Tax News

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INCOME TAX

Reminder For October 2011

Action Due	Due Date
TDS / TCS for Sep. 2011	07-10-11
PF for September 2011	15-10-11
ESI for September 2011	21-10-11
Quarterly return of TDS for Sept Quarter	15-10-11

SERVICE TAX

Action Due	Due Date
Service Tax for Sep. 2011 in case of company	05-10-2011 *(*)*
Service Tax for Sep. 2011 in case of a company for which e-payment is mandatory.	06-10-2011 *(*)*
Service tax for Quarter ending 30th Sept in case of assessee other than company that makes payment electronically.	06-10-2011 *(*)*
Service tax for Quarter ending 30th Sept in case of assessee other than company that does not make payment electronically.	05-10-2011 *(*)*
Half Yearly Service tax return	25-10-2011

(*) As 5th & 6th Oct. are Govt. holidays (due to Dussehra Pooja) , due dates can be considered as the next day.

INCOME TAX

Important Changes/Notification

2nd Protocol of DTAA with Singapore comes into effect – The second protocol amending the DTAA between India and Singapore that was signed in June 2011, has come into effect from 1st September, 2011. The provisions of this protocol would come into effect for taxable periods falling after 1st Janaury 2008, i.e. FY 2008-09 and beyond. The Protocol has introduced some clauses pertaining to exchange of financial information between the two countries. Details are in *Notification No. 47/2011/F. No. 500/139/2002-FTD-II.*

Supreme Court / High Court Judgments

Availability of benefit of block of assets on a EOU: The assessee, an individual engaged in the business of rig operation, transportation of LPG gas, marbles etc., had an export oriented unit - 'GTP Granites'. On the expiry of the term of the benefit available to 100% EOU u/s 10B of the IT Act, the assessee transferred the said unit to the closely held company called 'GTP Granites (P) Limited'. The AO found that there was a difference between the value of the assets transferred by the assessee and the value of the assets adopted by the closely held company, as on the date of transfer. The AO treated the difference as short term capital gains, the assets being block of assets transferred by the assessee.

The High Court held that even though the export unit was to be treated as an independent unit for the purpose of Section 10B, when the export unit formed part of the business of the assessee, on the expiry of tax holiday period, there was no logic in treating the assets as if they did not form part of block of assets for the purpose of working out the relief on capital gains. *Merely because* the assessee was once 100% export undertaking, the assessee could not be denied of the benefit otherwise available to the assessee on the block of assets on the expiry of tax holiday period for the purpose of the working of capital gains u/s 50(2). T*he depreciation percentage fixed is more of machinery specific rather than industry specific. Thus, if the assets transferred from the 100% Export Oriented Unit and the assets purchased, come for same percentage of depreciation as prescribed in the table, they can be said to form the same block of assets, and the assessee would be justified in seeking adjustment in the matter of working out the capital gains. 2011-TIOL-616-HC-MAD-IT.*

TDS liability on reimbursement of interest on credit limits of others: The assessee was engaged in the business of importing and dealing in pulses and edible oil. Assessment was made u/s 143(3). The AO contended that the appellant had not deducted tax at source on payment of interest on loan taken from three companies, 'M', 'P' and 'G'. A show cause notice was issued. Assessee contended that 'M' was a Government of India Enterprise and no TDS was required to be deducted in view of

Section 194A (e). In the other two instances, the assessee had imported the goods by utilizing the L/C limits of 'P' and 'G' with a bank, since its own limits with the bank were insufficient. The bank had charged interest from 'P' and 'G' for utilizing the limits which was paid by those two parties to the Bank. Subsequently, the appellant had paid commission @ 1% on utilized L/C limits to 'P' and 'G'. Thus, the amount paid by the assessee was the reimbursement of interest, and consequently, no TDS was liable to be deducted. The CIT(A) rejected the claim of the appellant and treated it as default. Aseessee went in appeal.

The High Court held that, the appellant had paid commission for utilizing the unspent credit facilities of others. This clearly came within the definition of interest as it was a debt incurred by the appellant, which included an obligation to pay fee or other charges in respect of the utilization of the unspent credit facility of other parties. Thus, the appellant had an obligation to deduct TDS from the amount paid. *2011-TIOL-590-HC-IT.*

Tribunal Judgments

Applicability of amendment in Sec 40(a)(ia) for Tax Deduction at Source: The Finance Act 2010 amended the provision of sec 40(a)(ia) whereby it allowed the assessee deducting tax, either in the last month of the previous year, or in the first eleven months of the previous year, to be entitled to deduction of the expenditure in the year of incurring it, if the tax so deducted at source, was paid on or before the due date u/s 139(1). In view of the fact that this amendment was done with retrospective effect from 01.04.2010, the Tribunal refused to declare it as having retrospective effect from the date of insertion of the provision i.e. 01.04.2005. *2011-TIOL-560-ITAT-MUM-SB.*

Taxability of compensation for discontinuing relationship with multilateral audit firm: The assessee, a Chartered Accountants firm, carrying on the auditing profession, received a certain sum in the capital account of the partners as received from an international consultancy firm Deloitte International (DTTI). The amount was not reflected by the assessee in its P&L a/c but directly credited to partners' accounts. Assessee contended that the receipt was not taxable in firm's hand as it was capital receipt in the hands of partners. AO held that it was a receipt of the firm liable for income tax. AO also imposed penalty stating that the assessee-firm camouflaged the nature of receipt by furnishing inaccurate particulars.

The Tribunal observed that DTTI had given choice to assessee, either to continue with it or discontinue with a compensation. Assessee, in its professional wisdom, chose to disassociate from DTTI and took the compensation. If it had continued, the earning would have been professional receipt and so the compensation also had the same nature, i.e. it was in the nature of revenue receipt. It was clear that the assessee firm had attempted to evade tax on a purely professional receipt by projecting it as a capital receipt. Besides, in the case of a partnership firm, receipt whether capital or revenue are to be credited to P&L A/c. The assessee in order to minimize disclosure, had directly credited the above receipt in the capital accounts of partners. This strategy was evasion of tax and so the AO was right in imposing the penalty levied on the assessee u/s 271(1)(c) of the Act. *2011-TIOL-559-ITAT-DEL.*

Deductability of imaginary loss arising out of valuation of interest rate swap: The assessee was dealing in government securities, bonds, debentures etc. During assessment, the AO noticed that the

assessee had claimed a deduction being loss on interest rate swap valuations. The assessee submitted that the deduction had been claimed on account of unrealized loss on the basis of valuation of interest rate swap. This valuation was arrived at by working out future extrapolation of the yield curve in accordance with the guidelines issued by the RBI, and the method of valuation consistently followed all along. The AO concluded that this unrealized loss was only a contingent liability. As the assessee was following mercantile method of accounting, so "no deduction can be made in respect of a liability which has not definitely arisen". CIT (A) also rejected the assessee's appeal.

On further appeal, the Tribunal held that, the question was not whether the deduction was to be allowed or not, but only the AY in which deduction was to be allowed. Thus in the long term perspective, it was wholly tax neutral. One of the mandatory accounting standard, (notification no. 9949 dated 25th January 1996), provided that "provisions should be made for all known liabilities and losses even though the amount cannot be determined with certainty and represents only a best estimate in the light of available information". This approach required all anticipated losses to be taken into account in computation of income taxable under the head 'profits and gains from business and profession'. The Tribunal was of the view that just because anticipated profits were not assessed to tax, it would not follow, as a corollary thereto, that anticipated losses could not be allowed as deduction in computation of business income. The impugned disallowance was accordingly deleted. This relief was, however, subject to the rider that the allowability in deduction in the current year was subject to verification of corresponding adjustment in the year in which next settlement date fell. *2011-TIOL-545-ITAT-MUM.*

A company can follow cash system for tax purposes: The assessee, a company, followed in accordance with s. 209(3) of the Companies Act, 1956, the mercantile system of accounting. However, for income-tax purposes, it followed the cash system of accounting according to which the profits were lower, and offered that sum to tax. The AO rejected the claim on the ground that u/s 209(3) of the Co's Act, a company was obliged to follow the mercantile system and that was also its' "regular method" for purposes of s. 145. However, the CIT (A) upheld the assessee's claim.

- On appeal by the department, the Tribunal held that: the assessee had regularly employed the cash system of accounting in recording its day to day business transactions. Section 209(3) of the Companies Act, 1956 does not override s. 145 of the Income-tax Act. There was also no valid basis for the AO's action in rejecting the books of account and system of accounting followed by the assessee. Further, since the department had accepted the assessee's system for the past several years, the principles of consistency applied. *STUP Consultants Pvt Ltd. V DCIT, ITAT.org, 9TH Sept 2011.*

Transfer Pricing: In the present case, the following principals of comparable uncontrolled transactions were discussed:

a) The conditions require that a case should not only be comparable but also have uncontrolled transactions. Both conditions must be met simultaneously.

b) The fact whether the comparable has a higher or lower profit rate has not been prescribed as a determinative factor to make a case incomparable. This is because profit is not a factor in itself, but a consequence of the effect of various factors.

c) The alternate argument that if the loss making companies are excluded, the high profit companies should also be excluded is not acceptable. DCIT vs. BP India Services Pvt Ltd (ITAT Mumbai), ITAT.org, 23rd Sept 2011.

Even unrelated parties can be "associated enterprises" if there is "de facto" control: It was held by the Tribunal that u/s 92A(1)(a) & (b), if one enterprise controls the decision making of the other, or if the decision making of two or more enterprises are controlled by same person, these enterprises are required to be treated as 'associated enterprises'. *Diageo India PVT Ltd vs. ACIT (ITAT Mumbai) ITAT .org, 21st Sept 2011.*

High profit/loss companies are not per se un-comparable: The Tribunal held that the argument, based on Quark Systems, 38 SOT 307 (SB), that exceptionally high and low profit making comparables are required to be excluded from the list of TNMM comparables is not acceptable. Merely because an assessee has made high profit or high loss is not sufficient ground for exclusion if there is no lack of functional comparability. *Diageo India PVT Ltd vs. ACIT (ITAT Mumbai) ITAT .org, 21st Sept 2011.*

Advance Rulings

Australia DTAA: Foster Pty, an Australia based company, entered into a contract with Ravva Oil Singapore (Singapore) Pte Ltd., for providing services in connection with the business of oil and gas exploration and production. Ravva Oil Singapore alongwith others, in turn entered into a production sharing contract with the Government of India for the exploration, development and production of mineral oil and gas in the Ravva Oil and Gas Field in India. Ravva Oil Singapore was not deducting tax on payments made by it to Foster under the belief that such payments were not chargeable to tax in India. Foster thereafter approached the AAR seeking a ruling on the question as to whether the consideration received/receivable by it under the terms of the agreement with Ravva Oil Singapore was liable to tax as royalty as defined in Article 12 of the DTAA between India and Australia. In its application, Foster also disclosed that the Revenue Authorities while completing the assessment on the tax return filed by Ravva Oil Singapore, disallowed the payments made by it by invoking section 40(a)(i) since no tax was deducted at source from the payment and that Ravva Oil Singapore had filed an appeal against that order of assessment and the same was pending.

On receipt of notice of the application, the Revenue raised a preliminary objection and submitted that the question as to whether the payments made by Ravva Oil Singapore on the basis of the agreement were chargeable to tax, had already been raised in various previous orders and the appeals were pending. Therefore, raising of the same issue for advance ruling relating to the same payment was not permissible in terms of the proviso to section 245R(2) of the Income-tax Act.

The AAR ruled that:

a) Once the Assessing Officer finds that the amount was not taxable in India, either under the Act or under the DTAA, there would be no obligation on the payer to make a deduction in terms of section 195 of the Act. If the payer had not raised that question directly, he ought to have raised that question while asserting his claim in respect of the amount paid to the payee.

b) The payee's question whether the amount received by it from the payer is taxable in this country, is already pending before an Appellate Authority, at the instance of the payer. Therefore, under clause (i) of the proviso to section 245R(2) of the Act, it would be appropriate for us to decline jurisdiction to

entertain this application. *Foster Pty Ltd v. ADIT, 2011-TII-23-ARA-INTL.*

SERVICE TAX

Important Circulars / Notifications

Cess on transfer of technology: The Central Government has amended Notification No. 17/2004-Service Tax, dated 10-Sep-2004, pertaining to "amount of cess paid on the said transfer of technology under the provisions of Section 3 of the Research and Development Cess Act, 1986 (32 of 1986)" by adding the following conditionality:

"(A) the said amount of Research and Development Cess is paid within six months from the date of invoice or in case of associated enterprises the date of credit in the books of account. Provided that the exemption shall be available only if the Research and Development Cess is paid at the time or before the payment for the service;

- (B) records of Research and Development Cess are maintained for establishing the linkage between the invoice or the credit entry, as the case may be, and the Research and Development Cess payment challan." *Notification No. 47/2011 – Service Tax, New Delhi, 19-Sep-2011.*

- **Taxable Service:** The Central Government has exempted the taxable services referred to under item (iii) of sub-clause (zzzzm) of clause (105) of section 65 of Finance Act, 1994. *Notification No. 45/2011 – Service Tax New Delhi, the 12-Sep-2011.*

- **Service tax on Sub-brokers:** The Central Government has amended the Notification No. 31/2009-Service Tax, dated 1-Sep-2009, by inserting the words "or authorised person, as the case may be", after the words, "provided by a sub-broker" referred to in sub-clause (zzb) of clause (105) of section 65. *Notification No. 44/2011 – Service Tax, New Delhi, the 9th September, 2011.*

SC/HC Judgments

Renting of Immovable Property Service – This case dealt with the issue of validity of service tax levied on renting out of immovable property. This issue had come up earlier in *Home Solution Retail India Ltd & Ors vs. UOI (2009-TIOL-196-HC-DEL-ST),* wherein it was held that section 65(105)(zzzz) was not applicable to renting of immovable property for use in the course of business or commerce, and thereby this activity was not subject to service tax. Accordingly, the notification and circular were declared *ultravires*.

After the above judgment, the provisions of sections 65(90a), 65 and 66 were amended by Finance Act, 2010, with retrospective effect. In the present case, these amendments and their Constitutional validity, including applicability of these amendments retrospectively, was challenged.

In the above *Home Solution case*, the Division Bench had opined that renting out of immovable property for use in the course of business or commerce by itself, did not entail any value addition and, therefore, could not be regarded as service. After a detailed analysis, the Larger Bench of the High Court held that the imposition of service tax under section 65(105)(zzzz) read with section 66 was not a tax on land and building which was under Entry 49 of List II. What was being taxed was an activity, and the activity denoted the letting or leasing with a purpose, and the purpose was business and its furtherance. Once there was a value addition and an element of service was involved, the service tax got attracted, as per Entry 97 of List I of Schedule seven. Hence the earlier decision of the Division Bench stood overruled, and the provisions of section 65(105)(zzzz) and section 66 of the Finance Act, 1994 as amended by the

Finance Act, 2010, are now held intravires.

Also, it was held that the legislature was within its rights to pass legislation, with retrospective effect. *2011-TIOL-610-HC-DEL-ST-LB*.

CESTAT Judgments

Technical Certification Service: A USA based Certification company was engaged in the process of certifying the conformity to safety standards of its clients' products. The safety mark provided by the US company was similar to BIS certification provided by Bureau of Indian Standards. The US company conducted a study of its clients' products and sent the technical data to the appellant, its Indian subsidiary, who then conducted a comparison of the technical data with the standards already made available by the parent company, and submitted a report to its parent company. The parent company in US thereafter interacted with its clients and advised further rectifications to their products. The clients in India made payments for these services to the US company which in turn remunerated its Indian subsidiary viz., the appellant, for its work.

The department demanded service tax from the appellant for the services undertaken and also proposed levy of penalties under sections 75, 76, 77 and 78 of the Finance Act, 1994 by classifying the activities undertaken by the appellant as 'Technical Inspection and Certification service'. Appellant contended that the services provided by it were to be treated as export and therefore, exempt from levy of service tax. With the lower authority confirming the levy of tax with interest and levy of penalties, appellant filed an appeal before CESTAT.

The appellant contended before CESTAT that it was the parent company in US who could be said to be engaged in providing the Technical Inspection and Certification service. The activities undertaken by the appellant came under the category of Consulting Engineer service, Business Auxiliary service, or Business Support service. It was further contended by the appellant that even if their activity was classifiable under the Technical Inspection and Certification Service, they were covered under the Category II of Rule 3 of Export of Services Rules, 2005 and hence not liable to pay service tax.

CESTAT observed that the activity undertaken by the appellant was in the nature of Technical Inspection and Certification service and confirmed the claim of the department regarding classification of service. However, CESTAT observed that the activity undertaken being partly performed in India and partly outside India, was covered by Category II of Rule 3 of Export of Service Rules. It was further held that the appellant had made out a strong prima facie case in their favour, and ordered full waiver of pre-deposit and granted stay against recovery of all dues during pendency of appeal. *2011-TIOL-1219-CESTAT-BANG.*

- **Cenvat credit based on debit notes:** The appellant manufactured Rigid PVC Films/PVC sheets and sold them to various customers by engaging a commission agent. The commission agent had issued debit notes to the appellant showing the invoice no., the name of the customer to whom goods have been sold through them, and also showing the amount of commission as well as service tax payable on such commission. Based on these debit notes, the appellant had taken CENVAT credit.

  The Revenue contented that 'debit note' was not a document specified under Rule 9(2) of the Cenvat Credit Rules, against which CENVAT credit could be taken. The Bench after considering the submissions observed that the issue here is that document is called debit

note and not invoice. It was only a difference in nomenclature of the document and not any different document itself because no case had been made out that information prescribed under rule 9(2) of the Cenvat Credit Rules was missing. Noting that the appellant had cited favourable decisions on the subject matter, the Bench held that it was only proper that the appellant should be granted waiver of the pre-deposit. *2011-TIOL-1213-CESTAT-MUM.*

Service Tax on Photography: The issue to be decided was whether or not, for the purpose of Section 67 of the Finance Act, 1994, the value of service provided in relation to photography would be the "gross amount charged" including the cost of material, goods used/consumed minus the cost of unexposed film. The Larger Bench observed that Service tax is levied on the gross value of taxable service. Service tax being destination based consumption tax, till the taxable service reaches its destination, all elements of cost making the service reachable to such destination contribute to the value addition and form part of value thereof. Agreement or understanding of the parties to determine the consideration for the service rendered and received does not affect incidence of tax. Hence in this case, the value of service in relation to photography would be the gross amount charged including cost of goods and material used and consumed in the course of rendering such service. The cost of unexposed film etc. would stand excluded in terms of Explanation to section 67 if sold to the client. *2011-TIOL-1208-CESTAT-DEL-LB*.

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