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Article

Taxability of hire purchase transactions in India

By **Anshul Mathur**

Hire purchase transactions are essential for industry and business houses in acquiring equipments necessary for stimulating growth. However, meticulous planning is required to arrange financing of the assets for making timely payments. Hire purchase is a financial facility which allows a business to use an asset over a fixed period, in return for regular payments. When all the installments have been paid, the buyer becomes the owner of the equipment. This ownership can transfer either automatically or on exercise of an option to purchase. In other words, hire purchase not only appertains to agreements wherein the buyer has an option to buy the goods, but also to those agreements where the property in the goods is to pass at the end of the term.

As regards applicability of sales tax on such transactions, it has always been clear that the first sale, namely the sale by the vendor to the financier is a sale taxable under the relevant sales tax enactment. However, the transaction between the financier and the buyer has been the subject matter of dispute and judicial scrutiny[1], as it did not fulfill an essential requirement of a typical sale transaction i.e. transfer of property or title of goods upfront. The buyer's argument is that the sale fructifies only at the end of the term of the agreement when the option to purchase is exercised whereafter the transfer of property takes place; and that only the last installment / option fee paid to the financier should be subjected to tax. This argument did not find favour with the court [2] but there was no codified alternative available at the relevant time. The court noted that a hire purchase is a mere bailment until it fructifies into a sale, and is not analogous to sale. This difference between a sale and a hire purchase assumed importance because the states were not empowered by the Constitution to tax a hire purchase which did not result in a sale. If a hire purchase resulted in a sale then sales tax was payable, but identifying the 'sale price' which would attract the levy was a herculean task, especially in the absence of any codification in that regard. There was lack of clarity not only with respect to the taxability of such transactions but also the amount which would suffer tax and the time at which the levy became applicable.

These problems were referred to the Law Commission, which recommended certain amendments in the Constitution[3] and a new clause (29A) was inserted in Article 366 of the Constitution[4], which provided that 'tax on sale or purchase of goods' would include the delivery of goods on hire-purchase or any system of payment by instalments. In effect, the delivery of goods on hire purchase was itself deemed to be a 'sale' regardless of whether the ownership passed on at a later date or did not pass on certain cases. Hence, the confusion caused due to diverse opinions about the levy of sales tax on hire purchase transactions, got seemingly cleared.

In line with the constitutional amendment, hire purchase got included in the definition of 'sale' in all the state VAT legislations. However, as far as uniformity in

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1 Instalment Supply (P.) Ltd. v. Union of India [1961] 12 STC 489 (SC); K.L. Johar V. Deputy Commercial Tax Officer [1965] 2 SCR 112

2 K.L. Johar v. Deputy Commercial Tax Officer [1965] 2 SCR112

3 Certain problems connected with power of the States to levy a tax on the Sale of Goods and with the Central Sales Tax Act, 1956, 61st Report, Law Commission of India, 1974.

4 46th Constitution (Amendment) Act, 1982

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the manner of taxing these transactions is concerned, it leaves much to be desired. The practices across States in respect of calculating the taxable turnover of such transactions are not uniform. While some state VAT legislations are totally silent about the method to be followed to calculate the taxable turnover in respect of a hire purchase transaction, other States have evolved highly structured practices allowing appropriate deductions while determining taxable turnover. For instance, interest charged separately and finance charges in respect of hire purchase are specifically excluded from the turnover of a dealer under the Tamil Nadu VAT Act [5]. On the other hand, under the Delhi VAT Act, 'sale price' in relation to the delivery of goods on hire purchase is the consideration payable to a person for such delivery including hire charges, interest and other charges incidental to such transactions, and such amounts are taxable upfront [6].

Another major issue of concern is the applicability of service tax as well as sales tax/ VAT on hire purchase transactions. Service tax is levied on hire purchase transactions under 'banking and other financial services'[7]. The Supreme Court has, in fact, upheld the constitutional validity of the levy of service tax on financial leasing services including equipment leasing and hire purchase[8]. As far as the taxable value is concerned, the Supreme Court held that the sum received as principal amount is not the consideration for services rendered; and that the lease management fee/ processing fee/documentation charges and interest charges which constituted the consideration for the services rendered are accordingly taxable. Further, the government has granted exemption upto 90% of the amount representing interest [9].

Thus, as on date service tax is applicable on the processing fee, documentation charges and on ten percent of the interest charges recovered in equated monthly instalments. A perusal of the Finance Act, 2012 reveals that the transactions specified as deemed sales under the Constitution have been excluded from the definition of service. Yet the 'activities in relation to delivery of goods on hire purchase' have been specifically declared as a service taxable under the Act[10]. Thus, the position is not likely to change in the near future.

In the absence of any specific exclusion for such charges under the VAT legislations such as Delhi VAT, these charges, namely processing fee/documentation charges and ten percent of the interest charges will attract the levies of service tax as well as VAT. In other words, there is double taxation on these amounts.

Standardisation of practices and uniformity is the need of the hour. Heterogeneous regulatory practices being followed in the realm of hire purchase transactions is inimical to the cause of a well-oiled industrial and business sector. A uniform, lucid and coherent legal regime governing such transactions is imperative to curtail time spent in squabbling over the application of the laws and allow industries and service providers to concentrate on their job.

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5 Rule 8(1)(c), Tamil Nadu VAT Rules, 2007.

6 Section 2(1)(zd) of the Delhi Value Added Tax Act, 2004 and Rule 4 of the Delhi Value Added Tax Rules, 2005.

7 Section 65(12), Finance Act, 1994

8 Association of Leasing and Financial Companies v. Union of India and Others, [2010] 29 STT 316

9 Notification No. 4/2006-S.T., dated 1-3-2006

10 Section 66E of the Finance Act, 2012 read with Notification No. 13/2012-ST dated 17-3-2012

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CENTRAL EXCISE

Notifications & Circulars

Finance Bill 2012 enacted – Consequential amendments: After the enactment of the Finance Bill, 2012 on 28th of May, five excise notifications namely, Notification Nos. 9, 10, 11& 18/2012-C.E., all dated 17-3-2012 and 23/2012-C.E., dated 8-5-2012 have been rescinded as they provided similar provisions/ benefits as are provided for in various Sections of the Finance Act, 2012. One such development, this year, was the increase in the standard and merit rates of Central Excise duty from 10% to 12% and from 5% to 6% respectively, in case of non-petroleum products. These changes are now part of the First Schedule to the Central Excise Tariff Act, 1985.

MRP based valuation – Abatement quantum revised: The percentage of abatement from the retail sale price, in case of MRP based assessment, has been enhanced to 35% for a number of items like air conditioners, domestic refrigerators, dish washing machines, computer monitors and TV set-top boxes. Notification No. 26/2012-C.E. (N.T.), dated 10-5-2012 which has amended Notification No. 49/2008-C.E. (N.T.) also withdraws MRP based assessment for air conditioners used by persons in the motor vehicles and commercial refrigerators.

Solar Power generation projects – Conditions for exemption to machinery therefor modified: Conditions for availing the exemption meant for machinery, auxiliary equipment and components required for the initial setting up of solar power generation projects or facility have been modified. As per Notification No. 26/2012-C.E., dated 8-5-2012 which has amended Notification No. 15/2010-C.E., the project developer has to pay the duty if the goods are not used in the project. Earlier, liability was on the manufacturer who cleared the goods for such projects.

Solar power generation projects – Cenvat Rule 6(6) benefits: The benefits under Rule 6(6) of the Cenvat Credit Rules, 2004 has been extended to supplies made for setting up of solar power generation projects or facilities. The said rule provides for non-applicability of substantive provisions of Rule 6 to certain specified supplies effected by a manufacturer using common inputs in dutiable and exempted goods. Further, Notification No. 25/2012-C.E. (N.T.), dated 8-5-2012 issued in this regard also changes the reference to Notification No. 6/2006-C.E., in the said Rule, to Notification No. 12/2012-C.E. It may be noted that Notification No. 6/2006-C.E. was superseded in this year Budget by the latter Notification.

Cenvat credit on structural components of boilers – Admissibility clarified: Cenvat credit on structural components is not admissible when they are used for laying of foundation or making of structures for support of capital goods/ boiler. C.B.E.& C. Circular No. 966/09/2012-CX, dated 18-5-2012 issued in this regard, clarifies that whether a particular structural component is a part of the boiler or a component to make structure for supporting the boiler is a question of fact and needs to be examined on a case to case basis. Earlier, Circular No. 964/07/2012-CX issued in April this year had stated that Cenvat credit would be available on structural components of boiler which are essentially parts of the boiler.

Ratio decidendi

Service of order – Speed post is not sufficient compliance: The Bombay High Court has held that service of an order by speed post cannot be accepted

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as valid service of the order under Section 37C(1)(a) of the Central Excise Act, 1944. The Court while reversing Tribunal's decision observed that it was obligatory for the department to either tender the copy of the decision to assessee or to send it by registered post with acknowledgement due [*Amidev Agro Care Pvt. Ltd.* v. *UOI* – 2012 (279) ELT 353 (Bom.)].

Components of bus bodies when not excisable: Components of bus bodies like window and door frames, windshield frame, battery box, engine bonnet, etc., made by the assessee while making bus bodies are not excisable as they are made for specific use in buses made by the assessee himself. CESTAT, Mumbai while holding so noted that these components could not be used in other buses made by other bus body builders and that no evidence was shown by the department to establish that such components were bought and sold by the assessee as commodity. It was held that the products in question were not marketable and hence not excisable [*MSRTC Central Workshop v. Commissioner* - 2012-TIOL-581-CESTAT-Mum.].

Bagasse – Cenvat Rule 6 provisions not applicable: The Allahabad High Court in its recent order has held that bagasse is not a manufactured product but is a waste/residue and that since the waste is never manufactured but it emerges in the process of manufacture of final product, provisions of Rule 6 of Cenvat Credit Rules, 2004 (CCR, 2004) are not applicable. The High Court observed that insertion of the explanation in Section 2(d) of the Central Excise Act, 1944 which defined 'goods', would not change the nature of bagasse from waste/residue to final product. Consequently, the High Court while quashing CBEC Circular dated 28-10-2009, held that the assessee was not required to reverse Cenvat credit under Rule 6 of CCR, 2004 [*Balrampur Chini Mills Ltd.* v. *Union of India* - Order dated 18-5-2012 of Allahabad High Court].

PVC floats – Classification of: PVC float used to support fishing net is classifiable under heading 39.26 of the Central Excise Tariff Act and not under Heading 89.27 ibid as floating structure according to CESTAT, Mumbai. The department had contended that the product was like a buoyant to the fishing net and that the latter heading was appropriate. The Tribunal noted that the product did not have integrated function of items such as buoys and beacons [*Commissioner* v. *Garware Marine Industries Ltd.* – 2012 (279) ELT 278 (Tri. – Mumbai)].

SERVICE TAX

Notifications & Circulars

Negative list being implemented from 1st of July: Finance Act, 2012 has brought a paradigm shift in the Service Tax regime by bringing the concept of Negative list to determine taxability. New Sections 65B, 66B, 66C, 66D, 66E, 66F and certain provisions of section 68 will come into effect from 1st of July, 2012 while Sections 65, 65A, 66, 66A and certain provisions of Section 67 will cease to have effect from the same date. As per the new provisions, all services except those provided for in the Negative list under Section 66D, are taxable. Notification Nos. 19 to 23/2012-S.T., all dated 5-6-2012 notifying effective date as 1-7-2012 have been issued. Further, Notification Nos. 12 to 14/2012-S.T., all dated 17-3-2012 will also come into effect from 1st of July. These notifications provide for exemptions/abatements for specified services. Notification No. 15/2012-S.T., dated 17-3-2012 which provides for the extent of tax

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payable by the receiver of service in some specified cases, under section 68(2) of the Finance Act, 1994, will also come into effect from 1-7-2012.

Settlement of Service Tax cases – New Rules introduced: New rules have been introduced wherein the procedure for filing and disposal of applications for settlement of Service Tax cases has been prescribed. The provisions providing for the settlement of Service Tax cases before the Settlement Commission were introduced this year in the Budget and have come into effect from 28th of May, 2012 when the Finance Bill, 2012 was assented to by the President of India. New Service Tax (Settlement of Cases) Rules, 2012, notified by Notification No. 16/2012-S.T., dated 29-5-2012 provide for filing of application along with a fee of Rs. 1000.

Compounding of Service Tax offences – New Rules notified: Provisions for compounding of Service Tax offences have since been introduced. New rules have been notified whereby an applicant may, either before or after the institution of prosecution, make an application, in the prescribed form to the compounding authority to compound the offence. The Service Tax (Compounding of Offences) Rules, 2012, notified by Notification No. 17/2012-S.T., dated 29-5-2012 prescribe specified compounding amounts in case of offences specified under Section 89 of the Finance Act, 1994. The said section itself was introduced last year as part of budget amendments when prosecution was re-introduced in Service Tax.

Rate of Service tax in specified cases: The Central Board of Excise and Customs has clarified that in case of 8 services as specified in the erstwhile Rule 7 of the Point of Taxation Rules, 2011, where the point of taxation was the date of payment of Service tax, the tax has to be paid @ 12% of the value if the payment for the service is received after 1st of April, 2012 even though the invoice had been raised before the said date. As per Circular No. 158/9/2012-S.T., dated 8-5-2012, 12% rate will also be applicable in cases where tax is being paid under the reverse charge and the payment has been made after the 1st of April of this year when the rate of Service tax was revised from 10% to 12%. The Circular also states that supplementary invoices may be issued to recover the differential amount.

Ratio decidendi

Refund of service tax – Relevant date when credit taken suo motu, reversed: Refund of excess Service Tax paid will not be barred by limitation in a case where suo motu credit of excess paid tax was taken and refund claim was filed when such credit was reversed on advice of the department. Ruling so, the Tribunal held that since the said suo motu credit taken of the excess paid tax was legal in view of precedent decisions, the relevant date for the purpose of refund would be the date of reversal of credit entry and not when the tax was initially paid [*Neptune Industries Ltd. v. Commissioner* – (2012) 35 STT 242 (Ahmedabad – CESTAT)].

Refund – Unjust enrichment when tax not payable: Merely because the invoice did not indicate that the Service tax was exempt, it cannot be concluded that the same was collected from the customers. CESTAT Ahmedabad in a case pertaining to refund of excess paid tax, due to exemption, has held that refund of service tax can not be denied stating that gross amount charged by the appellant is inclusive of the tax and hence incidence has been passed on to the service recipient. In this case, the

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appellant was availing exemption of small scale service provider but paid the tax with interest under protest as soon as they were informed that they were not eligible for exemption. After the Order-in-Original was issued dropping the proceedings, the appellant filed refund claim which was rejected while crediting the amount to the Consumer Welfare Fund. The Appellate Tribunal however held that the question that the gross amount included the tax amount or not would arise only when the service tax was payable. It was also noted that the tax was paid under protest [*Jageti & Co.* v. *Commissioner* - 2012 (26) STR 415 (Tri.-Ahmd.)].

Publishing details of medicines, not covered under BAS: In this case, the appellant collected advertisement charges from the manufacturers of medicines for publishing details of medicines manufactured such as name of product, name of company, price and packaging in a monthly publication 'Chemist News'. It was held that, in the absence of any information regarding the product such as its application, utilization, benefits etc, the activity cannot be said to be promotion of sale or marketing of goods and cannot be classified under business auxiliary service [*Federation of Gujarat State Chemists & Druggists Association* v. *Commissioner* - 2012-TIOL-549-CESTAT-AHM].

Receipts not in the nature of commission not taxable under Stock Broker Service: Commission or brokerage charged by stock broker, being consideration for taxable service provided, would alone be only liable to service tax and receipts not in the nature of commission or brokerage should not be taxed in disguise. The Tribunal held that charges like Misc. charges, Trade Guarantee Fund (TGF), Investor's Protection Fund (IPF), Stamp duty, Stock Exchange charges, Transaction charges, SEBI fees, Custom Protection Fund (CPF) and Demat charges were not to be included in the value of taxable service. [*LSE Securities Ltd* v. *Commissioner* - 2012-TIOL-593-CESTAT-DEL].

Relevant date for refund under Notification No. 41/2007-S.T.: The date of filing refund claim will be the relevant date to determine the percentage of the FOB value and not the date of export as per CESTAT. This case pertains to refund under Notification No. 41/2007-S.T., dated 6-10-2007 which grants refund based on FOB value of the exports. In this case, on the date of export, 2% of the FOB value was allowable as refund and on the date of filing refund claim, this percentage was increased to 8%/10% of the FOB value of export [*Shyamali Export* v. *Commissioner* - 2012-TIOL-595-CESTAT-MAD].

Rent-a-cab service – Scope: The scope of Rent-a-cab service was clarified by the Tribunal in its order where it was held that ordinary taxi operators on the street have not been brought under tax net under the entry for rent-a-cab scheme. In this case, the respondent was engaged in the business of giving taxi, mini buses, deluxe buses and non-deluxe buses on hire basis. He had a contract with various units of Indian Army for making available such means of transportation against request at the rates agreed to in the contract. The Tribunal held that the facts of the case were similar to the case of taxi operator on the street, only the rates were for a fairly long duration but each of the vehicles was not placed at the disposal of army for any fixed duration and therefore, the service provided was not classifiable under rent-a-cab service [*Commissioner* v. *Sapan Mehrotra* - 2012 (26) STR 219 (Tri.- Delhi)].

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CUSTOMS

Notifications & Circulars

Special CVD – Conditions for exemption to specified goods: The new revamped exemption scheme for Special CVD or SAD has come into force from 1st of June. As per Notification No. 32/2012-Cus., dated 8-5-2012 amending the basic Notification No. 21/2012-Cus., the conditions for exemption in case of specified goods have been changed so as to provide for declaration of State where the goods are intended to be taken for sale or for distribution on stock transfer basis Hitherto, the condition stated only intention to sell. Further, the importer has been provided with the option to give sales tax or CST registration number while retaining the option to provide VAT registration number.

Singapore – Exemption to goods imported therefrom broadened: Exemption notifications providing for exemption to goods imported from Singapore under the Comprehensive Economic Cooperation Agreement between India and Singapore have been amended to cover more goods. Notification Nos. 33 to 36/2012-Cus. all dated 14-5-2012 have been issued in this regard.

Drawback rates increased for gold and silver jewellery: The All Industry Rates of Drawback have been enhanced in the case of export of gold and silver jewellery and their parts. Drawback of Rs. 100.70 per gram is now available in case of gold jewellery while for silver jewellery, the new drawback rate will be Rs. 2590.80/kg as per Notification No. 46/2012-Cus. (N.T.), dated 24-5-2012.

Parallel imports when permissible: The Indian Finance Ministry has clarified that prohibition of imported goods for the purpose of protecting intellectual property rights as specified under Notification No.51/2010-Customs (N.T.), does not relate to all infringements under the parent Acts namely, Trade Marks Act, 1999, Designs Act, 2000, Patents Act, 1970, Geographical Indications of Goods (Registration and Protection) Act, 1999 and the Copyright Act, 1957. The CBEC Circular No. 13/2012-Cus., dated 8-5-2012 also states that the Patents Act provides for parallel imports while the Design Act prohibits same.

EPCG benefit available for spares for capital goods sourced from SEZ: Spares for the capital goods which have been sourced from the Special Economic Zones are eligible for benefit of Para 5.2A of the Foreign Trade Policy. DGFT Policy Circular No.65(RE-2010)/2009-14, dated 18-5-2012 states that such capital goods be treated as 'imported goods' and spares for them are hence eligible for EPCG Scheme.

Ratio decidendi

Refund – Unjust enrichment provisions when not to be invoked: The CESTAT, Delhi has held that unjust enrichment provisions need not be invoked when excess duty was paid due to mistake in EDI system and when the final print of the Bill of Entry mentioned lower rate of duty. Excess duty was paid due to non-updation of new exemption notification in the EDI system by the Customs. The Tribunal noted that no payment was adjusted towards Customs duty and that there was only excess payment in the bank. The Tribunal while allowing refund and while distinguishing the Apex court order in the case of *Solar Pesticides Pvt. Ltd.* - 2000 (116) ELT 401 (SC), held that in such cases certificate from chartered accountant was also not required [*Midi Extrusions Ltd.* v. *Commissioner* - 2012-TIOL-536-CESTAT-DEL].

Exemption to supplies to Mega power plants – Conditions: Customs Notification 21/2002-Cus. providing exemption to goods for mega power plants, does not provide any condition that the benefit is available subject to the provisions of the Exim Policy. CESTAT, Mumbai while expressing such prima facie view, waived pre-deposit in the case before it involving exemption under Notification No. 6/2006-C.E. to supplies made to mega power plant by following International Competitive Bidding procedure. Excise duty exemption was subject to the condition of exemption from Customs duty under Notification No. 21/2002-Cus. and the department sought to deny the exemption as EXIM policy provisions were not satisfied. [*Blue Star Ltd.* v. *Commissioner* - 2012-TIOL-603-CESTAT-MUM].

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News Nuggets

Annual Supplement to Foreign Trade Policy, released: The Annual Supplement for the year 2012-13 to the Foreign Trade Policy has been released on 5th June, 2012 by the Indian Commerce Ministry. The policy while granting some relief to exporters in terms of additional benefits and extension of some of the presently available concessions, also tries to restrict the outflow of foreign exchange by allowing domestic procurement against some of the popular duty credit scrips.

EPCG Scheme has been bestowed with major changes. Zero duty EPCG scheme has been extended for one year (upto 31 March 2013) with its enlarged scope to cover even units that are availing Technology Up-gradation Fund Scheme (TUFS) for another line of business. A new post-export EPCG scheme has been introduced under which the exporters may import capital goods on payment of duty and subsequently receive duty credit scrips on completion of export obligation. Since duties are paid at the time of import of capital goods, export obligation is set at 85% of the normal level.

Under EPCG scheme, EO would be only 25% of the normal export obligation in case of imports by eight North-Eastern states. EO under EPCG Scheme has been reduced to 75% of normal levels in respect of export of 16 specified green technology products.

Limited transferability of the scrips has been introduced in respect of Status Holder Incentive Scrips. The duty credit scrips granted under FPS, FMS, VKGUY, SHIS, MLFPS, SFIS and AIIS can be utilized for payment of central excise duty on goods procured from the domestic market. A new "e-BRC" system is being introduced whereby banks would electronically transfer information relating to foreign exchange realization to the DGFT's server. Exporters will not be required to make any request to the bank for issuance of BRC.

VALUE ADDED TAX (VAT)

Notifications

IT Products' list introduced in Chhattisgarh: The Chhattisgarh State Government has amended Entry 63, Part II of Schedule II of Chhattisgarh Value Added Tax Act, 2005 by Notification No. F-10/38/2011/CT/V (27), dated 16-5-2012 to provide for specified list of IT products instead of an omnibus entry "IT products including computers, telephones and teleprinters and wireless equipment and part thereof, DVD, CD". Further, Notification No. F-10/38/2011/CT/V (26) also dated 16-5-2012 notifies a list of 38 information technology products under Entry 63, Part II of Schedule II of the Act.

VAT Rates enhanced in Uttarakhand: The Uttarakhand State Government has enhanced the rate of VAT applicable to goods covered under Schedule II(B) from 4% to 5% and the goods falling under the residuary entry from 12.5% to 13.5% by Notification No. 189/2012/02(120)XXVII(8)/12 dated 28-5-2012. Simultaneously by Notification No. 494/2012/02(120)XXVII(8)/2012, also dated 28-5-2012, the previous notifications levying additional tax at 0.5% on goods covered under

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Schedule II(B) and 1% on goods covered under the residuary entry have been rescinded.

Ratio decidendi

Sale of flat & works contract – Maharashtra VAT Act provisions upheld: The Bombay High Court has upheld the constitutional validity of Section 2(24), proviso to Rule 58(1A) and Notification dated 9th July, 2010 issued under Section 42(3A) of the Maharashtra VAT Act. The constitutional validity of Section 2(24) of the Maharashtra Value Added Tax Act, 2002 as amended by Maharashtra Act XXXII of 2006 and Maharashtra Act XXV of 2007 were under challenge. It was contended that because of the amendment, an agreement for building and construction of immovable property which is not a works contract has been brought within the ambit and purview of the expression 'sale' and that the State Legislature was imposing a tax on a transaction which does not involve a sale of 'goods'. The court held that the effect of the amendment to Section 2(24) is to clarify the legislative intent that a transfer of property in goods involved in the execution of works contract including an agreement for building and construction of immovable property would fall within the description of a sale of goods within the meaning of the provision.

Dismissing the challenge to the proviso to Rule 58(1A) of the Maharashtra VAT Rules, 2005, the High Court observed that no material was brought on record to indicate that such provisions were arbitrary. It was also observed that composition scheme under Section 42(3A) as introduced by Notification dated 9th July, 2010 for registered dealers who undertake the construction of flats, dwellings, buildings or premises and transfer them in pursuance of an agreement along with land or interest underlying the land, was optional to registered dealer and there was no compulsion or obligation. The Court further declined to interfere as the terms of composition scheme were not established as being ex facie arbitrary and extraneous so as to be violative of Article 14 [*Maharashtra Chamber of Housing Industry* v. *State of Maharashtra* - 2012-VIL-35-BOM].

'Actually paid' not to mean 'ought to have been paid': 'Actually paid' means actual deposit in treasury and the same is not to be read down to mean 'ought to have been paid'. Bombay High Court in its recent order while dismissing the challenge to Section 48(5) of the Maharashtra Value Added Tax Act, 2002 (MVAT Act) has held that the context in which the words 'actually paid' are used in the MVAT Act, it means what has been as a matter of fact deposited in the treasury. In this case, the petitioner had challenged the constitutional validity of Section 48(5) which provided for the refund or set-off of tax 'actually paid', on the ground that the MVAT Act does not provide any machinery for the purchaser to ascertain whether the seller has actually paid VAT and that said section does not protect the purchaser in a case where the seller has not paid the tax into the government treasury which he had collected from the purchaser. It was contended that the words 'actually paid' used in section 48(5) be read down to mean 'ought to have been paid'. The court however observed that the concept of a set off presupposes that tax has been paid in respect of the goods in respect of which a set off is claimed and hence to allow a set off though the tax has not been paid actually would be to defeat the legitimate interests of revenue. It was held that in the overall statutory scheme of Section 48; sub-section (5) has a rational basis and foundation as in granting a set off, the legislature can impose conditions and that imposed in said section is not lacking in rationality. [*Mahalakshmi Cotton Ginning Pressing and Oil Industries* v. *The State of Maharashtra* - 2012-VIL-37-BOM].

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INCOME TAX

Notification

Transfer pricing methods – Introduction of new methods: The Central Board of Direct Taxes (CBDT) by Notification No. 18/2012 [F. No. 142/5/2012-TPL] dated 23-5-2012 has inserted a new Rule 10AB in Income Tax Rules, 1962 prescribing the application of an "other method" for computing the arm's length price in relation to an international transaction. This rule provides that for determination of the arm's length price in relation to an international transaction, any method which takes into account the price which has been charged or paid, or *would have been charged or paid,* for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances, considering all the relevant facts, can also be taken into account as alternate to the existing five methods. The rules are said to come into force from 1-4-2012 and shall apply to assessment year 2012-13 and subsequent years. This new provision would be of great help in evaluating transactions other than usual trading transactions e.g. pertaining to sale of unlisted shares, intangibles. However the notification does not specify circumstances in which it could be used. Therefore, just like existing methods, even in selecting "other method" as the most appropriate method, taxpayers will have to explain as to why any of the other five prescribed methods were rejected and why the "other method" is considered most appropriate to the facts and circumstances of the situation.

Ratio decidendi

Charging of interest under Section 234B not proper unless mentioned in the order: Examining the deletion of interest under Section 234B of the Income Tax Act, 1961, by the Tribunal, the Allahabad High Court held that though levy of interest is mandatory, such charge must be specific and clear. It observed that the actual charging of interest mentioning the provision of law under which it is charged must be made known to the assessee. In the instant case, the court did not accept that argument that even if assessment order or computation sheets do not provide for interest, since interest is mandatory, it can be charged in the demand notice [*CIT* v. *M/s Deep Awadh Hotels (P.) Ltd., Kanpur* ITA 81 & 82 of 2002].

Export sale proceeds may not constitute source of income outside India: The High Court of Delhi, in a recent judgment, distinguished between source of income and source of receipt of monies to hold that testing fees paid to a company in the U.S., which enabled the Indian company to export its products to Europe would be taxable as fees for technical services and be subject to deduction of TDS. The assessee argued that such testing charges were paid to earn an income from a source outside India and hence fell within exemption envisaged in Section 9(1)(vii)(b) of the Income Tax Act, 1961. However the court reasoned that the source of income is created the moment export contracts are finalized in India and also manufacturing activity was located in India. The importer located outside India was only a source of monies received and income component of export receipts was situated in India. [*Commissioner of Income Tax* v. *Havells India ltd,* Delhi High Court order dated 21-5-2012].

Unchanged definition of royalty as per DTAA applicable notwithstanding retrospective amendments: The

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ITAT, Mumbai has held, inter alia, that even while retrospective amendments to the definition of royalty in Income Tax Act, 1961 (The Act) have been effected, where the Indo-US DTAA is applicable, the beneficial definition as per the DTAA will hold force. It also stated that when payment is made by one non-resident to another non-resident outside India on the basis of contract executed outside India, Section 195 of the Act will not apply. The issue involved was disallowance under Section 40(a)(i) of the Act for non-deduction of TDS on payments made to a company based in the USA for provision of transponder. The department argued that the source rule would apply and non-existence of a PE was not relevant and payments made were for hire of transponder and in nature of royalty. [*B4U International Holdings Limited* v. *DCIT, Mumbai,* ITAT order dated 28-5-2012].

Disallowance under Section 14A – Onus to prove incurrence of expenditure: In this case the assessee-company had earned dividend income and long term capital gains and it contended that for earning these incomes no expenditure was incurred. The AO, however, applied provisions of Rule 8D read with Section 14A and disallowed a sum based in the formula provided thereunder. The Bench held that in the present case, the AO did not bring any evidence on record to establish that any expenditure had been incurred by the assessee for earning the exempt income and therefore, it was wrong on the part of the AO to compute disallowance of the expenses u/s 14A of the Act by merely applying Rule 8D(2)(iii) of the Rules. It also held that even for making an addition outside Rule 8D i.e. under section 14A prior to introduction of Rule 8D, the department has to establish incurrence of expense. The Tribunal also noted that expenditure like audit fee and directors' fee have to be incurred even if no activity is taking place in a company and hence apportioning such expenses towards investment is not desirable [*ACIT* v. *SIL Investments Ltd.* ITA No. 2431(Del)2010 dated 4-5-2012].

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