Tax News

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INCOME TAX

Reminder For November 2011

Action Due	Due Date
TDS / TCS for Oct. 2011	07-11-11
PF for October 2011	15-11-11
ESI for October 2011	21-11-11

SERVICE TAX

Action Due	Due Date
Service Tax for the month of Oct 2011 in case of company	05-11-2011
Service Tax for the month of Oct 2011 in case of a company for which e-payment is mandatory.	06-11-2011

INCOME TAX

Important Changes/Notification

Tax deduction at source on the deposit in bank during the pendency of Litigation of claim/ compensation: The Board had received references expressing difficulties in implementing provisions of section 194A of the Act in a situation where in the course of the proceedings before Supreme Court/High Court/ any other Court or Tribunal (hereinafter "the Court"), one or more than one litigant (hereinafter 'the depositor') is directed by the court, that a specified amount (hereinafter "deposit") be deposited in the bank either directly or through the court in order to protect the interest of litigants. Such deposits (usually time deposits) are kept in the bank in the names of the Registrar or any other name as per the order of the court. Difficulties are faced in making tax deduction at source on the interest periodically accruing on such time deposits, and about the person(s) as deductee who is entitled to TDS certificate in Form 16A.

After examination, the Board decided that:

1) The bank shall deduct TDS on the interest accruing on the above mentioned deposit(s) as per existing procedure and rates. The TDS certificate shall be issued by the bank in the name of 'the depositor'. If more than one person has been directed to deposit any specified amount, the amount of TDS shall be corresponding to each such depositor for the portion of interest accrued in its respective share in the total amount deposited and TDS certificates shall be accordingly issued by the bank.
2) At the time of making deposit of the amount ordered by the court, the depositor(s) shall submit a prescribed declaration with the court for record purpose and to facilitate the administration of TDS. The Registrar or any person authorized by the court will pass on this information to the bank concerned for proper deduction of TDS.
3) Some of the instances covered by this circular are:

a. In the course of appellate proceedings, the court directs an insurance company (the depositor) to deposit a part of compensation awarded by the Tribunal. This amount is deposited as Time Deposit in a bank in such name as directed by the court. The credit of TDS on interest accruing on such deposit will be allowed to the Insurance company.

b. The Court while deciding the cases of land compensation directs the authority concerned (liable for making payment of compensation) to deposit any sum in time deposit in any bank. If it's a tax-paying authority, the TDS on time deposit shall be in the name of the authority. If such authority is Central or State Government, no tax will be deducted.

c. The court adjudicating upon financial dispute during pendency of the case direct any party(ies) to deposit an amount as security in time deposit. The TDS on interest accruing on such deposit will be in

name of the depositor irrespective of the fact that at the directions of the court such time deposit was drawn in the name of the court officer.

4) The above procedure shall not apply to:

a. any deposit in the bank held by the court or any other person appointed by the court in the capacity of being an administrator or receiver or any authority of similar nature; or

b. any deposit which has not been made by any specific depositor but has arisen due to attachment made by the Court; or

c. the cases of "representative assessee" within the meaning of section 160 of the Act.

Circular No. 8/2011 Dated 14th Oct 2011.

Supreme Court / High Court Judgments

Interference in Tribunal's findings: The High Court held that unless the Revenue could prove perversity or illegality in the Tribunal's order, the finding of fact by the Tribunal relating to the arm's length price could not be challenged. *2011-TII-07-HC-P&H-TP.*

TDS on fee for professional services (U/S 194J): It was argued that the corporate/trust/society hospitals which provided medical services were not carrying on 'business' and not medical 'profession', and so payments received by them were not professional income but business income. Under the Medical Council Act, 1956, a corporate body could not carry on medical profession. It carried on "business" and, therefore, the payments received by corporate hospitals could not be treated as fee for professional services. However, the HC held that:

- a corporate hospital offered services in the course of medical profession being carried out by the doctors who were associated with the hospital as consultants or as employees. The said doctors were professionals and income earned by them was professional income. Thus as per explanation (a), income/fee received by the hospital towards services rendered in the course of carrying on medical profession was also a fee towards professional services.
- In case payment was made to a recipient for rendering services under medical or any other profession as stipulated, deduction of TDS was mandatory and it was immaterial whether the recipient was an individual, firm or an artificial person.
- For determining whether a payment was made towards "fee for professional services" or not, and whether TDS was deductible or not, the nature and character of the payment was relevant, not the manner in which the payment was accounted for by the payer.
- Payments made by the insurance company might be business expenditure as per accounts/books maintained by it, but TDS had to be deducted u/s 194J if the payment was made to a resident towards "fee for professional services". The fact that a third person and not the payer had availed the professional services was immaterial. Section 194J did not state that the payer must have availed and taken benefit of the professional services.

The payer might be making payment on behalf of a third person but would be liable to deduct TDS u/s 194J if Explanation (a) applied.

Arrears of rent received: The High Court held that maintenance and other charges were deductible from rent while calculating Annual Letting Value of the property. The arrears of rent received by the assessee after the court's order could be taxed in the relevant year to which the rent pertained. *2011-TIOL-636-HC-DEL-IT.*

Taxability of expenditure incurred on reconditioning of machines: *The* machine purchased in the year 1981 had broken down completely and remained idle since December 1991. Total reconditioning and overhauling of the machine was undertaken. It was held by the court that the machinery had outlived its utility and huge expenditure was incurred by replacing many vital parts in order to make the same functional, such that altogether a new machinery came into existence. Even if technically new asset had not come into existence, or the capacity of the overhauled machine after reconditioning was not enhanced, the fact remained that the reconditioning had resulted in imparting useful life to an old and unfit machinery, thus, resulting in a benefit of enduring nature. Thus the expenditure was of capital nature. 2011-TIOL-676-HC-DEL-IT in Income Tax.

Tribunal Judgments

Allotment of shares under ESOP: The assessee was an employee of M/s Pepsico India Holdings (P) Ltd (PIHL) in an executive position. PIHL was a part of Pepsico Inc. The assessee was granted valuable rights in shares of Pepsico Inc ESOP stock, held with Barry group of Merrill Lynch, USA. The rights were conferred on various dates. The assessee sold these shares in FY 2003-04 and claimed the gains as long term capital gains, because it had held the rights to the shares for a period of more than three years. Besides, assessee claimed deduction u/s 54F against these gains by way of investment in residential house.

Revenue contended that since the assessee had not paid for the purchase of shares at the time of allotment of rights under the ESOP Scheme, no transfer could be said to have taken place at that time, and so the assessee's claim that it had held the shares for more than three years was not valid. Hence the gain was a short term capital gain and not a long term capital gain. The Tribunal held that:

- It was clear that particular number of shares were allotted to assessee in different years at different prices, only that distinctive numbers were not allotted.
- The apparent benefit to assessee out of ESOPs scheme was that it was not required to pay the purchase price immediately at the time of allotment, but the same was to be deducted at the time of sale or redemption of shares.
- Since there was a fixed consideration of ESOPs shares, the right to the particular quantity of shares accrued to the assessee at the time of allotment itself. The sale of such valuable rights after three years was liable to be taxed under the head "long term capital gains" and not 'short term capital gains'.*2011-TIOL-664-ITAT-DEL.*

TDS on maintenance contract: It was held by the Tribunal that the

definition of rent under section 194-I did not provide any item for vehicle hire charges. Hence the assessee was required to deduct TDS in respect of vehicle hire charges under section 194C and not under section 194-I. *2011-TIOL-659-ITAT-AHM.*

TDS on Food expense: The assessee had not provided free meals and it had also not provided the pre-paid vouchers which could be exchanged for food in the canteen. The assessee had provided a lump sum allowance of food and taken a certificate from the employees that food for more than this amount had been purchased. Therefore, the assessee's case was not covered by exemption under Rule 3 as well as provisions of section 17(2)(vi), and so it was held that the assessee was required to deduct tax as per income slab of each employee. *2011-TIOL-659-ITAT-AHM.*

Transfer Pricing: The assessee, engaged in diamond processing, imported rough diamonds on free of cost basis from a group company and the cost of import was borne by the Supplier. The processing charges were fixed based on nature and quality of diamond processed and had no bearing on the cost of diamond. After processing as per the design and specification, the assessee exported the diamond back to the same group company. Therefore, according to the TPO, it was basically a job work done by the assessee on captive industry basis. For AY 2005-06, the assessee submitted that rate of processing charge was the same as in earlier years. The TPO noted that the assessee had not shown that this rate was the prevailing market rate and no other basis for fixing this market rate was given. TPO opined that the rate should have increased at least in the same proportion as the increase in rates paid by the assessee to its personnel. The personnel cost (part of processing charges) paid by the assessee increased but processing income decreased in the same period. TPO therefore concluded that the arms length consideration had not been received by the assessee. The Tribunal held that:

- There was no dispute that the assessee's transfer pricing methodology was accepted by the TPO in the AY 2003-04 and 2004-05 and the transactions with the AE's were held to be at arm's length.
- For the concerned AY, the assessee had given detailed reasons as to how and why there was fall in revenue. The TPO / AO had neither accepted nor rejected the same.
- The action of the TPO in making substantial adjustment on the basis of labour cost to revenue ratio of the previous year without providing any independent comparable case where revenue increase was based on such ratio, was not justified. Merely because the personnel cost had gone up, it could not be assumed that the processing income also would go up. The assessee's claim that the fall in revenue was due to unutilised capacity, increased depreciation and increased overall expenses, was quite reasonable.
- The adjustment done by the TPO in the ALP was therefore uncalled for.

Source of Income: It was held that when assessee failed to substantiate source of deposits in his brothers' NRI accounts, payments received as gift could be subjected to tax. *2011-TIOL-630-ITAT-MUM.*

Capital Gain: The assessee was owner of certain land, which it sold by registering the sale deed and transferring the possession in the previous year. It received payment by cheques, some of which got honoured in the previous year, and majority of them got honoured in the current year. It filed its return of income declaring long term capital gain. The AO while finalizing the assessment levied interest under sections 234A, 234B and 234C. Assessee contended that the capital gain had arisen in the current year only, and not in previous year, since approx 89% of the total consideration was received in the current year only. The Tribunal held that:

- The contention of the assessee that till all the cheques were honoured, the right of the assessee continued in the agricultural land, and hence capital gain did not accrue to the assessee, was not acceptable.
- The sale without payment of full consideration could have been made void at the option of the assessee and the assessee could have approached the court either for payment of balance amount or cancellation of sale deed when some of the cheques got dishonored. However it chose not to do so.
- The property was transferred the moment the sale deeds were registered and the possession was handed over in the previous year. For the purposes of section 2(47) of the Act, transfer was effected on the date on which the sale deed was registered. Therefore, the capital gain was liable to be taxed in assessment year 2007-08. *2011-TIOL-600-ITAT-DEL.*

Levy of penalty when there is a bonafide mistake: The assessee, a 100% subsidiary of NHAI, was incorporated as special purpose vehicle to construct, operate and maintain Expressway between Ahmedabad and Vadodara. It was implementing construction contract as per terms of contract entered into between NHAI and the Contractor for the project, an Indonesian company, by acting as a principal of the Indonesian company. During the implementation of the contract, the assessee had received a certificate from the contractor, for lower deduction of tax from the payments to be made to it. The DCIT (International Taxation), Chennai, being AO of the contractor, issued certificate dated 07-06-2002 valid till 31-03-2003 for "Nil" deduction of tax at source u/s 194C(4) of the Act. A similar certificate on 24-01-2001 was also issued by the AO of the contractor valid till 31-03-2002. After, such confirmation from the AO, the assessee did not deduct tax from the payments made to the contractor under the specified contract.

However, for AY 2003-04, the ITO Ahmedabad took the view that the certificate was required to be obtained u/s 195 as the contractor was a non-resident company and a certificate obtained u/s 194C(4) was not valid . Hence, he ignored the certificate issued u/s 194C(4) and accordingly, levied interest u/s 201(1A) of the Act. A penalty notice u/s 271C of the Act was also issued for Rs 35.3 million being 100% of shortfall of deduction.

In appeal against the penalty, before the CIT(A), the assessee contended that it had acted according to the 'Nil deduction certificate' issued by DDIT (International Taxation), Chennai. Further, the assessee had obtained confirmation letter dated 12-07-2002 from the DDIT(International Taxation), Chennai confirming the above certificate which was valid up to 31-03-2003. On this basis, it was argued that the assessee acted bonafide in not deducting tax from the payment made to the

contractor. It was also contended that though the applicable section was 195 but as the AO of the Contractor issued the certificate u/s 194C of the Act and confirmed that the recipient was a non-resident company, so the assessee could not be punished for mistake done by the DDIT(International Taxation), Chennai.

The CIT(A) confirmed the penalty to the extent of Rs.17.3 million and deleted the balance penalty for the period for which a nil deduction certificate was available. On further appeal, the department argued that for payment made to non-resident, section 195 of the IT Act was applicable and the assessee was required to deduct tax (TDS) @48% and not @ 2% u/s 194C. On the other hand, the assessee argued that there was reasonable cause, within the meaning of section 273B for deducting the tax @2%, that majority of the payment was made after the "Nil" certificate was issued . On this basis, the assessee was not required to deduct the TDS, however, the assessee had deducted tax on these payments made, till the date of certificate was received by it @2% and thereafter relying on the Nil deduction certificate, it ceased to deduct tax. Having heard the parties, the ITAT held that:

- In April & May 2002, no certificate u/s 194C(4) for deducting tax at 'Nil' or lower rate was available. In AY 2000-01 and 2001-02, the DDIT (International Taxation), Chennai, issued the said certificate under section 194C(4). The assessee, in these circumstances, was of the bona fide belief that it was required to deduct TDS u/s 194C of the IT Act and not u/s 195 of the IT Act which is applicable in case of non-resident.
- It was true that the assessee knew that he was making payment to non-resident, but this will not make any difference because the assessee obtained clarification in this regard from the DDIT (International Taxation), Chennai.
- An honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which assuming them to be true, would reasonably lead any ordinarily prudent and cautious man, to come to the conclusion that same was the right thing to do was a 'reasonable ground' to determine that assessee acted in good faith. In these circumstances, there is no justification for confirming the penalty levied by the CIT(A).
- Regarding CIT(A) direction for excluding the payments made on 31.03.2002 and from June to March, 2003 for the purpose of penalty under section 271C, it was confirmed that the view taken by the CIT(A) was fair and reasonable.

SERVICE TAX

Important Circulars / Notifications

Clarification on levy of service tax on service providers engaged in commercial construction/infrastructure development projects: In Circular No. 138/07/2011 – Service Tax dated 06.05.2011 it was clarified that the services provided by the subcontractors / consultants and other service providers to the Works Contract Service (WCS) provider in respect of construction of Dams, Tunnels, Road, Bridges etc. are classifiable as per Section 65 A of the Finance Act, 1994, under respective sub clauses (105) of Section 65 of the Finance Act, and are chargeable to service tax accordingly. Clarification has been requested as to whether the exemption is also available to the sub-contractors who provide Works Contract Service to these main contractors in relation to those very projects. The matter has been examined. It was clarified that when the service provider is providing WCS service in respect of projects and he in turn is receiving various services like Architect service, Consulting Engineer service, Construction of complex, Design service, Erection Commissioning or installation, Management, maintenance or repair etc., which are used by him in providing output service, then while exemption is available to the main contractor (as per

Section 65 (zzzza) of the Finance Act) , as regards the services provided by its subcontractors, the same are distinctly classifiable under the respective sub-clauses of section 65 (105) of the Finance Act, as per their description and that their taxability shall be decided accordingly. It is thus apparent that just because the main contractor is providing the WCS service in respect of projects involving construction of roads, airports, railways, transport terminals, bridges, tunnels, dams etc., it would not automatically lead to the classification of services being provided by the sub-contractor to the contractor as WCS. Rather, the classification would have to be independently done as per the rules and the taxability would get decided accordingly.

However, it is also apparent that in case the services provided by the sub-contractors to the main contractor are independently classifiable under WCS, then they too will get the benefit of exemption so long as they are in relation to the infrastructure projects mentioned above. *Circular No. 147/16/2011, 21st October 2011.*

SC/HC Judgments

Security service: The Appellant - Security Guards Board for Greater Mumbai and Thane District - a statutory authority constituted under Maharashtra Private Security Guards (Regulation of Employment and Welfare) Act, 1981, was responsible for regulating the employment of private security guards employed in factories and establishments in the State of Maharashtra, and for making better provisions for their terms and conditions of employment and welfare, under the State Government scheme. Under the scheme, the wages and allowances payable to the security guards by the Principal employer were prescribed. The Principal employers and the Security Guards were registered with the Board. The establishments were liable to remit to the Board the stipulated amounts every month for the payment of wages and allowances to the Security Guards besides which a levy was recovered to meet the expenses of administering the scheme.

Prior to May 1, 2006 the expression Security Agency was defined by sec 65(94) of the Finance Act, 1994 as any *"commercial concern" engaged in the business of rendering services, relating to the security of any property or any person, including services of providing security personnel.* The Finance Act, 2006 amended the definition by replacing "commercial concern" by "person". After this amendment a demand notice was issued to the Appellant for the recovery of service tax in the amount of approx Rs.129 million. The Commissioner confirmed the demand, holding that the activity of supplying security guards by the Appellant to factories and other establishments was a service which was covered under Section 65(94). The Appellant filed an appeal before the CESTAT, in which an application for waiver of pre-deposit was made. The Tribunal held that prima facie, the Appellant fell within the definition of 'Security Agency' under sec 65(94) and directed the Appellant to deposit an amount of Rs.48.8 million. The High Court held:

The Central Board of Excise and Customs, in its circular dated 18 December 2006, had clarified that activities performed by sovereign/public authorities under the provisions of law, were in the nature of statutory obligations, which were to be fulfilled in accordance with law. The fee collected by them for performing such activities was deposited in the Government Treasury. Such activity was purely in public interest and was undertaken as a mandatory and statutory function, and was not in the nature of a service provided to any particular individual for consideration. Since in this case the Appellant was a statutory body, the Tribunal was not justified in imposing a requirement

of deposit. 2011-TIOL-653-HC-MUM-ST.

CESTAT Judgments

Taxability of outbound tours: The appellant, M/s Cox & Kings (India) Ltd, was engaged in providing services of booking of air tickets, operating tours and other travel related services to various customers. Though the appellant was registered with the tax authorities under the category of 'tour operator service', 'air travel agent service' and 'travel agents service', there was a dispute regarding levy of service tax on outbound tours on the ground that they were taxable under 'tour operator service' since the 'tour operator' as well as the 'customers/recipients' were located within India. The department raised a demand with interest and penalties.

The appellant submitted before the CESTAT that the services provided in the outbound tours were performed outside India and therefore, they were not liable to service tax. It was further submitted that outbound tours would qualify as export of service under Export of Services Rules, 2005 and even assuming that they were liable to pay service tax, the appellant was entitled to abatement under Notification No. 12/2004-ST dated 10.09.2004, and the amount received be treated as cum-tax.

Countering this, the Department stated that in the instant case, planning, scheduling, organizing or arranging the tours was done by the appellant in India only and therefore, the activities came within the purview of the definition of 'tour operator'. Since the definition of 'tour operator' was fulfilled, the services provided by the appellant had to be regarded as rendered in India only.

The CESTAT observed that the Board's Circular No. 117 dated 30.10.2009 *prima facie* covered the issue involved. Even if a view was taken that planning, scheduling, organizing or arranging etc was done in India, it would mean that the service was partly performed in India and partly performed outside India. In such circumstances, the services provided by the appellant were *prima facie* covered by the Circular issued by the Board and therefore, a fit case for waiver of pre-deposit. CESTAT waived the balance amount of dues and granted stay against recovery during the pendency of the appeal. *2011-TIOL-1389-CESTAT-BANG* and *2011-TIOL-1390-CESTAT-DEL*.

Taxability of Coaching services: The appellant was a Company engaged in imparting training to children in the age group of 6-13 years, called "Mental Arithmetic". Training was imparted through 'Abacus' which was an ancient Chinese tool still widely used in China in the place of calculator. The coaching or training was primarily aimed at improving the child's memory, concentration, comprehension and ability to learn, retain and recall. The tax demand made by the Department was under three categories, namely, Franchisee Services, Training through Abacus, and Training given to Teachers. Assessee had paid Service Tax on Franchise Services. Department sought to tax the amount received through Abacus training given to the students, under "Commercial Training or Coaching Services".

Following a case law, Tribunal held that Abacus training was recreational training and therefore, came under the exempt category of services. As regards the Abacus training imparted to the teachers, Tribunal held that such training enabled the teachers to either get employment with a Franchisee imparting similar training or a teacher could open his or her own training centres and thereby get self-employed. Such training,

therefore, would come under Vocational Training, which came under the exempted category of services. The demand in respect of Abacus training to teachers was set aside by the Tribunal. *2011-TIOL-1330-CESTAT-MAD*.

Cenvat Credit: Assessee, a manufacturing company, availed Cenvat credit on service tax paid on sales promotion. Revenue denied credit on the grounds that sales promotion had nothing to do with manufacture of goods, therefore, input service credit was not available. It was held that since sales promotion was included in definition of 'input service', assessee had a strong prima facie case in its favour and, therefore, pre-deposit requirement of demand was to be waived of. *[2011] 14 taxmann.com 160 (Bangalore – CESTAT.*

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