Tax News

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INCOME TAX

Reminder For August 2011

Action Due	Due Date	
TDS / TCS for July 2011	08-08-11	*(*)*
PF for the July 2011	16-08-11	*(*)*
ESI for July 2011	22-08-11	*(*)*

(*) As due date is Sunday or a public holiday, so next day is taken as due date

SERVICE TAX

Action Due	Due Date
Service Tax for the month of July 2011 in case of company	05-08-2011
Service Tax for the month of July 2011 in case of a company for which e-payment is mandatory.	06-08-2011

INCOME TAX

Important Changes/Notification

Guidelines for prior permission to create a charge on the business assets- The Board has issued guidelines for granting of prior permission u/s 281 of the IT Act, 1961 to transfer or create a charge on the assets of the assessee:

- The taxpayers should apply in the prescribed form.
- The form has to be filed at least 30 days prior to the proposed date of transaction.
- The circumstances under which prior permission u/s 281 should be granted by the Assessing Officers are as follows:

  (*i*) If there is no demand outstanding and there is no likelihood of demand arising in the next six months, then the permission should be granted within ten working days of the receipt of the application.

  (*ii*) If undisputed demand is outstanding and there is no likelihood of demand arising in next 6 months, then the taxpayer should pay the same along with interest due thereon and then permission should be granted within ten working days of the receipt of the application.

(*iii*) If there is disputed demand outstanding, then the taxpayer should obtain stay for the same and indemnify the outstanding demand by way of bank guarantee or sufficient assets or by Department retaining the first charge on the assets proposed to be transferred or on which such charge is being created, to the extent of such demand. Thereafter, the permission u/s 281 would be granted by the A.O. within ten working days of the indemnification of the demand.

(*iv*) If demand is likely to arise in the next six month, then the A.O. should explore the possibility of action prescribed u/s 281B. For the assets excluding the asset under consideration, the A.O. should grant the permission within fifteen working days of the receipt of the application.

- There would be only one level of intervention *i.e.,* at the level of the Range head. The cases in which A.O. would require such approval would be where (*a*) value of assets being transferred or on which charge is being created, or (*b*) the amount of charge being created, is Rs. Ten crores or more.

The validity of the letter granting permission u/s 281 would be:

(*i*) One hundred and eighty days from the date of issue of approval, or

(*ii*) Service of order of attachment u/s 281B whichever is earlier.

- Once the asset is transferred or charge is created, the taxpayer should submit the documents, in this regard, to the A.O. for his record.
- This circular shall come into force with immediate effect. *Circular No. 4/2011 [F. NO. 402/69/2010-ITCC], dated 19-7-2011.*

Supreme Court / High Court Judgments

Taxability of commission received on transfer of distribution business to another company: The assessee was a distributor of Acer products, such as computers, laptops, desktops, etc for about two years. It incurred heavy losses. The assessee decided to transfer the distribution to M/s. SIL, through a written agreement with SIL. The distribution of the products was to be taken over by SIL on certain terms and conditions, including payment of commission on sale at the rate of one per cent. The assessee offered the commission income gained from its business as "business income" and set off the same against the business losses incurred in the same business. The AO treated the income of the assessee from commission as income from other sources and declined to set off against the brought forward business losses.

On Appeal High Court held that:

- It is noted that SIL in its Return had shown payment of commission made to the assessee as business expenditure and the same was allowed by the CIT(A);
- SIL has utilized the establishment and infrastructure of the assessee for carrying out sale of Acer computers. In the case of SIL, it was accepted by the Revenue that the commission paid by SIL to the assessee was business expenditure. If that was so, the business expenditure in the hands of SIL by natural corollary is the business income in the hands of the assessee. 2011-TIOL-431-HC-DEL-IT in Income Tax.

Status of Residence: The assessee, an employee of M/s. IBM Global Services India Pvt. Ltd. was deputed to work with designated IBM Global Services Customers on specified projects at Chicago, USA. As per the Deputation order, it was mentioned that the assessee would continue to be an employee of IBM Global Services India Pvt. Ltd. For the assessment year 2005-06, the Assessing Officer assessed the status of the assessee as 'resident' in terms of Section 6(1)(c) of the Act. The CIT(A) confirmed the order of the AO. On appeal, the Tribunal allowed the appeal partly by holding that for determining the status of the assessee as to whether he has to be assessed as a 'resident' or as a 'non-resident' of India, the period spent towards visit to India has to be excluded. The Tribunal held that the assessee was not in India for the requisite number of days under Section 6(1)(c) and accordingly held that the assessee's status has to be treated as 'non-resident'. Aggrieved, Revenue filed appeal before the High Court and submitted that the assessee was in India for a period of 78 days during the current assessment year and more than 365 days during the past four years and therefore, his status was to be treated as a 'resident' of India for assessment, in view of Section 6(1)(c) of the Act.

The HC held that:

The material on record clearly shows that the assessee worked in the USA, though he continued to be an employee of the company in India. Also, it was found by the Assessing Officer, the Appellate Authority, and the Tribunal, that excluding the time during which he was visiting India, the assessee was not in India for the requisite number of days (60 days) in the financial year, and therefore, he is to be treated as non-resident and cannot be taxed as a resident under Section 6(1)(c). *2011-TII-29-HC-KAR-INTL*.

Tribunal Judgments

- **Entire Business taken over as going concern:** The issue was that when entire business is taken over as going concern, and a composite fee is paid for same, whether the fee paid for use of trade mark is different from non-compete fee. Tribunal considered the entire agreement and held that use of trade mark, if any, by the assessee company is only an inseparable part of the entire agreement. By the non-compete clause of the agreement erstwhile owners are automatically excluded from use of such trade mark and they have bound themselves contractually not to carry on similar activities in whatever name for a period of 15 years. In view of this, since the payment was composite payment at the time of acquiring the business, even though payable over a period of 15 years in monthly instalments, the ITAT came to a conclusion that the amount has to be treated as capital expenditure. *2011-TIOL-473-ITAT-MUM in Income Tax.*

Tonnage Tax: The ship operated by the assessee was transporting thermal coal from one coast to another within the country, rendering the same services which could also be provided on land. The issue was whether it was a qualifying ship u/s 115VD of the Act, for the purpose of claiming the benefit of tonnage tax scheme under Chapter XII-C of the Act, which usually pertains to ships that do their voyage between international ports.

The Tribunal held that:

- The tonnage tax scheme does not distinguish between ships operating in coastal waters and those operating in international waters. There is no bar on the coastal shipping for the tonnage tax scheme.

- The law says that an assessee company is entitled for opting for tonnage tax scheme if it is operating qualifying ship and satisfies other conditions provided therein. The law does not say that the ship should always do its voyage between international ports. The law does not say anything about the distance to be covered by ship in a single voyage. The law presumes that the benefit of tonnage tax scheme is available to all sea-going ships satisfying the condition whether it is operated between Indian ports or between Indian ports and foreign ports. 2011-TIOL-479-ITAT-MAD-TM in Income Tax.

- **Taxability wherein project completion method as per AS-7 is applied:** Assessee, a builder, had taken up a slum rehabilitation project and started the construction of transit building on the land provided by Municipal Corporation of Greater Mumbai (MCGM) in FY 2005-06. The assessee received TDRs from MCGM upon handing over the possession of transit buildings, which it sold for about Rs. 155 million in the same FY in which these were received i.e. AYs 2006-07 and 2007-08 respectively. Since the TDRs had been received in lieu of handing over of formal possession of the buildings constructed by the assessee for slum dwellers, and since the project was not complete, the assessee set off these receipts against work-in-progress. The assessee was following mercantile system of accounting on project completion basis, and therefore, these receipts had not been shown as separate item of income.

The AO observed that TDR was nothing but Floor Space Index granted by Slum Rehabilitation Authority which could be used by recipient for construction of flats /premises in Mumbai, therefore, the income had accrued to the assessee on account of TDR which was required to be shown as income in the year of receipt. The issue was that when assessee followed project completion method as per AS-7, whether it was entitled to set off receipts from sale of TDR against costs of work-in-progress or should they be taxed in the year of receipt.

The ITAT held that,

- The assessee has been following project completion method which is an accepted method of accounting in construction business and also recommended as per accounting standard AS-7 of ICAI. Therefore, in such cases the income from the project has to be computed in the year of completion. The TDRs received are directly linked to the execution of the project and therefore, before the completion of the project, the income from TDR or any other receipt inextricably linked to the project will only go to reduce costs of the project. Therefore, the assessee had rightly set off TDR received against work-in-progress;

- Further, even if TDR receipt is assessed as independent item, deduction has to be allowed on account of the expenses incurred. The TDRs have been received in lieu of handing over of constructed transit buildings and therefore, cost of those buildings has to be deducted against income from sale of TDR. The cost of the buildings is claimed to be more than income from TDR, full details of which were given to the CIT(A), and therefore, even on this ground no income can be assessed in case of the assessee.

2011-TIOL-400-ITAT-MUM in Income Tax.

CUP Method:

The assessee-company imported coal from its Associate Enterprise (AE) and supplied the same to various consumers in India. While verifying the Arm's length price of the imports, the TPO found an instance of import made by the assessee for a price higher than the price quoted by another importer for the same day. Accordingly he proposed an adjustment to the total income of the assessee. Before the DRP, the assessee argued that the Tribunal had upheld the application of comparable controlled transaction. The DRP held that comparison of uncontrolled prices was the most appropriate method and so it upheld the adjustment.

In appeal before the Tribunal, the assessee argued that the comparable price has been obtained by the TPO from the customs authorities and the valuation of the customs authorities need not necessarily be realistic as that department is more interested in collecting import duties. Also, there is a possibility of differential price for different consignments depending upon the quality of goods imported by each assessee. It was submitted that this aspect has not been looked into by the TPO and that there is no rule that the coal imported by the assessee should be at the same price for which another assessee might have imported.

On appeal, the Tribunal held that:

- the customs authorities are assigning values to the imported goods on the basis of scientifically formulated methods and they are responsible for making a fair assessment value of the imported goods based on extensive international data. Therefore, price rate determined by customs authorities is credible.

- an assessee can establish its case for a price different than the customs price provided the assessee has produced evidence to support its proposition. In the present case, except its own internationally generated price, the assessee has not furnished any comparable data. Therefore, the assessee has no locus standi to question the credibility of the customs data relied upon by the TPO;

- in the present case, the assessee has not furnished any information to show that the coal imported by it was superior than the coal imported by the comparator used by the TPO.

- the essence of CUP method is a free comparison of variables in a free market condition. In the present case, there is no special reason to rely on a comparison based on controlled prices. When CUP method is applied in the present case, it is found that the import of coal made by the assessee from its AE has been over-invoiced. Therefore, Revenue is justified in making appropriate adjustment in the transfer pricing.

- once the adjustment is justified, the next question is the quantification of the adjustment. In the present case, the TPO has worked out the adjustment amount exactly on the basis of price variation between the companies. This is the most simple and acceptable method. *2011-TII-78-ITAT-MAD-TP.*

Taxability of Commission paid to UK-based parent company:

The assessee, an Indian subsidiary of a UK-based company (ACM, UK), was engaged in the business of ship-broking, arranging for transportation of cargo from India to other countries. The UK-based parent had an extensive worldwide network of international ship owners. The assessee needed contact information/details of international ship owners for arranging international shipments. Accordingly, it entered into a service agreement with the UK company, in terms of which, the UK parent was to identify potential international ship-owners, facilitate interaction with the Indian company and assist in establishing contact with the ship-owners regarding availability of ships on the requisite dates and freight charges. Subsequently, as per the contract between the ship owner and the customer, a commission was deducted from the gross freight payable by the customer and paid to the assessee, which in turn it shared with the foreign company. The assessee applied for a Nil deduction of tax at source certificate for remitting payments to ACM,UK. It was claimed that the commission payable to ACM, UK could not be characterized as fees for technical services under the DTAA, but was business income in its hands which could not be taxed in India in the absence of a PE in India. The AO however noted that ACM,UK was the majority shareholder in the assessee company, which procured business for its UK parent, and its activities were carried out wholly for the parent. He held that the Indian company constituted agency PE of the UK company as per Article 5 of the DTAA and hence the profits attributable to Indian operations were taxable in India. Accordingly, the assessee was directed to deduct tax at source before making payments to ACM UK.

In appeal, the CIT(A) held that the commission earned by the non-resident selling agent was for services rendered outside India and could not be considered as deemed to have accrued or arisen in India and hence was not taxable in India. It was observed that ACM UK did not carry on any business in India and had no fixed place of business. Though the assessee was a wholly owned subsidiary, its business was carried on independently and was managed by completely different sets of people. The agreement between the two companies was on a principal to principal basis and the assessee was not appointed as agent of the UK company to secure any business for it. On the contrary, the assessee was utilizing the services of the parent for which a commission was being paid and merely because it was a subsidiary, it does not create an agency PE as per Article 5 of Indo- UK DTAA. CIT(A) therefore, held that the payment of commission by the assessee to ACM UK was not chargeable to tax and, therefore, there was no obligation on the assessee to deduct tax at source.

In appeal before the Tribunal, the Revenue submitted that the income earned by ACM UK was by virtue of a business connection in India, therefore, income was deemed to have accrued to ACM UK in India under section 9 of the Act. The assessee was a subsidiary of the UK company and could not be considered as a person acting independently. Moreover, the assessee regularly secured orders for the parent company. Accordingly, the provisions of Article 5(4)(c) and Article 5 (5) of the DTAA would be applicable and since this was not considered by the CIT(A), it was argued that the CIT(A) should be directed to examine the same.

Having heard the parties, the Tribunal held that:

- The fact that the appellant is a wholly owned subsidiary of ACM UK and the fact that the appellant works only for ACM UK are factors which will have a bearing. These aspects have not been examined by the CIT(A). The case of the AO is based on Article 5(4) and Article 5(5) of the India-UK DTAA. The CIT(A) while reversing the order of the AO ought to have dealt with that aspect.
- While doing an assessment of either the appellant or of ACM UK, if they are ultimately found to be liable to tax in India, the Revenue is free to examine this aspect.

As far as the present appeal is concerned, the applicability of Article 5(4)(c) and Article 5(5) of Indo-UK DTAA, needs to be examined afresh by the CIT(A). *2011-TII-110-ITAT-MUM-INTL.*

SERVICE TAX

Important Changes/ Notification:

Clarification on "Completion of service"- Representations requesting clarification on "completion of service" as provided under the Point of Taxation Rules, 2011 and Service Tax Rules, 1994 have been received from certain sections of service providers. In many situations it is not possible to issue invoices within 14 days of the completion of the service since the exact date of completion of service is difficult to identify. Instances have been given where after the task of providing the service may be physically accomplished, but certain other formalities are required to be completed from the client's end before an invoice can be issued.

These representations have been examined. The Service Tax Rules, 1994 require that invoice should be issued within a period of 14 days from the completion of the taxable service. The invoice needs to indicate interalia the value of service so completed. Thus it is important to identify the service so completed. This would include not only the physical part of providing the service but also the completion of all other auxiliary activities that enable the service provider to be in a position to issue the invoice. Such auxiliary activities could include activities like measurement, quality testing etc which may be essential pre-requisites for identification of completion of service. The test for the determination whether a service has been completed would be the completion of all the related activities that place the service provider in a situation to be able to issue an invoice. However such activities do not include flimsy or irrelevant grounds for delay in issuance of invoice. The above interpretation also applies to determination of the date of completion of provision of service in case of "continuous supply of service". *Circular No. 144/13/ 2011 – ST.*

Exemption for association of dyeing units - The Central Government, on being satisfied that it is necessary in the public interest so to do, hereby exempts club or association service referred to in sub-clause (zzze) of clause (105) of section 65 of the said Act, provided by an association of dyeing units, in relation to the project, from the whole of service tax leviable thereon under section 66 of the Finance Act. For the purposes of this notification, project means common facility set-up for treatment and recycling of effluents and solid waste discharged by dyeing units, with financial assistance from the central or state government. *Notification No. 42/2011-Service Tax dated 25-July-2011*

CESTAT Judgments

• **CENVAT Credit on 'professional fees towards providing advisory services for acquisition of company':** The Assessee had taken advisory services from M/s Deloitte Touche Tohmatsu, India for acquisition of another company, for the purpose of sharing the overload of manufacturing activities of the existing sole manufacturing unit at Dharuhera. It had categorized these services as "input services" and claimed Cenvat credit. However, it was not allowed Cenvat credit.

The Commissioner (Appeals) while examining the issue maintained that the contention of the appellant that these advisory services were inputs towards manufacturing of the final product could not be accepted. According to him, these services, which had been utilized for acquisition of another company at another place, could not be unrealistically extended to fit in the definition of input service, and would therefore, attract service tax. He emphasized that the appellant had taken cenvat credit in respect of services which had been used neither in, nor in relation to, the manufacture of final products, nor clearance of final products, nor for providing an output service.

On appeal, the Tribunal observed:

- In the first place, there is a factual error in the finding of the Commissioner (Appeals) where he mentioned that the proposed activity was raising of capital for a new company. The matter under consideration was acquisition of a new company. The capital of the existing company had to be raised to pay the shareholders of the target company. Therefore, the bill raised by the consultant was in relation to providing advisory service for raising the equity capital of the appellant company. To that extent, the facts are recorded inaccurately.
- The definition given under Rule 2(l) for input services includes activities like setting up of a factory which precedes manufacturing activity. Also, once the assessee is eligible to take credit, there is no restriction in the Rules that the credit should be used only for the product manufactured using the input service. Once credit is taken, it can be utilized on any of the output services or final products of the company. It is not necessary that credit is to be used for paying the duty on the final product that is coming out of new plant proposed to be set up. Therefore, there is no merit in the argument that the cenvat credit taken relates to services of future business of the company.
- Regarding the issue that credit was taken in the factory based on an invoice issued in the name of the registered office, this is a matter which has been decided in many cases by the Tribunal, and credit cannot be denied for that reason. The provision relating to input service distributor is not applicable here because credit is not getting distributed to many locations. If at all applicable, it is only a procedural requirement and credit cannot be denied so long as there is no case of misuse of credit. *2011-TIOL-832-CESTAT-DEL in 'Service Tax'.*

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