
- Appellant had not made out a prima facie case for complete waiver and is ordered to make a pre-deposit. *2012-TIOL-1651-CESTAT-MUM***.**

Financial Difficulty: The appellants were engaged in construction of petroleum outlets for *M/s Indian Oil Corporation Ltd.* and a demand of service tax was raised on the ground that the appellant had not paid the Service Tax under the category of Commercial or Industrial Construction during the year September 2004 to October 2005. Since the lower authorities confirmed the demand, the appellant was before the CESTAT.

Before the CESTAT the appellant contested that the contract had to be treated as Works Contract and therefore, there was no liability for the period prior to 01.06.2007. Also, the financial condition of the appellant was very bad and it was not in a position to make any pre-deposit. The CESTAT observed –

- The claim for treatment of the service under the Works Contract had never been made and it was too late for making such claim at this stage.
- As regards the financial difficulty, from the Income Tax return it is known that the appellant had invested significantly in equity shares. So appellant was in a financial position to pay this amount.
- The CESTAT directed the appellant to pay the adjudged Service Tax amount within a period of eight weeks. 2012-TIOL-1592-CESTAT-AHM**.**

Renting of property by co-owners: Three individuals were co-owners of a building and had rented out the premises to a person, who issued different cheques to all the above individuals as they were co-owners. Appellant submitted that the amount received by the individuals would be within the threshold limit of SSI exemption as granted by Notification No. 6/2005-ST dated 01.03.2005 and amended vide Notification No. 08/2008-ST dated 01.3.2008. Revenue had considered the amounts received by all the applicants collectively and thrust the service tax liability individually on the persons. The CESTAT Bench observed –

- The said notification talks about the aggregate value of the taxable services rendered for the purpose of exemption, and in this case if individually all the appellants be considered as provider of such service, their aggregate value does not exceed the threshold limit.

- Hence, the applications for waiver of pre-deposit of amounts are allowed and recoveries stayed till disposal of appeals. *2012-TIOL-1572-CESTAT-AHM.*

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