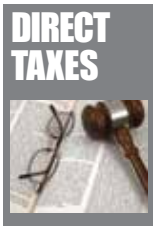
Legal Decisions[1]



Income Tax Act

LD/64/39

Shree Siddeshwar Souhardhana Sahakari Niyamit

vs.

The Income Tax Officer, Ward-1, Bagalkot

13th July, 2015

Interest earned by a cooperative society from its investment, done from its surplus deposit in a private limited company is liable to be deducted in terms of Sec. 80P(2)(a)(i)

The assessee, Shree Siddeshwar Souhardhana Sahakari Niyamit, is a cooperative society. The assessee had invested its surplus in Bilagi Sugar Mills Ltd. and Bilagi Pattana Sahakari Bank. During assessment, the interest earned on these investments was disallowed by the AO on the ground that the assessee had invested its surplus as deposit in a private limited company and therefore, income received was not relatable to the business of the assessee company and therefore such income was not eligible for deduction. The CIT(A) and Tribunal confirmed the order of the AO.

Relying on the Supreme Court judgment in *'Totgarh Co-operative Sale Society Ltd., vs. Income Tax Officer'* [(2010) 322 ITR 283], the Karnataka High Court held that the amount was deposited in the bank so as to earn interest and the interest income was attributable to carrying on the business of banking and therefore it was liable to be deducted in terms of Section 80P(1).

Service Tax

LD/65/40

Commissioner of Central Excise, Goa

vs.

New Era Handling Agency (2015)

8th July, 2015 (SC)

Activity of packaging of fertilizers is not liable to Service Tax under "Packaging Services"

M/s New Era Handling Agency ("NEHA"), Goa is engaged in providing packaging activity services in relation to fertiliser manufactured by M/s Zuari Industries Ltd., Goa for which they are receiving certain consideration.

The department was of the view that the activity undertaken by the appellant would come under the category of packaging services as defined in section 65(76b) of the Finance Act, 1994 and, therefore, they are liable to pay service tax.

Accordingly, show cause notice was issued demanding the service tax for the period 16/06/2005 to 31/03/2010. The show cause notice was adjudicated and demand was confirmed along with interest and penalty. Aggrieved by the said order, NEHA filed appeal before the Hon'ble Mumbai CESTAT.

CESTAT held that as per Essential Commodity Act 1955, read with Fertilizer Control Act Order 1985, it is clear that fertiliser cannot be marketed without packaging in the manner specified under the said order, thus packaging of fertiliser is a statutory requirement for sale of the fertiliser.

Sale of fertiliser in bulk requires a license to sell in bulk. As the appellant is not having any such license, therefore, packaging is a statutory requirement for sale of fertiliser by M/s Zuari Industries Ltd.

If marketing of fertiliser cannot take place without packaging, the appellant is a manufacturer as per section 2(f)(i) of the Central Excise Act, 1944, wherein manufacture includes any process incidental or ancillary to the completion of a manufactured final product. In other terms, the completion of fertiliser manufacture product occurs when packaging is done and without packaging, the fertiliser cannot be marketed. Vide order dated 17th September, 2014, the Hon'ble CESTAT held that appellant being a manufacturer is doing the packaging activity and does not fall under packaging activity defined in Section 65(76b) of the Finance Act, 1994.

The Supreme Court held:

After perusing the material available on records, the Hon'ble Supreme Court declined to interfere with the judgement passed by the Hon'ble Mumbai CESTAT and dismissed the appeal filed by Revenue.

[1] *Contributed by CA. Sahil Garud and ICAI's Editorial Board Secretariat, Indirect Taxes Committee & International Taxation Committee.*
Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.in. For full judgment, write to eboard@icai.in

LD/65/41

Geojit BNP Paribas Financial Services Ltd.
vs.
Commissioner of Central Excise, Customs & Service Tax
6th July, 2015 (KER HC)

Amount wrongly paid as service tax without even charge of service tax, does not have colour of "tax" and therefore, time-limit of section 11B would not apply to refund of said amount.

The assessee provided retail financial services to a foreign company and received payment in foreign exchange; but, paid service tax thereon by mistake. Assessee claimed that as per rule 3 of Place of Provision Rules, 2012, place of provision of service was outside India and hence, service tax was not payable and accordingly, filed refund claim for financial year 2012-13 on 23rd February, 2015. Department held in favour of assessee on merits that tax was not chargeable and therefore, refundable; but dismissed refund claim on ground that it was filed after 1 year from relevant date. Assessee filed Writ Petition on the ground that time-limit of section 11B would not apply to service tax paid by mistake.

Relying on the decision of Hon'ble Karnataka High Court in the case of *CCE vs. KVR Constructions* (2012), the petitioner argued that when service tax is paid mistakenly, Section 11B of the Central Excise Act has no application.

Relying on the decision of the Hon'ble Supreme Court in *Mafatlal Industries Ltd. vs. Union of India* [1997] 5 SCC 536, the Revenue argued that even if the payment was made under a mistake, the refund can only be processed in terms of Section 11B of the Central Excise Act.

The Court observed that the decision of Mafatlal Industries Ltd. would not apply to the case in hand. In this case, the levy was purely on account of mistake of fact in understanding the law. The petitioner assumed that the transaction for which he has paid tax, is covered under the law. The law does not cover such transaction for payment of service tax.

Therefore, it is not on account of any mistake of law but mistake of fact the service tax was paid. In that view of the matter; it has no colour of tax for the purpose of levy by the Department. The distinguishing feature for attracting the provisions under Section 11B is that the levy should have the colour of validity when it was paid and only consequent upon interpretation of law or adjudication, the levy is liable to be ordered as refund. When payment was effected, if it has no colour of legality, Section 11B is not attracted. The Court was also of the view that levy is not in accordance with the provisions of the service tax and therefore, such payment cannot be taken as a payment made relatable to Section 11B of the Central Excise Act.

The question of alternative remedy would arise if service tax is otherwise leviable under the Central Excise Act. Herein, in this case, there was no dispute with regard to the fact that no service tax is leviable for the service extended by the petitioner. Thus, the writ petition was held maintainable when the amount is arbitrarily withheld without any justification under law as the refund claimed by the petitioner is not relatable to Section 11B of the Central Excise Act. Similar view was also taken by the Karnataka High Court in *K.V.R. Constructions vs. CCE* [2010] 28 VST 190 and by the Madras High Court in *Natraj & Venkat Associates vs. Asstt. CST*.

The High Court held:

When amount paid as "service tax" was never chargeable to tax, refund thereof is not governed by Section 11B hence, assessee's writ against denial of refund is maintainable, as amount was arbitrarily withheld without any justification under law. Question of alternate appeal remedy would not arise, as tax itself was not leviable.

LD/65/42

Sai Wardha Power Co. Ltd.
vs.
UOI & Others
14th July, 2015 (MUM HC)

Once the SEZ unit secures the approval of the "Approval Committee" and furnishes a declaration in Form A-1 verified by the Specified Officer of the SEZ, the jurisdictional DC/AC is enjoined with a duty to issue the authorization in Form A-2

The petitioner is a power generating unit in the SEZ in Warora. Petitioner unit desired to seek the benefit of Notification Nos.17 of 2011 and 12

of 2013 and claimed *ab initio* exemption from payment of service tax.

The petitioner unit furnished a declaration, in Form A1, verified by the Specified Officer of the SEZ to the respondent No.2, the Jurisdictional Deputy Commissioner, Customs, Central Excise & Service Tax for issuance of Form A2.

In view of Notification No. 7 of 2014, the respondent No.2 was enjoined with a duty to issue Form A2 in favour of the petitioner unit within a period of 15 days from the issuance of Form A1. Despite the approval of the list of the specified services rendered by the SEZ unit of the petitioner by the Approval Committee and despite the issuance of Form A1 by the Specified Officer concerned, the respondent No.2 refused to issue Form A2 in favour of the petitioner thereby depriving the petitioner of the benefit of the Government Notifications of the years 2011 and 2013. The respondent No.2 asked the petitioner unit to supply some documents. According to the petitioner, since the respondent No.2 was not entitled to make any further enquiry in the matter after the issuance of Form A1 and was enjoined with a duty to issue Form A2, the petitioner has approached this Court, seeking the aforesaid relief.

The petitioner contended that the respondent No.2 has illegally refused to issue Form A2 to the petitioner unit on the ground that the petitioner unit was involved in the activity of manufacture and sale of electricity and as sale of electricity did not fall within the list of specified services, the petitioner was not entitled to Form A2.

The petitioner further stated that it was apparent from the notifications and also from the provisions of the SEZ Act of 2005, that the respondent No. 2 is not empowered to make any further enquiry after the list of specified services is approved by the Approval Committee and a declaration in Form A, verified by the Specified Officer of the SEZ is tendered to the respondent No.2 for issuance of the authorisation, in Form A2. It was submitted that in view of the provisions of Rule 54 of SEZ Rules, 2006, the performance of the petitioner SEZ unit is required to be monitored only by the Approval Committee and the respondent No.2 could not have refused authorization, in Form A2 for the reasons mentioned in the impugned communication.

The respondent argued that before granting authorization in favour of the petitioner in Form A2, the respondent No.2 wanted to ensure whether the authorisation could be so granted. It is, however, admitted that the issue whether the manufacture and sale of electricity are different businesses stands answered in favour of the petitioner by the judgment of the appellate authority, dated 29th October, 2013 in the appeals filed by the petitioner unit. It is stated that some of the claims of the petitioner unit for refund of the service tax had been rejected in the past and, therefore, the respondent No.2 had directed the petitioner to produce certain documents to substantiate its claim for issuance of authorisation under Form A2.

The Court observed that the petitioner had an option to either pay the service tax in advance or not to pay the same, subject to the conditions provided in the notifications. For seeking *ab initio* exemption, the petitioner unit was required to secure the approval of the list of services, as are required for the authorised operations of the unit on which the unit desires to claim exemption from service tax from the 'Approval Committee' and the latter had granted approval to the list of services for which the petitioner desired to claim exemption from service tax. Admittedly, the petitioner unit also furnished a declaration, in Form A1 verified by the Specified Officer of the SEZ along with the list of specified services.

The respondent No.2 was obliged to issue the authorisation, in Form A2 to the petitioner unit in the circumstances of the case. Mere issuance of Form A2 by the respondent No.2 would not absolve the petitioner unit of its liability to pay the service tax and cesses along with interest on delayed payment, if it is subsequently found that the petitioner unit has not used the services exclusively for the authorised operations as per the undertaking, in Form A1.

In terms of Notification No.12 of 2013, the petitioner unit is enjoined with a duty to submit to the Superintendent of Central Excise, a quarterly statement, in Form A3, furnishing the details of specified services received by it without payment of service tax. If that is so, the respondent No.2 could not have refused the authorisation to the petitioner unit in Form A2 on the ground that some of the claims made by the petitioner for

refund had been rejected in the past. Ample safeguards are provided by Notification No.12 of 2013 for recovery of service tax and cesses along with interest on delayed payment if it is found that the specified services on which the exemption has been claimed, have not been used exclusively for authorised operations.

The High Court held:

Respondent No.2 was not justified in refusing the authorization in Form A2 to the petitioner unit for the aforesaid reasons. There is nothing in Notification No.12 of 2013 that prohibits an SEZ unit from availing the option of not paying the service tax ab initio, if the Positive Net Foreign Exchange is not achieved. The respondent No.2 has illegally denied the benefit of Notification No.12 of 2013 to the petitioner unit.

Excise Law

LD/65/43

Shabina Abraham & Others
vs.
Collector of Central Excise & Customs
29th July, 2015 (SC)

An assessment proceeding under the Central Excises and Salt Act, 1944, cannot continue against the legal representatives/ estate of a sole proprietor/manufacturer after he is dead.

Shri George Varghese was the sole proprietor of Kerala Tyre and Rubber Company. By October 1985, this proprietary concern had stopped manufacture and production of tread rubber. By a show cause notice dated 12th June,1987, it was alleged that the assessee had manufactured and cleared tread rubber from the factory premises by suppressing the fact of such production and removal with an intent to evade payment of excise duty for the period from 1st January, 1983 to 31st December, 1985,. The provisions of Section 11A were invoked and duty amounting to ₹74,35,242/- was sought to be recovered from the assessee together with imposition of penalty for clandestine removal.

On 14th March, 1989, the said Shri George Varghese died. As a result of his death, a second show cause notice was issued on 18th October, 1989 to his wife and four daughters asking them to make submissions with regard to the demand of duty made in the show cause notice dated 12th June, 1987.

By their reply dated 25th October, 1989, the said legal heirs of the deceased stated that none of them had any personal association with the deceased in his proprietary business and were not in a position to locate any business records. They submitted that the proceedings initiated against the deceased abated on his death in the absence of any provision in the Central Excises and Salt Act to continue assessment proceedings against a dead person in the hands of the legal representatives. The said show cause notice was, therefore, challenged as being without jurisdiction.

As the Central Excise Authorities posted the matter for hearing and refused to pass an order on the maintainability of the show cause notice alone, the legal heirs approached the High Court under Article 226 of the Constitution by filing a Writ Petition in January, 1990. The learned single Judge of the High Court quashed the proceedings against the legal heirs stating that the Central Excises and Salt Act did not contain any provisions for continuing assessment proceedings against a dead person. Against this, revenue went in appeal. The Division Bench of the High Court of Kerala reversed the single Judge's judgment.

The appellant argued that a reading of Sections 2(f), (3), Section 4(3)(a), Section 11 and 11A as they stood at the relevant time, would show that unlike the provisions of the Income-tax Act, there is no machinery provision in the Central Excises and Salt Act for continuing assessment proceedings against a dead individual. Appellant further invited Court's attention to the Central Excise Rules and Rules 2(3) and 7 in particular to buttress his submission that there is no machinery provision contained either in the Act or in the Rules to proceed against a dead person's legal heirs.

The respondent argued that a close reading of Section 11 of the Central Excises and Salt Act will indicate that sums are recoverable from an assessee by an attachment and sale of excisable goods belonging to such assessee and further that if the amount so recoverable falls short, it can be recovered from the person himself as an arrear of land revenue. Inasmuch as a dead man's property

can be attached and sold and proceeded against, it is clear that the necessary machinery is contained in the Central Excises and Salt Act. Section 11A of the said Act is a machinery provision and, therefore, the rule to be applied is that the construction should be preferred which makes a machinery Section workable.

Respondent also referred Court to the definition of "person" in Section 3(42) of the General Clauses Act to buttress their submission that a legal representative would be included within a "person" as so defined.

Respondent referred Court to Section 6 of the said Act dealing with registration and argued that registration of a person makes him a legal entity liable to be assessed as such. The general principle, namely, that a cause of action abates when a person who institutes a proceeding dies is not applicable in the present case. The position under the Income-tax Act would be entirely different as income tax is a tax leviable on a person whereas a duty of excise is leviable on manufacture of goods.

The court observed that it is clear that there is in fact no separate machinery provided by the Central Excises and Salt Act to proceed against a dead person when it comes to assessing him to tax under the Act. It also observed that under the Central Excises and Salt Act, an assessee means "the person who is liable to pay the duty of excise under this Act. The present tense being used, it is clear that the person referred to can only be a living person as was held by Hon'ble Bombay High Court in the case of *CIT vs. Ellis C. Reid* (1931) AIR 333.

The Court observed that apart from the fact that there is nothing about dead persons in Section 11, Section 11 is limited only to recovery of sums that are due to the Government. The very opening words in Section 11 show that duty and other sums must first be payable to the Central Government under the Act or the rules. If such sums are not "payable" then the provisions of the Section do not get attracted at all. We have seen that the Act contains no machinery provisions for proceeding against a dead person's legal heirs, such as are contained in the Income-tax Act. Obviously, therefore, duty and other sums do not become "payable" without such machinery provisions.

The Court held that:

While allowing the appeal, the Hon'ble Apex Court observed that in a taxing Act, one has to look merely at what is clearly said. There is no room for any intendment. There is no equity about a tax. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied. One can only look fairly at the language used.

In interpreting a taxing statute, equitable considerations are entirely out of place. Nor can taxing statutes be interpreted on any presumptions or assumptions. The court must look squarely at the words of the statute and interpret them. It must interpret a taxing statute in the light of what is clearly expressed; it cannot imply anything which is not expressed; it cannot import provisions in the statute so as to supply any assumed deficiency.

International Taxation

LD/64/44

In Re., Measurement Technology Ltd.,

Services in the nature of management and procurement service payments to UK company not taxable as FTS

The applicant, Measurement Technology Ltd. ('MTL UK') is a company incorporated in UK and engaged in the development and supply of intrinsic safety explosion protection devices, field bus and Industrial networks, lightning and surge protection and gas analysis equipment. It is a wholly owned subsidiary of MTL Instruments Group Ltd., UK (MTL group). MTL Instruments Private Limited ('MTL India') is a subsidiary of MTL Group in India and is engaged in the business of manufacturing industrial control equipment's used for process control in hazardous environments. MTL UK entered into two agreements with MTL India.

Under Agreement 1, MTL UK was to provide managerial services was to provide managerial services through an employee designated as Group Operations Director (GD) to MTL India through either telephone or e-mails and such services include review and general guidance, monitoring, financial and operational progress, human resource matters including hiring new personnel, setting up individual targets and

performance appraisal etc. MTL UK recovered only 50% of cost of GD plus 5% as consideration for providing "Management Services" from MTL India. The GD made occasional visits to India but the stay did not exceed 30 days in a year.

Under Agreement 2, MTL UK was to provide procurement services to MTL India. MTL UK had set up a procurement team in the UK who looks into the global sourcing requirements of all the raw materials within MTL Group including MTL India and then identifies the best material for MTL India at the best available prices. The procurement team was constituted in the UK with a view to reduce cost and to avoid duplication of procurement efforts within MTL Group. MTL UK is compensated by MTL India for providing "Procurement Services" at 30% of the cost of procurement team.

Issue: MTL UK applied to the AAR to seek a ruling on whether the services rendered by it are chargeable to tax in India as per the India-UK tax treaty.

The tax department sought to tax these services on the ground that management consultancy services provided by MTL UK was making available the knowledge and experience of global standardisation to MTL India. Since such services were attached with expertise same should be regarded as technical. The department relied on AAR Ruling of Intertek Testing Services India (P.) Ltd. to submit that the term 'technical' ought not to be confined only to technology relating to engineering, manufacturing or other applied sciences. Further the department also relied on Supreme Court ruling in GVK Industries Ltd. & Anr. wherein it was held that the advice given by financial consultancy firm for procuring loans shall be regarded as technical and consulting services. The department also contended that strategy developed by the applicant and implemented by MTL India also partakes the character of royalties under Article 12(3)(a) being payment for the use of plan, or for information concerning industrial, commercial or scientific experience. The Department submitted that the information provided by the MTL UK like accounting policies, HRD policies, market researches, bank information *etc.* is its proprietary information which it does not share with any other person.

It was held:

AAR held that post amendment the ambit of FTS and a clause relating to 'make available' is inserted in the India-UK treaty saying that in order to qualify as FTS such services should make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or technical design. AAR thus concluded that post amendment, managerial services are not covered in the definition of FTS and even the technical or consultancy services, if they do not meet the criteria of 'make available', cannot be treated as FTS.

AAR noted various facts including the nature of service and that the services were provided from the UK mainly and even visits during a year are generally for short duration having aggregate number of days of visit in a year never exceeding 30 days. AAR also referred to sample e-mails sent by GD to MTL India and concluded that the services generally related to human resource matters, cost control, fund management, quality and design reviews etc. AAR regarded such services as routine managerial activities and thus held that same cannot be classified as technical or consultancy services. The AAR noted that such services were not making available any technical knowledge of enduring benefit in nature which would enable employees of MTL India to apply them on their own in future.

AAR held that the procurement services provided through agreement No.2. *"can never be classified as technical or consultancy in nature and surely are not making available any technical knowledge, experience, know-how etc.".*

With regards to the issue of PE AAR accepted MTL UK's contention that as GD never visited India for more than 30 days in a year his visit would not constitute a 'service PE'. With respect to department's royalty argument AAR opined that same *"is a very far-fetched argument because services provided under both agreements are general and routine in nature and do not create any intellectual property. It cannot even be imagined that rendering of such services would*

qualify as 'Royalties' as per the provisions of Article 13 of the India-UK Treaty."

Accordingly, the AAR ruled that amount received by the applicant for services rendered as per both the agreements was not chargeable to tax in India as per the provisions of the India-UK Tax Treaty.

LD/64/45

In Re., SkillSoft Ireland Limited,

Revenues received for providing E-learning services are taxable as royalty

SkillSoft Ireland Limited ('the applicant' or 'SIL Ireland') is engaged in the business of providing on demand e-learning course offerings, online information resources, flexible learning technologies and performance support solutions. SIL Ireland had entered into a Reseller Agreement with SkillSoft India, for sale of the said products. The Indian entity bought the products from the SIL Ireland on a principal-to-principal basis and in turn sold them same to the Indian end-users under the Master License Agreement ('MLA') in its own name. The MLA was primarily in the nature of a software/content license agreement whereby the Indian end-users were permitted to access the e-learning platforms and educational content.

The Indian entity provided the end-users with access code/web-link for the said products. The end users were granted with a non-exclusive, non-transferable license to use and allow the applicable authorised audience to access and use the products (without the right to sub-license).

According to the SIL Ireland, by using software and techniques, it had developed copyrighted products on several topics which were electronically stored on its server outside India and that no element of human interaction was involved in its e-learning platforms, which was restricted to software enabled virtual interaction only.

SIL Ireland raised the following questions before the AAR:

- Whether payments were in the nature of FTS under Article 12(3)(b) of DTAA between India and Ireland;
- If the said payments are not construed as FTS, whether it amounted to royalty under Article 12(3)(a) of DTAA;
- Whether PE was created for the SIL Ireland under Article 5 of the DTAA; and
- Whether the payments would be subject to tax withholding u/s 195 of the IT Act

During the course of hearing the Department did not argue that the payments were to be classified as FTS/as business income in India and that SIL Ireland had a PE in India. The only contention on behalf of the Revenue was that the payment amounted to royalty. Thus, the arguments were centered on the issue of royalty. AAR noted that the products consisted of two components namely the "course content" and the "software" through which the course content was delivered to the end-customer.

It was held:

The AAR observed that the in relation to the coverage of computer programme and computer database within the ambit of 'literary work' in Article 12(3)(a) of DTAA, AAR relied on the case of FactSet Research Systems Inc. (relied by SIL Ireland) wherein it was held that computer database fell within the scope of 'literary work' vide inclusive definition in Section 2(o) of Copyright Act.

AAR rejected SIL Ireland's argument that software was covered under ITES since CBDT notification dated September 18, 2013 defining ITES was only meant for eligible assesses who had exercised the option for application of Safe Harbor Rules and thus, it wasn't applicable to SIL Ireland.

The AAR observed that several copyrighted software containing simulation exercises designed by SIL Ireland were marketed and the specially designed softwares were not available in public domain. AAR further noted that the said products were 'licensed by SIL Ireland to SkillSoft India under the Agreement and further sub-licensed/distributed to end customers in India under the Customer Agreement' and thus, it was not correct to say that applicant's case was completely different from the facts of a case surrounding software. Thus AAR held, that software and computer databases created by the applicant were within the ambit of 'literary work' and consequently covered under Article 12(3)(a) of DTAA. Further considering that the distinction between copyright and copyrighted

article as illusionary in nature, the AAR rejected the contention of SIL Ireland that the payments were received for copyrighted article.

Grant of non-exclusive, non-transferable rights in the license

SIL Ireland argued that it wasn't involved in the provision of right to use in copyright of a literary, realistic or scientific work, in patent, trademark, design or model plan *etc.* and what was granted to the Indian end-users was the right to access educational content and not a copyright. AAR relied on the rulings in the case of Citrix Systems Asia Pacific Pvt. Ltd. and Karnataka HC's ruling in *CIT vs. Synopsis International Old Ltd.* (which were akin to SIL Ireland's facts) and held that *"In this case also similar words have been used in the reseller agreement as well as Master License Agreement. Therefore, irrespective of use of the words like non-exclusive and non-transferable in these two agreements, there is definitely transfer of certain rights of which the applicant is the owner."* Further it was held that it was not necessary that there should be a transfer of any exclusive right and in terms of DTAA consideration paid for use/right to use confidential information in form of computer programme software constitutes royalty.

AAR thus ruled in favour of Revenue, by holding that the payments received by the applicant were in the nature of royalty under article 12(3)(a) of the DTAA subject to tax withholding u/s 195 of the IT Act.

LD/64/46
CIT
vs.
Grup Ism (P.) Ltd.
(Del HC)

Delhi High Court rules on scope of 'Fees for Technical Services' in case of Liaison/ Solicitation services.

Grup Ism ('Taxpayer') entered into contract with two UAE entities *viz.* M/s CG International ('CGS') and M/s Marble Arts and Crafts LLC ('Marble Arts') wherein one of the non-resident acted as an agent of the Taxpayer for co-ordinating with various authorities in Abu Dhabi in relation to the project management consultancy awarded to the Taxpayer and other non-resident solicited business for the Taxpayer in various parts of the world except India.

Section 9(1)(vii) of the ITA deals with the taxability of 'Fees for Technical Services'. Explanation 2 to s. 9(1)(vii) defines FTS to include consideration for rendering technical, managerial or consultancy services. Independent Personal Services (IPS) Article of applicable DTAA provides that the income derived by a resident of the Contracting State in respect of professional services shall be taxable only in the resident State if specified conditions are satisfied.

In the facts of the present case, the Taxpayer Company was awarded project management consultancy by the Works Department of Abu Dhabi to act as a consultant for project management of marble works for one of the mosques at Abu Dhabi. As per terms of the contract, the Taxpayer was responsible for organising procurement of marble from India and supervising its processing at Abu Dhabi. In relation to the above contract, the Taxpayer made payments to two non-resident parties (UAE entities) *viz.* M/s CGS International, UAE (CGS) and M/s Marble Arts and Crafts LLC, UAE (Marble Arts) for the services procured from them. Marble Arts assisted in documentation, guidance and liaison with various departments and in obtaining approval from various departments. It was paid a fee of 5% of the gross amount received from the Works department and an additional US$ 50,000 for identification and selection of UAE national as a partner for the Taxpayer in this project. Services of CGS included soliciting business for the Taxpayer in different parts of the world except India, identifying, introducing and providing details of prospective clients. It was paid a fee of 15% of the amount received from the clients so introduced. CGS confirmed that it received consultancy charges from the Taxpayer.

The Taxpayer contended that the payments made to UAE entities were not in the nature of consultancy charges, the Taxpayer further relied on IPS Article and urged that it was not liable to withhold any taxes while making payment to Marble Arts and CGS. The Tax Authority took a view that the services were covered as FTS as defined in explanation 2 to Section 9(1)

(vii). Further, it contended that IPS Article is in applicable since services were provided by the company and not by an individual. The First Appellate Authority and the Delhi Income Tax Appellate Tribunal ruled in favour of the Taxpayer. The Income Tax Department has filed an appeal in the High Court against this ruling

Question arose whether the Taxpayer was liable to withhold tax on the payment made to UAE entities for the services availed?

The assessee contended that the payments made to UAE entities were not in the nature of consultancy charges. Further, as per Article 14 of India-UAE DTAA, Independent Personal Services ('IPS') it was not liable to withhold any taxes while making payment to Marble Arts and CGS.

It was held:

On the issue whether taxpayer was liable to withhold tax u/s 195 as the said services are Fees for Technical Services ('FTS') under Section 9(1)(vii), the Court held that mere fact that as per confirmation of CGS, amount received was stated as consultancy charges would not determine the actual nature of services rendered by UAE entities. Consultancy services would mean something akin to advisory services provided by the non-resident, pursuant to deliberation between parties. Generally, it would not involve instances where the non-resident is merely acting as a link or facilitator between the resident and another party or where the non-resident is directly soliciting business for the resident and generating income out of such solicitation. Accordingly, the payments made by the Taxpayer would not qualify as 'consultancy services' to come within the scope of FTS and thus, it is not liable to withhold tax on the same.

On the question of applicability of IPS Article of India-UAE DTAA, the Court stated that the two requirements for applicability of IPS Article were:

- Income must be of a resident of the Contracting State (UAE) and
- Income must be in respect of professional services or independent activities of a similar character.

As per Article (4)(1)(b) of the DTAA, 'Resident of a contracting state' means any person who is liable to tax and Article 3(e) defines 'person' to include a company. Thus, the HC rejected the contention of Tax Authority that IPS article was inapplicable. The services in question could be classified either under IPS Article or Article 22 (Other Income) of the DTAA–both of which provide that the income shall be taxable in the State of residence (UAE) and hence the issue as to whether the above services fall within the scope of 'professional services' under IPS Article is irrelevant. For this reason also, the Court held that taxpayer is not liable to withhold taxes on the payment made to UAE entities.

Transfer Pricing

LD/64/47

CIT vs. Canon India Private Limited (Delhi HC) (2014)

Unutilised subsidy from AE is not an Income.

The assessee, Canon India, is a wholly owned subsidiary of M/s Canon Singapore Pvt. Ltd. ('CSPL'). The assessee entered into various agreements/transactions with the Canon Group of Companies for purchase and resale of Canon products such as photocopiers, printers, scanners and cameras in India. Canon India is also engaged in software development and as a part of its business, exports software and provides software related services to other Canon Group of Companies.

During AYs 2006-07, 2007-08 and 2008-09, Canon India filed its return of income and disclosed the transactions with its Associated Enterprises ('AEs'). The Transfer Pricing Officer ('TPO') found that the reported international transactions entered into by the assessee with its AE's were at arm's length. However, the TPO found that the assessee had incurred Advertisement, Marketing and Promotional ('AMP') expenditure, which was much in excess of the expenditure incurred by other comparable entities.

On the aforesaid basis, the TPO concluded that the part of the AMP expenditure was incurred by the assessee on building/promoting the brand 'Canon' and the corresponding benefit of such

excess expenditure had been passed on to the assessee's holding company-CSPL.

The TPO, accordingly, made transfer pricing adjustments of ₹33.25 crore and ₹52.20 crore for AYs 2007-08 and 2008-09 respectively. AO also added ₹7.63 crore and ₹10.51 crore respectively, as unutilised subsidy received by the Assessee from its holding company–CSPL on the contention that the subsidies received by the assessee became its property notwithstanding that the same had not been spent for the purposes for which they were received. The additions were upheld by the DRP, and aggrieved, the assessee filed appeal before the Tribunal.

The ITAT in its order held that the following receipt/expenses were to be excluded from the scope of AMP expenditure:

(i) Subsidy;
(ii) Trade discount in volume rebate;
(iii) Cash discount;
(iv) Commission.

ITAT further held that unspent subsidy was not the income of the assessee but was held in trust by the assessee, to be spent for the specific purposes for which it had been remitted by CSPL.

In respect of the AY 2006-07, both, the department and the assessee challenged the order of the Tribunal before jurisdictional High Court, which disposed off the appeals by remanding the matter to the Tribunal for a de novo consideration in accordance with the principles of law as enunciated in its decision.

It was held:

Unutilised subsidy:

The department submitted that the amount of unutilised subsidy should be treated as income of the assessee, and that although the quantum of subsidy received would have to be considered at the time of making TP adjustments, the same could not be reduced from the AMP expenditure at the threshold.

Assessee countered by submitting that subsidy was received for meeting specific advertisement and sales promotion expenditure and the assessee was obliged to utilise the amount of subsidy for the specified purposes. Reliance was placed on the Tribunals' Special Bench decision in the case of LG Electronics.

Treatment of subsidy:

The High Court noted that amount utilised by the assessee for advertisements and sales promotion activities had been directly reduced from the relevant expenditure, and the balance unutilised amount remaining after incurring the expenditure was reflected as "Current Liabilities".

The High Court observed that Revenue had not disputed the fact that subsidies were received by the assessee from CSPL against specific obligation to incur expenditure on specific activities and it was not open for the assessee to divert the amount for any purpose other than for which it was remitted, and also that assessee was accountable to CSPL for the amount received. The HC noted that the Tribunal had examined the relevant facts and also concluded that the unspent amount is to be held in trust on behalf of CSPL and this was also confirmed by CSPL.

For these reasons, the High Court concluded that it would clearly be impermissible for assessee to appropriate and reflect the amount of unutilised subsidy as its income, and thus assessee had rightly not credited the subsidies received to its Profit & Loss Account, but reflected the same as a current liability.

The High Court also held that in view of assessee's obligation to utilise the subsidy for the specific purposes, the revenue could be recognised only on the application of the subsidy for the specified purposes, i.e., *"Assessee could credit the Profit & Loss Account with the quantum of subsidy only if the corresponding expenditure was also debited to the Profit and Loss Account maintained by the Assessee."*

The High Court thus rejected Revenue's contention that unutilised subsidy is required to be recognised as income of the assessee in the year of its receipt, holding that this would be "contrary to the matching concept, which is the substratal principle for computing income during a relevant period". The HC thus ruled that where assessee follows Accrual/Mercantile system of Accounting, income can be recognised only when the matching expenditure is also accounted for irrespective of the cash outflows/inflows during the year. High Court held it was incorrect to recognise the subsidies received for incurring specific expenditure as income without accounting for the corresponding expenditure.

The High Court thus upheld the view of the Tribunal in this regard and ruled in favour of the assessee on this ground. Whether subsidy to be excluded from AMP expenditure.

The High Court then considered the issue whether subsidy received by the assessee has to be excluded from AMP expenditure at the threshold before making any TP adjustments. HC opined that this question would be inextricably linked with the manner in which ALP of the relevant international transaction is determined.

As this issue had been remanded by this Court to the Tribunal in the decision for AY 2006-07, the HC held that it would be premature to consider this issue in isolation and without reference to the determinative exercise to be conducted by the Tribunal or the concerned Income Tax Authority. HC held, *"The question whether subsidy has to be reduced from the AMP expenditure incurred by the Assessee at the threshold or by way of a later adjustment would depend on various factors including the comparables selected for the purposes of determining the ALP as also the methodology adopted."*

The High Court thus remanded this issue stating that it would be open for the Revenue as well as the assessee to take all available contentions with respect to this aspect before the concerned authority.

LD/64/48
Firestar International Pvt. Ltd.
vs.
ACIT
(Mumbai ITAT)(2015)

LIBOR is a proper rate over SBI PLR-rate for benchmarking interest on loan.

The assessee, Firestar International Pvt. Ltd., is engaged in the business of export of diamonds and manufacture of jewellery. During AY 2010-11, assessee had advanced a loan of US $ 6.60 million to Synergies Corp. USA (AE).

The assessee had charged interest from its AE @ LIBOR+300bps. AO, however, determined the income on account of interest chargeable from the AE by applying a rate of 4.75%, being the State Bank of India (SBI) Prime Lending Rate for domestic loans.

Accordingly, AO proposed a TP adjustment of ₹2.71 crore. DRP confirmed the TP-addition.

Issue was whether SBI-PLR can be used to benchmark loan that was advanced in Foreign Currency?

It was held:

The ITAT considered the decision of Delhi High Court in the case of Cotton Naturals Ltd which was related to determination of ALP of interest charged by Indian company on loan advanced by it to its foreign subsidiary in foreign currency. Following the ruling of the High Court, the Tribunal held that interest rate should be the market determined interest rate applicable to the currency concerned, in which the loan has to be repaid and not on the basis of interest payable on the currency or legal tender of the place or the country of residence of either party.

Further, the ITAT held that in the present case we find no reason to uphold the application of SBL PLR on rupee loan as a benchmark to compare the interest rate on loan advanced by the assessee to its Associated Enterprise in foreign currency.

As the loan in the instant case has also been given in foreign currency i.e. US $, therefore, we find no infirmity in the assertions of the assessee that the interest rate charged at LIBOR + 300 bps is liable to be considered as an Arm's Length rate of interest.

As a consequence no further transfer pricing adjustment is required to be made in order to

compute the Arm's Length Price of the interest earned by the assessee on loan advanced to its Associated Enterprise." Accordingly, ITAT directed AO to delete TP-addition of ₹2.71 crore.

LD/64/49
Indegene Lifesystems Pvt. Ltd.
vs.
ACIT
(Bangalore ITAT)

Transfer Pricing adjustment on corporate guarantee confirmed, issuance costs impact profits; Distinguishes Bharti Airtel.

The assessee, Indegene Lifesystems, is a company engaged in rendering pharma services. During AY 2008-09, assessee transferred funds to Indegene US and Indegene Singapore (borrowers) for their capital investment and business development. For the funds transferred, the assessee made a loan agreement with the said subsidiaries on 30th March, 2006. The assessee also funded the finance requirements for capital investment and business development of Indegene Australia, and entered into a loan agreement with Indegene Australia on 4th July 2006.

Since the loan transaction between the assessee and Associated Enterprises (AEs) was an international transaction, the rate of interest charged for the loan has to pass the arm's length test as laid down in Section 92 of the Act. The TPO considered corporate bonds issued by the companies in India as against the government bonds for the comparability of the interest rate earned, contending that the government bonds carried only interest risk and no credit risk wherein the corporate bonds have elements of both the risk embedded in them.

The assessee contended that it had submitted that DRP did not deal with the application of LIBOR rate of exchange and did not deal with the decisions referred to by the assessee. Assessee submitted that TPO did not consider the interest rate of corporate bonds prevailing in the countries in which the loans were given by the Assessee, i.e., in the United States of America, Singapore and Australia. Assessee had placed reliance on the decision in *Siva Industries & Holdings Ltd.* [TS-438-ITAT-2011(CHNY)]

wherein identical issues was considered, and ITAT had held that in the matter of determination of ALP in respect of a loan transaction, LIBOR rate of interest should be the interest rate applied for determining the ALP.

TPO relied upon the safety level of the corporate bonds based on the grading issued by CRISIL and considered the loans given by the assessee similar to corporate bonds, contending that the risks in the loans given are too high for the company. The TPO thus computed interest rate at 17.26%, and proposed adjustment of ₹47.84 lakh, which was confirmed by the DRP. Aggrieved, assessee appealed before ITAT.

It was held:

ITAT referred to these decisions relied on by assessee and held that *"ALP is to be determined for the international transaction, that is, on international loan and not for the domestic loan. Hence, the comparable, in respect of foreign currency loan in the international market, is to be LIBOR based which is internationally recognized and adopted"*. ITAT observed that Revenue had not disputed that interest rate charged by the assessee was much higher than the LIBOR rates. Revenue had also not disputed that the decisions rendered by the Chennai Bench of the Tribunal in the case of Siva Industries & Holdings Ltd. has not been overruled or any other contrary decision has been taken on the issue by any Benches of the Tribunal. Accordingly, ITAT held that the interest charged in the loan transaction in question has to be held to be as at arm's length. ITAT thus deleted TP adjustment and allowed assessee's appeal. ■

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