Legal Decisions[1]

DIRECT TAXES

Section 9 of the Income-tax Act, 1961, read with Article 7 of DTAA between India and USA - Income - Deemed to accrue or arise in India

US-applicant carrying on bill discounting activities for Indian group company is not liable to tax in India in view of the Double Taxation Avoidance Agreement between India and USA as discount given does not represent interest paid upfront

ABC International Inc. USA, *In re*, May 3, 2011 (AAR)

The applicant US-company provides various financial services. It wants to carry out bill discounting activities for its Indian group company ABC India for purchase of promissory note, 'PN', at a discount on 'without recourse' basis and make remittance of purchase price (i.e., face value minus discounting charges). It wants to carry out these activities without having any physical presence in India.

ABC India proposes to transact with the applicant for purchase of bills of exchange drawn by them on the buyer in pursuance of goods sold under normal/merchanting trade as well as purchase of promissory notes (PN) issued by such buyer. The discount for purchasing the PN will be calculated on the basis of various factors such as prevalent LIBOR plus certain margin depending upon the market condition. ABC-India will send the requisite set of documents alongwith endorsed PN through their bank. The applicant will make the payment of PN purchased (after deducting its discounting charges as per the agreement) to the bank, which in turn will make the payment to ABC-India. In no case the applicant makes ABC India liable to make payment to the applicant in case of delay or default in payment by the entity who issued the PN.

The Authority for Advance Rulings held that discounting of a bill amounts to purchase of the negotiable instrument and it does not involve any relationship of debtor and creditor between the endorser and the endorsee. As a general rule, an endorsement of a promissory note does not also result in an assignment of the original debt.

As per the definition, for any interest to accrue, there must be a borrowing, debt, deposit or obligation to repay. In the absence of any of those elements present, it is difficult to postulate accumulation of interest or its payment. When a promissory note is discounted, no doubt keeping in mind the prevailing rate of interest, no obligation is incurred for repayment of the money by the person who discounts the instrument or the person who gets it discounted, except that in the case of a discounting with recourse, the person who gets it discounted continues to be liable to the endorsee. In a case of endorsement without recourse, even that possibility does not arise. Of course, the person who gets the instrument discounted pays for getting present payment on an instrument that becomes due for payment at a later date. But that consideration cannot be treated as payment of interest upfront in the context of the Law Merchant and the Negotiable Instruments Act and the commercial and legal implications of a discounting of an instrument.

But in a simple transaction of discounting of a bill of exchange and prompt payment, there is no contracts implied or express to deem the amount involved as a deposit or loan. In instant the case it cannot be said that the parties intended the amount involved as a loan or as money owed. It was purely a discounting of a promissory note payable at a future date and making of immediate payment on taking a discount. It cannot be held that any payment of interest is involved in the proposed transaction. The promissory note to be discounted is also not to bear any interest on the purchase price covered by the note for the delayed payment.

The underlying element that can give rise to interest is the existence of a debt claim. In other words, a debt has to exist for interest to be generated. However, discounting of a promissory note does not involve the creation of a debt or the coming into existence of a debtor-creditor relationship, and the discount given does not represent interest paid upfront by the resident company when it gets the note discounted. Thus, the discount given could not be held to be interest within the meaning of Article 11 of the DTAA.

The purchase price payable for the goods is represented by the promissory note executed by the purchaser and it is payable in future without interest. So, all that the discounting achieves is that it enables the seller to realise the price of the goods then and there or prematurely but at a cost. That cost cannot be termed as interest paid by the seller.

[1] *Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.org.*

The promissory note taken by the seller, an Indian tax resident in lieu of the price to be paid, is a promissory note payable on demand. This is clear from the facsimile of the promissory note produced by the applicant. No place of payment is specified, nor is it put forward that the purchaser, the debtor, would apply to the seller to specify the place of payment. Hence applying the normal rule that the debtor must seek the creditor', the payment is to be made in India to the Indian entity. It is this promissory note payable in India that is discounted by the applicant. The discounted amount is sent to India as can be seen from the Discounting Agreement produced. On discounting, the income accrues or is deemed to accrue. An amount can accrue or arise if a legal right to receive it is acquired. On discounting the promissory note, the legal right to receive the proceeds accrues to the applicant. If so, the income to the applicant accrues in India. It is not disputed that it is the business income of the applicant. That business income accrues in India, though realised later. Such business income is taxable in India under the Income-tax Act subject to the rights conferred by or the protection afforded by the DTAA.

Under Article 7 of the DTAA, the profits of an enterprise of a contracting State shall be taxable only in that State unless the enterprise carries on business in the other contracting State through a permanent establishment situated therein. It is the case of the applicant that it has no permanent establishment in India. Assuming for the purpose of this ruling that the applicant has no permanent establishment in India, the income is not interest income, Article 11 of DTAA is not attracted. Thus, it has to be ruled that the income of the applicant from discounting would not be taxed in India, on the case set out by the applicant in the light of Article 7 of DTAA.

Section 9 read with Section 195 of the Income-tax Act, 1961, read with Article 12 of DTAA between India and USA - Income - Deemed to accrue or arise in India

Where as per requirement of foreign service receiver, applicant recruited managerial personal from foreign affiliate company and reimbursed salary and expenses paid by foreign affiliate; to expatriate employees, amounts reimbursed by applicant are taxable as "Fees for Included Services (FIS)" under DTAA and also under Act

Verizon Data Services India (P.) Ltd., *In re*, May 27, 2011 (AAR)

The applicant is a wholly owned Indian subsidiary of U.S. company Verizon. The applicant is engaged in providing services relating to development and maintenance of telecom software solutions and information technology services. The applicant exports services from India to Verizon US. Verozon-US feels that applicant needs individuals from US. Therefore, three of employees of US affiliate GTE-OC are to be recruited. The applicant entered into a Secondment Agreement with GTE-OC.

The applicant submits that payments made are in nature of reimbursement of salary and expenses paid by GTE-OC to expatriate employees. The salary and benefits paid to expatriate employees have suffered withholding tax under section 192. The same amount cannot be subjected to withholding tax under section 195.

The Authority for Advance Rulings held that the preamble of the Personnel Secondment Agreement states that to perform certain managerial services, the applicant has procured the services of US based personnel who are under the employment of GTE-OC. A team of three employees has been sent by GTE-OC. One of them has assumed the position of the Managing Director of the applicant company. While these employees are providing services to the applicant, they will remain the employees of GTE-OC. Their employment can only be terminated by GTE-OC. It goes to show that it's GTE-OC who has rendered managerial services to the applicant company. For the items paid or provided to the employees, the applicant is to reimburse GTE-OC on the basis of bills presented by GTE-OC. At the time of remittance, the obligation to withhold taxes is upon the applicant and if any amount is held as taxes the applicant is required to pay GTE-OC an additional amount. In other words, the applicant is required to pay the amount net of taxes. This again is an important aspect of the agreement. Firstly, it is GTE-OC's employees who are to perform managerial services in India and secondly, the applicant is liable to bear the taxes on the remittances. There is no argument that the remittances are in consideration for the services rendered. The reason for the applicant to bear the taxes on the impugned payments to GTE-OC lies in the fact that the services rendered by GTE-OC are liable to tax in India.

Without GTE-OC the seconded employees have no locus standi vis-à-vis the applicant . It is a trite law that the capacity in which the person receives the amount determines its taxability in his hands. In that view of the matter the sums that are remitted by the applicant accrue and arise to GTE-OC for providing services to the applicant. What accrues and arises to the employees is by virtue of their employment with GTE-OC. The application of the income by GTE-OC while making payment of salaries to its employees has nothing to do with its accrual. The nature of the two receipts, one in the hands of GTE-OC for rendering services and the other in the hands of employees by way of salaries spring from different sources and are of different character and represent different species of income. By correlating the two payments/receipts in the Personnel Secondment Agreement, neither the nature nor substance of the transaction would change to give it the character of reimbursement. The name given to the transaction does not decide the nature of the transaction. A receipt is what it is and not what it is called. The salaries

are paid out of the income of GTE-OC. The total income of GTE-OC may be the sum total of receipts under different heads of income, for example: business, royalties, fees for included services, house property, interest, dividends etc. but the expenditure incurred by way of salaries to the employees cannot *ipso facto* determine the nature of the income which is to be brought to tax either under the Act or under the DTAA in the hands of GTE-OC. Therefore, the amounts paid by the applicant to GTE-OC represent income in the hands of GTE-OC.

One of the seconded employees is to perform the function as Managing Director of the applicant and other two are to supervise and provide directions in the manner through which the activities of the applicant are to be carried out and to liaise with the parent company in USA.

It is fairly clear that the functions performed by these seconded employees are purely managerial in nature.

From the memorandum of understanding of the DTAA it is clear that the services which are not in the nature of technical services, the make available clause would not apply. As the services provided by GTE-OC are in the nature of managerial services, the payments made by the applicant are covered under "fees for included services" under Article 12 (4) of the DTAA. As the services are managerial in nature, the payments are also covered under "fees for technical services" as defined under *Explanation 2* to section 9(1)(vii) of the Act.

The amounts reimbursed by the applicant represent income accruing to GTE-OC and accordingly charged to tax within the provision of section 195. The amounts reimbursed by the applicant are taxable as "Fees for Included Services (FIS)" under the DTAA and also under the Act.

Section 41(1) read with Section 256 of the Income-tax Act, 1961- Remission or Cessation of trading Liability

If loan is taken for acquiring any capital asset, waiver thereof would not amount to any income exigible to tax; on other hand, if this loan is taken for trading purpose and is treated as such from very beginning in books of account, waiver thereof may result in income moreso when it is transferred to Profit and Loss account

Logitronics Pvt. Ltd v. CIT, February 18, 2011 (DEL)

The assessee-company was engaged in the business of manufacturing of electronic products. It was enjoying loan facility from State Bank of India (SBI). As on 31.03.1998, the principal amount of loan due to the bank was ₹4,76,92,213 and outstanding interest was ₹1,90,42,295. During the pendency of recovery proceedings, the assessee had settled the matter with the SBI for payment of ₹1,85,00,000 against loan of ₹4,76,92,213 (principal amount), the remaining sum of ₹1,90,42,295 was waived. In the tax return filed by the assessee, it showed interest waived as income but not the amount of loan waived by SBI. The amount of interest written off i.e., ₹1,90,42,295 was credited to profit & loss account and was offered for taxation. However, the principal amount written off i.e. ₹2,91,42,213 that was directly taken to balance sheet under the head capital reserve, was not offered for taxation. The Assessing Officer held that even waiver of principal amount of loan was also taxable.

The Delhi High Court held that in the context of question of waiver of loan amount, the answer would depend upon the purpose for which the said loan was taken. If the loan was taken for acquiring the capital asset, waiver thereof would not amount to any income exigible to tax. On the other hand, if this loan was for trading purpose and was treated as such from the very beginning in the books of account, the waiver thereof may result in the income, moreso when it was transferred to Profit and Loss account.

In the instant case, the assessee had obtained the loan or credit facility by way of hypothecation of finished goods, semi-finished goods, raw material, book debts, receivable claims, securities and rights by way of first charge, which indicated that the assessee had obtained the loan facility for its business activity or trading operations. However, the Tribunal noted that this aspect of the matter whether the whole amount of the loan had been utilised either for the purpose of acquiring capital asset or for the purpose of business activity or trading activity had not been looked into or examined by the Authorities below. For this reason, the Tribunal has restored the case to the file of the AO for fresh adjudication. There was no reason or occasion for the assessee to feel aggrieved by the order and prefer this appeal. Thus, no substantial question of law arose.

Section 41(1) read with Section 28(iv) of the Income-tax Act, 1961- Remission or Cessation of trading Liability

Where assessee engaged in the business of sale/ purchase of shares and business of taking loans and further providing it to parties, wrote back unclaimed loan taken from a party, which was obtained as a part of source of funds employed by assessee in its business, amount was to be treated as receipt of capital nature and could not be added in assessee's taxable income

Logitronics Pvt. Ltd v. CIT, February 18, 2011 (DEL)

The assessee is an investment company engaged in the business of sale/purchase of shares and business of taking loans and further providing it to the parties. The AO found that the assessee had credited a sum of ₹25,00,000 in Profit and Loss Account on account of remission of liability with respect of certain unsecured loans appearing in its financial results. This amount represented loan taken from one SHPL more than ten years ago. Since there was no communication from the party and no claim was made for so many years the loan was written back. It was treated

as capital receipt and was not taken as taxable income in the computation of assessable income for the assessment year in question. The AO held that the amount as written off liability was the income of the assessee and added in the taxable income. The Commissioner (Appeals) confirmed the order of the Assessing Officer. However, the Tribunal deleted the addition made.

The Delhi High Court held that what was to be seen is as to whether the aforesaid loan was taken for trading purpose or it was to generate some capital assets. The assessee was an investment company engaged mainly into the business of purchase and sale of shares. It was also engaged into taking business loans and further profits done to the parties. The Commissioner (Appeals) held that the amount of loan was utilised for its financing business. The Tribunal accepted the plea of the assessee that loan was not used in the financing business, but was used in long term investment made in shares. Thus, it was explained that the assessee was a company engaged, *inter alia*, in the business of finance and making investments in shares. The loan obtained by the assessee from SHPL was part of the source of funds employed by the assessee in its business. In pursuance of the business of financing, the assessee advanced loans at interest. Such loans were advanced out of interest-free own funds available with the assessee in the form of share capital and reserves or out of borrowed funds in the form of loans, etc. The loans borrowed were to augment the funds available with the assessee, to be advanced on interest. Such loans borrowed were a source of funds. It could not be said that the assessee was in the business of borrowing and advancing loans – it could never be the business of an assessee to borrow money by way of loans. Thus, the money borrowed, was only a source of funds.

Furthermore, the Tribunal reached a finding of fact that the amount of loan was not used in financing business. Having regard to these findings of facts constituting the nature of loan, the question was to be answered in affirmative and, accordingly, the appeal by the Revenue was also to be dismissed.

Section 44BB read with Section 9 of the Income-tax Act, 1961- Non-resident, business of exploration mineral Oils, etc.

Once it is held that the income is from its oil exploration and production activities as envisaged under section 44BB if a part of the income falls under 'Royalties' or 'Fees for Technical Services', there is no scope to assess such receipts under these heads; revenues earned or to be earned by applicant under seismic data acquisition and processing contracts in India are taxable under section 44BB

Bergen Oilfield Services AS, Norway, *In re*, May 16, 2011 (AAR)

The applicant, a Norway company provides geophysical services to oil and gas exploration industry. Cairn-India has awarded contract to the applicant to carry out 3D Marine Seismic Data Acquisition services in the offshore coastal areas. The applicant states that the services rendered by it will be utilised by the Cairn in its oil exploration and production activities under the ambit of section 44BB. The applicant further stated that for the purposes of conducting seismic surveys, the vessel is mobilised from outside India to the site area in India where the work is to be carried out. Similarly, when the vessel is demobilized, after completion of the work, it involves moving out of equipment and personnel from the site area. The applicant is paid for mobilisation as well as demobilisation of its vessel from the site area. The question arose as to whether entire mobilisation/ demobilisation revenues received by the applicant with respect to seismic data acquisition and/or processing contracts would be taxable in India or revenues attributable to distance travelled by the vessel in India would be taxable in India.

The revenue contended that the services contemplated in section 44BB are services other than those coming within the purview of *Explanation 2* to section 9(1)(*vii*). The services of exploration industry extended by the applicant fall under *Explanation 2*. It was submitted that the income by way of fees for technical services chargeable under section 9(1)(*vii*) has to be computed under section 44DA in a case like this where the service provider has a Permanent Establishment in India. It is contended that the exclusion clause in *Explanation 2* does not apply in the case of the applicant because it is not undertaking a mining or like project. Such project is undertaken by someone else and certain technical

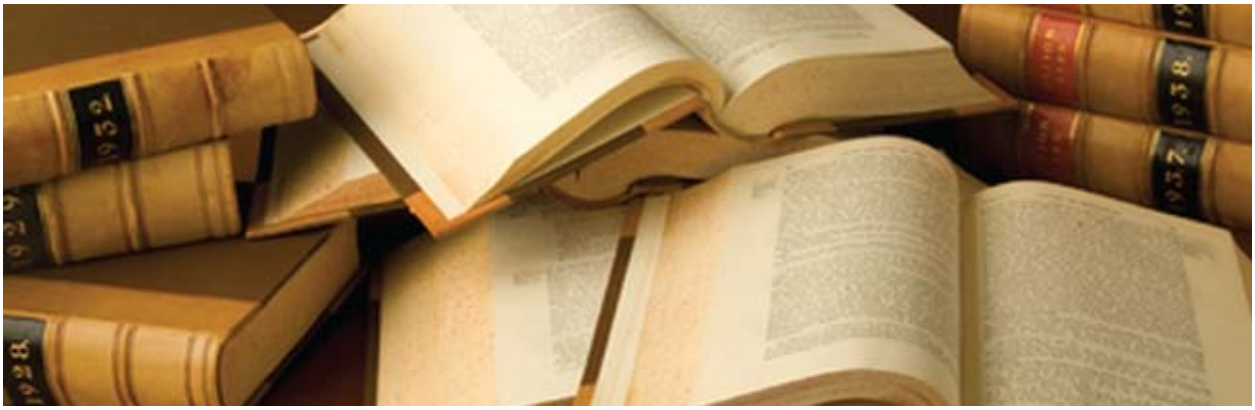
services are rendered by the applicant to the business enterprise that takes up the project. In short, the revenue contended that section 44BB would come into play only if the applicant goes out of the purview of section 9(1)(*vii)*, read with *Explanation 2* thereof.

The Authority for Advance Rulings held that the issue had arisen in the case of *Geofizyka Torun Sp.Zo.o*, In re [2010] 186 Taxman 213 (AAR - New Delhi), wherein this Authority held that: "If the business is of the specific nature envisaged under section 44BB, the computation provision therein would prevail over the computation provision in section 44DA. In other words the income received by a non-resident businessman for the technical services provided in relation to prospecting and extraction of mineral oil, will be governed by section 44BB for the purposes of computation. If all the services that are in the nature of technical services within the meaning of *Explanation 2* to section 9(1)(*vii)* are to be computed in accordance with section 44 DA, very little purpose will be served by incorporating special provision in section 44BB for computing the profits in relation to the services connected with the exploration and extraction of mineral oils. The provision will then operate in a very limited field."

It cannot be said that section 44BB will become otiose or altogether redundant, but its scope and content will be unduly curtailed by adopting the interpretation sought to be placed by the revenue." Therefore, revenues earned or to be earned by the applicant under seismic data acquisition and processing contracts in India are taxable under section 44BB of the Income-tax Act at of effective tax rate of 4.223 per cent.

Once an assessee opts to come under section 44BB(1) of the Act, the provision itself deems its profits and gains as 10 per cent of the aggregate of the amounts specified in sub-section (2). Sub-section 2(a*)* specifies that that aggregate amount is the amount paid or payable whether in or out of India to the assessee on account of provision of services in India. In the scenario, there is no scope for splitting up the amount payable to the assessee. If the assessee wants to seek such a splitting up it has to go under section 44BB(3) of the Act.

The scheme of computation of income under section 44BB does not provide any leeway to apply simultaneously both the sub-sections (1) and (3) of section 44BB to the income arising from the business activities falling under the ambit of section 44BB(1). It even goes to the extent that if a part of the income falls under 'Royalties' or 'Fees for Technical Services', there is no scope to assess such receipts under these heads, once it is held that the income is from its oil exploration and production activities as envisaged under section 44BB. If the applicant desires to know the answers to the two issues, then it has to first exercise the option to get its income computed under section 44BB(3). In view thereof, the entire mobilisation/demobilisation revenues received by the applicant with



respect to seismic data acquisition and/or processing contracts would be taxable in India at effective rate of 4.223 per cent.

Section 147 read with section 154 of the Income-tax Act, 1961- Income Escaping Assessment

Income Tax Officer can give up a rectification proceedings initiated under section 154 and then proceed to make an income escaping assessment under section 147 for same assessment year

CIT v. India Sea Foods, January 17, 2011 (KER)

Both the first appellate authority as well as the Tribunal declared the reassessment as invalid only by virtue of the fact that prior to initiation of proceedings for reassessment, the Assessing Officer issued notice for rectification of assessment under section154 and it is after giving up the same that too, without issuing any express order, the assessment was reopened.

The Kerala High Court held that if an assessment happens to be an under-assessment or a mistaken order, the course open to the Assessing Officer is either to rectify the assessment if it is a mistake falling under section 154 or to make income escaping assessment under section 147. Both these provisions are self-contained provisions wherein conditions for invoking the powers and the procedure to be followed and the time limit within which orders are to be passed are mentioned.

In the instant case the Assessing Officer first felt that the excessive relief granted in the computation of relief under section 80HHC is a mistake that could be rectified under section 154 and following the mandatory requirement contained under section 153(3), notice was issued to the assessee. The assessee brought to the notice of the Assessing Officer that there was no apparent mistake in the proceedings issued and so much so, assessment could not be rectified. The Assessing Officer apparently accepted the objection raised by the assessee and gave up the proceedings initiated under section 154. But the assessee was not informed that the proceeding initiated under section 154 was dropped. However, after expiry of the period provided for rectification of assessment under section 154, the Assessing Officer initiated proceedings under section 147 for making income escaping assessment by issuing notice under section 148. Admittedly notice under section 148 was issued within time and reassessment also was completed under section 147 within the statutory period. The question to be considered was whether the initiation of proceedings under section 154 and the dropping of the same without issuing an express order in that regard will affect the validity of re-assessment under section 147.

The fact that the Assessing Officer initiated rectification proceedings under section 154 does not mean that he should stick to the same only and proceed to issue orders as proposed. The very purpose of issuing a notice to the assessee is to give him opportunity to raise objection against the proceeding which includes the assessee's right to question the maintainability of the rectification proceedings. If the assessee convinces the officer that rectification is not permissible, the Assessing Officer is absolutely free to give up the same and see whether there is any other recourse open to him to achieve the purpose i.e. to bring to tax escaped income. In this case even though the Assessing Officer did not issue any specific order dropping the proceeding initiated under section 154 based on the objection filed by the assessee, the only inference possible after expiry of the time provided for completion of proceedings under section 154 is that the Assessing Officer has given up the proposal. Further, when a notice is issued under section 148 for making income escaping assessment, the Assessing Officer obviously made it clear that the proceedings under section 154 is dropped and he proposes to proceed with reassessment under section 147. In fact, even if the Assessing Officer had proceeded with the rectification proceedings under section 154 which was not sustainable, it was open to the Commissioner of Income Tax to exercise his powers under section 263, set aside the order issued under section 154 and direct the Assessing Officer to consider income escaping assessment under section 147 which the Assessing Officer is free to initiate. In this case the Assessing Officer himself realised the mistake of initiating

rectification proceedings and when he noticed that the correct recourse open to him under the Act was to make an income escaping assessment, he was entirely free to do it and there was nothing wrong in the Assessing Officer giving up rectification proceedings, though initiated by him based on reply filed by the assessee and then initiating an income escaping assessment by issuing notice under section148 within the statutory period.

Section 201 of the Income-tax Act, 1961- Deduction of tax at source- Failure to deduct or pay, Consequences of

Even where in proceedings under section 201, in show cause notice Assessing Officer had observed that in acquisition of shares, capital gains were deemed to accrued or arise in India and, therefore, TDS was to be deducted by appellant on making payment, matter might be remitted to Assessing Officer to ascertained jurisdictional issue; and it is open to assessee to approach High Court under Article 226 of the Constitution

Richter Holdings Ltd. v. Asstt. Director of Income-tax (International Taxation), June 13, 2011 (KAR)

It was averred that the first respondent issued a show cause notice to the petitioner/appellant Cyprus company regarding proceedings under section 201(1) and 201(1A) in respect of indirect acquisition of 51 per cent shares of Sesa Goa Limited without deduction of TDS. It was further averred from the show cause notice that after expressing a tentative opinion in respect of reasoning given, the Assessing Officer had observed that objections/reply/ details might be furnished before the next date of hearing, but at the end of the show cause notice, the Assessing Officer has observed that in view legal provision, the company Westglobe Ltd. along with Richter Holdings Ltd. Cyprus had jointly acquired indirectly 2,00,74,834 shares of Sesa Goa for total consideration of Rs.4087 crores on which capital gains deemed to accrue or arise in India. Therefore, in accordance with provision of section 195 TDS was to be made deducted on these payments made to the company Earlyguard. The petitioner contended that the said show cause notice was not a show cause notice at all and the Assessing Officer has already prejudged the matter and wherefore, no useful purpose would be served in giving a reply to the show cause notice.

The Single Judge declined to interfere with the show cause notice on the ground that the petitioner, having received the show cause notice, should approach the first respondent-assessing officer and give its reply and all the contentions that were urged in the writ petition could be urged before the Assessing Officer.

The Karnataka High Court held that having regard to the contents of the show cause notice, it was is clear that it was open to the appellant to urge all the facts including jurisdictional fact before the Assessing Authority by placing

the version of the appellant with corroborative evidence, documentary or otherwise. On a reading of the show cause notice, no person of ordinary prudence would come to the conclusion that no useful purpose would be served by remitting the matter to the first respondent. Further, in view of the decision of the Supreme Court in *Vodafone International Holdings B.V.* v. *Union of India* [2009] 221 CTR (SC) 617, the interest of the appellant could further be safeguarded by directing that the appellant would appear before the first respondent by raising jurisdictional fact and the jurisdictional fact would be tried as a preliminary issue and if the appellant would be aggrieved by the finding on the preliminary issue relating to jurisdictional fact, it was open to the appellant to approach the High Court under Article 226 of the Constitution. Therefore, the show cause notice issued by the first respondent did not call for interference in exercise of writ jurisdiction of the High Court.

Section 245R of the Income-tax Act, 1961- Advance Rulings – Procedure on receipt of application

Authority for Advance Rulings has jurisdiction to see whether the transaction is designed prima facie for avoidance of Income-tax

ABC International Inc. USA, *In re*, May 3, 2011 (AAR)

The authority for advance rulings has jurisdiction to see whether the transaction is designed *prima facie* for avoidance of Income-tax. Section 245R(2) of the Act must receive a purposive interpretation. The proviso to section 245R though placed in the context of the initial allowing of the application (really, admitting for consideration) for consideration and for giving a ruling, its object is clear. It seeks to prevent the obtaining of a ruling when the question is already in the seisin of the regular authorities under the Act, when it involves a determination of fair market value of any property or when it relates to a transaction or issue that is designed *prima facie* for the avoidance

of income-tax. It is true that at the stage of allowing the application under section 245R(2) of the Act, the Authority can and should consider all these questions. But that fact does not prevent the Authority from considering the question when the application is taken up for rendering a ruling under sub-section (4) of section 245R of the Act. After all, the object of the proviso to section 245R(2) is very clear. It is to tell the Authority to decline a ruling if any one of those aspects is involved. If after the order under section 245R(2) is made and while the application is being considered under section 245R(4), it becomes apparent that one of the provisos is attracted, it behoves this Authority to decline a ruling. After all, section 245R is an integrated section not only dealing with the admission of an application but also its final disposal and the mere fact that the disabilities are placed at the earlier stage, cannot lead to the position that the disabilities should be ignored even when they become discernible when the application is taken up for final disposal.

Proviso (iii) to section 245R(2) of the Act gives the Authority for Advance Rulings the jurisdiction to test the transaction projected before the Authority to see whether it is designed *prima facie* for the avoidance of income-tax. Proviso (*iii*) to section 245R(2) enables this Authority to test the transaction or issue for finding out whether as put forward, it was designed for the avoidance of income-tax.

What is the effect of the use of the expression *prima facie* in the provision? According to the P. Ramanatha Aiyar's Law Lexicon, *prima facie* means, 'at first sight, on the first appearance, on the face of it; so far as can be judged from the first disclosure, presumably; a fact presumed to be true unless disproved by some evidence to the contrary, arising at first sight, based on the first impression'. The expression used is not ex-facie, meaning, in the light of what is apparent. The use of the expression *prima facie* thus, gives a little leeway to this Authority to consider the question of avoidance of tax, but still, it gives to this Authority only the jurisdiction to consider the question *prima facie*. This seems to suggest that this consideration can only be at the initial stage of the application. To confine it to that stage would really defeat the purpose of the introduction of the proviso. But since the intention appears to be not to confer on this Authority the jurisdiction to thoroughly examine the facts and circumstances to come to a definite conclusion as to whether a scheme for avoidance of tax is involved, the inquiry in this regard can only be of a limited nature. Thus, considered on the facts of this case, it is difficult to say *prima facie* that there is a scheme for avoidance of income-tax. Counsel for the applicant pointed out that in terms of the Treaty, the income would be the 'business income' of the applicant and would be taxable under the Statute in the USA. All ABC entities involved have separate corporate identities and legal existence. It is one thing to say that one can pierce the corporate veil in an appropriate case but the existence of a series of legal entities validly

incorporated under the relevant laws, cannot be ignored. There is also nothing illegal in one subsidiary dealing with another subsidiary. There is no case here that the transactions leading to the discounting of the promissory note are sham or illegal. When it is so, the transaction is to be tested in the light of Law Merchant wherever apt and the provisions of statute law wherever they apply.

Section 254 of Income-tax Act, 1961- Appellate Tribunal – Orders of

Where Tribunal had relied upon a decision of another Tribunal which had not been cited at time of hearing, order of Tribunal could not be recalled

Geofin Investment (P) Ltd. v. CIT, May 27, 2011 (DEL)

The petitioner submitted that the tribunal had erred in dismissing the application under Section 254(2) as the tribunal in its order, had referred to and relied upon decision of another ITAT Bench which had not been cited at the time of hearing.

The Delhi High Court held that there was no merit in the said contention. Under Section 254(2), a mistake apparent from the record can be rectified. The power is circumscribed and limited. There should be mistake which is apparent before the power can be exercised. This is a mandatory pre-condition.

The Tribunal in its order, referred to the controversy in question relating to disallowance made on account of short term capital loss and long term capital loss. The entire issue was examined on merits including the judgments relied upon the petitioner assessee. After examining the matter in detail, the tribunal allowed the appeal filed by the revenue. While allowing the appeal, the tribunal also referred to another decision of ITAT, Mumbai Bench. Reliance and reference to reasons stated in the said case could not be regarded as a mistake apparent from the record. It is not unusual or abnormal for Judges or adjudicators to refer and rely upon judgments/ decisions after making their own research. In view of the aforesaid, there was merit in the present writ petition and accordingly the same was dismissed.

Section 256 of the Income-tax Act, 1961- High Court – Reference to

Non-traceability of record, shortage of staff cannot be held to be sufficient cause for condoning department's delay in filing appeal

Commissioner of Income-tax v. Indian Hotels Co. Ltd, May 9, 2011 (SC)

Condonation of delay of 656 days in filing the appeal before the High Court was rejected. Explanation for the said delay were that; (i) due to circumstances beyond control, the appeal could not be filed in time; (ii) the case records were old and not traceable; (iii) procedural formalities were involved in the Department and the papers were to be processed through different officers in rank for their comments, approval, etc., and then the preparation of the draft of appeal memo, paper book and (iv) there were administrative difficulties such as shortage of staff. It was further submitted that the appellant had good chance of succeeding in the appeal and if the relief as prayed for was not granted, grave and irreparable loss would be caused to the revenue.

The Supreme Court held that the explanations did not make out a sufficient cause for condonation of delay in filing the appeal before the High Court. Therefore, the Special Leave Petition was to be dismissed.

Section 263 of the Income-tax Act, 1961 - Revision - Of orders prejudicial to interest of revenue

Where Commissioner while passing order under section 263 has given a specific direction that Assessing Officer should pass consequential orders within a period of three months but no consequent order was passed even after three years, time limit would be held to have expired

Commissioner of Income-tax, Delhi-IV v. Goyal M.G. Gases (P.) Ltd, February 23, 2011 (DEL)

Under section 263(1), the Commissioner is empowered to call for and examine the record of any proceeding under the Act and if he considers that any order passed by an Assessing Officer is erroneous insofar as it is prejudicial to the interest of the revenue. He may, after giving the assessee an opportunity of being heard and after making or causing to make such enquiry as he deems fit, 'pass such order thereon as the circumstances of the case justify', including an order enhancing or modifying the assessment, or cancelling the assessment and directing a fresh assessment. In view of this provision it is clear that the Commissioner may pass any order as the circumstances of the case justify.

Where the Commissioner, while passing the order under section 263, has given a specific direction that the Assessing Officer should pass the consequential orders within a period of three months approximately, this direction would certainly fall within the expression 'such order thereon as the circumstances of the case justify' appearing in section 263(1). The consequential order had not been passed for over a period of approximately three years and eight months. Where no period of limitation is prescribed then, in any event, a reasonable period of limitation ought to be adopted. The non-specification of a period of limitation does not mean that the Assessing Officer can wait interminably or for an infinite period before passing the consequential order. And, in the context of the direction given by the Commissioner for passing the consequential orders within three months approximately, a period of three years and eight months is certainly much beyond the reasonable period that could be allowed to

the Assessing Officer to pass the consequential order. Therefore, it was to be concluded that the time-limit for framing the consequential order had expired.

Rule 10B of the Income-tax Rules, 1962 read with Section 92C of the Income-tax Act, 1961 – Determination of arms length price under Section 92

Where (i) assessee manufactured all season wipers and snow wipers, which were exported to associated enterprise to be sold in the market of USA (ii) associated enterprise provided to assessee certain parts free of cost and manufacturing process of wipers does not require any advance technology (iii) associated enterprise also purchased such wipers from Chinese manufacturers, CUP method, would be the most appropriate method for determining Arm's Length Price [Assessment Year 2006-2007]

Clear Plus India (P.) Ltd. v. Dy. CIT, January 11, 2011 (ITAT-DEL)

The assessee manufactured all season wipers and snow wipers, which were exported to the associated enterprise which had given interest free unsecured loan of about Rs. 1.81 crores to the assessee on 31.03.2006, i.e., on the last date of concerned financial year. The associated enterprise also purchased such wipers from Chinese manufacturers. The assessee maintained invoices of Chinese goods purchased by the associated enterprise. The associated enterprise had provided to the assessee certain parts, being blister, flexer and boot free of cost. The manufacturing process of the wipers did not require any advance technology. The assessee had used CUP method to justify its sale price. An analysis was made in respect of all kinds of wipers with respect to the sale price of the assessee and the sale price of Chinese manufacturers to the associated enterprise. In this analysis the assessee added the price of blisters, flexer and boots to the price at which wipers were sold to the associated enterprise for the reason that Chinese manufacturers used their own parts in the process of manufacture. From the analysis, it was seen that the price charged by the assessee from the associated enterprise in respect of the wipers of the sizes of "11 to 24" was more than the price charged by the Chinese manufacturers. However, the position was reverse in respect of "26 and 28" all season wipers. In the case of snow wipers, the invoices raised by the assessee were of higher amounts than those of the Chinese manufacturers.

The main question was whether, CUP was the most appropriate method in the case of the assessee for determining arm's length price.

The Delhi Bench of Tribunal held that rule 10B prescribes the method for determine arm's length price by different methods. In case of CUP method, it is provided that the price charged or paid for property transferred

or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified. Such price is adjusted to account for difference, if any, between the international transaction and the comparable uncontrolled transactions or between enterprises entering into such transactions, which could materially affect the price in the open market. The adjusted price so obtained is to be taken as arm's length price.

In the instant case, goods were sold by the Chinese manufacturers in the USA market. The assessee had also sold the goods in U.S.A. market. Therefore, market conditions in the territory of sale were the same. In view thereof, the buyer in the USA market would be more concerned with quality and price rather than economic conditions prevailing in China and India.

CUP method is the most direct method for determining arm's length price. CUP method is a preferred method and it leads to more reliable results vis-a-vis the results obtained by applying transaction profit method. The focus is on the market in which products are acquired. The CUP method could validly be employed provided product comparability is established. Therefore, it would have been appropriate for the assessee to make the data of the associated enterprise available to the Assessing Officer, at least in respect of sale of Chinese and Indian wipers so as to establish the comparability. Nonetheless that by itself would not displace the CUP method, which is objective in terms of the purchase price of the associated enterprise. Accordingly, in the instant case, CUP method was the most appropriate method for determining arm's length price.

INDIRECT TAXES

Excise/Customs

Heading 8803 of the First Schedule to the Customs Tariff Act, 1975- Aircraft

No rulings is required on classification of imported parts of aircraft and ground handling equipment when same is agreed upon by supplier-importer and concerned Commissioner; exemption be available under Notification No. 39/36-Cus, dated 23-7-1996 on production of certificate procured from Ministry of Defence

AmSafe Services India Pvt. Ltd., In re, May 13, 2011 (AAR)

The applicant is a subsidiary company of AmSafe-UK. The applicant proposes to import and supply parts of aircraft and ground handling equipment to Hindustan Aeronautics Limited (HAL), a Public Sector Undertaking. The supplies to HAL from the Customs Port or from the private bonded warehouse shall be made against a custom duty exemption certificate (CDEC) provided to the applicant by HAL.

The applicant has claimed that the goods proposed to be imported by it for supplies to HAL are classifiable under heading 8803 of the First Schedule to the Customs Tariff Act, 1975 as parts of aircraft, even though based on the individual description of the goods, these may independently be otherwise classifiable under different headings of the said First Schedule. The applicant has also claimed that it is eligible for the exemption from basic Customs duty and additional Customs duty on such imported parts in terms of the entry at Serial No. 10 of Notification No. 39/96-Cus dated 23.7.1996 on the basis of Customs Duty Exemption Certificate (CDEC) made available to it by HAL.

The Authority for Advance rulings held that the Commissioner has since indicated vide its letter dated 12th April, 2011 that pursuant to the directions of the Authority the applicant had a meeting with the officers of the Department. Apparently the applicant has explained the basis adopted by the Department for the classification under HSN of the various parts proposed to be imported by the applicant. The Commissioner has informed through the Departmental Representative appearing in the proceedings that vide its letter dated 1st April, 2011, the applicant has revised the HSN classification of the goods which they intend to import and sell in India and, therefore, there were no disputed classifications. In view of the aforesaid developments and in view of the lack of detailed information before it, the Authority would not go into the merits of the classification of various items adopted by the Commissioner of Customs and accepted by the applicant.

Notification No. 39/96 exempts various goods of the description specified in the Table annexed to the Notification from the whole of the duty of customs leviable thereon under the First Schedule and the additional duty leviable thereon under Section 3 of the Customs Tariff Act, 1975 subject to the conditions specified in the corresponding entry of the said Table. Serial No. 10 *inter alia* exempts aircrafts, aircraft parts, aircraft engines and aircraft engine parts. The entry at S. No. 10 indicating the goods (covering aircrafts related goods) and conditions subject to which the exemption is available.

From the text of the operative part of notification 39/96-Cus dated 23.7.1996, it is observed that the scope of the exemption in the notification is not confined only to goods falling under a particular chapter or a heading of the First Schedule. All goods specified in the Table and falling anywhere in the First Schedule to CTA, 1975 would be eligible for the exemption subject to fulfillment of the conditions specified therein. Accordingly the applicant is eligible for the exemption in respect of aircrafts, aircraft parts, aircraft engines etc. specified against Serial No.10 subject to fulfillment of the corresponding conditions irrespective of the fact whether such goods are classified under heading 8803 or any other heading of the First Schedule to CTA, 1975.

The exemption in Notification No. 39/96-Cus. dated

23.7.96 are (i) is intended for imports by certain specified entities; (ii) only some of the entities are required to produce a certificate; (iii) the certificate has to be signed by different authorities for imports by different class of entities.

The exemption shall apply only if the conditions specified in column (3) against Serial No. 10 of the notification are complied with i.e. the applicant shall produce a duty exemption certificate showing the details of the purchase order placed by the Ministry of Defence and the quantity of items required to be imported to execute the order in accordance with the conditions. The duty exemption certificate shall also indicate the details of the purchase order placed on the foreign suppliers indicating the description and the quantity of the items as specified in the conditions of exemption. The exemption shall not be available if the duty exemption certificate is signed by the General Manager, Procurement Division, HAL and countersigned by its Managing Director. The exemption shall apply only if the certificate contains the prescribed information and is signed by an officer not below the rank of a Joint Secretary to the Government of India in the Ministry of Defence.

Service Tax

Section 65(12) of the Income-tax Act, 1961- Banking and other Financial Services

Leasing of locomotives, coaches and wagons for a short duration to a lessee on rent, bearing no correlation to either life of equipment or cost of equipment, would not be exigible to service-tax

RITES Ltd. In re, April 8, 2011 (AAR)

The applicant provides consultancy services in various facets of transportation like Railways, Highways, Airports, Urban transport, Ropeways etc. in India and abroad. The company intends to enter into business of providing locomotives, coaches, wagons, etc. under Operating Leasing Agreement in the domestic market. The criteria for that may be company to take locomotives either on operating lease or through outright purchase from Indian railways which in turn may be leased or sub-leased to the prospective clients in India.

The applicant has stated that it proposes to operate on dry lease of its locomotives, coaches and wagons etc. and dry lease is a leasing arrangement of equipment for definite periods with obligation on the lessee to return the leased article on the expiry of the term and pay rent as agreed to during the term of the agreement. This should not be considered a transaction that attracts liability for service-tax.

The Authority for Advances Rulings held that the definition speaks of "financial leasing service" including equipment lease or hire purchase. Financial leasing is indicated as meaning a lease transaction where four elements have to cumulatively exist including the payment of the lease amount being calculated as to cover the full cost of the asset together with the interest charges and the lessee being entitled to own the leased asset at the end of the period after making the lease payment.

A transaction of hire purchase contemplates the payment of the value of the equipment by the hirer and transfer of title to the hirer at the end of the transaction. In fact, it is said that generally in a transaction of equipment lease or hire purchase, it is the hirer who identifies the equipment to be leased/purchased and determines the value to be paid and all that the lessor has to do is to pay the money for the equipment and negotiate with the hirer to pay rental or instalments to be fixed for use of the equipment taking note of the price paid by the lessor and the interest on the investment made by him. The term of the lease (or the period) is also generally chosen by the lessee. Therefore, when clause (12) of Section 65 dealing with "banking and other financial services" takes in financial leasing services including "equipment leasing" and "hire purchase"; the natural way of understanding the transactions of equipment leasing and "hire purchase" is as transactions analogous to "financial leasing services", in the definition of which they are included. Actually, hire purchase even otherwise falls under that category.

It appears to be logical to understand the expression "equipment leasing" as having an element of financing like a "hire purchase" or a "financial leasing service" and it cannot be understood as taking in a mere leasing of an equipment for a short duration unrelated to the life and cost of the equipment and without the intention of giving the lessee the option to purchase the equipment on the expiry of the term or on fulfilling its obligation to pay the

hire charges (which takes in the value of the equipment itself) in instalments in terms of the transaction.

Section 65(12) of the Act defines banking and other financial services. The intention manifested is to deal with financial services. Whether it is financial services rendered by a banking institution or by a non-banking institution, those will fall under the definition. Originally, in addition to a banking company or a financial institution including a non-banking financial company, any other body corporate rendering such a service was also included. With a view to rope in other commercial concerns undertaking the business of rendering financial services, the definition was amended to include them. The services remained banking and other financial services. Financial services included financial leasing services and that included equipment leasing and hire purchase.

The thrust of the definition was always on financing as a service, whatever form it took and whoever undertook it. It is, therefore, easier to understand the expression "equipment leasing" as a leasing involving financing with a view to enable the lessee to acquire title to the equipment at the end, and that, that alone is covered by the definition and not a lease of an equipment simplicitor. Unless financing is involved, the leasing of equipment would not come within the purview of Section 65(12) of the Act.

In the instant case the equipment is purchased or taken on lease by the applicant. It is proposed to be granted on a lease for a short term (in fact, on behalf of the petitioner it is submitted that it was proposed to grant a lease for two years only). The lease amount or rent is to bear only a small proportion to the cost of the equipment. The term of the lease has no correlation with the life of the equipment which on the expiry of the short term, would revert to the control of the applicant. The subject matter of the lease was to be in the possession and effective control of the lessee during the term of the lease. There was no intention to convey the title to the equipment to the lessee on the expiry of the term or to confer on the lessee an option to purchase the equipment. It appears to be a simple case of hiring of locomotives, coaches/wagons for a short duration on a rent to be paid by the lessee who was entitled to have the equipment under its control and risk during the term of the lease. Such a transaction cannot come within the purview of "financial leasing services" contained in Section 65(12) of the Act.

Since exclusive possession and effective control of the equipment is to be transferred to the lessee during the term of the lease, section 65(105)(zzzzj) cannot also be attracted. The proposed leasing of the locomotives coaches/wagons by the applicant for a short duration to a lessee on a rent, and the term of rent bearing no correlation to either the life of the equipment or the cost of the equipment, same would not be exigible to service-tax under the Finance Act, 1994 on the basis of the definition in Section 65(12) of the Act.

Section 66A of the Finance Act, 1994, read with Sections 51 and 53 of the SEZ Act, 2005- Services received from outside India

Services of maintenance, repair and overhauling services provided to domestic and international airlines in SEZ are taxable; no exemption is provided under SEZ Act

MAS-GMR Aerospace Engineering Company Ltd, In re, May 13, 2011 (AAR)

The applicant is a joint venture company of GMR, Hyderabad International Airport Limited, Hyderabad and Malaysian Aerospace Engineering, SDN-BHD, Malaysia. The applicant has obtained a registration as a co-developer of an aviation specific SEZ adjacent to the Hyderabad Airport. The applicant either through itself or its 100 per cent subsidiary or by a Special Purpose Vehicle (SPV) has proposed to set up a unit within the SEZ. The applicant has proposed to provide maintenance, repair and overhauling (MRO) facilities to domestic as well as foreign aviation entities. The applicant proposes to enter into a contract with an overseas entity located in Singapore who will procure contracts for MRO services from domestic and foreign airlines. The overseas entity will sub-contract to the applicant the contract for MRO services which will be carried out in the SEZ. The applicant will be paid in convertible foreign exchange by the overseas entity. The applicant also proposes to enter into direct contracts with domestic and foreign airlines who will pay the applicant in convertible foreign exchange.

The applicant proposes to carry out the entirety of the MRO services within the SEZ. According to the applicant the activity of repair gets concluded when the repair is carried out on the aircraft. Therefore, the service is received by the recipients as soon as the repair activity is carried out inside the SEZ. The consumption of the service is also therefore simultaneous.

The authority for advance rulings on the issue whether SEZ's are outside customs territory of India held that where the exempted goods/services entered into a SEZ are not utilised for authorised operations or are not duly accounted for, penal action can be taken against the entrepreneur or developer *inter alia* under the Customs Act, 1962 and other Customs Laws. In other words, Customs laws have been made applicable to SEZs in the SEZ scheme itself under specific situations. This provision complements the provisions of sub-section (1) of Section 53 of the SEZ Act and is a confirmation that SEZs have been declared as being outside the Customs territory of India for a specified purpose only that is, undertaking authorised operations.

A reference is also invited to Section 26 of the SEZ Act which lists out the exemptions from Customs and Excise duties for goods moving in and out of SEZ. If an SEZ were really deemed to be a territory outside India as the applicant would like to believe there was apparently

no need for such an expansive list of exemptions & concessions. Infact there was no need to exempt goods from customs and excise duties under Indian laws when such goods are intended to be supplied to foreign lands. Likewise there was no need for granting exemptions under Section 7 of the SEZ Act from payment of taxes, duties or cesses under 21 different fiscal statues listed in the First Schedule to the Act if SEZs were to be deemed to be territories outside India. Consequently all enactments (whether relating to fiscal levies, labour laws, banking laws or any other law) which apply to the territory of India apply in equal measure to the notified areas of special economic zones as well. If a particular law is applied to SEZs with modifications (the Income Tax Act, 1961 applied to SEZ under Section 27 of the SEZ Act), it cannot lead to an inference that other laws which may not have been specifically mentioned in the SEZ Act have no application to SEZs All central laws apply to SEZs with modifications or exceptions, if any, as provided in the SEZ Act itself or in rules made thereunder.

Provision of Section 51 of the SEZ Act relating to the said Act having an overriding effect would need to be invoked only if any inconsistency is noticed between the provisions of the SEZ Act and any other law for the time being in force.

Section 64 of the Finance Act provides that Chapter V of the Act extends to the whole of India except the State of Jammu and Kashmir. Services provided to and from an entity in a SEZ are provided from India. Section 53(1) of the SEZ Act does not make the Finance Act, 1994 inapplicable to a SEZ. In the absence of any inconsistency there is no need to invoke section 51 of the SEZ Act.

Section 66A of the Finance Act, 1994 provides for levy of service tax under certain specified situations on services received from outside India. The applicant has claimed that since the MRO services are provided in a SEZ which according to him is outside India no such tax is leviable under the said provision. However, as discussed in the preceding paragraphs SEZs are deemed to be outside the customs territory of India only for undertaking authorised operations; all other enactments are applicable to the operations carried out in the SEZs. The MRO services would therefore be performed within the territory of India and Section 66A will have no application in the context of these activities. The services provided by the applicant would be taxable under Section 66 of the said Finance Act, 1994.

The aforesaid MRO services provided by the applicant cannot also be considered as export of taxable services under the Export of Services Rules, 2005 since in terms of clause (ii) of Rule 3 (1) of the Export of Services Rules, services specified in sub-clause (zzg) of clause (105) of Section 65 of the Finance Act shall be considered as export only if such services are performed outside India. SEZs being part of India, performance of such services in the SEZs does not entitle them to be categorized as exports of taxable services.

It was to be concluded that:

(i) Service tax is applicable on the services rendered by the applicant to the overseas entity for contract with:- (a) Domestic airlines who operate domestic flights to India; (b) Domestic airlines who operate international flights; and (c) Foreign entities who operate international flights.

(ii) Service tax is applicable on the services rendered by the applicant directly to: (a) Domestic airlines who operate domestic flights to India; (b) Domestic airlines who operate international flights; and (c) Foreign entities who operate international flights.

(iii) Service tax will be chargeable on the services rendered within the SEZ unless specifically exempted under the SEZ Act or under the Finance Act, 1994 or any Rules or Notifications there under. There is no such exemption presently available in respect of MRO services proposed to be provided by the applicant.

(iv) MRO services proposed to be carried on by the applicant will be chargeable to service tax on an interpretation of Section 66A of the Finance Act, 1994 read with Rule 3(ii) of the Import of Service Rules

(v) MRO services rendered to the overseas entity for: a) Domestic airlines who operate domestic flights to India; (b) Domestic airlines who operate international flights; and (c) Foreign entities who operate international flights. will not qualify as export of services under the Export of Service Rules,2005.■