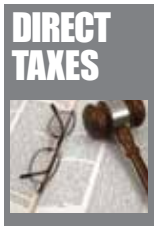
Legal Decisions[1]



Income Tax Act

LD/63/62

CIT-I

vs.

M/s Malibu Estate Ltd.

18th March, 2015 (New Delhi HC)

[Assessment Year 2007-2008]

Accounting Standard 7–revenue recognition as Percentage Completion or Project Completion

Given that Project Completion Method was permitted in the earlier years by the Revenue, the rule of consistency ought not to be departed from by the Revenue by invoking the Percentage Completion Method for the year under consideration

The assessee carried on business as a colonizer and real estate developer and it developed a colony known as 'Malibu Town' in Gurgaon. For revenue recognition, the assessee had consistently followed the project completion method and in the earlier years, this method was accepted by the Revenue and deemed to be the most appropriate for the activity in question.

The assessing officer in the year under consideration felt that the appropriate method of accounting for revenue recognition was AS-7 supported by the Institute of Chartered Accountants of India and accordingly, the assessing officer added deemed sales in respect of 22 properties of the assessee.

The High Court observed that both the project completion method and percentage completion method can achieve the same result and further, took cognisance of the Hon'ble Supreme Court's decision in the case of *CIT vs. Balahari Investment Pvt. Ltd. (2008) 299 ITR 1* establishing that the project completion method was an appropriate method. The High Court opined that the principle of consistency ought not to be departed from in this case by the Revenue and accordingly, it dismissed the appeal of the Revenue.

LD/63/63

Sri Y. Rathiesh

vs.

The Commissioner of Income Tax–I, Visakhapatnam

6th August, 2014 (AP)

Section 198 of the Income-tax Act, 1961 – Credit of tax deducted at source

Once cash system is followed and income is not offered to tax in the year, the assessee cannot be permitted to take credit of the tax deducted at source in that year. Further, the said tax deducted at source should be treated as income under section 198 of the Income-tax Act

The assessee, a Managing Director of M/s. A. P. Tanneries Limited ('the Employer'), gave loans to the Employer and one other company. While the Employer was just showing the accumulated interest in its books without actually paying the interest to the assessee, the other company paid interest on the loan to the assessee regularly. The assessee adopted a hybrid system of accounting and offered the interest income from the Employer on cash basis, whereas, offered the interest income from the other company on mercantile basis. However, the assessee claimed benefit of the entire Tax Deducted at Source (TDS), which was including the tax withheld by the Employer.

The Revenue contested that though it is permissible for an assessee to adopt dual method for the same return, the assessee cannot claim the benefit of TDS in its entirety and at the same time refuse to pay tax on the corresponding interest.

The High Court observed that the assessee can adopt both the systems of accounting for different components in one and the same return and confirmed that once cash system is adopted for a particular component, the liability to pay tax arises only when the concerned amount is received as income. However, the High Court opined that the assessee cannot be permitted to blow hot and cold at one and the same time and therefore, the assessee cannot be permitted to use the TDS credit to cover other amounts even while refusing to show the amount of interest in his return. Further, the High Court held that as the amount of TDS becomes incapable of being adjusted or counted towards tax payable, it acquires the character of income as per Section 198 of the Act. Accordingly, the High Court held that the assessee was not permitted to give credit to the amount representing the TDS as tax and on the other hand, it shall be treated as an income for the concerned assessment year.

LD/63/64

Taparia Tools Ltd.

vs.

Joint Commissioner of Income Tax Special Range-1, Nashik

23rd March, 2015 (SC)

Section 36(1)(iii) of the Income-tax Act, 1961– interest expenditure on debentures

The assessee making the payment of interest upfront

[1] *Contributed by CA. Sahil Garud and ICAI's Editorial Board Secretariat, Indirect Tax Committee, Committee on Banking, Insurance and Pension, Committee on International Taxation.*

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to the debenture holders is allowable as a deduction in the first year itself though the life of the debentures is of five years despite of the accounting treatment.

The assessee had issued non-convertible debentures, where two options as regards payment of interest thereupon were given to the subscribers/debenture holders. The debenture holders could either receive interest periodically *i.e.* every half yearly @ 18% p.a. over a period of five years or else, the debenture holders could opt for onetime upfront payment of ₹55 per debenture. In the second option, ₹55 per debenture was to be paid immediately as upfront on account of interest. Two debenture holders opted for one time upfront payment towards interest and these two debenture holders were paid interest accordingly.

The assessee followed Mercantile System of accounting and the upfront payment of interest on debentures was written off in the books of accounts over a period of five years. However, for the purposes of Income-tax Act, the assessee had claimed deduction of revenue expenditure on account of upfront payment of interest to two of its Debenture holders in the A.Y. 1996-97 and 1997-98. The assessee contended that assessment should be made in accordance with the provisions of Income-tax Act and not on the basis of entries in the books of accounts and the said deduction was allowable under provisions of Section 36(1)(iii) of the Income-tax Act as all the conditions thereof was fulfilled.

The assessing officer treated the interest payment as 'deferred revenue expenditure' to be written off over a period of five years. In the assessment years under consideration, the assessing officer allowed only 1/5th of the payment of total interest made, though the entire payment was made upfront. On appeal to the High Court by the assessee, the High Court applied the principal of 'Matching Concept' and dismissed the appeal.

The Supreme Court held as under:

The deduction under Section 36(1)(iii) of the Income-tax Act relates to the amount of interest paid in respect of capital borrowed for the purpose of business or profession and the assessee is entitled to full amount of deduction on account of interest in which it is actually paid. Once the genuineness is proved and the interest is paid on the borrowing, it is not within the powers of the AO to disallow the deduction either on the ground that interest is unreasonably high or that the assessee had himself charged a lower rate of interest on the monies which he lent.

By allowing only 1/5th of the upfront payment actually incurred, though the entire amount of interest is actually incurred in the very first year, the AO treated both the method of payment at par, which was unsustainable.

The High Court had erred in applying the 'Matching Concept' and further, the only aspect which

needed examination was as to whether provisions of Section 36(1)(iii) read with Section 43(iii) were satisfied or not. There is no concept of deferred revenue expenditure in the Income Tax Act except under the specified section, *i.e.*, where amortization is specifically provided, such as Section 35D of the Act.

The moment second option was exercised by the debenture holder to receive the payment upfront, liability of the assessee to make the payment in that very year, has arisen. Further, in the instant case, the liability was also quantified and discharged as well in that very accounting year.

The normal rule is that revenue expenditure is to be allowed in the year in which it is incurred. If the assessee claims that expenditure in that year, the Revenue cannot deny the same. However, in those cases where the assessee wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of 'Matching Concept' is satisfied, which upto now has been restricted to the cases of debentures.

The assessee was in consonance with the provisions of the Act which permit the assessee to claim the expenditure in the year in which it was incurred, merely because a different treatment was given in the books of accounts cannot be a factor which would deprive the assessee for claiming the entire expenditure as a deduction.

LD/63/65

Queen's Educational Society.
vs.
Commissioner of Income Tax
16th March, 2015 (SC)

Section 10(23C)(iiiad) of the Income-tax Act, 1961

When a surplus is ploughed back for educational purposes, the educational institution exists solely for educational purposes and not for purposes of profit. Relevant factors are (a) predominant object test, (b) whether institution merely makes surplus by imparting education or activities are being carried "for profit"' and (c) whether generating surplus is incidental to educational activity.

The assessee Queen's Educational Society was established with the sole object of imparting education and therefore claimed exemption u/s 10(23C)(iiiad) for AY 2000-01 and 2001-02. However, AO rejected assessee's claim. However, the CIT(A) and ITAT ruled in assessee's favour. The Hon'ble Uttarakhand High Court set aside the ITAT's judgment. The assessee preferred an appeal before the Hon'ble Supreme Court.

The Hon'ble Supreme Court recorded about satisfaction of three main requirements regarding Section 10(23C)(iiiad) being (a) the educational institution must exist solely for educational purposes (b) it should not be for purposes of profit and (c) the aggregate annual receipts of such institution should not exceed the amount or annual receipts as may be prescribed *i.e.* 1 crore (as prescribed by Rule 2CA).

Reliance was placed upon pronouncements in the case of *CIT vs. Surat Art Silk Cloth Manufacturers' Assn.* [(1980) 121 ITR 1], *Aditanar Educational Institution vs. ACIT* [(1997) 224 ITR 310] and *American Hotel & Lodging Assn. Educational Institute vs. CBDT* and summed up the law on Section 10(23C) (iiiad) and (vi) as:

(1) Where an activity of education is primarily for educating persons, the fact that it makes a surplus does not lead to the conclusion that it ceases to exist solely for educational purposes and becomes an institution for the purpose of making profit.

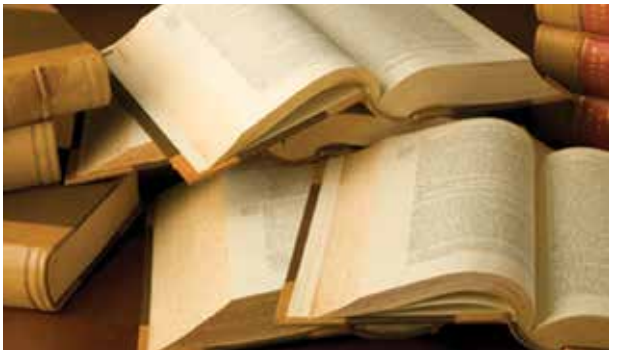
(2) The predominant object test must be applied–the purpose of education should not be submerged by a profit making motive.

(3) A distinction must be drawn between the making of a surplus and an institution being carried on "for profit". No inference arises that merely because imparting education results in making a profit; it becomes an activity for profit.

(4) If after meeting expenditure, a surplus arises incidentally from the activity carried on by the educational institution, it will not be cease to be one existing solely for educational purposes.

(5) The ultimate test is whether on an overall view of the matter in the concerned assessment year, the object is to make profit as opposed to educating persons.

The Hon'ble Supreme Court observed that reliance was placed upon by the Uttarakhand High Court on the judgment in the case of *Municipal Corpn. of Delhi vs. Children Book Trust* and *Safdarjung Enclave Educational Society* [(1992) 3 SCC 390] was out of context since it was in relation to property tax. The Supreme stated that "High Court has erred by quoting a nonexistent passage from an applicable judgment, namely, Aditanar and quoting a portion of a property tax judgment which expressly stated that rulings arising out of the Income-tax Act would not be applicable".



With reference to Uttarakhand High Court's reliance on Supreme Court ruling in case of Aditanar, the Hon'ble Supreme Court recorded that it is clear that the High Court did not apply its mind independently. What has been copied is one paragraph from the Supreme Court judgment in Aditanar followed by a paragraph of faulty reasoning by the Assessing Officer and the said faulty reasoning of the Assessing Officer has been wrongly said to be the law laid down by the Apex Court.

Supreme Court further relied on judgment in the case of *S.RM.M.CT.M. Tiruppani Trust vs. CIT* [(1998) 2 SCC 584] and observed that when a surplus is ploughed back for educational purposes, the educational institution exists solely for educational purposes and not for purposes of profit. The Supreme Court recorded that the Uttarakhand High Court's final conclusion that if a surplus is made by an educational society and ploughed back to construct its own premises would fall foul of Sec 10(23C), is ignorant of the language of the Section and also ignorant of the tests laid down in the Surat Art Silk Cloth case, Aditanar case and the American Hotel and Lodging case. Ruling in favour of the assessee, the Supreme Court held that reasoning of the ITAT order (set aside by the High Court) is more in consonance with the law laid down by this Court, and approved its decision.

LD/63/66

Commissioner of Income Tax, Gauhati & Ors.

vs.

M/S. Sati Oil Udyog Ltd & Anr

24th March, 2015 (New Delhi)

Retrospective amendment in Section 143(1A) of the Income-tax Act, 1961–constitutional validity

On the constitutional validity of retrospective amendment to Section 143(1A), the Supreme Court decided that the clarificatory amendment is constitutionally valid and is applicable to the tax evaders.

The assessee filed its annual return for assessment years 1989-1990 and 1991-1992 showing a loss. The assessing officer levied an additional tax under Section 143(1A) for the two assessment years by applying the amendment to section 143(1A) retrospectively. On writ petitions, both the single bench and division bench of the Gauhati High Court held that the retrospective effect given to the amendment would be arbitrary and unreasonable in as much as the provision, being a penal provision, would operate harshly on assessees who have made a loss instead of a profit, the difference between the loss showed in the return filed by the assessee and the loss assessed to income tax having to bear an additional income tax at the rate of 20%.

The Revenue argued that the amendment made to Section 143(1A) with retrospective effect was merely clarificatory and even without such amendment, the same position would obtain qua losses as would obtain *qua* profits inasmuch as the expression "income" would comprehend both profit as well as losses. The Revenue placed reliance on the decisions of the Supreme Court in the case of *Commissioner of Income Tax Central, Delhi vs. Harprad & Company Pvt. Ltd. (1975) 3 SCC 868* and *CIT Joint Commissioner of Income tax, Surat vs. Saheli Leasing & Industries Ltd. (2010) 6 SCC 384* to contend that the word "Income" would include within it both profits as well as losses. The Revenue contended that since object of section 143(1A) is to prevent tax evasion; the said section would have to be read in the light of the aforesaid object.

Further, the Revenue highlighted that the reason for the subject amendment was decisions of the Delhi High Court in the cases of *Modi Cement Limited vs. Union of India (1992) 193 ITR 91* and *JK Synthetics Limited vs. Asst. Commissioner of Income-tax (1993) 2000 ITR 594* and the decision of the Allahabad High Court in the case of *Indo Gulf Fertilizers & Chemicals Corp. Limited vs. Union of India (1992) 195 ITR 485*, which held that losses were not within the contemplation of section 143(1A) prior to its amendment.

The Supreme Court held as under:

Object of Section 143(1A) is the prevention of evasion of tax. Taking a cue for the decision of the Supreme Court in the case of *K. P. Varghese vs. ITO (1982) 1 SCR 629*, section 143(1A) can only be invoked where it is found on the facts that the lesser amount stated in the return filed by the assessee is a result of an attempt to evade tax lawfully payable by the assessee. The burden of proving that the assessee has so attempted to evade tax is on the revenue by establishing facts and circumstances from which a reasonable inference can be drawn that the assessee has, in fact, attempted to evade tax lawfully payable by it.

Subject to the aforesaid construction of Section 143(1A), the Supreme Court upheld the retrospective clarificatory amendment of the said section and allowed the appeals.

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LD/63/67

ACB India Limited (Formerly M/S Aryan Coal Benefications (P) Ltd.)

vs.

Assistant Commissioner of Income Tax

24th March, 2015 (DEL)

Section 14A r/w Rule 8D of the Income-tax Act, 1961

Value of 'tax exempt investments' only to be considered while computing the "average value of investment" under Rule 8D(2)(iii), instead of 'total investment'.

The assessee, ACB Limited, engaged in the business of coal preparation *i.e.* beneficiation of coal, transportation, loading of coal, and related activities, reported an exempt income of ₹18,26,360/- amongst other heads of income. Assessee's claim of "no disallowance should be made as no expenditure is incurred" was rejected by the AO and hence, the first condition of applicability of Section 14A was fulfilled. AO applied Rule 8D by taking into consideration the total quantum of interest other than that invested, under Section 14A in terms of Rule 8D, and arrived at the said figure after multiplying it with the result of the average value of investments and over average value of assets derived by him. The AO, thus added back ₹19,96,242/- under Section 14A by taking into consideration the entire amount of investment of ₹38,61,09,287/-.

The CIT(A) on analyzing the records, recorded that the amount of investment attributable to dividend as on 31.03.2008 was only ₹3,53,26,800/- and not the amount noted by the AO. Accordingly accepting the basis of calculation of AO, the CIT(A), applying the provisions of rule 8D(2)(iii), directed a disallowance of 0.05% of the amount determined to be the average investment.

Revenue then preferred an appeal before ITAT. ITAT affirmed the calculation of AO in terms of Rule 8D and restored his order. Aggrieved, the assessee preferred an appeal before the Hon'ble Delhi High Court.

The High Court observed that the AO, instead of adopting the average value of investment of which income is not part of the total income i.e. the value of tax exempt investment, chose to factor in the total investment itself. High Court remarked that even though the CIT(A) recorded the average value of investment, the AO instead of correcting the error preferred to apply his own equations.

On considering the above reasoning's, the findings of ITAT and lower authorities were set aside and the High Court consequently directed the AO to substitute the amount of ₹38,61,09,287/- (total investment) with ₹ 3,53,26,800/-(average investment) to arrive at the exact disallowance of 0.05% by allowing the assessee's appeal. The High Court therefore reversed the decision of ITAT and allowed assessee's appeal, and directed the AO to calculate tax effect consequently.

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LD/63/68

M/s Yash Society

vs.

Chief Commissioner of Income Tax

12th March, 2015 (BOM)

An Institution ostensibly for philanthropic purpose and in reality for profit, would not qualify for deduction under Section 10(23C) of the Income-tax Act, 1961.

The present petition was filed against the impugned order rejecting the petitioner's (hospital) application for grant of approval under section 10 (23C)(via) of the

Income-tax Act, 1961 (Act) for A.Y. 2009-10 on the ground that the primary requirement of Section 10 (23C) that the petitioner was established for philanthropic purposes did not get fulfilled as found evident from the creation of capital assets from the surplus funds. It was the case of Revenue that during the relevant assessment years, there was a significant increase in asset base along with generation of surplus showing systematic generation of profits from the activities of the trust and the increase in assets helped the petitioner to generate more income and profits.

Section 10 (23C) provides for a twin test: firstly, the purpose for which the trust is existing, which should be solely an existence for a philanthropic purpose and secondly it should not be for profit.

In the instant case, it was undisputed that the petitioner was earning surplus revenue from its activities and that the assets were increasing. This surplus revenue was utilised for acquisition of assets which was capable of generating more income.

The High Court held that:

An Institution ostensibly for philanthropic purpose and in reality for profit, would not qualify for deduction under Section 10(23C).

Service Tax

LD/63/69

M/s Madhura Coats Pvt. Ltd.

vs.

Union of India

11th March, 2015 (Kant)

A sanctioned refund of service tax cannot be denied when stay application is filed alongwith appeal against Appellate Authority's order dismissed by CESTAT. Single Judge's order of interest payment @ 12% p.a. on refund upheld, however Revenue was given the liberty to seek expedition of appeal before CESTAT

The issue involved was whether the assessee was liable to service tax for the period September 10, 2004 to December 31, 2004, where, service tax was paid by a non-resident person. The Commissioner of Central Excise subsequently allowed assessee's claim for refund of service tax for said period. Thereafter, assessee filed another refund application, which was allowed to the extent assessee was found entitled but a direction was given to credit the same to the Consumer Welfare Fund in terms of Section 11B(2) of Central Excise Act, without making the payment to assessee on the ground that such payment would amount to unjust enrichment.

Aggrieved by the said order, assessee appealed before Commissioner (Appeals) who allowed assessee's claim and amount of service tax deposited was ordered to be paid to assessee. Consequently, Revenue filed an appeal before the tribunal along with an application for staying the implementation of appellate order passed by the Commissioner; however, same was rejected by the tribunal. Despite rejection of such stay application, service tax was not refunded to the assessee. Hence, a writ petition was filed by assessee before the Karnataka High Court, which was disposed of with a direction that assessee would be entitled to interest at 12% p.a. from date of deposit upto the date of payment, instead of 6% p.a. as prescribed u/s 11BB of Central Excise Act. However, there was no direction in the judgement for payment of service tax deposited by assessee. Aggrieved again, the assessee preferred the instant appeal.

Revenue contended that if assessee's instant appeal was allowed and amount of service tax was refunded to assessee, Revenue's appeal which was pending before the tribunal would become infructuous. Revenue therefore argued that assessee's claim for refund ought to be rejected. Rejecting this contention, the High Court remarked that *"If the contention of the learned counsel for the respondent is accepted, then the filing of the stay application by respondent in its appeal before the Tribunal would become meaningless and so would be the rejection of the stay application"*.

The High Court observed that the mere fact that the stay application of Revenue was rejected by the tribunal would mean that order of Appellate Authority needs to be given effect to. Further the Revenue had also not challenged Tribunal's order dismissing stay application. The High Court stated that *"If the contention of the learned counsel for the respondent is accepted that since the appeal is pending before the Tribunal, the refund should not be directed, then it is not understood that why at all the respondent had filed an application for grant of stay before the Tribunal."*

The High Court held that Revenue was fully aware that it was liable to refund the service tax amount because once its stay application had been rejected; appellate authority's order directing refund ought to be implemented, as tribunal's order had become final. Therefore, without interfering with Single Judge's observation w.r.t. payment of interest @ 12%, The High Court directed refund of service tax deposited by assessee. The High Court, therefore allowed assessee's appeal as well as writ petition directing implementation of Commissioner (Appeals) order of refund. However, liberty was granted to Revenue to file application for expeditious disposal of appeal by the Tribunal and it was ordered that the impugned refund would be subject to final orders of CESTAT.

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LD/63/70

Vikram Hospital Pvt Ltd

vs.

Commissioner of Central Excise, Customs and Service Tax (Mysore) (2015)

Assessee must be given an opportunity to file Stay application before rejecting the appeal straight away

The appellants had filed the Stay application after a lapse and gap of about seven (7) months from the date of their filing of the ST-4 application. The appellant's request for waiver of pre-deposit and stay against recovery had been rejected by the Commissioner, on the ground that the application was filed belatedly and further since the appellant had not discharged the entire amount of penalty, the appeal itself has been rejected.

The CESTAT Bangalore held that the settled legal position is that even if a stay application has not been filed, before rejecting the appeal the appellant should be given an opportunity to file such an application and consider the same rather than rejecting the appeal. In this case the application for waiver of pre-deposit filed has been rejected on the ground of delay without citing any legal provisions to support the observation of the Commissioner. In the absence of any legal provision prescribing the time limit for filing stay application and having regard to the fact that appellant had filed application for waiver of pre-deposit before the appeal was being considered and personal hearing was granted, I consider that the Commissioner's decision to reject the appeal as not maintainable cannot be sustained. Accordingly the impugned order is set aside and the matter is remanded to the learned Commissioner to consider the application for waiver of pre-deposit in accordance with law.

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LD/63/71

M/s Larsen And Toubro Ltd

vs.

CST

(Delhi) (2015)

Works Contracts are liable to Service Tax even before June 1, 2007-Three Technical Members differ with two Judicial Members -Five Member Bench of CESTAT holds in favour of Revenue by 3-2 majority

The Five Member Bench has now issued the order on this important issue. Interestingly, the Bench is divided in the ratio of 3:2 with the President and the other Judicial Member holding that prior to 01.06.2007 no service tax is leviable, that the Delhi High Court ruling in G D Builders case is in error on the principles of per incurium and subsilentio and overruling the CESTAT larger Bench decision in case of BSBK Pvt. Ltd. However, the three Technical Members differed with the judicial Members and were unanimous in holding the contrary. Though the issue has been decided in favour of revenue by 3:2 ratio, it

is undisputedly, the findings of the President of CESTAT which makes an interesting reading and it is like a text book on various legal principles, the Constitution of India and the distribution of powers of taxation between the Union and the States and how to interpret the precedent decisions.

LD/63/72

Commissioner of Central Excise & Service Tax
vs.
Hyundai Motor India Engineering (P) Ltd
(2015)

Export of services-Relevant date for claiming refund under Rule 5 of CENVAT Credit Rules-No error in order of CESTAT holding that relevant date is date of receipt of consideration

The assessee is a 100 % export oriented unit (EOU) registered under Software Technology Parks of India (STPI) for export of computer software and Information Technology Enabled Services (ITES). Its basic area of work is providing product designs, modeling and analysis in car engineering etc. The assessee had entered into agreement with two car manufacturers in South Korea for providing design and analysis services. The assessee filed several refund claims for the period from December 2007 to August 2009 on a quarterly/monthly basis. In all there are 12 refund claims involved. All these refund claims have been rejected by all the authorities below. Therefore, the assessee became unsuccessful right from the adjudicating authority till the first appellate authority, but the assessee was successful in persuading the learned CESTAT and got the relief, naturally the judgment of the lower authority was reversed. Three points were formulated by the learned CESTAT which are as follows:

i. "Whether relevant date specified under Section 11B of Central Excise Act, 1944 is relevant for refunds under Rule 5 of the CENVAT Credit Rules, 2004 read with Notification No.05/2006-CE (NT) dated 14.03.2006?
ii. Eligibility of services as input services for grant of refund.
iii. Whether CENVAT credit availed on the input services before payments for the services received?"

The Hon'ble High Court held that:

It appears the learned CESTAT decided the first issue relying on the judgment of the Bombay Bench of the Tribunal in the case of *C.C.E., Pune -I vs. Eaton Industries P. Ltd. 2011* (22) S.T.R. 223 (Tri.- Mumbai) 2011-TIOL-166-CESTAT-MUM to hold that the relevant date for calculating the time limit for grant of refund would be the date of receipt of consideration and not the date when the services were provided. If the date of receipt of consideration is reckoned then the claims are perfectly

within time limit, and if date of rendering services is taken then obviously most of the claims would be time barred. The Tribunal has held that the relevant date would be the date of receipt of consideration and, when such decision has not been appealed against nor it has been reversed or overruled by any superior forum, the said judgment is binding. The learned CESTAT recorded no contrary decision. However, learned counsel for the appellant - Revenue asserts before us that a contrary decision has been rendered in the year 2014 by the Bombay Bench of the Tribunal. Unfortunately that judgment referred was neither produced before the Tribunal nor before us and even case number or cause title of the same could not be informed by the learned counsel appearing for the appellant. We, therefore, do not find any illegality or infirmity with the order of the learned CESTAT and we agree with the decision rendered by it on the issue.

As regards admissibility of CENVAT credit on construction service, the learned CESTAT relied on the decision in the case of *Infosys Ltd. vs. C.S.T., Bangalore* 2014-TIOL-409-CESTAT-BANG)wherein the definition of 'input services' has been considered and admissibility of CENVAT credit in respect of various services and the rationale to take such a view has been discussed. Therefore, on the prayer of the learned counsel for the assessee that the matter can be remanded for calculating the refund claim, following the decision of the Tribunal in the case of Infosys Ltd. (*supra*), the learned CESTAT remanded the matter to the original adjudicating authority, and it is not argued that the aforesaid decision is appealed against or reversed. In view of the aforesaid adjudication, we do not find any infirmity or illegality in the judgment of the learned Tribunal to hold otherwise, because it is a pure case of remand to consider admissibility of CENVAT credit in respect of various services. We do not find any infirmity in the order of the learned Tribunal.

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LD/63/73

Automotive Manufacturers Private Ltd

vs.

Commissioner of Central Excise & Customs

(2015) (MUM)

Authorised service station-Section 67 mandates levy of ST on value or consideration received for rendering services-any consideration received for supply of goods is not covered within its scope: CESTAT

The appellant is an authorised dealer of Maruti Udyog Ltd., and are registered with the department as an authorised service station for Maruti cars and they have been discharging service tax liability on servicing/repairing of the vehicles undertaken by them.

While reparing or servicing of the vehicles, they also sometimes used parts on which sales tax/VAT liability is discharged. The parts and components are procured from M/s Maruti Udyog Ltd. and they have lifted these parts from the warehouse/depots of Maruti Udyog Ltd. For bringing these parts to their service station, they have to incur octroi and other local taxes, freight, loading and unloading charges *etc*. Therefore, while selling these parts to the clients as part of servicing activity, they include the cost incurred by them towards freight, loading, unloading *etc*. as 'handling charges' and pay sales tax on the goods on the value inclusive of handling charges. Sometimes they sell the parts as such without undertaking any service/repair activity and in such cases also they collect handling charges and discharge the sales tax liability.

The jurisdictional CE authorities at Nagpur were of the view that these handling charges collected by the appellant are liable to service tax since a composite activity of sale as well as service has been carried out. *Vide* an order-in-revision the CCE, Nagpur confirmed the Service Tax demand of ₹ 4.86 lakh and, therefore, the appellant is before the CESTAT.

It was submitted that the handling charges form part of the value of the goods sold on which sales tax/VAT liability has been discharged and this is towards the freight/loading and unloading charges involved in handling of the automobile components procured from M/s Maruti Udyog Ltd. and these have nothing to do with the service/repair of the motor vehicles of Maruti Suzuki. Reliance is also placed on the Board's Circular no. 96/7/2007-ST dated 23/08/2007 wherein it is clarified that service tax is not leviable on a transaction treated as a sale of goods and subject to levy of sales tax/VAT when spare parts are sold by a service station during the servicing of vehicles. The appellant also relied on the decision in Dynamic Motors 2011-TIOL-1876-CESTAT-DEL in support.

The AR submitted that since the handling charges are service rendered, service tax is leviable and hence the demand needs to be sustained.

The Bench observed -

1) We notice that the appellant are charging handling charges whenever automobile parts are sold either independently or as part of the service and repair of automobiles. In both the situations, invoices are issued for the sale of the goods as well as for collection of service charges for the services rendered.
2) Handling charges were incurred in connection with the procurement of the goods and are included in the value of the goods sold and sales tax/VAT liability is discharged on the value inclusive of the handling charges. Therefore, we do not understand how service tax levy would apply especially when the goods are subject to sales tax/VAT on a value inclusive of handling charges. It is not in dispute that

the handling charges are incurred in connection with the procurement of the parts. If that be so they will obviously form part of the value of the goods when they are subsequently sold.

3) Section 67 of the Finance Act, 1994 mandates levy of Service Tax on a value or consideration received for rendering the services. Therefore, any consideration received for supply of goods is not covered within the scope of section 67. The decisions of the Tribunal in the case of Ketan Motors Ltd. and Dynamic Motors cited supra also support this view.

Holding that the order is clearly unsustainable in law, the same was set aside.

.....

LD/63/74

Commissioner of Central Excise & Service Tax
vs.
M/s Hotel Amarjit Pvt Ltd
(2015) (MUM)

Revenue cannot take new ground and seek rectification of mistake in final order: CESTAT

This is an application filed by Revenue for rectification of mistake in the final order passed by the Bench in the matter of appeal filed by M/s. Hotel Amarjeet Pvt. Ltd.

The appellant is registered with the department under the category of 'Mandap Keeper Service'. While rendering 'Mandap Keeper Services' they were also providing catering services. However, they split the charges received for the services rendered into two parts - one towards 'hall charges' for the temporary usage of the banquet hall for conducting the functions and the other for supply of food. They discharged service tax liability on the 'hall charges' collected from the customers. However, they did not pay service tax on the food charges collected. It was their contention that, as regards supply of food, the transaction is one of sale, and therefore, no service tax is leviable. They also claimed that food is exempt from sales tax.

Two show cause notices were issued for the period 2005-06 to 2009-10 and 01/04/2010 to 30/09/2011 demanding ST of ₹1.11crore and ₹44.15 lakh respectively.

Suffice to mention that in the final order, the Bench had concluded that in the case of Mandap Keeper Services, catering service is incidental and ancillary and, therefore, the charges for catering services would be includable in the taxable value of Mandap keeper Services.

In the matter of the first demand notice demanding ST of ₹1.11crore, the Bench had in its final order observed thus –

5.5 As regards the contention of the appellant with regard to time bar, there is some merit in this argument. The show-cause notice dated 15.11.2010 seeks to demand Service Tax for the period 1.4.2005 onwards i.e. even beyond the extended period of 5 years. Therefore, the demand for the period 1.4.2005 to 30.9.2005 falls outside the extended period and confirmation of Service Tax demand in respect of this period cannot be legally sustained and, we hold accordingly.

Revenue is not happy with this portion of the order and has, as mentioned, filed an application for rectification of the mistake.

It is submitted that the ST-3 returns for the period of April 2005 to September 2005 & October 2005 to March 2006 were filed by the appellant, M/s Hotel Amarjeet Pvt. Ltd. on 28/03/2007 and, therefore, the show cause notice issued on 15/11/2010 covering the period 01/04/2005 onwards is within the period of five years from the date of filing the return.

Inasmuch as the mistake in this regard in the impugned order of the Tribunal may be rectified, submitted the AR.

The Bench observed -

"We have gone through the impugned order and it is seen that neither in the show cause notice nor in the impugned order the fact of filing of the return by the appellant on 28/03/2007 has been recorded anywhere. Therefore, we requested the Ld. A.R appearing for the Revenue to show us in which part of the order appealed against, this fact has been recorded or in which part of the show cause notice this fact is recorded. The ld. A.R fairly conceded that the fact of the ST-3 return having been filed on 28/03/2007 is neither mentioned in the order nor in the show cause notice. If that be so, Revenue cannot allege that this Tribunal has committed an error. Thus, this ground mentioned in the application of the rectification of the mistake is a new ground, which cannot be considered at this stage...."

Holding that there is no merit in the ROM application filed by the Revenue, the same was dismissed.

.....

LD/63/75

The Commissioner of Central Excise
vs.
M/s. Britannia Industries Ltd.
19th March, 2015 (MAD)

Scope of 'input service' specified under Rule 2(l) of the Cenvat Credit Rules, 2004 defined.

The assessee in this case availed Cenvat Credit facility on outdoor catering services provided in the factory premises to its employees and that was objected to by the Department stating that outdoor catering services do not fall within the ambit of definition 'input service', specified under Rule 2(l) of the Cenvat Credit Rules, 2004. The core issue involved in this appeal is whether the assessee can utilise the cenvat credit facilities in respect of outdoor catering services, provided in the factory for its employees, as input service.

The Tribunal dismissed the appeal holding that Cenvat Credit is admissible on 'outdoor catering service' as the same is an input service relating to business.

The High Court held that:

"Input service" read as a whole makes it clear that the said definition not only covers services, which are used directly or indirectly in or in relation to the manufacture of final product, but also includes other services, which have direct nexus or which are integrally connected with the business of manufacturing the final product. In the facts of the present case, use of the outdoor catering services is integrally connected with the business of manufacturing cement and therefore, credit of service tax paid on outdoor catering services would be allowable.

Corporate Laws

LD/63/76

Jiangsu Skyrun Wuxi Co. Ltd.

vs.

Syrma Technology Pvt. Ltd.

22nd December, 2014 (BOM)

Company's commercial solvency is not ground to reject winding up petition

Respondent's contention that winding-up petition is not maintainable as the company is running profitably and has employees working was rejected. Commercial solvency of a company cannot be a sole ground to reject the admission of a winding-up Petition, particularly when the debt is admitted...and other ingredients of Section 433 and 434 are present.

HC admitted petition filed by Jiangsu Skyrun Wuxi Co. Ltd. ('petitioner') for winding up of Syrma Technology Pvt. Ltd.('respondent') on the ground that it was unable to pay its debts u/s 433 and 434 of the Companies Act, 1956. The petitioner had sold and delivered goods alongwith invoices according to the seven purchase orders placed by the respondent. Respondent company acknowledged its debt and admitted its liability and assured to pay the outstanding amount to the petitioner shortly *vide* its emails. However, despite repeated assurances, respondent failed to remit outstanding dues. Hence, a statutory notice was issued by the petitioner calling upon the respondent company to pay the sum of USD 226,283.40. The respondent failed to reply to the notice and thus, petitioner filed instant winding up petition before Bombay High Court ('HC').

The respondent company contended that the fact that respondent's insurance company had paid US$ 181,026.72 to the Petitioner in settlement of its claim against the aforesaid invoices was suppressed and thus, petition was liable to be dismissed. It relied on the decision of *Agarwal Industries Ltd. vs. Golden Oil Industries (P) Ltd* for this contention.

The respondent further contended that the payment receipt cum subrogation form signed by the petitioner to respondent's insurance company, not only used the word "subrogate" but also used the words "assign" and "transfer" which meant that petitioner had assigned and transferred to all its powers to recover money from respondent company to the insurance company. Thus, it was submitted that instant petition filed in the sole name of petitioner was bad in law and not maintainable. Further, the respondent company contended that it was a sound, running and profitable company employing about 1200 employees and having net fixed assets worth over Rs. 16 crore and thus, it was not liable to be liquidated.

HC further rejected respondent's contention that only insurer could initiate and maintain any action against it, as petitioner had assigned and transferred its rights to recover money to the insurance company. HC observed that a company not paying dues could not take such defense and held that petitioner was indeed entitled to file the instant petition. HC placed reliance on foreign ruling in *Mason vs. Sainbury & Anr.* [1 99 E.R. 538], in this regard.

Furthermore, HC rejected respondent's contention that claim in present petition was damages and not 'debt' and there was no ascertained liability, thus, present petition was not maintainable. HC held that such contentions were baseless and untenable and also observed that since respondent had already acknowledged its debt and admitted its liability; such contention could not be raised.

With regard to respondent company's contention that it was a sound and profitable one and therefore was not liable to liquidated, HC stated, "the commercial solvency of a company cannot be a sole ground to reject the admission of a Company Petition, particularly when the debt is admitted and there is no bona fide dispute". Relying on co-ordinate bench decision in *Global Trust Bank Ltd. vs. Killick Nixon Ltd [(2005) 128 CompCas* 1007 (Bom)] and Supreme Court's decision in *IBA Health (India) Pvt. Ltd. vs. Info-Drive Systems Sdn. Bhd* [2010 (10) SCC 553], HC held that merely because the respondent company was a running concern and had employees working, cannot be a reason to reject a winding up petition when the other ingredients of Sections 433 and 434 were present.

Accordingly, observing that respondent company was unable to pay its debts and had raised false/dishonest defences, HC admitted winding up petition against respondent company.

Insurance Law

LD/63/77

Dhropadabai and Others

vs.

Technocraft Toolings

19th March, 2015 (SC)

Section 2(n) of Workmen's Compensation Act, 1923, Section 2(14) & 53 of the Employees' State Insurance Act, 1948–"Insured" person not entitled to compensation under the 1923 Act.

The wife and minor children of the deceased filed

an application for grant of compensation under the Workmen's Compensation Act, 1923 after the deceased employee succumbed to a chest pain at the work place. The High affirmed the view expressed by the labour Court that the deceased had breathed his last during the course of his employment. However, the legal heirs would not be entitled to get compensation under the 1923 Act as the deceased was an insured person under Employees' State Insurance (ESI) Act, 1948 and accordingly, would be compensated under the ESI Act.

The Supreme Court held:

Once an employee is an "insured person" under Section 2(14) of the 1948 Act, neither he nor his dependents would be entitled to get any compensation or damages from the employer under the 1923 Act.

Note: Judgment and Order of Bombay High Court upheld.

SARFAESI

LD/63/78

Arunbhai Kalyanbhai Sutariya
vs.
Nutan Nagrik Sahakari Bank Ltd & Anr.
10th March, 2015 (SC)

During the pendency of appeals before the Appellate Authorities, no coercive steps shall be taken for recovery of the amount under the provisions of the SARFAESI Act.

The appellant had filed an appeal before the Debt Recovery Tribunal and the Respondent Bank had filed an appeal before the Gujarat State Cooperative Tribunal against the impugned Order. While directing the afore-mentioned appellate authorities to decide the two appeals within 3 months, the SC held that during the pendency of afore-stated appeals before the Appellate Authorities, no coercive steps shall be taken for recovery of the amount under the provisions of the SARFAESI Act.

Information Technology Act, 2000

LD/63/79

Shreya Singhal
vs.
Union Of India
24th March, 2015 (SC)

Section 66A of the Information Technology Act, 2000.

Section 66A of Information Technology Act held to be arbitrarily, excessively and disproportionately invading the right of free speech and upsetting the balance between such right and the reasonable restrictions that may be imposed on such right. Section 66A held to be unconstitutional also on the ground that it takes within its sweep protected speech and speech that is innocent in nature and is liable therefore to be used in such a way as to have a chilling effect on free speech. Expressions used in Sec. 66A held to be nebulous in meaning.

The petitioner, Shreya Singhal, *vide* a Writ Petition filed before Hon'ble Supreme Court of India, challenging the constitutional validity of Section 66A of the Information Technology Act, 2000. The petitioner contended that the expression in the Statement of Objects and Reasons behind insertion of Section 66A that it has given rise to new forms of crimes is incorrect and that sections 66B to 67C and various sections of the Indian Penal Code are sufficient to deal with relevant crimes. The petitioner's main contention was that section 66A infringes the fundamental right to free speech and expression and is not saved by any of the eight subjects covered in Article 19(2) of the Constitution of India. According to the petitioner, the causing of annoyance, inconvenience, danger, obstruction, insult, injury, criminal intimidation, enmity, hatred or ill- will are all outside the purview of Article 19(2).

Placing reliance upon judgment in the case of *Sakal Papers (P) Ltd. & Ors. vs. Union of India* [(1962) 3 S.C.R. 842], the SC observed that it is not open to the State to curtail freedom of speech to promote the general public interest. The SC then analysed the term "Reasonable Restrictions" taking support of ruling in the case of *Chintaman Rao vs. The State of Madhya Pradesh* [(1950) S.C.R. 759], *Dr. N. B. Khare vs. State of Delhi,* [(1950) S.C.R. 519], *Mohd. Faruk vs. State of Madhya Pradesh & Ors.,* [(1970) 1 S.C.R. 156], and *State of Madras vs. V.G. Row,* [(1952) S.C.R. 597]. Rebutting the contentions raised by the Addl. Solicitor General [Respondent], SC stated remarked that "... we do not find anything in the features outlined by the learned Additional Solicitor General to relax the Court's scrutiny of the curbing of the content of free speech over the internet".

Further, relying on the decisions in the case of *S. Rangarajan vs. P. Jagjivan & Ors.* [(1989) 2 SCC 574], *Ramji Lal Modi vs. The State of U.P.* [(1957) S.C.R. 860] and *Dr. Ramesh Yeshwant Prabhoo vs. Prabhakar Kashinath Kunte & Ors.* [(1996) (1) SCC 130], SC remarked that *"Viewed at either by the standpoint of the clear and present danger test or the tendency to create public disorder, Section 66A would not pass muster as it has no element of any tendency to create public disorder which ought to be an essential ingredient of the offence which it creates".*

The SC further analysed the meaning of the term *"defamation"* and observed that for something to be defamatory, injury to reputation is a basic ingredient. Section 66A did not concern itself with injury to reputation. Something may be grossly offensive and may annoy or be inconvenient to somebody without at all affecting his reputation. The SC therefore held that Section 66A was not aimed at defamatory statements at all. The SC also held that Section 66A had no proximate connection with incitement to commit an offence.

The SC further analysed Section 268 of Indian Penal Code by comparing it with Section 66A. SC observed that in Section 268 the various expressions used are ingredients for the offence of a public nuisance, and these ingredients now become offences in themselves when it comes to Section 66A. The SC further observed that expressions like "criminal intimidation" used in Section 66A is also not defined and that and the definition clause of the Information Technology Act, *i.e.* Section 2 does not say that words and expressions that are defined in the Penal Code will apply to this Act. Thus in the context of Section 66A, SC remarked that "....every expression used is nebulous in meaning."

The SC held that applying the tests referred to in Chintaman Rao (*supra*) and V.G. Row's (*supra*) case, it is clear that Section 66A arbitrarily, excessively and disproportionately invades the right of free speech and upsets the balance between such right and the reasonable restrictions that may be imposed on such right.

Relying on ruling in the case of *Kameshwar Prasad & Ors. vs. The State of Bihar & Anr.* [(1962) Supp. 3 S.C.R. 369], SC remarked that "...Section (66A) is unconstitutional also on the ground that it takes within its sweep protected speech and speech that is innocent in nature and is liable therefore to be used in such a way as to have a chilling effect on free speech and would, therefore, have to be struck down on the ground of overbreadth. The SC further noted that possibility of an act being abused is not a ground to test its validity.

The SC observed that Section 66A purports to authorize the imposition of restrictions on the fundamental right contained in Article 19(1)(a) in language wide enough to cover restrictions both within and without the limits of constitutionally permissible legislative action. SC remarked that *"...the possibility of Section 66A being applied for purposes not sanctioned by the Constitution cannot be ruled out. It must, therefore, be held to be wholly unconstitutional and void".*

The SC ruled on Section 118(d) of Kerala Police Act which relates to 'Penalty for causing grave violation of public order or danger'. The SC held Section 118(d) of Kerala Police Act also to be unconstitutional remarking that *"what has been said about Section 66A would apply directly to Section 118(d) of the Kerala Police Act, as causing annoyance in an indecent manner suffers from the same type of vagueness and over breadth, that led to the invalidity of Section 66A, and for the reasons given for striking down Section 66A, Section 118(d) also violates Article 19(1)(a)...".*

Separately, the SC rejected petitioner's arguments and affirmed the constitutional validity of Section 69A of the Information technology Act, 2000 and the Information Technology (Procedure & Safeguards for Blocking for Access of Information by Public) Rules 2009.

International Taxation

LD/63/80
DDIT
vs.
Serum Institute of India Limited
(ITAT Pune) (2013)

Rates for TDS specified in DTAA overrides the TDS rates in section 206AA in the absence of a Permanent Account Number

The assessee Serum Institute of India Ltd, an Indian company is engaged in the business of manufacture and sale of vaccines. During the year, the assessee has made several payments to non-residents (NRs) in the nature of interest/royalty/Fees or Technical Services (FTS). The payments made were taxable in India, tax was required to be withheld on these payments if the payee was in India. However, as the NRs had not furnished a PAN, the assessee applied lower tax rates as prescribed under the Double Tax Avoidance Agreement (DTAA), as against the 20% under Section 206AA of the Income Tax Act.

Issue:

The Income Tax Department considered the difference between 20% and rate under the DTAA as a *"short deduction"* on the payments made to such NRs. The Income Tax Department observed that the lower rate prescribed under the DTAA was not applicable since some NRs did not furnish a PAN. So the Tax Authority initiated recovery proceedings and also levied interest under the Income Tax Act against the Taxpayer.

Under the scrutiny assessment, the assessee contended before the Assessing Officer (AO) that the Income-tax Act does not mandate an NR to obtain a PAN. Thus, the requirement of furnishing the same would not arise. Further, the 20% tax rate cannot prevail over the rate under the DTAA, as the rates prescribed are beneficial. The AO accepted the contention of the assessee that the DTAA rates prevail over the rates specified in any other section since they are beneficial to the assessee. Aggrieved, the Income Tax Department filed an appeal before the Tribunal.

The Tribunal held that:

Under the Income-tax Act, in case where the payee does not furnish the PAN to the payer, the payer is required to deduct tax on higher rates. The Tribunal followed the landmark judgement of the Supreme Court in the case of Azadi Bachao Andolan (263 ITR 706) and held that the provisions of DTAA overrides the Income Tax Act in cases where the DTAA is beneficial to the NR. Therefore, the lower tax rate prescribed under the DTAA applies, whether or not the NR furnishes a valid PAN. Hence the assessee was required to deduct tax as per the rate prescribed in DTAA.

LD/63/81
Swiss reinsurance Co. Ltd.
vs.
DDIT
(ITAT Mumbai) (2014)

Mere establishment of subsidiary in other country won't be deemed as PE of foreign Co.

The assessee company incorporated in Switzerland received income from providing Re-insurance in India. The reinsurance premium received by the assessee was claimed as business income and it was further claimed that in absence of any Permanent Establishment (PE) in India, the entire business income was not taxable in India.

The Assessing Officer noticed that the assessee through its Singapore Branch had entered into service agreement with Swiss re-Insurance Co. Pvt. Ltd. (SRSIPL), an Indian subsidiary, for obtaining risk assessment services, market insurance and administrative support in India and in turn remunerated/compensated SRSIPL. The Assessing Officer was of the opinion that the personnel and staff had rendered services to the assessee as de-facto employees. He concluded that the SRSIPL had provided technical and core reinsurance services and, therefore, Dependent Agency Permanent Establishment (DAPE) came into play and held that since the income of the assessee was being earned from India on a regular and continuous basis, the income of the assessee was taxable in India in terms of Section 9(1)(i). The DRP upheld the said order.

Held:

The ITAT relied on the decision of the Delhi HC in case of *DIT vs. E-Funds IT Solution* (42 taxmann.com 50) wherein it was held that establishing subsidiary in other treaty country would not result in creating and establishing PE of a foreign holding company in the said third country. Thus, SRSIPL is not a PE of assessee.

A perusal of the facts of the case go to show that none of the conditions specified in clauses (a)(b) & (c) of Explanation 2 to Section 9(1) above are satisfied. Therefore, it cannot be said that the assessee is having any business connection in India.

As regards to assessee having PE within the purview of Article 5 of DTAA between India and Switzerland, the Tribunal concluded that the employees of SRSIPL are not providing services to the assessee as if they were the employees of the assessee. Therefore, conditions laid down under article 5 are also not fulfilled to treat SRSIPL as PE of the assessee. Moreover, as per article 5(4) of treaty, reinsurance has been specifically excluded by the treaty. Considering the services rendered by SRSIPL in the light of the OECD commentary of article 5, SRSIPL cannot be considered as PE of the assessee. Facts of the case clearly show that the employees of the SRSIPL has only provided services to SRSIPL and there is no nothing on record to prove that the employees had provided services to the assessee or the assessee is paying their salaries or perquisites. To sum up, the assessee does not have any business connection in India in the light of Explanation2 to Section 9(1).

There was neither Service PE nor Agency PE in the form of SRSIPL. Considering the facts in totality in the light of the relevant provisions of the law and the DTAA, the assessment order was set aside and accordingly the Assessing Officer was directed not to treat the income of the assessee as taxable under the Act.

Transfer Pricing

LD/63/82
Sony Ericsson Mobile Communications India Pvt. Ltd. and others
vs.
CIT
(Delhi HC)

Advertising, Marketing and Promotion expenditure

The assessee was engaged in import, distribution and marketing of products manufactured by their foreign associated enterprises ("AEs") under their brand(s). The intangible rights in the brand-name/trademark/trade-name ("marketing intangible") were owned and controlled by the foreign AE.

The assessee had benchmarked their international transactions of import of finished goods for resale, by adopting transactional net margin method ("TNMM") with profit level indicator ("PLI") of operating profit/total cost ratio, or resale price method ("RPM") with PLI of gross profit/ sales.

The Transfer Pricing Officer ("TPO") made adjustments on account of AMP expenditure incurred by the assessee. The TPO was of the view that incurrence of substantial AMP expenses by the assessee, in relation to the marketing intangibles owned by the foreign AE, were in the nature of services for creation or improvement of marketing intangibles and, therefore, for the benefit of respective foreign AEs. Thus, the TPO concluded that the assessee should have been compensated by the foreign AEs, at arm's length.

A Special Bench of the Delhi Tribunal ("SB") was constituted in the case of LG Electronics India Pvt. Ltd., ("LG India") to examine the above issues of TP of marketing intangibles in detail. The SB, *vide* its order dated January 23, 2013, ruling substantially in favour of the Income Tax Department held:

Incurrence of proportionately higher AMP expenses, than comparable companies' AMP expenses, would be treated an international transaction of provision of service of brand building for the foreign AE.

The quantum of AMP expenses incurred by such comparable companies was referred to as the "Bright Line" and anything in excess of the Bright Line was termed

as "non-routine" expenses. Such, "non-routine" expenses should have been recovered from the legal owner of the brand along with appropriate mark-up.

The subsidy received from foreign AEs should be reduced for computing the arm's length price. Further, expenses which are inextricably linked to sales, such as trade discount, dealer commission, *etc.*, should not be considered a part of cost/value of international transactions.

The SB also summarised a set of principles for undertaking benchmarking of such transactions. Aggrieved, the assessee as well as the Revenue filed appeals under Section 260A of the Income-tax Act, 1961 ("Act") before the HC.

Issues:

- Whether TPO had jurisdiction to examine the AMP transactions when no specific reference has been made by the AO.
- Can the AMP expenses be categorised and treated as an international transaction under Section 92B of the Act.
- In respect of the AMP expenses, can the TP adjustment be made and under what circumstances the adjustment can be made and whether the Tribunal was right in holding that TP adjustment in respect of AMP expenses should be computed by applying Cost Plus Method.
- Whether the Bright Line Test adopted by the Tribunal for benchmarking the AMP, was a valid method.
- Whether the Tribunal was right in distinguishing and directing that selling expenses, such as trade/ volume discounts, rebates and commission, *etc.*, cannot be included in AMP expenses.

Held:

Jurisdiction of TPO:

The HC held that, in view of insertion of sub-section (2B) to section 92CA by Finance Act 2012 with retrospective effect, the TPO had a valid jurisdiction to examine the AMP transactions even though no specific reference was made by the AO.

International Transaction:

The HC held that AMP expense by the assessee in relation to the marketing intangible owned by the foreign AE, is an international transaction under Section 92B of the Act.

Use of RPM:

While selecting comparables, internal comparables would not be appropriate since AMP expenses do not get factored and compared. For this reason, external comparables, not being the legal owner of the brand name, trade mark etc. but performing similar functions including AMP expenses should be used to give more accurate and precise results. However if a comparable did not perform AMP functions which was performed by the tested party, then such comparable have to be discarded.

Further, the HC observed that the AO/ TPO can make adjustments in relation to substantial AMP expenses incurred by the tested party in comparison to the comparables. In case, it would not be possible to make adjustments, then RPM may not be the most appropriate method to be adopted.

Brand Building:

The HC held that it is erroneous to compare brand building with advertisement expenses. The HC held that it was possible to build a brand name without incurring substantial advertisement or promotion expenses. There also cases where in spite of extensive and large scale advertisements, brand values have not been created. Brand creation and value, depends upon various factors and it is a long term process.

Bright Line Test:

The Tribunal had adopted an overall approach that all the Indian entities incurring AMP expenses should be benchmarked using Bright Line Test. The HC observed that such an approach is neither mandated nor stipulated under the law or any international commentaries or under universally accepted and applied general principles of international taxation.

Economic ownership:

The HC held that economic ownership of brand and marketing intangibles is important factor for determining the pricing mechanism of distributors, having long term distribution licenses. The brand valuation would be mandated and required if the Indian entity was deprived, denied or transfers economic ownership, upon termination of the distribution-cum-marketing agreement or upon transfer of economic ownership to a third party. In such a situation, the distributor / India AE might seek compensation from the legal owner of the brand and it may require transfer pricing assessment.

Direct Marketing Expenses:

The HC upheld the SB ruling and held that marketing or selling expenses like trade discounts, rebates, *etc.* offered to sub-distributors or retailers are not in the nature and character of 'brand promotion' expenses, as they are not directly linked to brand building exercise, but connected to marketing and increased volume of sales or turnover.

Markup:

HC held that appropriate markup would be comparable

gross profit on the cost or expenses incurred as AMP. The mark-up has to be benchmarked with comparable uncontrolled transactions or transactions for providing similar service / product, and not the interest rate of Reserve Bank of India with a further mark-up.

Consequentially, the HC remanded the matter for de novo consideration to the Tribunal holding that the legal ratio accepted and applied by the Tribunal relying upon the SB Ruling was erroneous and unacceptable.

LD/63/83
CIT-I
vs.
Cotton Naturals (I) (P.) Ltd
(Delhi High Court) (2014)

Determining ALP of transaction of loan of money provided to AE

The assessee advanced a loan to its wholly-owned subsidiary in the USA. The assessee selected the Comparable Uncontrolled Price method (CUP) to benchmark the interest received on the loan and claimed that the interest received at the rate of 4% was comparable with the export packing credit rate obtained from independent banks in India. The TPO held that the arm's length interest rate should be taken as 14% p.a. This was reduced to 12.20% by the DRP by adopting the Prime Lending Rate fixed by the Reserve Bank of India.

The Hon'ble HC held that:

The reasoning recorded by the TPO suffers from a basic and fundamental fallacy. TPO held that the comparable test to be applied is to ascertain what interest would have been earned by the assessed by advancing a loan to an unrelated party in India with a similar financial health as the taxpayer's subsidiary. The finding of the TPO that for this reason is the interest rate should be computed at 14% per annum i.e. the average yield on unrated bonds.

Rules 10B and 10C of the Income Tax Rules indicate factors that ought to be taken into account for selection of the comparables, which necessarily include the contractual terms of the transaction and how the risks, benefits and responsibilities are to be divided.

The assessee's act of incorporating a subsidiary in United States was done with the intention to expand and promote exports in the said country and was a legitimate business decision. This is not unusual but common. Transfer pricing rules treat the domestic AE and the foreign AE as two separate entities and profit centres, and the test applied is whether the compensation paid for the products and services is at arm's length, but it does not ignore that the two entities have a business and a commercial relationship. Once this is accepted, then one cannot accept the reasoning given by the TPO that the transfer pricing adjustment could restructure

the transaction to reflect maximum return that a party could have earned and this would be the yardstick or the benchmark for determining the interest payable by the subsidiary AE. This is not stipulated nor mandated by Chapter X of the Act and Rules. They do not curtail the commercial freedom, nor they ban or prohibit a legitimate transaction.

The transfer pricing determination would decide what an independent distributor and marketer, on the same contractual terms and having the same relationship, would have earned/paid as interest on the loan in question. What the assessee would have earned in case he would have entered into or gone ahead with a different transaction, with a party in India, is not the criteria. What is permitted and made subject matter of the arm's length determination is the question of rate of interest and not re-classification or substitution of the transaction. The AO or DRP did not dispute the assessee using CUP method for computing ALP.

Interest rates payable on currency specific loans/ deposits are significantly universal and globally applicable. The currency in which the loan is to be re-paid normally determines the rate of return on the money lent, *i.e.* the rate of interest. Thus, the interest rate should be the market determined interest rate applicable to the currency concerned in which the loan has to be repaid and should not be computed on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party. There is no justification or cogent reason for applying PLR which is applicable to loans in Indian rupee for outbound loan from Indian parent to its AE abroad. ■