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Negative List – Need to re-visit business transactions

By **Kapil Sharma and Narendra Kumar Singhvi**

There is a paradigm shift in the way services will be taxed from this month (July, 2012) onwards. Under the new regime, all services, which are not included in what is popularly known *as 'negative list of services',* will be taxed. The negative list approach to levy service tax has substantially altered service tax law impacting transactions involving supply of service. The introduction of negative list prior to the introduction of GST has also created significant gaps in the availability and use of tax credits. This situation will no doubt add to the cost of services in India.

Businesses have to comply with the new provisions introduced by Finance Act, 2012, but this might not be as easy as it initially appeared. This can be understood from the structural changes discussed hereinafter. It is likely to pose many problems which can no doubt, be resolved with some care and caution.

A negative list, as the term suggests, means all services except those specified in the list will be taxable. Now, service tax is payable on all services which come within the purview of the definition of 'service', *except* those specified in the negative list and excluding those which are exempted through notifications issued by the Central Government.

Unlike goods, which are tangible and therefore can be described fairly accurately, defining services poses formidable problems to the law-makers. Though the definition of *'service'* appears simplistic there are many surprises and causes for concern to taxpayers and the department alike, which may lead to increase in the number of court cases in the near future. The term 'service' has been defined to mean any activity for consideration. However the term 'declared service' includes an act of forbearance also.

With the introduction of the concept of *'declared services'* wherein certain specified services have been included within the definition of taxable services, one cannot rule out the possibility of over-lapping levies on a particular transaction. The number of taxable levies which stood at 116 (approx.), in the positive list regime, will now increase tremendously. This increase in the scope of service tax will also impact the manufacturing sector.

Another area of concern for assessees in the all pervading new regime relates to the shifting of onus. Existing litigation on issues such as classification, valuation, abatement and exemptions is already very high in the positive list regime. However, with the coming into force of the negative list regime, the assessee is now required to prove that there is no *liability to pay* service tax. As the spread of the levy is all pervasive, such a levy is likely to intensify the tussle between the department and the assessees over issues of taxability of services.

The domain of reverse charge mechanism has also been widened by introducing a new mechanism for certain specified classes of assessees and services. The scheme has been amended by fastening the liability to pay service tax on reverse charge basis, partly on the service provider and partly on the service receiver. This will now require affected businesses to ascertain the services which will create a shift in liability on them. The same assumes more importance owing to the fact that even payment of service tax in full by the provider in these specified cases will not

absolve recipient of service from the liability.

As part of the negative list regime, the Government has introduced a new set of rules for determining the place of supply of service, known as the Place of Provision of Services Rules, 2012. These rules contain principles on the basis of which the jurisdiction to tax a service gets determined. These rules also supersede the existing Export of Services Rules, 2005 and the Taxation of Services (Provided from outside India and Received in India) Rules, 2006, which will now require businesses to the *re-visit their practices* relating to export and import of services.

Implementation of GST in the developed economies of the world shows that a clear lead time of 18 months was provided to various stakeholders for them to transit to the new tax regime, whereas the negative list regime has no *transition provisions* to determine the status of on-going contracts such as services already provided and not invoiced.

Businesses also need to take stock of the compliance requirements in respect of services which shall become taxable for the first time and to address tax planning options available , as these issues have to be tackled at this stage itself. It is crucial for all service providers to re-visit all the decisions taken earlier and to review the business model in order to gain from the new provisions.

[The first author and second author are respectively Principal Associate and Associate in Lakshmikumaran & Sridharan, New Delhi]

SERVICE TAX

Notifications & Circulars

Negative list implemented from 1st of July: The new regime of Service Tax based on Negative List of Services, together with several other accompanying changes, has come into force from 1st July, 2012. To implement the new regime, Notifications No. 25/2012-S.T. to 40/2012-S.T. and Notification No.28/2012-C.E.(N.T.) have been issued on 20th June, 2012. The important changes are noted in the following paragraphs.

Changes in mega exemption notification: The list of exempted services has been extended by issuing a new notification superseding the earlier Notification No. 12/2012-S.T. As per the new Notification No. 25/2012-ST, dated 20-6-2012 (effective 1-7-2012), legal services provided by an advocate or partnership firm of advocates to another advocate or similar firm have been exempted. When services are provided by advocate or firm of advocates to business entity having turnover upto Rs. 10 lakhs in the preceding financial year, exemption will be available. Other services which have been granted exemption are:

- Auxiliary educational services and renting of immovable property service provided to or by educational institutions in respect of education.
- Construction services relating to railways have been expanded to include monorail or metro projects.
- Transportation of passengers has been extended to transport in a ropeway, cable car or aerial tramway.
- Services provided to government, local authorities or a governmental authority for carrying out 'any' activity in relation to any function ordinarily entrusted to a municipality are exempted. Previously specified activities alone were exempted.
- Works contract services by sub-contractors are

exempted when the said services are provided to another contractor providing exempted works contract services.

The following services have been included for exemption:

- Services of public libraries by way of lending of books, etc.
- Services by Employees State Insurance Corporation (ESIC) to persons governed under Employees' Insurance Act, 1948.
- Services by way of transfer of a going concern as a whole or an independent part thereof.
- Services by way of public conveniences such as washroom, lavatory or toilets.
- Services by a governmental authority by way of any activity in relation to any function entrusted to a municipality under Article 243W of Constitution.

Changes in abatement notification: Notification No. 26/2012-S.T., dated 20-6-2012 has been issued in supersession of Notification No. 13/2012-S.T., dated 17-3-2012. A major change brought in by this new notification is the grant of 75% abatement to construction of a complex, building, civil structure or a part thereof, intended for sale to a buyer, as a whole or in part. This new entry excludes cases where entire consideration is received after issue of completion certificate by the competent authority. This abatement is available subject to the conditions that value of the land is included in the amount charged from the service receiver and no Cenvat credit is availed on inputs.

The Place of Provision of Services Rules, 2012: A new Place of Provision of Services Rules, 2012 have been notified, through Notification No. 28/2012-ST, dated 20-6-2012, in supersession of the Export of Services Rules, 2005 and the Taxation of Services (Provided from outside India and Received in India) Rules, 2006. As per these rules, place of provision shall generally be the location of the service receiver and when the same is not available, location of the service provider shall be taken as the place of provision (PoP). In respect of specified services, PoP shall be the location where the services are actually performed. Similarly, PoP of services provided directly in relation to an immovable property will be the place where the immovable property is located or intended to be located. In respect of events, PoP will be the place where the event is actually held. For services like those provided by banks, PoP will be the location of the service provider. PoP in respect of transportation of goods shall be the destination but in case of such service provided by goods transport agency, PoP will be the location of the person liable to pay tax on such service.

Changes in Reverse Charge mechanism: CBEC has issued Notification No. 30/2012-S.T., dated 20-6-2012 in supersession of its earlier Notification No. 15/2012-S.T., dated 17-3-2012. This notification relating to reverse charge mechanism essentially amends entries relating to services provided by advocates and government or local authority.

Valuation Rules amended: Service Tax (Determination of Value) Rules, 2006 have been amended by Notification No. 24/2012-S.T., dated 6-6-2012. The amendments provide for determination of value of service portion in the execution of a works contract. Gross amount charged after deducting value of property in goods transferred shall be the value of service portion. If such value is not ascertainable, then for works like new construction 40% of the total amount charged shall be taken. The amendments also provide for determination of value of service portion involved in supply of food in a restaurant or outdoor catering. Value for the purpose of service tax shall not include demurrage, interest on delayed payment for

provision of services or sale of property, accidental damages due to unforeseen actions and subsidies and grants given by government which do not directly affect value of services.

Service Tax Rules amended: Service Tax Rules, 1994 have been amended by Notification No. 36/2012-ST, dated 20-6-2012 wherein certain terms like banking company, body corporate, goods carriage, legal service, life insurance business, non-banking financial company, place of provision, renting of immovable property and supply of manpower have been defined. 'Person liable for paying service tax' has been substituted to make service recipient liable in respect of services like those provided by advocates to business entity located in taxable territory, manpower supply and services portion in works contract. A new Rule 6A has been inserted to define 'export of services'. To be covered under 'export of service', service provider should be located in the taxable territory, the service recipient should be located outside India, the service should not have been specified in the negative list, the place of provision of the service should be outside India and payment for such service should have been received in convertible foreign exchange.

Other important notifications: Notification No. 31/2012-ST, dated 20-6-2012 has been issued to provide exemption to specified services received by exporter of goods. This new notification supersedes Notification No. 18/2009-S.T., dated 7-7-2009. Notification No. 33/2012-S.T., dated 20-6-2012 supersedes Notification No. 6/2005-S.T., dated 1-3-2005 but the exemption to small scale service providers continues. Exemption to services provided to SEZ developer or unit and used for authorized operations is now governed by new Notification No. 40/2012-S.T., dated 20-6-2012 issued in supersession of Notification No. 17/2011-ST,dated 1-3-2011. Refund of Service Tax (rebate) paid on taxable services used for export of goods in respect of specified services provided earlier under Notification No. 52/2011-S.T. has been provided under Notification No. 41/2012-S.T., dated 20-6-2012 with the list of specified services being omitted consequent to introduction of new regime based on negative list.

Negative list amendments – Orders issued to rectify certain omissions: In the maze of amendments relating to introduction of new regime in Service Tax, in Section 68 of the Finance Act, 1994 relating to payment of tax by persons liable, reference to Section 66 was not amended by substituting it with Section 66B, the new charging section. Service Tax (Removal of Difficulty) Order, 2012 has been issued now to carry out such substitution. As education cess and secondary and higher education cess governed by Finance Act, 2004 and Finance Act, 2007 respectively, refer to Section 66 of the Finance Act, 1994, Service Tax (Removal of Difficulties) Second Order, 2012 has been issued to insert an explanation after Section 66B which states that references to Section 66 shall be construed as references to Section 66B. C.B.E. & C. has also issued Circular No. 160/11/2012-S.T., dated 29-6-2012 to clarify this position.

Transportation of passengers and freight by railways, exempted: Services provided by railways for transportation of passengers by AC and first class coaches and transport of goods have been exempted till 30-9-2012 by Notification No. 43/2012-S.T., dated 2-7-2012.

Ratio decidendi

Cenvat credit admissible if nexus between input service and manufacture, proved: Cenvat credit would be available if the nexus between the input

service and manufacture of goods is proved. This position was reiterated by the CESTAT in a case before it wherein the question involved was admissibility of Cenvat credit on stockbroker's service which was used by the respondent for acquiring shares in another company with which the respondent had entered into an MOU for purchase of electricity for the purpose of manufacture of excisable product. The Tribunal held that the understanding was that the other company would supply electricity to the respondent subject to the condition that the latter would invest in former and such facts brought out the nexus between stock broker's service and manufacture of goods. It was held that in this case, stock broker's service qualified to be input service and credit thereof was available – *CCE* v. *Neuland Laboratories Ltd.* – 2012-TIOL-678-CESTAT-BANG.

Insurance service provided by government department, liable to Service Tax: Insurance business is not a sovereign act and insurance service rendered by a government department for insuring vehicles owned by government departments is liable to Service Tax. Ruling so, the High Court of Karnataka has upheld the order confirming Service Tax demanded from Insurance Department of Karnataka Government. The petitioner was engaged in insurance business in respect of vehicles owned by government departments and commercial concerns, vehicles in which the government had a financial interest and vehicles for which government had advanced money. The petitioner had assailed Service Tax demand on the grounds that the nature of activity performed by them was fully in public interest and undertaken as a mandatory function – *Karnataka Govt. Insurance Dept.* v. *Asst. CCE* – 2012 (26) S.T.R. 521 (Kar.).

Pre-payment and reset charges taxable: Prepayment charges and reset charges can be considered as cost incurred by the borrower towards value added services like prepayment of loan and restructuring of loan according to CESTAT. In an order on this issue, it held that such charges were relatable to lending and liable to service tax under banking and other financial services. The appellant was involved in the business of providing finance for housing and urban development. The question before the Tribunal was whether prepayment charges and reset charges collected towards pre-closure of loan and resetting of loan would attract the levy of service tax - *Housing & Dev. Corporation Ltd. (HUDCO)* v. CST, 2012 (26) S.T.R. 531 (Tri. – Ahmd.).

Service Tax applicability in case of joint development agreements for construction of residential complex: The Tribunal ruled in favour of the Department in a case involving service tax liability for residential complex construction. In this case, the appellant, engaged in construction of residential complexes, entered into Joint Development Agreements (JDA) with land owners (LO) as per which a portion of constructed area, in the form of flats/houses, would be assigned in favour of the LO. The Tribunal held that the contention of the appellant that in JDA, the relationship of service provider and service receiver did not exist between the LO and the appellant was not sustainable since the parties were neither taking risks jointly nor doing any common activity and further, there was no participation by the LO in organizing or carrying out the activity. To be covered under statutory exclusion, residential complex as a whole should be for personal use and the same was not applicable to individual flats in a complex and therefore, flats given to LO were not excluded from the ambit of service tax on personal use ground. The Tribunal also held that the flats handed over to the LO were not different from what were sold to the individual buyers and value of flats handed over to LO would be the same value adopted for individual buyer – *LCS City Makers Pvt. Ltd.* v. *CST* – 2012-TIOL-618-CESTAT-MAD.

CENTRAL EXCISE

Notifications & Circulars

Refund of Cenvat credit – New procedures and formula notified : Rule 5 of Cenvat Credit Rules, 2004 was amended from 1-4-2012 to incorporate new formula for calculation of refund of unutilized Cenvat credit. Accordingly, Notification No. 5/2006-C.E. (N.T.) has been substituted by Notification No. 27/2012-C.E. (N.T.), dated 18-6-2012 to give effect to the amended provisions. Requirement of certification of details of refund by chartered accountant when the claim exceeds Rs. 5 lakh does not find mention in the new notification. Correctness of claims pertaining to export of services shall be certified by an auditor.

Cenvat Credit Rules amended consequent to new regime of service tax based on negative list: Cenvat Credit Rules, 2004 have been amended by Notification No. 28/2012-C.E. (N.T.), dated 20-6-2012 to harmonise the same with the new regime of service tax based on negative list. Besides consequential changes, an explanation has been inserted in Rule 3 to disallow utilization of Cenvat credit for payment of service tax in respect of services where the person liable to pay tax is the service recipient. In case of distribution of Cenvat credit of service tax attributable to service used in more than one unit, concept of 'relevant period' has been introduced and an explanation to define the same has also been inserted.

Bank guarantee acceptable for exemption to supplies to mega/ultra mega power projects: Bank guarantee has also been made an acceptable instrument of security for claiming exemption to supplies made for setting up a mega or ultra mega power projects in case the certificate regarding mega/ultra mega power project status is provisional. Notification No. 28/2012-C.E., dated 27-6-2012 amends Notification No. 12/2012-C.E. which hitherto accepted only fixed deposit receipts.

Ratio decidendi

Cenvat credit on capital goods used to manufacture exempted goods initially but later used for dutiable goods: Cenvat credit on capital goods cannot be denied only on the ground that in the beginning only exempted goods were manufactured using such capital goods. The Karnataka High Court has held that since these capital goods were subsequently utilized in the manufacture of dutiable products, credit would be available. It was observed that there was no material to indicate that said capital goods were purchased with an undertaking to use the same exclusively for manufacture of exempted goods. In this case, initially, the capital goods were used only for manufacture of exempted buses but subsequently, they were used also for manufacture of dutiable products - *Commissioner* v. *Kailash Auto Builders Ltd.* - 2012 (280) E.L.T. 49 (Kar.).

Cenvat credit on cement/steel used in construction of storage tanks: Cenvat credit would be admissible in respect of duty paid on cement and TMT bars used in manufacture of storage tanks and pollution control equipments. The Karnataka High Court has held that once the storage tanks and the pollution control equipment constituted capital goods, Cenvat credit on raw material used in their construction would be eligible though the storage tanks became immovable property. The Court in the present case also examined the recently amended explanation to Rule 2(k) of the Cenvat Credit Rules, 2004 placing embargo on availment of credit on items like

cement used in construction of factory shed and held that such exclusion would be attracted when cement/ TMT bars are used in relation to building or foundation/ support structure of capital goods - *Commissioner* v. *SLR Steels Ltd.* - 2012 (280) E.L.T. 176 (Kar.).

Bank not liable for penalty for discounting export bill: Bank is not liable for penalty under Rule 27 of the Central Excise Rules, 2002 for the act of discounting export bills or sending export bills for collection as part of normal banking operation. CESTAT, Mumbai has further held that a banking transaction would not normally violate the Central Excise law especially when it is carried out as part of normal banking operation. SCN was issued proposing imposition of penalty on the bank for their failure to surrender sale proceeds of the goods in spite of the notices issued by the department. The department had proceeded against the bank's client (exporter) for recovery of deemed Cenvat credit availed through fraudulent bills - *Dena Bank* v. *Commissioner* – 2012-TIOL-699-CESTAT-Mum.

EOU – Demand when warehousing certificate not given by consignee: The Karnataka High Court has held that merely because the consignee had not issued re-warehousing certificate as per Rule 20 of the Central Excise Rules, 2002, showing that the goods had been received from the consignor and stored in their warehouse, Rule 20(4) demanding duty from the consignor cannot be invoked. The High Court while holding so, noted that according to the mahazar drawn by the Customs authorities, entire consignment had reached the premises of the consignee, also an EOU, but the goods got destroyed near the gate. The consignee had not issued the warehousing certificate fearing liability to pay duty - *Crystal Marble & Granite Pvt. Ltd.* v. *Commissioner* – 2012 (280) E.L.T. 371 (Kar.).

Explanation inserted in a notification applicable retrospectively: Explanatory notification has to be treated as part and parcel of notification which is clarified and is operative from the date of original notification. Madras High Court has held that such explanation does not operate with prospective effect as it does not give any substantive right independently. In the instant case, Notification No. 40/2001-C.E. (N.T.), dated 26-6-2001 provided refund of the excise duty paid in case of exports. Education Cess (EC) was levied from 9-7-2004 and later, on 6-9-2004 an explanation was inserted to clarify that the refund of EC would also be available. The Court while relying on Rajasthan High Court order in another case allowed the writ petition granting refund of education cess as well - *Loyal Textiles Mills Ltd.* v. *Commissioner* - 2012 (280) E.L.T. 8 (Mad.).

Valuation in case of captive consumption – Conversion charges and conversion cost: Conversion charges are inclusive of conversion cost plus profit element and cost of production for the purposes of Rule 8 of Central Excise Valuation Rules, 2000 cannot be equal to the conversion charges as charged by the assessee from another unit. The CESTAT, Mumbai has set aside the order confirming demand alleging lower declaration of conversion cost in case of goods removed for captive consumption to own units while removing same goods to another unit charging higher conversion charges. CESTAT upheld the contention of the assessee that higher conversion charges in case of different units included the profit element also and hence cannot be taken as the basis for the purpose of assessment of goods captively consumed - *Tata Iron and Steel* v. *Commissioner* – 2012-TIOL-682-CESTAT-Mum.

CUSTOMS

Notifications & Circulars

FTP Supplement 2012 implemented – Customs Notifications amended: Various Customs notifications including those pertaining to Export Promotion Capital Goods (EPCG) Scheme (both 3% and zero duty) and Status Holders Incentive Scheme (SHIS) have been amended to incorporate changes as announced in the Annual Supplement 2012 to the Foreign Trade Policy 2009-14. Notification No. 42/2012-Cus., dated 22-6-2012 issued in this regard amends five notifications. In the EPCG scheme, changes relating to extension of zero percent duty scheme; lower EO for specified green technology products and for units in North Eastern region; and relaxation in EO for carpet, coir and jute industry have been incorporated. SHIS notification has been amended to provide for import of components and spares of capital goods already imported. However, notification giving effect to the newly introduced post-export EPCG scheme is yet to be issued.

Mega power projects – Bank guarantee permissible in case of provisional status certificates : Option of giving bank guarantee has been extended to imports for mega power projects in case the certificate from the concerned department regarding mega power project status is provisional. Now importers have the option of furnishing either fixed deposit receipt or bank guarantee from any scheduled bank. Notification No. 43/2012-Cus., dated 27-6-2012 has been issued in this regard.

Post clearance audit of imports – More B/Es to be covered: The Central Board of Excise and Customs has decided to enhance the percentage of bills of entry selected for the Post Clearance Audit (PCA) till the time On-site Post Clearance Audit (OSPCA) is implemented for all importers. Circular No. 15/2012-Cus., dated 13-6-2012 states that the higher facilitation levels under RMS require scrutiny of more bills of entry under PCA.

Recovery under Section 28AAA – Proper officers notified: Specified officers of DRI, DGCEI, Excise and Customs have been notified as proper officers for the purposes of newly introduced Section 28AAA of the Customs Act, 1962. Section 28AAA which was introduced in this year's budget provides for recovery of duty from person to whom duty credit scrip was issued and such instrument was obtained by collusion or, willful misstatement or suppression of facts by such person. Recovery action arises when such instrument is utilized by another person for the purpose of payment of duty. Notification No. 53/2012-Cus. (N.T.), dated 21-6-2012 issued in this regard amends Notification Nos. 44/2011-Cus.(N.T.) and 40/2012-Cus. (N.T.), dated 2-5-2012.

e-BRC – Procedural guidelines issued: Guidelines have been issued by DGFT for banks, exporters and the Regional Authorities in case of electronic uploading of Bank Realisation Certificates (BRCs) by the banks and their utilization by the Regional Authorities while granting benefits under Chapter 3 of FTP. Circular No. 1/2012, dated 18-6-2012 also illustrates how the said benefits will be calculated while considering net foreign exchange earnings.

China – Exemption to specified imports therefrom: Readymade garments, shoes, quilt/blankets, carpets and local herbal medicines imported from China through the specified land routes have been exempted from basic and additional customs duties. Notification No. 41/2012-Cus., dated 14-6-2012 issued in this regard amends basic Notification No. 38/96-Cus.

Rail cum road vehicles classifiable under Chapter 87: Vehicles which can be used on roads as well as rails are to be classified under Chapter 87 of the Customs Tariff Act, 1975. Circular No. 14/2012-Cus., dated 11-6-2012 relies upon Note 4(a) to Section XVII of the Tariff for this purpose.

Skimmed milk powder – Export prohibitions removed: Skimmed milk powder is freely exportable from India with effect from 8-6-2012. As per DGFT Notification No. 2(RE-2012)/2009-14, dated 8-6-2012 export of milk and cream including whole milk powder, dairy whitener and infant milk foods remains prohibited i.e. is not allowed to be exported.

Ratio decidendi

Refund of cess paid on export goods – Applicability of unjust enrichment: Andhra Pradesh High Court has held that FOB value of the export goods cannot be said to include taxes, duties and cess payable on exports. The High Court while relying upon Incoterms, 2000 and the sale contract between the appellant and the buyer held that it is always the duty and obligation of the seller to bear the costs of customs formalities as well as the duties, taxes and charges payable on exports. It was held that since the invoice value was also FOB value, it cannot be said to include duty paid under the Cess Act. Cess was not separately mentioned in shipping bills but the court held that refund was eligible and unjust enrichment was not applicable as the presumption under Section 28D of the Customs Act, 1962 stood *rebutted* - *Asia Pacific Commodities Ltd.* v. *Asst. Commissioner* – 2012 (280) E.L.T. 481 (A.P.).

Confiscation of IPR violating goods when not sustainable: Goods alleged to be infringing IPR by bearing trademark 'Dove', were held as not liable for confiscation when the time prescribed in the IPR Act and the Rules was not followed and when Rule 3 of the Intellectual Property Right (Imported Goods) Enforcement Rules, 2007 was not complied with. The CESTAT, Mumbai relying on a Madras High Court order held that the provisions of IPR Act and the Rules would be inapplicable in such a case. It was noted by the Tribunal that on the same day another bill of entry was also filed by the same CHA for another importer having identical goods which were allowed to be released and the same resulted in discrimination with the present assessee - *SRK Enterprises* v. *Commissioner* – 2012 (280) E.L.T. 264 (Tri.- Mumbai).

Suspension of IE code – Jurisdiction: JDGFT without being the 'adjudicating authority' under Section 11(4) of FTDR Act has no power/authority/jurisdiction to pass on order suspending IEC. Calcutta High Court in its order has held that when Deputy DGFT had imposed penalty upon the appellant, JDGFT cannot, under Section 11(4), suspend IE code for non-payment of such penalty as Section 11(4) specifically provides for suspension of IEC in such cases only by the adjudicating authority - *Shree Gouri Shankar Jute Mills Ltd.* v. *Union of India* - 2012-TIOL-427-HC-KOL-EXIM].

Refund – Limitation when rectification sought under Section 154: Correction of mistake in the shipping bill under Section 154 of the Customs Act, 1962, to revise the quantity exported, cannot be used to defeat the time limit prescribed under Section 27 for claiming refund. The CESTAT, Bangalore in its order observed that refund has to be as per the provisions of Section 27 when the alleged excess duty was paid on the basis of the declared invoice price. The assessee had contended that mistake in the quantity mentioned in the shipping bill was liable to be corrected under Section 154 and refund shall be granted without considering the same as hit by time-bar - *Commissioner* v. *Sesa Goa Ltd* – 2012-TIOL-665-CESTAT-BANG.

VALUE ADDED TAX (VAT)

Notifications & Circulars

WCT-TDS rate enhanced in Bihar: The rate of deduction of TDS in respect of works contract has been enhanced from 4% to 5% under the Bihar VAT Act. Notification No. S.O. 102, dated 22-6-2012 issued in this regard amends Notification S.O. 50, dated 22-6-2005.

Input tax credit in Maharashtra: No input tax credit shall be allowed in Maharashtra unless the corresponding tax is paid by the selling dealer. Trade Circular No. 8 T of 2012, dated 21-6-2012 has been issued by the Commissioner of Sales Tax in the light of judgment in the case of Mahalakshmi Cotton Ginning Pressing and Oil Industries, Kolhapur reported at 2012-VIL-37-BOM.

Inter-state sale of goods against Form C - Reversal of input tax credit under Delhi VAT Act: Delhi Value Added Tax (Second Amendment) Act, 2012 has amended/inserted Section 9(10) and Section 10(3) of the DVAT Act to provide for reversal of prescribed percentage of input tax credit on inter-state sale of goods against Form C. The prescribed percentage is referred to in Rule 7 of the DVAT Rules which covers the transactions specified under section 9(4), section 9(6) and section 10(3). The goods sold on inter-state basis against Form C are specifically covered under section 10(3), however, goods purchased for use in manufacture of finished goods which are sold inter-state against Form C were earlier not covered under section 10(3). Therefore, a need was felt to specifically prescribe a percentage of reversal of input tax credit under section 9(10) in respect of such goods used in manufacture of finished goods which are sold inter-state against Form C.

Ratio decidendi

Deduction of turnover of sub-contractors – Delhi VAT provisions upheld: The Delhi High Court in its recent order has upheld the validity of Section 5 of the Delhi Value Added Tax Act (hereinafter 'DVAT Act') read with Rule 3(2) of the Delhi Value Added Tax Rules. The petitioner had contended that the provisions do not provide for a mechanism to compute taxable turnover after deducting the turnover of sub-contractors who are registered dealers themselves, thus leading to double taxation. The court held that even though there is no specific provision like the APVAT Act in the Delhi VAT Act (to exclude turnover of sub-contractors), it cannot be a ground for judicial review of the legislative action. The court stated that even if it is presumed that the specific provision in AP VAT Act makes it a better legislation in comparison with DVAT Act, the same cannot be a ground for declaring statute as arbitrary or ultra vires. It observed that as per the mechanism provided under the DVAT Act, the turnover of the sub-contractor is not taxed in the hands of the contractor but through a different mechanism of allowing input tax credit of the tax paid by the sub-contractor to the main contractor and hence does not result in multiple taxation - *Larsen and Toubro Ltd. v. UOI – 2012*-VIL-40-DEL.

Change in government policy not a force majeure: Force majeure like fire, flood and other natural calamities, riots, strike or lockout will not include circumstances like change in policy of the Central Government. The petitioner company after getting the eligibility certificate (as eligible industrial unit) for a period of 9 years from 3-2-1997 till 2-2-2006 and after getting exemption certificate, had

closed its business in August 2002 on the ground that due to change in Central Government policies, its operations were no longer commercially viable. Eligibility certificate was withdrawn as the unit was closed for a period of more than 6 months and tax and interest were demanded deeming the withdrawal of exemption certificate from the date of its validity as per relevant provisions. The petitioner contended that its case was covered under one of the exceptions provided in the provisions as discontinuance of business by the unit or closing down of its business for a continuous period exceeding six months except in case of fire, flood and other natural calamities, riots, strike or lockout which in the opinion of the committee concerned, was beyond the control of the unit. The court denied the said benefit of exclusion after holding that the exception was applicable to specific natural calamities and the case of the petitioner did not fall within the express provisions which covered fire, flood, riots, strike or lock outs. The court held that force majeure would not include contingency or circumstances like change in the policy of the Central Government and hence withdrawal of the exemption and the eligibility certificate was justified - *T.D.T Copper Limited* v. *Haryana Tax Tribunal, Chandigarh* – 2012-VIL-42-P&H.

INCOME TAX

Notification

No TDS on purchase of software from resident of India: TDS is not required to be deducted under Section 194J on payment for acquisition of software from an Indian resident subject to specified conditions. Notification No. 21/2012 [F.No.142/10/2012-SO(TPL)] S.O. 1323(E), dated 13-6-2012 specifies conditions like acquisition of software in subsequent transfer without any modification by the transferor, deduction of tax under Section 194J on payment for previous transfer of such software or under Section 195 on payment for any previous transfer of such software from a non-resident. Declaration shall be obtained by the transferee to the effect that tax has been deducted as per applicable clause.

Ratio decidendi

Tax rate as per DTAA cannot be increased by education cess: The tax payer in this case offered for tax its income on account of interest and royalty at the rates of tax prescribed in Double Taxation Avoidance Agreement (DTAA) between India and Singapore. The tax authorities increased the said tax rate by adding education cess. On appeal, ITAT held as per Articles 11 & 12 of the DTAA "tax" chargeable in India on interest and royalties cannot exceed 15% and 10% respectively and the expression 'tax' as per Article 2(1) included 'income tax' and 'surcharge' thereon. Article 2(2) states that 'tax' shall also include "any identical or substantially similar taxes which are imposed by either Contracting State after the date of signature of the present Agreement in addition to, or in place of, the taxes referred to in paragraph 1". Education Cess was introduced by the Finance Act, 2004 and it is described in Section 2(11) of the Finance Act, 2004 as additional surcharge for purposes of the Union. The ITAT held that education cess being in the nature of a tax was covered by Article 2 and the upper limit of tax rate applied to tax including education cess and hence, tax liability under DTAA cannot be increased by education cess - *DIC Asia Pacific Pte Ltd* v. *ADIT,* I.T.A. No.: 1458/Kol/2011, dated 20-6-2012.

No disallowance under Section 14A when potential of earning taxable income exists: The taxpayer earned income which was exempt under Section 10(23G) of Income Tax Act, 1961 from

investments in the shares of a power company. For making this investment the funds were raised by issuing optionally convertible premium notes which were redeemed on premium. The taxpayer claimed a deduction of the said premium which was rejected by the tax authorities on the ground the expenditure was incurred in respect of tax-free income. On appeal the ITAT deleted the addition holding that the said investment had the potential of generating taxable income in the form of short term capital gains and hence the premium cannot be regarded as expenditure incurred exclusively in relation to earning of exempt income so as to invoke Section 14A of the Act. Further, it was held that since no exempt income had actually been earned during the year under consideration, disallowance under Section 14A could not be sustained - *Avshesh Mercantile P. Ltd.* v. *DCIT ,* ITAT Mumbai, ITA No.5779/Mum/2006.

Classification of income under DTAA - Consultancy fees is not taxable as 'other income': The taxpayer paid consultancy fees to a Singapore company on which tax was not deducted at source by claiming that under India-Singapore DTAA the payment did not constitute 'fees for technical services' (FTS). The AO made a disallowance of the payment under Section 40(a)(ia) of Income Tax Act, 1961 holding that that there was a failure to deduct tax at source. In departmental appeal the Tribunal held that the consultancy fees in the present case did not constitute FTS as per India-Singapore DTAA as it did not "make available any technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein". It was held that if the criteria of FTS was not satisfied, its taxability cannot be said to be governed by the residuary category of 'other income' under Article 23 of the DTAA since this article applied only to "items of income which are not expressly mentioned in the foregoing Articles of this Agreement" - *DCIT* v. *Andaman Sea Food Pvt. Ltd.,* ITAT Kolkata I.T.A. No.: 1412/Kol/2011, dated 19-6-2012.