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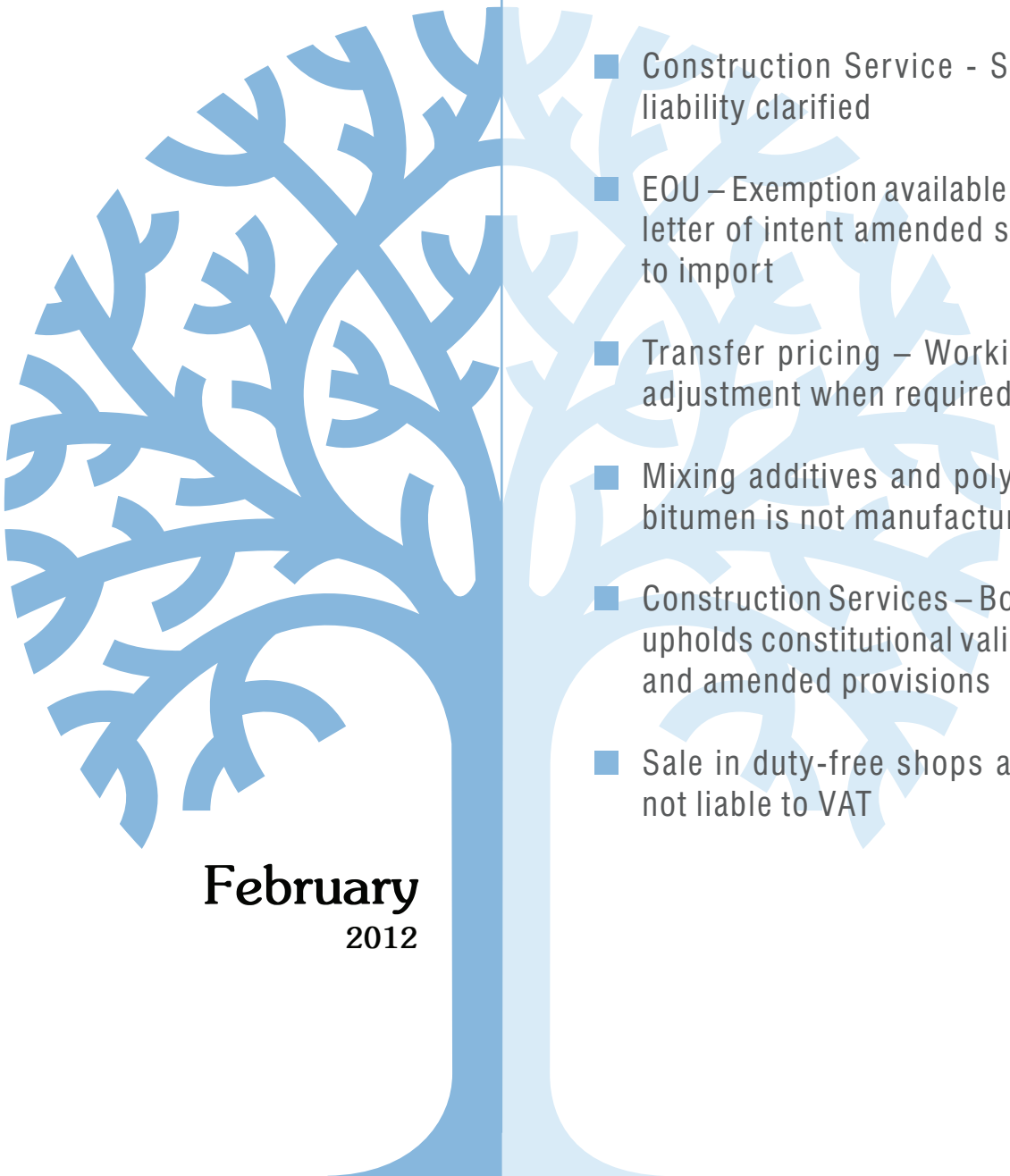

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Article

Contractual right no more a capital asset?

By **Sumeet Khurana**

Brief background

The case of Vodafone involved capital gains tax implication on transfer of shares of a Cayman Island entity CGP Investments (CGP) by another Cayman Island entity Hutchison Telecommunications International Limited (HTIL) to a Netherlands resident entity Vodafone International Holdings (VIH). HTIL had direct and indirect control to the extent of 52% of an Indian entity Hutchison Essar Limited (HEL). That apart, HTIL also had managerial and controlling rights along with a further 15% equity interest in HEL by virtue of certain agreements it had with other shareholders of HEL. The Indian Revenue Authorities had initiated action upon the transfer of shares by HTIL in CGP alleging capital gains taxable in India on the premise that transfer of CGP resulted in transfer of a capital asset situated in India, being the shares / controlling interest in HEL.

Tax demand was raised on VIH on the ground that it was liable to deduct tax at source or alternatively it is the representative assessee of HTIL for its tax liability. Rejecting the contentions of the Revenue Authorities, the Supreme Court has made various observations which have arguably set the tone for discussion on a number of allied issues. One such observation of the Court was that contractual rights do not constitute a capital asset. This article dwells upon this key characterization of capital asset.

The facts and findings in Vodafone's case

In the facts of the case, the seller i.e. HTIL also had some managerial and controlling rights in the form of (i) right to direct a downstream subsidiary as to the manner in which it should vote (ii) call options to buy further shares (iii) Tag Along rights (iv) right to nominate directors etc. which were also transferred to VIH. The issue arose as to whether these constitute a property right and hence a capital asset. In this regard, the majority order of Hon'ble Chief Justice and Hon'ble Justice Swatanter Kumar observes "In this case, we are concerned with the expression 'capital asset' in the income tax law".....“did HTIL possess a legal right to appoint directors onto the board of HEL and as such had some "property right" in HEL?.....“A legal right is an enforceable right i.e. enforceable by a legal process.".....“...enforceability is an important aspect of a legal right.".....“Applying these tests, on the facts of this case and that too in the light of the ownership structure of Hutchison, we hold that HTIL, as a group holding company, had no legal right to direct its downstream companies in the matter of voting, nomination of directors and management rights." Hon'ble Justice S. Radhakrishnan in his separate judgment has more explicitly stated that these are contractual rights and do not sound in 'property', hence cannot be, in the absence of a statutory stipulation, considered as capital assets.

These observations have the potential of leading to a conclusion that no contractual right can be a capital asset; a result of this would be that income from transfer of such rights could be capital receipt not chargeable to tax. However the key question is whether such a wide proposition, potentially limiting the scope of capital gains tax, really flows from the decision in Vodafone case.

The legal position prior to Vodafone's decision

The expression 'capital asset' has been defined under Section 2(14) of Income Tax Act, 1961 to mean 'property of any kind' held by assessee subject to certain exclusions. The expression 'property', as appearing in the erstwhile Article 19(1)(f) of the Constitution was considered by a Seven Judge Constitutional Bench of Supreme Court in *Commissioner, Hindu Religious Endowments, Madras* v. *Sri. Lakshmindra Thirtha Swamiar of Sri. Shirur Mutt.* [(1954) SCR 1005]. It held therein that there is no reason as to why the word 'property' as used in that article should not be given a liberal and wide connotation and should not be extended to those well recognised types of interest which have the insignia or characteristics of proprietary right.

This decision was subsequently followed in *Ahmed G. H. Ariff* [76 ITR 471] wherein a three Judge Bench of Supreme Court held in the context of wealth tax that 'property' is a term of widest import and subject to any limitations that the context may require, it signifies every possible interest which a person can clearly hold or enjoy. On similar lines a three Judge Bench of the Supreme Court in *A. Gasper* [192 ITR 382] held that tenancy rights constituted capital asset. Subsequently in *Ganapathi Raju Jogi* [200 ITR 612] Supreme Court held route permits as also being capital assets.

In various rulings the High Courts have consistently held contractual rights as being capital assets. For illustration, the following have been held to be capital assets by the respective High Courts;

- Leasehold right – Andhra Pradesh High Court in *Rajendra Mining Syndicate* v. *CIT* -[1961] 43 ITR 460)
- Right to subscribe for shares in a company – Punjab & Haryana High Court in [1964] 52 ITR 399
- Contractual right to obtain title over immovable property – Bombay High Court in *Sterling Investment* - [1981] 123 ITR 44
- Leasehold right – Calcutta High Court in *Pramia Engineering* - [1992] 202 ITR 298
- Right to obtain sale deed – Bombay High Court in Tata Services Limited - [1979] 122 ITR 594.

None of the above rulings have been considered by the Supreme Court in the case of Vodafone.

Conclusion

The earlier rulings wherein a 'capital asset' was understood in a wider sense did not have an occasion to deliberate specifically on the issue of whether 'contractual rights' can be capital asset, whereas the decision in *Vodafone* has examined this aspect in detail. Thus the decision in *Vodafone* can be considered as the new law and the principles enunciated therein be applied henceforth, displacing the hitherto understood meaning. A rider to this unqualified enunciation of law is that it must not be held subsequently that the observations of the Court are only in the nature of obiter made by the Court as a passing observation and thus not the of the *Vodafone* decision. In such event the observations in *Vodafone* on such count will lose their binding sheen. Further, given the facts in this decision, it may also be argued that *Vodafone* is confined to declaring that only where the rights are conferred and governed by a specific statute (here Companies Act, 1956) a modification of such rights through contracts may not result in genesis of a capital asset. However a definitive certainty which prevailed on this issue has certainly been stirred and the ripples of the decision in *Vodafone* will be felt in subsequent decisions.

[The author is Joint Partner, Direct Tax Team, Lakshmikumaran & Sridharan, New Delhi]

CUSTOMS

Notifications & Circulars

Gold, silver and platinum - Duty structure revamped; Customs duty on non-industrial diamonds increased: Duty structure for import of gold, silver and platinum has been changed to ad-valorem rates. The fixed rates of duties as applicable earlier were seen as contributing to revenue loss with the rates of these metals registering huge increases in recent period. Consequently, over all customs duty on the said items has increased. Gold and silver bars up to 95% gold/silver content are now eligible to nil rate of basic customs duty if imported by actual user for refining. Rate of basic customs duty on non-industrial diamonds including lab grown diamonds has also been increased to 2% from nil. Notification Nos. 1, 2 and 3/2012-Cus., all dated 16-1-2012 (effective from 17-1-2012) have been issued in this regard. Further, Notification Nos. 3/2012-Cus. (N.T.), dated 16-1-2012 (effective 17-1-2012) and 4/2012-Cus. (N.T.), dated 17-1-2012 have been issued to fix the tariff value on import of gold and silver.

Natural rubber latex – Effective rate of BCD: Rate of basic customs duty on natural rubber latex, whether pre-vulcanized or not, will be reduced from 17th of January, 2013. Effective rate of BCD will be Rs. 49 per kg. only if the duty amount per kg. calculated at the rate of 70% ad-valorem is more than Rs. 49 per kg. It is not known why such post-dated exemption has been granted by Notification No. 4/2012-Cus., dated 17-1-2012 issued in this regard.

Special CVD refund – Some relaxations: Cost Accountants and statutory auditors have been now allowed to issue certificates on non-passing of Special CVD incidence in case of its refund under Customs exemption notification. Earlier only chartered accountants were authorized to do so. C.B.E.C. Circular No. 1/2012-Cus., dated 5-1-2012 issued in this regard amends the earlier Circular No. 18/2010-Cus. In another development, importers have been given more time to utilize re-credited Special CVD. Circular No. 2/2012-Cus., dated 16-1-2012 extends time limit for utilizing re-credited DEPB scrips/ Reward Scheme scrips in case of refund of 4% Spl. CVD till 31st of March, 2012. The time limit for such utilization was earlier available only upto 15-9-2011.

Pneumatic tyres – Exemption from BIS standard mark: Commercial vehicle tyres, Off the road tyres, Run flat tyres and Collapsible mini tyres are importable without BIS standard mark as per the latest instructions of Central Board of Excise and Customs. Instruction No. 528/109/2011-STO(TU), dated 30-1-2012, while referring to office memorandum of Department of Industrial Policy and Promotion under the Ministry of Commerce, states that the above said type of tyres would not be covered by Pneumatic Tyres and Tubes for Automotive Vehicles (Quality Control) Order, 2009. These Indian provisions are already disputed by some countries under the Technical Barriers to Trade agreement of the WTO.

Fused Silica – Classification clarified: Fused Silica is classifiable under Tariff Item 3207 40 00 of the Customs Tariff Act, 1975 when in the form of powder, granules or flakes and under Tariff Item 7002 31 00 when in the form of unworked tubes and rods. Latest C.B.E.C. Circular No. 3/2012-Cus., dated 1-2-2012 issued in this regard rejects classification of the product as Quartz under Chapter 25 and as an inorganic chemical under Chapter 28 while placing reliance on Interpretative Rules 1 & 6 and Chapter Note 3 of Chapter 28.

Ratio decidendi

Advance license issued as per SION – Exemption not deniable by Customs: Advance licences once issued for a given quantity and for a given value, customs duty exemption cannot be denied by Customs authorities

in respect of such quantity and value of import on extraneous grounds for which they have no jurisdiction to investigate. In the case before CESTAT, assessee had imported Palm Stearine and crude Palm Stearine under Quantity Based Advance Licence Scheme for the manufacture and export of perfumed glycerine soap (Pears) during the period from January, 1993 to January, 2002 but investigations revealed that only part quantity was utilized for export of soap. The CESTAT observed that the appellants had consistently maintained and represented that the fixed SION was not workable as per their requirements and hence there was no question of mis-representation. The duty demand was however upheld by the CESTAT as the material imported was not capable of being used in the export product *[Hindustan Lever Limited* v. *Commissioner - 2012*-TIOL-53-CESTAT-MUM-CUS].

Refund of excess duty paid in provisional assessment - Unjust enrichment not applicable prior to 13-7-2006 : The Delhi High Court, after examining the relevant provisions relating to refund and provisional assessment, has held that in case of duty paid in excess during provisional assessment, Section 27 of the Customs Act, 1962 will have no applicability during relevant time. The refund is to be governed by the provisions of Section 18 itself, and therefore the assessee need not file a refund claim. As a corollary, it was further held that Section 18 of the Customs Act, at the relevant time, did not have any provision to deny refund of excess duty in case the duty had been passed on to the customers. The section was amended with effect from 13-7-2006, and therefore, in this case, where the bill of entry was provisionally assessed in 1998 and finally assessed in 1999, the issue of unjust enrichment did not arise [*Commissioner* v. *Indian Oil Corporation* - Delhi High Court order dated 9-1-2012 in CUSAA No. 43/2011].

EOU – Exemption available even when letter of intent amended subsequent to import: Merely because the goods were not eligible for exemption at the time of importation, as per CESTAT, benefit cannot be denied if the certificate was produced later, at the time of clearance of goods from Customs. The appellant-EOU had imported racks for packing tractors but same were included in the list of duty free goods only vide an addendum after filing bill of entry but before clearance of goods. The Tribunal noted that an EOU being a Customs bonded warehouse and since returnable racks were used for packing of export goods, movement of goods from port to EOU would not require duty payment and hence exemption under Notification No. 52/2003-Cus. would be available *[John Deere Equipment Private Limited* v. *Commissioner* - 2012-TIOL-76-CESTAT-Mum].

CENTRAL EXCISE

Notifications

Gold and silver – Duty structure changed: As in the case of customs duty, excise duty rates have also been modified in case of gold and silver. These items will attract *ad-valorem* central excise duty instead of specific rate of duty. Consequently, notification prescribing effective rate of duty for DTA clearance from EOU has also been amended to provide for *ad-valorem* rate for such goods. Notification Nos. 2 & 3/2012-C.E. both dated 16-1-2012 but effective from 17-1-2012 amending basic Notification Nos. 5/2006-C.E. and 23/2003-C.E. have been issued in this regard.

Ratio decidendi

Mixing additives and polymers with bitumen is not manufacture: The Supreme Court has, in its recent order, held that process of mixing polymers and additives with bitumen does not amount to manufacture. The court noted that by mixing of polymers in hot bitumen

to increase its softening point and penetration, quality alone is improved while bitumen remains bitumen and its end use also remains the same. The court held that the process did not result in transformation of bitumen into a new product having different identity, characteristic and use and hence the same was not manufacture *[Commissioner* v. *Osnar Chemical Pvt. Ltd.* – Supreme Court Judgment dated 13-1-2012 in CA Nos. 4055 and 4056 of 2009]

Cenvat credit on goods used in testing tailor-made machines, available: Goods used for testing made-to-order machines are inputs used in relation to the manufacture of such machines and are eligible for credit under Rule 57A of erstwhile Central Excise Rules, 1944. Supreme Court in its recent judgment has held that the process of testing the customized FFS machines was inextricably connected with the manufacturing process because manufacture was not complete till the time the machines met contractual specifications. The court while allowing the credit noted that it was not possible to meet obligations unless the machines were subjected to individual testing *[Flex Engineering Limited* v. *Commissioner*– Supreme Court Judgment dated 13-1-2012 in CA Nos. 7152 of 2004 and 429-31 of 2012].

Exemption not available unless all conditions followed: Supreme Court of India has held that to get the benefit of an exemption notification all conditions specified therein have to be followed. The court denied the benefit of Notification No. 3/2001-C.E. to the assessee supplying naphtha to some other entity even when the same was used in the manufacture of fertilizers. The court noted that the condition specified in the annexure to the exemption notification stated that where the intended use was elsewhere than in the factory of production, the exemption shall be allowed if the procedure set out in the 2001 Rules was followed. It rejected the plea of the assessee that exemption would be available when the one of the conditions i.e. end use (use in manufacture of fertilizers) was satisfied. Exemption was denied as the procedure in the rules was not followed [*Indian Oil Corporation Ltd.* v. *Commissioner* – Supreme Court judgment dated 13-1-2012 in CA 8048 of 2004 and 4530-32 of 2005].

Sale through intermediary – Applicability of SW&M Rules: The Karnataka High Court has held that the definition of industrial or institutional consumer, as laid down under Rule 2A of the Standards of Weights & Measures (Packaged Commodities) Rules, 1977 cannot be borrowed for the purpose of interpretation of "retail package" as defined under Rule 2 (p) of the PC Rules. The Court, relying on the meaning of "consumer" as given under the Consumer Protection Act held that it does not cover people who buy goods for resale or for commercial purposes. The High Court hence held that the requirement of Rule 6 need not be complied by a manufacturer who sells its packaged goods to an industrial/ institutional consumer through stockist. In the facts of the case, the assessee sold his goods to industrial consumers through intermediaries and the Department had contended that since the goods were not directly sold to industrial consumers, the exemption from making declarations under Rule 6 ibid., as contemplated under Rule 2A of the PC Rules, shall not be applicable [*EWAC Alloys Ltd.* v. *Union of India* - 2012 (275) E.L.T. 193 (Kar.)]

Rebate – Simplified procedure deniable when SCN pending: Allahabad High Court in its recent order has held that the assessee is not entitled to the simplified procedure for refund of unutilized Cenvat credit and for rebate in case of exports when a show cause notice for recovery is pending. As per the simplified procedure, after preliminary scrutiny, 80% of the rebate is to be sanctioned within 15 days of filing of rebate claim. The court noted that as per Circular No. 828/5/2006-CX dated 20-4-2006, the simplified procedure was available only to manufacturers against whom no offence case had been booked by Department in last 3 years and where no recovery of short levy is pending *[LML Limited* v. *Commissioner* – Allahabad High Court Order dated 4.1.2012 in Writ Tax No. 1777 of 2011].

News Nuggets

"Preparations" to cover only ready to use goods

Authority for Advance Rulings (AAR) recently held that the word "preparation" refers to something which is made ready for use [Advance Ruling No. 1/2012, dated 27-1-2012 – Arteco Coolants]. The AAR was dealing with classification of super-concentrates proposed to be imported for manufacture of anti-freezing preparation having qualities of anti-corrosion also. The department claimed that the goods merited classification as anti-freezing preparations. But, the AAR held that since the concentrate could not be put to use as anti-freezing agent as such it would not fall under the description of "anti-freezing preparation" under Heading 3820 but will be covered under residual entry of 3824 90 90 of the Customs Tariff Act, 1975. It was noted that the properties of anti-freezing and anti-corrosion are both important in anti-freezing preparations and that it cannot be said that any one of them gives them the essential character.

Lipsticks weighing less than 10g whether covered under SW&M Act?

Applicability of Standards of Weights and Measures provisions for any product below 10g has remained contentious as far as valuation under excise law is concerned. Recently, Bombay High Court on 1st of February, 2012 [*Hindustan Lever Ltd.* v. *Commissioner*], in the case pertaining to valuation of lipsticks weighing 2.2g, has remanded the issue to CESTAT after quashing the latter's order. The CESTAT by its order dated 21-6-2011 had held that since the price declared in case of lipsticks was on per piece basis and not as per their weight and since they were also sold in retail in pieces, exemption under Rule 34 of Standards of Weights and Measures (Packaged Commodities) Rules, 1977 was not available to them. The Tribunal had hence held that the goods should be valued under Section 4A of the Central Excise Act, 1944. The High Court however, after noting that a contrary order in the case of Cadbury India was not brought to the notice of the Tribunal, quashed the impugned order and remitted the matter for de novo consideration.

Cosmetic sets with plastic insert classifiable as cosmetics

The US Court of International Trade has on 3rd January, 2012 [*Estee Lauder* v. *United States*] held that "Blockbuster" cosmetic sets containing cosmetic case, brush case and applicator would be classifiable under sub-heading 3304.20.00, HTSUS. Cosmetic box/case had cosmetics like lipstick, eye pencil, eye shadow, nail lacquer, blush, etc. in promotional packaging with plastic insert into which cosmetic products are fitted to protect during shipment. The case was also useful while displaying the product. The US Customs had sought classification under sub-heading 4202.12.20 ibid. holding that the case gave the product its essential character. The court while relying on GRI 1, 3(b) and 6 noted that the cosmetics within the product gave it essential character and hence the product would be classifiable under chapter 33.

SERVICE TAX

Circulars

Works Contract service – Gross amount under Composition scheme: The Central Board of Excise and Customs has clarified that the explanation inserted in Rule 3(1) of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007 on 7-7-2009 is applicable prospectively. As per the explanation, the gross amount for payment of service tax under the composition scheme would include free of cost supplies. Board's Circular 150/1/2012-S.T., dated 8-2-2012 now clarifies that such free supplies would not be includible for the works contracts which had commenced prior to 7-7-2009 or where any payment (excluding credit or debit to account) for such service had been made prior to such date.

Construction Service – Liability clarified: The C.B.E. & C. has issued Circular No. 151/2/2012-S.T., dated 10-2-2012 wherein several issues on Service Tax liability under Construction Service have been clarified. In respect of tripartite business model involving landowner, builder/developer and contractor, the circular clarifies that for period before 1-7-2010, construction service provided by builder/developer will not be taxable in terms of circular dated 29-1-2009. For the period after 1-7-2010, Service Tax will be payable if part payment has been received or developments rights were received before issuance of completion certificate. It is also clarified that re-construction undertaken by a building society by engaging a builder/developer will not be chargeable to Service Tax as the same is meant for personal use of the society/its members. Service Tax is not payable, for period before 1-7-2010, on construction of additional flats made as part of the reconstruction, for sale to other buyers. For such other buyers, Service Tax is payable after 1-7-2010 if any payment is received before issuance of completion certificate. The circular also clarifies liability in cases where flats constitute an investment and BOT projects besides stating that joint development agreements will also come under the ambit of Service Tax where mutuality of interest and sharing of risk and profit are involved.

Ratio decidendi

Import of Services - Constitutional validity of provisions upheld: Constitutional validity of provisions concerning import of services i.e. Section 66A of the Finance Act, 1994 and the Taxation of Services (Provided from Outside India and Received in India) Rules, 2006, were upheld by the Allahabad High Court recently. The court while denying the plea that the scope of levy should be limited to India, held that the State is competent to legislate on matters which have an indirect or intangible effect in the territory of India. Court referred to Clause 2 of Article 245 of the Constitution of India which provides that no law made by the Parliament shall be deemed to be invalid on the ground that it would have extra-territorial jurisdiction, while it observed that the State is empowered to legislate any law which is applicable to the persons residing within its territory and on all things and acts within its territory. Reference was also made to *GVK Industries Limited* v. *Income Tax Officer* - (2011) 4 SCC 36 where the Supreme Court had held that the Parliament is not constitutionally restricted from enacting legislation with respect to extra territorial aspects which have any direct or indirect, tangible or intangible impact or effect or consequences for the territory of India [*Glyph International Ltd.* v. *Union of India* – Allahabad High Court Order dated 16-12-2011 in 1243-44 of 2010 and others].

Construction services – Constitutional validity of specific provisions upheld: Explanation in relevant provision relating to Service Tax on construction of new building intended for sale where payments were received before completion and services under Section 65(105)(zzzzu) of the Finance Act, 1994 for preferential allotment were held as constitutionally valid by the Bombay High Court. The Court proceeded to determine whether the object of tax on the services in question can be said to be tax on land or building or not and concluded that in order to be a tax on land and building, tax must be directly imposed on land and building. The High Court held that a tax imposed on contract or arrangement in relation to land and building will not be a tax on land and building and thus, outside the scope of Entry No. 49 of List II of the Constitution of India. It was observed by the court that the services of preferential allotment are provided by builders and the said Section was introduced to plug tax evasion by charging amount under different heads [*Maharashtra Chamber of Housing Industry* v. *Union of India* – Bombay High Court Order dated 20-1-2012 in W.P. No. 1456 of 2010 and others].

VALUE ADDED TAX (VAT)

Notifications & Circular

Movement of goods by unregistered dealers: A circular has been issued under the Karnataka VAT Act, providing instructions with respect to movement of goods taxable under the Karnataka VAT Act by service providers/ persons who are not registered under the Act. The Karnataka Circular No. 45/2011-12 [No. ADCOM(I&C)/ P.A./CR-37/2011-12], dated 30-1-2012 which provides for taking permission from jurisdictional Addl.CCT or an officer authorised by him, covers persons/ organizations transporting goods for (i) use in research and development; (ii) providing advertising services; (iii) use in providing diagnostic services; (iv) for use in providing any other service; and (v) for own consumption and use.

Kerosene Oil – Exemption under Rajasthan Entry Tax Act: Tax payable under the Rajasthan Tax on Entry of Goods into Local Areas Act, 1999 on entry of Kerosene Oil brought into the local area and sold through PDS in the state has been exempted from 9-3-2011, subject to the conditions mentioned in Notification No. 12(106) FD/Tax/2011-84 dated 17-1-2012. Other Kerosene oil (not to be sold through PDS) has been exempted under Notification No. 12(106)FD/Tax/2011-85 dated 17-1-2012 with effect from 29-6-2011 subject to the specified conditions.

Ratio decidendi

Sale in duty-free shops at airports, not liable to VAT: The assessee has its duty free shops at all major international airports in India where several articles including liquor are sold. One such shop was located at Bangalore International Airport. The issue that arose for determination before the court was whether the sales made by Duty Free Shops (DFS) are liable to VAT under the Karnataka VAT Act or CST. The court observed that the goods which had been brought from foreign countries had been kept in bonded warehouses and they were transferred to duty free shops situated at Bangalore International Airport. When the goods are kept in the bonded warehouse, it cannot be said that the goods had crossed the customs frontiers. The court noted that the goods sold at the duty free shops would be said to have been sold and delivered before the goods crossed the customs frontiers of India, as it was not in dispute that the duty free shops were beyond the customs frontiers of India. Thus, it was held that the state of Karnataka could not tax any such sale transaction which takes place at the duty free shop, which are not within the customs frontiers of India [*Hotel Ashoka* v. *Assistant Commissioner of Commercial Taxes* - 2012-03-VIL-SC].

Sale to company for Mumbai High not covered under exports or inter-state sale: Movement of goods from the state of Maharashtra to Mumbai High does not constitute a movement from one state to another state as Mumbai High does not form part of any state in the Union of India. Relying on *Aban Loyd Chiles Offshore Limited v. Union of India* [2008 (227) E.L.T. 24 (S.C.)], the Bombay High Court pointed out that the sovereignty which India exercises in relation to the continental shelf and the exclusive economic zone is qualified with reference to the purpose for which sovereign rights are recognized both by the Constitution and by legislation. It held that sovereignty is defined in terms of the purpose for which it is conferred namely, for exploring the continental shelf / exclusive economic zone and for exploiting its natural resources and does not incorporate a territorial ownership of the coastal state over the area. The court thus concluded that sale made by the assessee to ONGC for purpose of Mumbai High did not constitute an inter-state sale under the CST Act or a sale in the course of export out of India as contemplated by Section 5(1) of the CST Act. The assessee had sold helium gas to ONGC which is engaged in the production of gas and crude oil at Mumbai High situated about 150 kms from the coast line of Maharashtra [*Commissioner of Sales Tax* v. *Pure Helium (India) Ltd.* - 2012-VIL-11-Bom].

Sale when not in course of import: Delhi High Court has held that to claim benefit under Section 5(2) of the Central Sales Act, 1956, the import should have a direct nexus and should be connected with the transaction of sale in India. The appellant had imported a bank note processing system. The court noted that the appellant may have imported the equipment to sell the same to the bank but there was no legal or contractual obligation to sell the equipment only to Canara Bank, Bangalore. Therefore, the court held that subsequent sale by the appellant to such buyer is not covered by Section 5(2) ibid. [*Giesecke & Devrient India Pvt. Ltd.* v. *Commissioner of Sales tax* - 2012-VIL-04-DEL].

INCOME TAX

Ratio decidendi

Transfer Pricing – Power to collect data u/s 133(6); contemporaneous data: In this case, for the comparability analysis, the Transfer Pricing Officer (TPO) conducted enquiries from certain companies by exercising powers u/s 133(6) of the Income Tax Act, 1961. The taxpayer alleged that process adopted for issue of notice u/s 133(6) and use of such information was inappropriate for reasons like arbitrary basis of selecting companies for seeking data by issue of notice and non-availability of such information in public domain and also at the time of preparing TP study. It was also argued that TPO had not established that the information so obtained was authentic and complete e.g. segmental information received u/s 133(6) was used despite the same not forming part of annual report of comparable company.

On appeal, the ITAT held that as per Rule 10D the information and documentation to be maintained by a taxpayer should be contemporaneous and should exist at the time of filing return of income. This provision, however, does not restrict the power of TPO from making enquiries thereafter for determining the correct Arm's Length Price. It noted that as per principles of natural justice when any information is sought to be used against the appellant, reasonable opportunity of hearing should be given. The matter was remitted back to AO for fresh adjudication. The ITAT also observed that turnover filter (Turnover not less than INR 1 crore and not more than INR 200 crore) adopted by the taxpayer for rejecting potential comparables was appropriate to the facts of its case [*Kodiak Networks (India) P. Ltd.* v. *ACIT - ITA 1413/Bang/2010 (ITAT Bangalore)*].

Transfer Pricing – Applicability of CUP method, change of method by assessee: The taxpayer was in the business of manufacturing silica. It had sold silica to its associated enterprises ("AEs") in Germany, Indonesia and Philippines, and adopted comparable uncontrolled price ("CUP") method to justify the value of international transactions with the AEs, based on exports to unrelated parties. The Transfer Pricing Officer ('TPO') pointed out certain defects in the application of CUP method and made an adjustment. Before ITAT the taxpayer pleaded that the CUP is not the most appropriate method as comparables were not available. It was pointed out that the comparable sales were not made in the same country wherein the AEs had ultimately sold silica. ITAT accepted the pleas and restored the whole matter to the file of the Assessing Officer for fresh determination of the arm's length price of international transactions with AEs by applying an appropriate method [*DCIT* v. *Insilco Limited* - 2012-TII-11-ITAT-DEL-TP (Delhi ITAT)].

Permanent establishment (PE) – Agency, onus to prove: The taxpayer was engaged in the business of operation of ships in international traffic. The AO had held that as the taxpayer had an agent in India which concluded contracts, obtained clearances and performed some other work, whereby it constituted a PE in India. The taxpayer contended that as per the applicable tax treaty an independent agent does not constitute a PE unless the remuneration of the agent is not at arm's length. It argued that AO has not established absence of arm's length remuneration. Accepting the contention of taxpayer, the ITAT held that the AO had not discharged the onus of establishing dependence of the agent in terms of the remuneration of agent being lower than

arm's length and a fresh opportunity cannot be granted for the same. Accordingly it was held that the agent did not constitute a PE [*Delmas France* v *ADIT - ITA No. 9001/Mum/10 of 2007 (Mumbai ITAT)*].

Gains from sale of shares – 'Capital gains' or 'business income': The taxpayer had availed services of portfolio managers and offered the gains as 'capital gains'. The transactions were delivery based and shown under the head "investments" in the accounts. Considering the frequency of transactions, the tax authorities held that the income arising was taxable as business profits. On appeal, the ITAT held that the intention of the taxpayer was to maximize its profits and the portfolio manager carried out trading in shares on behalf of his clients to maximize profits. It also observed that the facts that (i) treatment given in earlier year was accepted as 'capital gain' or (ii) that the balance sheet disclosed the transactions as 'investments', cannot alter the view and taxability aspects did not change merely because transactions were not undertaken by taxpayer itself, but by appointing an agent in the form of a portfolio manager [*Radials International* v. *ACIT - I. T. A. No. 1368 (Del) of 2010 (ITAT Delhi)*].

Interest liability under Section 220(2) when demand notice not complied with: This case involved computational aspects of levy of interest under Section 220 of Income-tax Act, 1961. The taxpayer had not discharged the demand raised as per notice of demand under Section 156 along with the assessment. The matter was decided in favor of the taxpayer by first appellate authority however on further appeal held against it by ITAT. The AO levied interest for the whole period on the demand as confirmed by ITAT. The taxpayer contended that interest was not payable for the period during which the favorable order of the first appellate authority was operative. Rejecting the plea, the High Court held that the interest was leviable for the whole period as the taxpayer had not complied with notice of demand [*Girnar Investments Limited* v. *CIT* - WP(C) NO.5750/2010 (Delhi High Court)]

Transfer pricing – Working capital adjustment: The taxpayer, a fully owned subsidiary of entity in Germany had adopted Transactional Net Margin Method (TNMM) for determining the arm's length price of transactions with parent company. The TPO modified the manner in which TNMM was applied and made some adjustment. Before the ITAT the taxpayer sought 'working capital adjustment' though such adjustment was not sought before TPO. The Revenue Authorities also argued that, since the comparable companies were provided by the taxpayer itself, it should not be permitted to contend that there were differences in those comparables requiring adjustment. Rejecting these contentions, the ITAT held that the difference on account of working capital can have material effect on the price charged and hence on operating profit and therefore, if the working capital level of comparable companies was not comparable, the same required adjustment [*Demag Granes & Components (India) Pvt Ltd* v. *DCIT* - 2012-TII-07-ITAT-PUNE-TP].