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Article

Tax planning in letter and spirit

By **R. Subhashree**

The media, in recent months, has been focussing extensively on tax planning, tax avoidance and aggressive tax planning. All ingredients that go into a good story- big monied corporates funnelling money to low-tax jurisdictions, abusing the legitimate means and incentives , the shocked ordinary tax payer with no resources to plan or effect similar savings… have been used to the hilt. Of course, there was no allegation of actual breaking of any law, or of 'tax fraud' as with seized assets or falsified documents. Thus, the companies observed the law in letter but perhaps not in spirit. The victims were, surprisingly, developed countries with elaborate tax laws, sizeable number of transnational entities and experience with international taxation. The recent G8 meeting pledged greater information sharing and coordinated efforts to curb abuse of legal arrangements.

Interestingly, post questioning and public outbursts threatening to boycott goods in UK, Starbucks agreed to pay around 10 million pounds in taxes in succeeding years irrespective of profit or loss. It had been reporting losses in the previous years. Taxes are not voluntary payments or donations. The question is not about duty to pay taxes or the freedom to arrange one's financial transactions or economic affairs. It is one of fairness and certainty to both parties – the tax payer and the state.

Leveraging differences in market price, tax rates, manufacturing costs is not a new phenomenon. But, the size of evasion alleged, coupled with the fact that instead of avoiding double taxation, double non-taxation resulted, has revenue authorities in Europe and the US urging reform and correction.

The entities being investigated set up subsidiaries with little or no operations in tax favourable jurisdictions and transferred earnings. By applicable definitions of permanent establishment (PE), business connection, earning, taxable income etc, the countries where most of the transactions happened or earning arose received no tax on them. One method was to create a subsidiary as a licensee or owner of intellectual property and transfer huge payments towards royalty, marketing advice etc. In the case of companies engaged in e-commerce, raising invoice on overseas subsidiary and location of servers in low tax havens, enabled companies to avoid paying tax on advertising or other revenues earned in the country where the actual transaction took place.

So this brings us to the basic question - what should be taxed? The reason for collecting taxes is said to be that every person enjoying the infrastructure and stable political/economic environment to earn the income should contribute his share to the government that has enabled it. Income – received, arising, accruing, deemed to be received/arise/accrue would be subject to tax. Income is more than just cash inflow and could cover gains, benefits, appreciation in value and so on. Different jurisdictions exempt certain items like royalty, capital gains, dividends, etc., based on policy considerations. In the said cases of abuse, the concept of income has become hazy and subject to varied interpretations. Further, tax rules based on territorial limits seem inadequate to take care of digitalisation of commerce. For instance, in *ITO* v. *Right Florists Pvt. Ltd.* [ITA No. 1336/

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Kol./2011 decision dated 12-4-2013 (ITAT Kolkata)], it was held that a website (virtual presence) cannot constitute PE and the servers hosting the website should be in taxable territory to constitute PE.

Permanent Establishment

The concept of permanent establishment is defined in different ways in different treaties. For instance, as per a 1996 decision of the German Federal Tax Court, a pipeline running through Germany using which a Dutch company transported oil, was held to be a PE though there was any personnel stationed / engaged to operate the line within Germany nor did it have a place of business. A PE can be a fixed place of business, service PE, dependent agent, installation PE and so on.

Harmonising all definitions across jurisdictions or even within a country is idealistic but impractical. For instance the Authority for Advance Rulings (India) held that no inference can be drawn from the India-US treaty MOU in order to interpret terms in the India-Netherlands treaty[1]. Each country arrives at its own point of resolution between ceding tax base, reducing rates and remaining an attractive investment destination. Tax laws will be peculiar to the State, its level of development, demography, advantages of natural resources, scarcity of labour and so on. Other suggestions have been to simplify the rules, have a flat rate of tax or attribute earnings on basis of operations.

Aggressive tax planning

A European Commission recommendation in December 2012 states that while signing Double Taxation Avoidance Agreements (DTAAs), the parties must draft the terms so that an item is exempt only if it is subject to tax in the other contracting state or states. While this may result in greater scrutiny of transactions and exchange of information, it does not solve the problem of structuring. As in the case of Apple which negotiated a low tax rate with Irish Authorities[2].

Anti-avoidance provisions

General anti-avoidance or anti-abuse rules (GAAR) are said to empower the authorities to look into the substance of a transaction in order to determine whether a transaction is genuine or not. However India's experience in framing and trying to implement the same is enough indication that it is not an easy option. Britain has brought in GAAR but the task of proving that an 'arrangement' is abusive or 'one of the main purposes' is to attain a tax benefit can be cumbersome.

When governments need revenue and particularly during times of recession, they will resort to every tool at their disposal, as Greece did with 'presumptive taxation'- which works more like wealth tax and is payable on the basis of assets owned even when a person does not have 'income'. Tax planning and structuring to the point of over-leveraging may not work. As in the case of companies trying to push up return on equity by having a small equity base and rest of the funds through fixed-charge bearing funds (say debentures). The model works as long as rate of earnings far exceed the fixed charges. Perhaps erecting zero-tax mazes is reaching a saturation point. Companies need to be able to substantiate their choices. For this, they need an enabling

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[1] http://aarrulings.in/it-rulings/uploads/pdf/1323783672_perfetti.pdf

[2] Subcommittee-memo-on-offshore-profit-shifting-apple.pdf

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environment where the tax regime is perceived as fair and both law and its implementation are certain.

'It's a cup of coffee. It's not an internal combustion engine. I take the point about branding and advertising, but the generic coffee-making process is not that difficult'[3] – the Public Accounts Committee observed on being told that the value creation happens outside UK – to serve coffee in UK, premium beans are bought through a Swiss entity and the recipe is obtained from a Dutch entity .

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CUSTOMS

Notifications & Circulars

Risk Management System (RMS) introduced in exports: After introduction of Risk Management System (RMS) in 2005 for imports, the Central Board of Excise & Customs (CBEC) has now decided to introduce the same for exports at the Customs locations where the Indian Customs EDI System (ICES) is operational. The present practice of routine verification of self-assessment and examination of shipping bills (SB) will be discontinued, and the RMS will give the message to ICES as to whether the SB should be taken up for verification and examination or 'let export order' allowed upon payment of applicable duty. As per Circular No. 23/2013-Cus., dated 24-6-2013, in the first phase of implementation of RMS, output will be given to ICES in respect of consignments upto the verification stage, while in its second phase the RMS will also aid in selecting shipping bills for drawback scrutiny and Post-Clearance Audits (PCA). Accordingly, the Board's existing circulars regarding examination and assessment norms would stand modified, while the Accelerated Clearance System vide Circular No. 30/2003-Cus dated 4-4-2003 would be phased out. RMS for exports will result in low risk consignments being cleared based on self-assessment of the exporters and reduce time for clearance of cargo. To begin with, this system will be introduced from 15-7-2013 at ICD Mulund and ICD Patparganj.

Filter elements – Classification of: Elements of filters are to be classified as per their constituent material. Elements (of filters) that are made up of paper would be classifiable under Heading 4812 or 4823 and if they are made up of textile material for technical use then under Heading 5911. If they are made up of glass then Heading 7019 will be applicable. Filters by themselves are classifiable under Heading 8421. CBEC Circular No. 24/2013-Cus., dated 27-6-2013 issued in this regard relies on explanatory note to Heading 84.21 under the World Customs Organization's HSN.

Electrical Energy – Import Policy revised from 'restricted' to 'free': The Director General of Foreign Trade (DGFT) has amended Import Policy for import of Electrical Energy classifiable under Tariff Item 2716 00 00 in Schedule I to the Customs Tariff Act, 1975 from 'restricted' to 'free'.

[3] http://www.publications.parliament.uk/pa

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DGFT Notification No. 27(RE-2013)/2009-2014, dated 5-7-2013 also states that import of electricity will not, therefore, require an authorisation.

Milk and milk products from China – Import prohibitions extended: Prohibition on import of milk and milk products (including chocolates and chocolate products and candies/confectionary/food preparations with milk or milk solids as an ingredient) from China has been extended till 23-6-2014 as per DGFT Notification No. 23(RE-2013)/2009-2014, dated 18-6-2013. Earlier, the prohibition imposed by notification dated 2-7-2012 was to expire on 23-6-2013.

Customs Brokers Licensing Regulations, 2013 notified: Customs House Agents Licensing Regulations, 2004 have been superseded by the Customs Brokers Licensing Regulations, 2013. The basic structure and the outline of the 2004 regulations remain unchanged. This change brought by Notification No. 65/2013-Cus. (NT), dated 21-6-2013 is consequent to the amendment carried out this year through the Finance Act, 2013 wherein reference to 'Custom House Agent' in the Customs Act, 1962 was substituted with 'Customs Broker'. The obligations of customs broker include exercising due diligence to ascertain the correctness of any information provided to a client relating to clearance of cargo, not withholding information contained in any order or public notice on cargo clearance issued by Commissioner of Customs and conducting verification of the antecedent and correctness of Importer Exporter Code (IEC) number. A new obligation of informing any change of postal address, telephone number, e-mail etc to the Department within one month has also been imposed.

Ratio decidendi

Refund of SAD on clearances by SEZ to DTA: Benefit of exemption extended to Special Additional Duty (SAD or Special CVD) by way of refund under Notification No. 102/2007-Cus. will be available in cases of domestic clearances of goods from SEZ, if all the conditions stipulated under the said notification are satisfied. CESTAT, Ahmedabad was of the view that words "at the time of importation" must be read holistically with Section 30 of the SEZ Act, 2005 relating to duties of customs on goods cleared from SEZ to DTA. It was noted that intention of the Government is to grant refund of SAD when imported goods are subsequently sold, subject to fulfillment of conditions specified in the said notification. [*Adinath Trade Link* v. *Commissioner* - 2013-TIOL-874-CESTAT-AHM]

Central Excise officers empowered to issue notice for violation of Customs (IGCR) Rules: Under Rule 8 of the Customs (Import of Goods at Concessional Rate of duty for Manufacture of Excisable Goods) Rules, 1996 (IGCR Rules), only the Assistant Commissioner of Central Excise can initiate proceedings against the importer on violation of conditions of the Notification No. 36/96-Cus., according to CESTAT, Mumbai. The appellant had claimed exemption under said notification read with Notification 13/97-Cus., and IGCR Rules. However, certain quantity of inputs could not be used for manufacture of finished goods and a demand notice was issued by the Commissioner of Customs, Pune. The Tribunal allowed the appeal holding that the demand notice issued by the Commissioner of Customs was beyond jurisdiction. [*PCS Industries* v. *Commissioner* - 2013-TIOL-1004-CESTAT(MUM)]

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Refund of excess duty paid due to mention of wrong currency in bill of entry: Mentioning of wrong currency in the bill of entry resulting in application of wrong exchange rate has been held by CESTAT, New Delhi as clerical mistake. It was further held that when on account of such clerical error a higher amount of duty has been paid, re-assessment is not required before filing of refund claim as this clerical mistake can be corrected under Section 154 of the Customs Act, 1962. [*Secure Meters Limited* v. *Commissioner* - 2013-TIOL-984-CESTAT-DEL]

Stay of redemption fine in the absence of provisions: Placing reliance on the judgment in *Babubhai Patel & Co.* - 1984 (17) ELT 152 (Tribunal), CESTAT, Mumbai has held that a stay can be granted against recovery of redemption fine. It was held that stay can be granted under the incidental and ancillary powers of an appellate authority, even though Section 129E which deals with grant of stay, does not specifically mention redemption fine. [*Gammon India Ltd.* v. *Commissioner* - 2013-TIOL-928-CESTAT-MUM]

CENTRAL EXCISE

Notification

Legal Metrology (PC) Rules amended: Legal Metrology (Packaged Commodities) Rules, 2011have been amended. The definition of the terms 'institutional consumer' and 'industrial consumer' have been rationalized and instead of being part of explanation, they have been inserted under a separate rule to make them applicable to the entire rules. The term 'retail consumer' has been re-defined by excluding the proviso. The new definition of 'retail package' includes industrial consumer and institutional consumer also. The said amendments have been made by Notification No. GSR 359(E) dated 6-6-2013.

Ratio decidendi

Cenvat credit – No limit prescribed for dutiable/exempted goods in Rule 6: Benefit of Rule 6(3)(1)/6(3)(b) of the Cenvat Credit Rules, 2004 is available even when the quantity of dutiable goods manufactured is very less. CESTAT, New Delhi while holding so observed that there is no percentage fixed in the Cenvat Credit Rules to decide that if dutiable goods are much below that percentage, the manufacturer will be treated as exclusive manufacturer of exempted goods. It was noted that said Rule 6 gives an option to the manufacturer to pay an amount equal to 5% of the value of exempted goods. Earlier, the department had denied the benefit observing that quantity of dutiable goods manufactured was very less. [*Oberthur Card System Pvt. Ltd.* v. *Commissioner* – 2013 (292) ELT 515 (Tri.-Del.)].

Supply against Advance Release Order not necessary to be duty free: CESTAT, Mumbai has held that in case of goods procured against ARO or the invalidation letter issued by the DGFT, it is not mandatory to avail the benefit of Notification No. 44/2001-C.E. (N.T.). The Tribunal in this regard noted that the supplier had not claimed refund of terminal excise duty but in fact has paid substantial amount of duty from PLA and hence there was no case of shifting of credit. It was observed that the rules also do not require clearance of goods duty

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free by following procedure under said notification. The Tribunal hence allowed the Cenvat credit to the appellant-receiver of goods as there was no loss of revenue. [*Oleofine Organics (India) Pvt. Ltd.* v. *Commissioner* – 2013 TIOL 896 CESTAT-Mum.]

MRP based valuation when words "industrial use" used on package: CESTAT, Ahmedabad has held that just because the assessee had mentioned "exclusively for industrial use" and "not to be sold in loose", Rule 34 of the Standards of Weights and Measures (Packaged Commodities) Rules cannot be compulsorily applied. The Tribunal noted that a manufacturer has a choice of making a claim of not printing MRP on the package and that if he makes a choice to take the benefit of Rule 34, he is bound to print on the package the words specified in the rule and also show that he is eligible to exemption from printing MRP. It was hence held that goods could not be taken out of the purview of the Weights and Measures Rules only because words "industrial use" were found on the goods. Assessment was hence allowed under Section 4A of the Central Excise Act, 1944. [*Mexim Adhesive Tapes Pvt. Ltd.* v. *Commissioner* – 2013 TIOL 837 CESTAT-Ahmd.]

MRP valuation – Applicability to boxes containing retail packs: Cardboard boxes in which retail packs are removed by the assessee to their job-workers for packing in different retail packs (Celebration packs) cannot be said to be wholesale packages. The Tribunal in this case observed that wholesale packages are packages which are sold to intermediary in bulk to enable such intermediary to sell, distribute or deliver commodity in smaller quantity, and as job-workers were not intermediaries in this case who would sell or distribute the retail packs, the cardboard boxes are not wholesale packs. It was hence held that valuation of such goods was to be done under Section 4A of the Central Excise Act, 1944 on the basis of the MRP printed on the retail packs contained therein. [*Cadbury India Ltd.* v. *Commissioner* - 2013 (292) ELT 468 (Tri-Mum.)].

Rebate when ARE-1 not produced: Bombay High Court has allowed the claim for rebate of central excise duty in case of exports when the assessee was not able to produce the original or the duplicate copy of the ARE-1 before the authorities. Assessee had, in this case lost the documents and had also filed FIR in this regard. The revisionary authority was of the view that production of such document duly endorsed by the customs authorities was essential to prove export of duty paid goods. The court however noted that the procedure prescribed in the notification and the CBEC Manual is to facilitate processing of rebate application and to enable the authorities to be satisfied of the conditions of export of goods and of payment of duty thereon and that such procedure cannot be raised to the level of mandatory requirement. [*UM Cables Ltd.* v. *Union of India* – 2013 TIOL 386 HC-Mum-CX]

Exemption to waste & scrap – Effect of marketability: CESTAT, Mumbai has allowed the benefit of exemption under Notification No. 89/95-C.E. to the manufacturers of refined oil on their clearance of gums, waxes, recovered oil, fatty acids, etc. arising during the manufacture of refined oil. The department in this case was of the view that the above mentioned goods were not waste and scrap in as much as they had marketability and were in fact sold to the manufacturer of washing soaps. The Tribunal however held that exemption under the said notification for waste, etc. was not

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dependent on marketability for the simple reason that exemption presupposes excisability which in turn presupposes marketability. It was observed that the waste exempted under the said notification is necessarily such waste which is marketable, excisable and dutiable, as exemption will arise only when the goods are otherwise dutiable. Contention of the department that goods should be of no value was also rejected by the Tribunal. [*Maheshwari Solvent Extraction Ltd.* v. *Commissioner* – 2013 TIOL 978 CESTAT-Mum.]

Cenvat credit on inputs used in the manufacture of capital goods permanently attached to earth: Cenvat credit on steel items used for fabrication of cooling bed for rolling mills, where cooling bed gets permanently attached to the earth, is permissible. CESTAT, New Delhi has held that as rolling mills qualify to be capital goods and steel items procured by the assessee are necessary for manufacture of part of capital goods, the same shall qualify as inputs. The Tribunal while allowing such credit relied on the judgment of Chhattisgarh High Court in the case of *Associated Cement Company Ltd.* [2011 (267) ELT 55 (Chhattisgarh)]. The department had relied on the decision in the case of *Vandana Global Ltd.* - 2009 (238) ELT 420 (Tri-LB). [*Jodhpur Alloys Pvt. Ltd.* v. *Commissioner* - 2012 (292) ELT 448 (Tri-Del.)]

SERVICE TAX

Notification

SEZ - Exemption to services received by Unit or Developer of SEZ: Exemption to services received by a unit in SEZ or developer of SEZ provided under Notification No. 40/2012-S.T. has been amended by new Notification No. 12/2013-S.T. dated 1-7-2013 superseding the earlier one. In case of upfront exemption, consumption within SEZ is not provided for in the new notification but the service shall be exclusively used for the authorized operations. The relevant Form A-1 required for claiming such exemption has been suitably amended. A quarterly statement in Form A-3 shall be filed providing details of specified services received without payment of service tax. Refund shall be admissible in respect of the specified services that are commonly used for authorized operation as well as non-authorized operations, or the specified services on which *ab initio* exemption is admissible but not claimed. The formula to compute refund has been omitted and the service tax paid on the specified services that are common to the authorized operation in an SEZ and the operation in DTA unit shall be distributed as per Rule 7 of the Cenvat Credit Rules, 2004.

Ratio decidendi

Manufacturing under own brand name and selling through marketing agent does not amount to BAS: The assessee had entered into a marketing agreement and manufactured goods using raw material supplied by the other. The goods were manufactured under the assessee's own brand name. Holding this to be job work, the department sought to collect service tax under Business Auxiliary Service. The Tribunal however, held that the assessee cannot be said to be a job worker and no service tax is to be levied. It observed that service

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tax, if any, could only be collected from the other party – selling agents of the assessee. [*Y.M. Krishna SSK Ltd.* v. *Commissioner,* 2013 (30) S.T.R. 681 (Tri. – Mumbai)]

'Renovation' includes dismantling of existing structure – Credit admissible: Accepting the reasoning of the lower authorities, the Tribunal held that dismantling the existing structure is part of 'renovation' and Cenvat credit can be availed on services used in dismantling the existing structure in the factory. The department had argued that mere dismantling was not covered by the term renovation. However it was opined that renovate includes rebuilding, repair etc and renovation is done by dismantling the structure in part or in full. [*Commissioner* v. *Jindal Pipes Ltd.*, 2013 (30) S.T.R. 686 (Tri. – Del.)]

Input service credit prior to date of registration can be distributed: Where there was no dispute as to receipt of input services by head office and the services being capable of being distributed, the head office could distribute the same though on that date, it had not obtained Input Service Distributor (ISD) registration. In the instant case, credit was distributed by head office by issuing invoices before obtaining registration as ISD. [*Precision Wires India Ltd.* v. *Commissioner,* 2013 (31) S.T.R. 62 (Tri. –Ahmd)]

Cenvat credit distribution without taking ISD registration: CESTAT, Bangalore has held that Input Service Distributor registration is required only when Cenvat credit is distributed, but, if the credit is only transferred from one manufacturing unit to another unit of Large Taxpayer Unit (LTU), the transaction is governed by Rule 12A of the Cenvat Credit Rules, 2004. It was held that the authorities should determine whether the transaction was 'transfer' of credit or 'distribution' of credit. The Tribunal observed that sub-rule (4) of Rule 12 does not require mention of ISD registration number in the transfer challan. The Tribunal hence held that the contention that since challans did not contain registration number and hence were not valid for taking Cenvat credit, had no statutory backing. [*3M India Ltd.* v. *Commissioner,* 2013 TIOL 913 CESTAT-Bang.]

Incentive received, bad debts and discount not includible in taxable value: Examining the includibility of certain items for valuation of services, the Tribunal held that incentive being a receipt for appreciation does not form part of consideration. It also held that, non receipt of consideration which becomes a bad debt and cash discount which does not enter consideration received cannot be included for valuation for the purpose of charging service tax. [*Commissioner* v. *Facinate Advertising & Marketing,* 2013 (31) S.T.R. 77 (Tri. – Del)]

No service tax liability when project office not to be considered as PE: The Tribunal held that the project office of the appellant company in India, which has been set up for implementation of the project in terms of agreement between the Government of Uttranchal and the Canada based appellant company, cannot be called the permanent establishment of the appellant company in India, as the project office is not doing any work other than the work relating to the project and would get wound up once the project is completed. The term "permanent establishment" referred to in sub-Section (2) of Section 66A would cover branch or agency of a foreign based company, which has been set up in India to carry out its business on long

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term basis and this term would not cover the project office. Thus, in case of deputation of some of its employees to project office in India, the provisions of Section 66A would not be applicable and this has to be treated as where the appellant have provided the service to itself. [*SNC Lavalin* v. *Commissioner*, 2013-TIOL-911-CESTAT-DEL]

Agreement for joint working not covered under Management Consultancy service: In this case, the appellant and the other company agreed to integrate and jointly carry out day-to-day functions in both the companies in various areas specifically mentioned in the said clause. It was also agreed that the functions would be used jointly and the activity cost incurred by either of the parties in agreement would be shared proportionately between the appellant and the other company. In other words, the terms and conditions of the agreement clearly show that the agreement was for rendering executory services and for sharing of the cost towards the same. The Tribunal came to a conclusion that the agreement did not result in rendering of management consultancy services by the appellant to the other company. [*Glaxo Smithkline Pharmaceuticals Ltd.* v. *Commissioner*, 2013-TIOL-867-CESTAT-MUM]

Royalty charges paid 'in relation to manufacture': Input services used in relation to manufacture cover royalty paid on IPR services for using brand name of another on the product manufactured. The assessee manufactured and cleared plywood under his own name as well as with brand name of another affixed on some of the finished goods. The department sought to deny credit on the ground that the assessee was only trading in goods and not manufacturing the same. Fortified by the finding of the Range Superintendent that the assessee was engaged in manufacture of the plywood using its own and another's brand, the Tribunal held that Cenvat credit was admissible in respect of royalty paid. [*Century Plywoods (I) Ltd.* v. *Commissioner*, 2013 (31) S.T.R. 58 (Tri. –Kolkata)]

No penalty for belated filing of nil return: Affirming the case before it to be fit for invoking waiver of late fee as per Rule 7C of Service Tax Rules, the Tribunal granted relief to the assessee. In the instant case, the assessee had not rendered any taxable service during the impugned period and had filed nil returns, though belatedly. [*Suchak Marketing Pvt. Ltd.* v. *Commissioner*, 2013 (30) S.T.R. 593 (Tri. – Kolkata)]

VALUE ADDED TAX (VAT)

Notifications

Submission of information online in Form DP-1 in Delhi: Commissioner, Value Added Tax, Delhi has directed all the registered dealers under the DVAT Act, 2004, as on 31-3-2013 to furnish the updated dealer profile in Form DP-1 online, using their login ID and password. Notification No. F.3(352)/Policy/VAT/2013/231-241, dated 28-5-2013 issued in this regard states that it is mandatory for all registered dealers to inform the Commissioner about any amendment in respect of their business activities, as detailed in Section 21 of the DVAT Act. It also states that it is mandatory for all

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registered dealers to declare the name of manager of business, PAN and Importer Exporter Code (IEC) under Section 95. Notification No. F.3(352)/Policy/VAT/2013/314-324, dated 20-6-2013 as amended by notification dated 5-7-2013 has further partially modified the earlier notification and now prescribes different dates for different assessees. As per the amendment, this information in Form DP-1, shall be submitted by the dealers online as per following schedule:-

Class of Dealers	Last date for submission of information online in Form DP-1
Dealers having GTO > Rs. 50 lacs in the year 2012-13	7-8-2013
Dealers having GTO > Rs. 25 lacs and < Rs. 50 lacs in the year 2012-13	14-8-2013
Dealers having GTO < Rs. 25 lakhs in the year 2012-13	21-8-2013

Sun glasses not covered under Spectacles: Commissioner VAT, Delhi has clarified that spectacles and sun glasses are different from each other and hence rate of VAT on sun glasses would be 12.5% as the same are unspecified items. Ruling under Section 85 of the Delhi VAT Act issued by Notification No. 337/CDVAT/2013/163, dated 11-6-2013, clarifies that Entry No. 115 of Schedule III to Delhi VAT which reads as *"Spectacles, parts, and components thereof, contact lens and lens cleaner"* pertains to frames bearing lenses for corrective purposes while sun glasses may be worn for protection against glare of the sun, protection against flying debris or for just aesthetic purposes. The ruling being clarificatory in nature will be effective retrospectively from 1st April, 2005.

Ratio decidendi

Franchise agreement does not attract provisions of Kerala VAT: Royalty received by a company from the franchisees for use of trademark is not liable to VAT under the Kerala VAT Act, 2003. The Division Bench of the Kerala High Court held that the tests laid down in the case of *BSNL* [(2006) 3 SCC 1], for a transaction to qualify as transfer of right to use goods, are squarely applicable to the present case. The Court observed that two of the conditions laid down in the *BSNL's* case namely, 1) the right of the transferee to the exclusion of the transferor; and 2) the transferor not having the right to transfer the same rights to any other person during such period of transfer, are not satisfied in the present case. The assessee had contended that the transaction attracted service tax alone under the taxable category of 'franchise services', and having paid service tax, the same would not be exigible to VAT. The Single Judge of the Court but had held that royalty received by the dealer would be liable to tax under Section 6(1)(c) of the KVAT Act. [*Malabar Gold Private Limited* v. *Commercial Tax Officer, Kozhikode* - 2013-VIL-49-KER-ST]

West Bengal Tax on Entry of Goods into Local Areas Act, 2012 is ultra vires Constitution of India: Calcutta High Court has held that West Bengal Tax on Entry of Goods into

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Local Areas Act, 2012 is *ultra vires* Article 304(b) of the Constitution of India. The court noted various purposes stated in Section 18 of the Act for which the proceeds of the levy under the impugned Act were to be used, and held that, going by the plain ordinary meaning of Section 18, many of the benefits contemplated therein might be part of the general obligations of the State to its tax payers and the people of the State and hence utilization of the fund for the functions, like construction of roads and bridges for linking markets, construction of railway over-bridges and subways, supply of electricity and water and maintaining pollution free environment, has a remote/no connection with the development of trade and commerce. The impugned Act was held not to be compensatory in nature due to the lack of disclosure of any quantifiable benefits. It was also noted that prior assent of the President was further not obtained by the State in this case. [*Bharti Airtel Limited* v. *State of West Bengal* - 2013-VIL-48-Cal]

INCOME TAX

Circulars

Revised guidelines on transfer pricing of R&D centers: Following various representations from industry and professionals, by way of Circular No. 5 of 2013 dated 29-6-2013 CBDT has withdrawn Circular No. 2/2013 dated 2-3-2013 regarding applicability of Profit Split Method (PSM) as Most Appropriate Method (MAM) in respect of Research & Development Centers and transfer / use of intangibles. The circular had provided that the Transfer Pricing Officer, before applying Comparable Uncontrolled Price (CUP) Method or Transactional Net Margin Method (TNMM) should record reasons for not adopting PSM as MAM.

Further, Circular No. 6 of 2013 dated 29-6-2013 has been issued to replace Circular No. 3 of 2013 dated 26-3-2013 to provide guidance on identifying contract R&D centers with insignificant risk. The new circular recognizes three categories of R&D centers i.e. Entrepreneurial in nature, Cost sharing basis and contract R&D centers. It seeks to provide guidelines for determination of risk level as against the cumulative conditions in erstwhile circular by suggesting to examine as to who performs the economically significant functions e.g. conceptualization and design of product, who provides funds / capital for research, who has and actually carries out supervision and control over the research activities and whether the parent entity is from a low tax jurisdiction as prescribed for the purpose of Section 94A in which case a rebuttable presumption made is that the said parent is not controlling the risk. The circular also emphasizes the relevance of conduct of the parties over the written contracts so as to ascertain as to who is the real owner of the intangible developed as against mere legal owner.

Ratio decidendi

Transfer pricing provisions not applicable to an investment in share capital and to transactions where there is no income: In the instant case, the assessee was engaged in the business of manufacture and sale of distribution and power transformers and rural electrification projects on turnkey basis. The assessee had made investment of Rs. 211.88 millions in its overseas subsidiaries. The transaction of investment in share capital of overseas subsidiaries was treated as an '*international transaction*' under Section

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92B by CIT(A). He ordered a fresh assessment referring these transactions to the TPO as per the provisions of Section 92C of the Income-tax Act for determining the arm's length price. On appeal, the Tribunal held that the transactions were not in the nature of those referred to Section 92B and transfer pricing provisions were not applicable as there was no income arising from the transaction. [*Vijay Electricals Ltd.* v. *Addl. CIT* (ITA No. 842/Hyd/2012) ITAT (Hyd) dated 31-5-2013]

No disallowance under Section 40(a)(ia) for short deduction of TDS: In the instant case, the assessee made certain payments to various contractors, however, tax was deducted at source at a rate lower than that prescribed under the Act. The expenditure was disallowed under Section 40(a)(ia) by AO and CIT (A). On appeal, the Tribunal observed that a comparative reading of Section 201(1A) and Section 40(a)(ia) shows that a case of short deduction of tax is not covered by Section 40(a)(ia) though the same is covered by Section 201(1A). Accordingly, the Tribunal opined that the expenditure the genuineness of which is not doubted, should not be disallowed under Section 40(a)(ia) even if there is short deduction of tax in those cases. [*Apollo Tyres Ltd.* v. *DCIT,* ITA No. 31/Coch/2010, ITAT (Cochin) Order dated 29-5-2013]

Direct payment to Group Gratuity Scheme – Deduction allowable under Section 36(1)(v): In the instant case, a gratuity fund duly approved by the CIT was set up by the assessee. However, instead of contributing towards the approved gratuity fund set up by itself, the assessee made the initial payment and the annual premium directly to the LIC (Group Gratuity Scheme).The claim for deduction was disallowed by the AO on the ground that payment towards the gratuity fund was not made to an approved gratuity fund and therefore not allowable under Section 36(1)(v). The Supreme Court observed that the real intention behind Section 36(1)(v) is that the employer should not have any control over the funds of the irrevocable trust created exclusively for the benefit of the employees. Since the assessee had absolutely no control over the fund created by the LIC for the benefit of the employees of the assessee, the conditions stipulated in section 36(1)(v) were satisfied and the assessee could claim deduction. [*CIT* v. *Textool Co. Ltd.* - Civil Appeal No. 447/2003 (SC)]

Tax free transfer of land by selling shares: In the instant case, the assessee was holding 98.73% shares in another which had purchased a plot of land from its group company for Rs. 3.75 crores and the said land was the only asset it had. The assessee sold its shareholding and paid STT and claimed the long-term capital gain on shares to be exempt by virtue of Section 10 (38). However, the assessing officer rejected the said claim alleging that it was a device adopted by the assessee to avoid taxes on the transfer of land. On appeal to the High Court applying the principle '*tax planning may be legitimate provided it is within the framework of law*' laid down by the Apex Court, held that the assessee has a legal right to resort to such a tax planning and take advantage of the benefit of the law or loopholes in the law. [*Bhoruka Engineering Inds. Ltd.* v. *DCIT,* ITA No. 120/2011 (Karnataka)]

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