



# Direct tax

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### Mumbai Tribunal

Interest on refund is eligible on tax paid in compliance with S. 195(2), which is later refunded.

Ss. 195(2), 244A; A/y 2007- 08 & 2008-09; in favor of taxpayer

The taxpayer is a non-resident company. While making payment to another non-resident, the taxpayer made an application to the tax authority under section 195(2) regarding withholding of tax obligations. The tax authority held that payment made to another non-resident was taxable in India. Accordingly, the taxpayer deposited tax in India. Aggrieved by the order, the taxpayer filed an appeal before the first appellate authority, which held that this income was not taxable in India. Therefore, the amount deposited pursuant to the order was refunded without granting interest as per section 244A of the Income Tax Act (ITA), relying on various Central Board of Direct Taxes (CBDT) circulars. Aggrieved, the taxpayer appealed before the first appellate authority, which held that the taxpayer was eligible for interest under section 244A of the ITA, since refund is arising as per the provisions of the ITA and not according to the circular. Aggrieved, the tax authority appealed before the tribunal.

Held, since tax was deposited pursuant to the order passed by the tax authority, the taxpayer was eligible for interest on refund since this was arising according to the provisions of the ITA. Circular No. 7 of 2007, complied with by the tax authority, states that no interest shall be granted if this arises against the order appealed under section 248. However, a circular cannot override the provisions of the Act, and hence, the taxpayer was eligible for

interest on refund arising out of tax paid in compliance with the provisions of section 195(2) of the ITA. Hence, the appeal to the tax authority was dismissed.

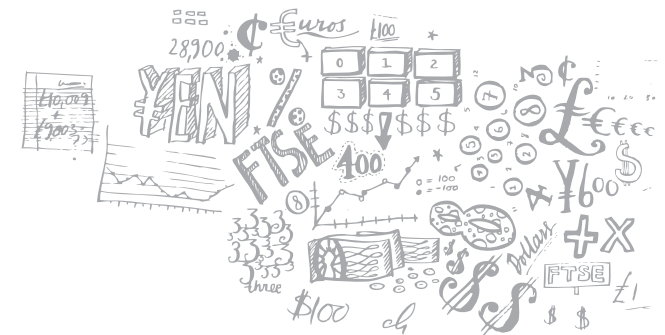
### Mumbai Tribunal

On facts, reopening of assessment was invalid on the basis of the audit objection raised.

Ss.147, 254(2A), 35A of ITAT Rules, 1963; A/y 1999-00; in favor of taxpayer

The taxpayer is a wholly owned subsidiary of a non-resident company and is engaged in the business of investing in joint venture companies, financing and advancing loans and deposits. The taxpayer claimed a deduction on irrecoverable debts. The tax authority added back the deduction of the irrecoverable debt claim in a rectification proceeding, based on an objection raised by the internal audit department of the taxpayer. Aggrieved, the taxpayer appealed before the first appellate authority, which set aside the order of the tax authority holding that there is no mistake apparent from the record. The tax authority consequently reopened the assessment order to reassess the deduction claimed by the taxpayer. On appeal, the first appellate authority allowed the appeal of the taxpayer on merits and rejected the tax authority's contentions. However, the first appellate authority confirmed the reopening of the assessment. Aggrieved, the tax authority appealed before the tribunal and the taxpayer filed cross objections for confirmation of the reopening of the assessment.

Held, the reasons recorded by the tax authority only have to be looked into to decide the validity of reopening the assessment, which in the present case was not made available to the taxpayer. Furthermore, the tax authority had no relevant material or cause for justification in reopening the assessment. The facts relating to making of the advance were available in the notes on return of income. Hence, it cannot be said to be fresh material in justification of the belief that the income had escaped assessment. As a result, the appeal to the tax authority was dismissed.



## Landmark judgments

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### Return and assessment

#### Supreme Court of India

Failure to provide an opportunity for cross examination does not warrant quashing of the entire order.

S.143 (3); in favor of tax authority

The taxpayer was not provided an opportunity by the tax authority to cross examine the witnesses. The taxpayer went in writ before the High Court (HC), which set aside the entire order of assessment on the said ground. Aggrieved, the tax authority made an appeal before the Supreme Court.

Held, the taxpayer should have gone in appeal to the first appellate authority on this issue rather than pursue a writ petition, and that in the process, the taxpayer had failed to avail of the statutory remedy. Furthermore, the HC should have directed the tax authority to grant an opportunity to the taxpayer to cross examine the witness. Hence, the HC order was set aside and liberty was granted to the taxpayer to move to the first appellate authority for the matter within six weeks.

*ITO vs. M Pirai Choodi [2010-TIOL-96-SC-IT-LB]*

#### Mumbai Tribunal

Surcharge is to be calculated before giving MAT credit on tax payable.

S 115JAA; A/y 2000-01; In favor of tax authority

In the assessment for the relevant year, the taxpayer contended that while computing the tax liability, credit for minimum alternate tax (MAT credit), paid under section 115JA, should be given before calculating the surcharge. This was rejected by the tax authority, which gave MAT credit after calculating surcharge. The first appellate authority upheld the action of the tax authority. Aggrieved, the taxpayer appealed before the tribunal.

Held, section 115JAA provides for tax credit in respect of tax paid on deemed income relating to certain companies. Therefore, such tax credit takes the character of the tax, such as advance tax or self-assessment tax, and has to be reduced from the tax and surcharge payable, i.e., the tax and the surcharge thereon have to be calculated first and thereafter MAT credit has to be deducted.

*Classic Shares & Stock Broking Services Ltd vs. ACIT [2010-TIOL-667-ITAT-MUM]*

### Computation of income

#### High Court Of Delhi

Payment for acquisition of technology to improve existing products is revenue expenditure.

Ss 32, 37; A/y 2001-02; in favor of taxpayer

The taxpayer, engaged in the manufacture and sale of auto electrical components for two- and four- wheeler manufacturers, made payment to its associate enterprise (AE) for (a) acquisition of knowhow and (b) supply of technology for improvement of existing products. While the payment toward acquisition of knowhow was capitalized by the taxpayer, the payment for supply of technology was claimed as a revenue expense. The tax authority treated this expenditure as capital and disallowed it. The taxpayer unsuccessfully appealed before the first appellate authority. On further appeal, the tribunal accepted the contention of the taxpayer that the design acquired by the taxpayer was not in relation to setting up of the plant or machinery, but was related to the process of manufacturing, and as such, the taxpayer did not obtain any asset of enduring nature. Aggrieved, the tax authority appealed before the High Court.

Held, the taxpayer was required to modify the design of its components, pursuant to a change in the design specifications of automobiles manufactured by its Indian clients. To facilitate and incorporate these changes in the technical know-how and design

already provided by the AE to the taxpayer (which the taxpayer had already capitalized), payments were made for supply of the technology. These payments secured for the taxpayer modification of assets already acquired and improvement in its existing design and no new asset was created. Furthermore, the taxpayer did not acquire any proprietary interest in the design, but was merely a licensed user of the modified know-how. The further contention of the tax authority was that since the licensed know-how falls under the provision allowing depreciation on intangible assets, the impugned payment could only be entitled to depreciation and could not be accepted as the question of depreciation only arises when the expenditure is held to be capital in nature. Moreover, no asset was “acquired” or “owned” by the taxpayer as a result of this payment, which is a condition for claim of depreciation. The expenditure was, therefore, allowable as revenue expenditure. The appeal of the taxpayer was allowed.

*CIT vs. Denso India Pvt. Ltd. [ITAs Nos. 1011/2007,16/2008, 107/2009, 293,839 & 840 of 2010]*

## High Court of Delhi

Loss, as on last day of preceding financial year, is deductible from the book profits for computing MAT, and not loss as on the last day of the current financial year.

S. 115JB; A/y 2002-03; in favor of the taxpayer

The taxpayer company had accumulated losses according to its books at the end of FY 1. During FY 2, also being the relevant

previous year, on a petition made by the taxpayer, the Delhi High Court accorded its approval to set off the taxpayer’s existing losses with the paid up equity share capital. While computing MAT for FY 2, the taxpayer reduced the amount of loss according to the books, claiming that the loss brought forward from FY 1 should be considered and not loss as at the end of FY 2. The tax authority, however, held that since during the year no losses were available to the taxpayer during the year, to set off as they had already been wiped out by reduction of the capital, nothing was deductible from the taxpayer’s book profits. On appeal, the first appellate authority upheld the view of the tax authority. On further appeal, the Delhi Tribunal ruled in favor of the taxpayer. Aggrieved, the tax authority preferred an appeal to the High Court.

Held, the expression “losses brought forward” can mean losses which existed as on the last date of the previous financial year, which have been brought forward in the current financial year, to be adjusted while computing the book profit for MAT. What happens during the course of the year is not relevant, since such a contingency has not been taken note of in the provision. In any case, if the loss has increased during the year, the tax authority will not take this increase in loss into account. Therefore, in such cases, the rule of literal interpretation needs to be adopted. As a result, the appeal of the tax authority was dismissed.

*CIT vs. Sumi Motherson Innovative Engineering Ltd [2010-TIOL-756-HC-DEL-IT]*

## Bangalore Tribunal

On facts, notional addition on basis of royalty receivables adjusted against purchase consideration was unjustified as it did not lead to tax evasion.

Ss. 5, 9(1) (vi); India - Germany DTAA; A/y 2003-04; In favor of taxpayer

The taxpayer, a non-resident company, amended an existing technical collaboration agreement with an Indian collaborator (ICo) by entering a supplementary agreement, as a result of which no royalty was payable by the ICo to the taxpayer on contract products exported to the taxpayer, provided the invoices raised by the Indian company did not include any royalty. The existing agreement was originally approved by the Government of India (GOI), according to which the taxpayer supplied the right to use the technology, patent, design, etc., to the ICo, which manufactured the contract products. Royalty was paid to the



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taxpayer when the products were sold to outside parties, but, according to the revised agreement, royalty was not payable when exported to the taxpayer. After analyzing the position before and after the supplementary agreement, the tax authority took the view that the agreement had been drafted in such a way that receivables of royalty, in the hands of the taxpayer, were adjusted against the purchase consideration payable to the ICo, leading to understatement of income and evasion of tax on royalty. If the products had been sold to outside parties, the invoice would have included the royalty amount chargeable to tax. Accordingly, addition was made on account of notional income. On appeal, the first appellate authority upheld the addition on the ground that the supplementary agreement was not approved by the GoI, and relying on the Supreme Court's (SC's) judgment in the case of McDowell (154 ITR 148), it held that the taxpayer had avoided tax. Aggrieved, the taxpayer appealed before the Tribunal.

Held, the tax authority's finding was based only on a presumption that royalty was deemed to have been paid to the taxpayer by the ICo without withholding tax, and this was not supported by any tangible proof. Furthermore, no approval was required from the GoI for nonpayment of royalty, since its approval was only required for foreign exchange remittances. Charging royalty from the ICo for the products supplied to the taxpayer, and then adding it back to the invoice raised by the ICo would result in nullity. It was to avoid this situation that affairs were arranged in a way that receipt of royalty was eliminated and payment for purchases was reduced. The taxpayer could not be expected to make royalty income with reference to the sale affected to it by the ICo when the know-how to manufacture these products was supplied by the taxpayer. The taxpayer had every right to arrange

its affairs legally in order to reduce its incidence of tax. The appeal of the taxpayer was, therefore, allowed.

*Robert Bosch GmbH vs. ACIT [2010-TII-149-BANG-INTL]*

## Mumbai Tribunal

Commission paid to agent for services rendered outside India is not taxable in the absence of a business presence in India.

Article 7, India-UK DTAA; In favor of taxpayer

The taxpayer, engaged in the business of entertainment, event management and marketing, entered an agreement with a resident of the UK, engaged in the business of acting as an agent for world-famous artistes (who were also non-residents) and providing these artiste management services. For the performances rendered by the artistes in India, the taxpayer paid them remuneration as well as reimbursed their expenses in connection with their visit. The taxpayer also paid commission to the agent. It, however, did not withhold tax at source on commission on the ground that the services were rendered outside India by the agent to the limited extent of coordinating the engagements of non-resident artistes in India, and were, therefore, not taxable in India in the absence of any business presence in India. It also did not withhold tax on reimbursement of expenses to the artistes on the ground that these did not have any element of income. The tax authority, however, was of the view that according to the agreement, the agent was acting as the agent of the artistes as well, and since the agreement

referred to gross payments to be made, net of taxes, but consideration was later split into reimbursements, the agent's commission and artist fees with a view to avoid paying taxes in India. Therefore, all payments made were a single consideration payable to the artistes and were taxable in India. On appeal, the first appellate authority held in favor of the taxpayer. Aggrieved, the tax authority appealed before the Tribunal.

Held, there was no material on record to substantiate the contention of the tax authority that the entire consideration, including the agent's commission, in fact pertained to the remuneration payable to the artistes for performing in India. The contention that the agent's commission was exorbitant was not sufficient to conclude that such payment was in fact payment made to artistes. Furthermore, the argument, that without a presence in India, the agent could not render the services, which he agreed to do under various agreements, was to be rejected in the absence of evidence. The agent had neither taken part in any event in India nor been involved in activities in India so as to fall under Article 18 of the tax treaty. The services of the agent were rendered outside India and income arising from them was chargeable under Article 7 of the tax treaty. In the absence of a business presence in India, the commission to the agent was only taxable in the UK. Therefore, there was no obligation on the part of the taxpayer to withhold tax on the payments. In respect of reimbursement of expenses, the Tribunal held that it was a settled law that payments in respect of reimbursement of expenses were not taxable. As a result, the appeal was decided in favor of the taxpayer.

*ADIT vs. Wizcraft International Entertainment Pvt. Ltd. [ITA No 3208/Mum2003]*

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## Bangalore Tribunal

On facts, interest was imputable according to TP provisions on outstanding receivables from AE.

Ss 92C, 92CA; A/y 2004-05; partly in favor of tax authority

The taxpayer, an Indian company, had transactions during the year with its associated enterprise (AE) in the US. The tax authority made an addition by way of interest on the debts outstanding from the AE for more than six months, as on the last day of the year, by holding that by parking huge funds with its AE, the taxpayer was deprived of funds and its profitability was affected. The taxpayer's contention that the debts arose on account of differences between the billing patterns of the two entities did not find favor with the tax authority. The interest income was worked out at the prime lending rate (PLR) approved by the State Bank of India during the relevant period. On appeal, the first appellate authority upheld imputation of interest, but directed calculation of interest on the basis of LIBOR/US-FED after providing for appropriate adjustments made to the nature of and term of the loan, the credit standing of AE- USA, the security for the loan, etc. He also directed the tax authority to allow a reasonable period for collection of receivables and only compute interest for the excess period. Aggrieved, both the taxpayer and the tax authority appealed before the tribunal.

Held, in the present case, there was an outstanding balance of receivables due to international transactions, and hence, the income element of the transactions continued to be a matter within the purview of Arms Length Price (ALP) determination.

Furthermore, the taxpayer had not demonstrated the real difference between the billing patterns of the AE and the taxpayer and how this could lead to outstanding receivables of significant magnitude. It was also not the case that the taxpayer was operating the business with its own funds and not paying interest in India on borrowed funds. The potential loss arising out of the situation was definitely a factor to be considered while evaluating the financial impact of international transactions concluded with the AE. Thus, an addition was warranted. However, relief was to be allowed in respect of a certain initial interest-free period, as held by the first appellate authority. However, the Indian rate of interest was properly applicable instead of the US rate, but instead of the PLR of the State Bank of India, a reasonable rate that would be available to the taxpayer for short-term deposits was to be applied. Therefore, taking into consideration all the aspects of the case, e.g., an interest-free period and piece-meal remittance of the receivables, an ALP rate of 5% was fixed and the tax authority was directed to compute the income accordingly.

*Logix Micro Systems Ltd. vs ACIT [ITA No 524/Bang/2009]*

## Mumbai Tribunal

On facts, pledge of shares in favor of director-taxpayer as a security for a loan was not a sale so as to be taxed as his income.

S. 2(24) (iv); A/y 2004-05; in favor of taxpayer

The taxpayer was the director of an Indian company (ICo), the

Board of Directors of which resolved to borrow funds from the taxpayer for a temporary period free of interest and in turn agreed to pledge with the taxpayer, as security for the loan, shares of another group company (GCo) that the ICo held. The shares of the GCo had a book value of INR1/- and shares to the extent of the loan amount were pledged. In pursuance of a letter from the taxpayer, the shares were transferred to his demat account. According to the letter, such a transfer was by way of pledge and a security for the loan. However, these shares had a market value that was far above their book value. When the loan was repaid, the taxpayer released the pledge of shares. The tax authority, however, treated the credit of shares to the demat account of the taxpayer as a sale and taxed the difference between the book value and market value of the shares pledged as the deemed income of the taxpayer. According to the tax authority, the taxpayer acquired the shares of the GCo under the façade of a loan transaction, to have control and management of the company. The tax authority also relied on the fact that certain provisions of depository regulations were not complied with, although it was not disputed that the provisions of company law were complied with. On appeal, the first appellate authority held in favor of the taxpayer. Aggrieved, the tax authority preferred an appeal to the Tribunal.

Held, the sale and pledge of dematerialized shares continues to be additionally governed by other laws such as the Sale of Goods Act, Contract Act, etc., as well as the Depository Participants Act (DPA), the provisions of which are only directory and not mandatory. The claim of the taxpayer that it had taken physical possession of the shares by having his name registered as the beneficial owner in the demat account, but in the law he held the shares only as a pawnee and the ICo was the beneficial owner,

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was upheld and this claim was in accordance with company law. The contention of the tax authority that pledge of shares was made after disbursement of the loan and that the amount of loan was disproportionate to the market value of its security were matters to be agreed upon between the parties. It is a settled law that the question of whether the title passed from the vendor to the vendee depends entirely on the intention of the parties, which is to be gathered from various factors. In this case, although the taxpayer had his name entered in the register of the depository as a beneficial owner, this was not conclusive evidence of the title of the shares. The transaction was always intended to operate as a pledge and no property was intended to be given. Furthermore,, although the provisions of the DPA provided for a mechanism for the creation of a pledge, this was not the only way to do so and the provisions of other laws such as the Contract Act were also applicable. The ICo was again recognized as the beneficial owner after repayment of the loan. The contention of the tax authority that the transaction was merely a façade was only a presumption. The taxpayer did not have absolute rights over the shares at any point in time, and he could only sell those shares, as provided by the law, with the surplus, if any, being repaid to the ICo. The taxpayer would not in such a scenario derive any benefit or perquisite. Thus, there was no sale on the credit of the shares of the GCo to the demat account of the taxpayer, and the transfer was only by way of delivery of possession of the shares as security for repayment of the loan given to the ICo by the taxpayer. The transaction was, therefore, not taxable in the hands of the taxpayer.

*JCIT vs. Shri Mukesh D. Ambani [ITA No 7604/Mum/2007]*

## **Mumbai Tribunal**

The intention of the taxpayer is to be inferred to determine the nature of income from shares as business income or capital gains.

*Ss.28, 45; A/y 2005-06; in favor of taxpayer*

The taxpayer company, a member of the Bombay Stock Exchange (BSE), was engaged in the business of shares and stock broking. It declared its income under the head of business and capital gains, both short term and long term. The tax authority, however, sought to tax the short-term capital gains as business income on the ground that the taxpayer had purchased shares in small lots and entered approximately 300 transactions during the year consistently. He held that the taxpayer being a broker, transactions were related to its business and there was no intention to hold the shares, and that the taxpayer had treated income from similar transactions as business income in the subsequent year. The taxpayer appealed before the first appellate authority, which accepted its explanation. Aggrieved, the tax authority appealed before the Tribunal.

Held, in the present case, the taxpayer had maintained the distinction between trading shares and investment shares in its records. Volume of transactions is an important indicator of the intention of the taxpayer as to whether it would deal in shares as a trading asset or to hold them as an investment, but it certainly was not the sole criterion. The contention that because the sale and purchase were determined by volatility in the market and that it was against the basic feature of the investment was not sustainable. The taxpayer had not borrowed any funds for

making transactions. The taxpayer's claim could not be negative merely on the basis of the frequency of the transactions. Furthermore, the taxpayer had been declaring such income under the head of capital gains in earlier years as well and this was accepted by the tax authorities. Since the modus operandi of the taxpayer had not changed, there was no reason to deviate from earlier conclusions in the interest of consistency. The taxpayer had maintained a separate investment portfolio and all sales out of this were identifiable to purchases made under this portfolio. All these factors outweighed the test of the frequency of the transactions. Hence, the tax authority's appeal was dismissed.

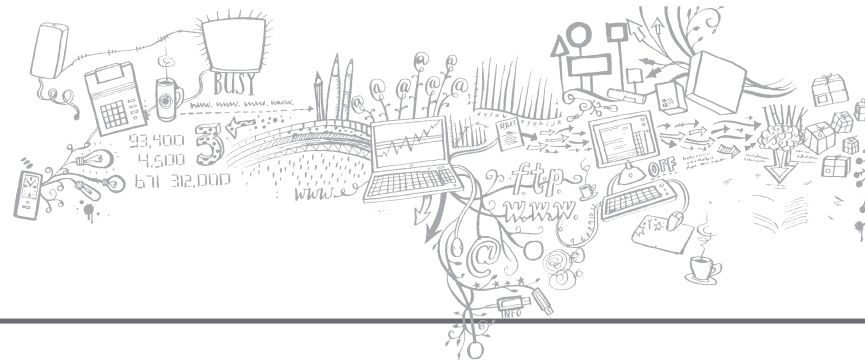
*DCIT vs. SMK Shares & Stock Broking Pvt Ltd. [ITA No 799/2009].*

## **Hyderabad Tribunal**

Deduction is available to the developer of an industrial park when units are kept ready during the year, although they are not operational.

*S. 80IA4 (iii); A/y 2006-07; in favor of taxpayer*

The taxpayer, a company engaged in the business of real estate and construction work, claimed deduction under section 80IA of the ITA on income earned by renting and selling units constructed in an industrial park. This was denied by the tax authority on the ground that although the approval for the undertaking was granted by the Ministry of Commerce & Industry during the relevant year, it was only notified by the CBDT under section 80IA in the subsequent year. Furthermore, although deduction was available only after the number of "units" prescribed in the



approval letter were “located” in the industrial park, according to the Industrial Park Scheme, the taxpayer had merely completed the construction of the said units, but these were not occupied and functional by the end of the relevant year. Unsuccessful before the first appellate authority, the taxpayer appealed before the Tribunal.

Held, the notification under section 80IA, although issued in a subsequent year, covered the relevant tax year as well. The date of notification was irrelevant and it could not be treated as conclusive. The notification was only issued for the purpose of notifying the industrial park, which was already approved by the GoI during an earlier year. Furthermore, the word “locate” means to fix or establish in a position, locality, place, etc., and does not refer to the functioning of the units. The taxpayer had completed the construction of all the required units in the industrial park, and thus, had made the units ready in all respects and had also paid for the entire cost of the project during the year. If the parties that had taken the units from the taxpayer on lease did not make the unit functional, the tax authorities could not find fault with the taxpayer. Hence, deduction under section 80IA was available to the taxpayer as a developer during the year in question.

*Meenakshi Infrastructures (P) Ltd. vs. DCIT [ITA No 313/Hyd/2010]*

## Mumbai Tribunal

Expenditure incurred wholly for Indian business is not covered by S. 44C; tax was not to be withheld on payment made through foreign head office to a group company for procurement services outside India.

Articles 7, 13, India- Korea DTAA; A/y 2001-02, 2002-03; In favor of taxpayer

The taxpayer was a Korean company, engaged in turnkey projects relating to procurement, engineering and construction, and had a permanent establishment (PE) in India. The taxpayer entered a contract with Indian companies for execution of its projects, and in the process, also opened a project office in India. The taxpayer claimed deduction of salary and staff welfare expenditure incurred on Korean staff working on the project in India. The tax authority, however, disallowed the expenses, citing section 44C of the ITA, which provides limits for deduction for head office expenditure in the case of non-residents, on the ground that certain expenses had to be treated as general and administrative overheads in the absence of adequate details. On appealing before the first appellate authority, the taxpayer contended that only direct expenses were charged to the project office in India, which did not include any administrative overheads, and that there was a systematic method of allocating direct costs incurred by the staff in India. The first appellate authority ruled in favor of the taxpayer. Aggrieved, the tax authority appealed before the Tribunal.

Held, section 44C is only applicable in the event there are common expenses, which are incurred by the head office for its various branches. Any expense incurred wholly and exclusively for the

purpose of Indian business does not fall within the ambit of section 44C. Since the expenses were wholly and exclusively incurred for the Indian project, and were arrived at on a very systematic basis, section 44C of the ITA was inoperative. The expenditure in question was, therefore, allowable in entirety.

The taxpayer also paid certain sums to a group company outside India for providing services relating to identification and procurement of material, arranging coordination between foreign vendors and the taxpayer and monitoring incidental activities, without withholding tax. The tax authority, therefore, disallowed such payments, holding such payments as fees for technical services (FTS) on which tax was to be withheld. The taxpayer contended that it had paid commission to the group company, which had helped it to procure materials of the best possible quality and prices. The payments were made through the head office outside India and not directly. Since payments were made by a non-resident outside India to another non-resident outside India for services rendered outside India, tax withholding was not required as the group company did not have a PE in India. The first appellate authority held in favor of the payer. Hence, the tax authority came up in appeal before the Tribunal.

Held, relying on the decision of the Mumbai Tribunal in Linde AG [62 ITD 330], that as payments were made to the group company through its head office outside India for services rendered outside the country, no income accrued or arose in India, and therefore, the payments were not taxable in India. Therefore, there was no withholding tax obligation and consequent disallowance was unjustified.

*DDIT vs. Samsung Engineering Co Ltd [2010-TII-169-ITAT-MUM-INTL]*

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## Tax withholding

### Mumbai Tribunal

Authorized dealer bank is not liable to withhold tax while remitting short-term capital gains to NRIs.

Ss. 204 (ia), 195 (1) & (2); A/y 2005-06; In favor of taxpayer

The taxpayer, engaged in the business of banking and undertaking portfolio investment business for Non-resident Indian (NRI) clients, made foreign remittances to such clients who were residents of the UAE without deduction of tax, contending that the remittances represented short-term capital gains arising on sale of government securities in India, which were exempt from capital gains tax in India under the India-UAE Tax Treaty. Even otherwise, the taxpayer was not responsible for withholding tax by virtue of section 204(ia) of the ITA, which fixes liability on the taxpayer, being the authorized dealer, to withhold tax only in the case of long-term capital gains. The tax authority, however, held that such capital gains were not exempt from tax under the tax treaty as the NRIs were individuals who were exempt from taxation in the UAE and could not be treated as residents of the UAE. On this ground, the tax authority sought to treat the taxpayer as an assessee in default and levied interest. On appeal, the first appellate authority held the taxpayer as the person responsible for withholding tax, relying on the general provision of section 204(iii), which makes the payer of the income the person so responsible. However, the demand was deleted on

the ground that capital gains arising to NRIs residing in the UAE could not be taxed in India under the tax treaty. Aggrieved, the tax authority, as well as the taxpayer, appealed before the Tribunal.

Held, since the taxpayer was an authorized dealer bank, remittances made by it to NRIs in the UAE, representing consideration for transfer of government securities, being foreign exchange assets with a maturity period of 364 days, were excluded by section 204(ia), since these were in the nature of short-term capital gains. The taxpayer could not be held responsible for withholding tax on the basis of the general provision of section 204(iii), since that was a general provision, whereas section 204(ia), which was enacted later, was a specific provision. Moreover, it is well settled that although NRIs are not actually assessable for tax in the UAE, they cannot be denied the benefit of the tax treaty. Therefore, the taxpayer was not required to withhold tax on such remittances and the demand raised was unsustainable.

*DDIT vs. Hongkong & Shanghai Banking Corporation Limited*  
[2010-TII-161-ITAT-MUM-INTL]



### Mumbai Tribunal

Impossibility of performance releases the taxpayer from the obligation to withhold tax.

Ss. 195(2), 201, 201(A); A/y 2001-02; In favor of taxpayer

The taxpayer, an Indian company engaged in the business of transporting passengers by air, entered a wetlease agreement with a non-resident company to acquire three aircraft. However, due to certain non-compliance issues or defects, the taxpayer terminated the contract. The non-resident company disputed the termination and referred the matter for arbitration, which was to be governed by English laws. The arbitrators held the termination to be wrongful and ordered compensation sum to be deposited by the taxpayer in an escrow account in the UK to avoid seizure of its UK assets. The taxpayer sought a "No objection" certificate from the tax authorities in India to remit the compensation, the latter ordered withholding of tax. The appeal against this order before the first appellate authority and the Tribunal were unsuccessful. Request for permission from the arbitration authorities to withhold tax was refused on the ground that it was an arbitration award, and as such, no tax could be withheld on it. On appeal, a higher authority in the UK mandated deposit of the amount in the escrow account, pending stay of matter. Subsequently, the appeal was dismissed and it was held that no tax could be withheld. Consequently, the non-resident company withdrew the amount from the escrow account. The tax authority chose to deem the taxpayer as a defaulter, and accordingly,

sought to collect tax and interest. On appeal, the first appellate authority concluded against the taxpayer, and therefore, a further appeal was made by the taxpayer to the Tribunal.

Held, legal precedents do not appear to lay down a proposition that a judgment debt is not income. However, when an amount is a judgment debt, tax cannot be withheld from it according to the Civil Procedure Code. Since in this case, the foreign award was not declared enforceable in India, it could not be said to be a judgment debt. However, the taxpayer had approached several forums and courts in the UK, requesting consent to comply with the order of the tax authority, which was denied. Hence, the taxpayer was rendered powerless to effect any withholding of tax. The courts of appeal in the UK did not permit the taxpayer to comply with the tax withholding obligation. On the other hand, by directing the taxpayer to pay the amount into the escrow account, and thereafter, allowing the non-resident to withdraw this, it made it impossible for the taxpayer to withhold tax and put issues beyond its control. The tribunal referred to various case laws to hold that when a taxpayer is prevented from performing its obligations under the law and its performance becomes a legal impossibility, despite its bonafide efforts, it should be discharged from withholding tax obligations, and hence, cannot be regarded as a defaulter. Therefore, in view of the peculiar facts and circumstances of the case, it was a case of impossibility of performance and the taxpayer could not be said to be an assessee in default.

*National Aviation Co. of India vs. DCIT [2010-TII-170-ITAT-MUM-INTL]*

### India concludes negotiations on exchange of information agreements

Negotiations on exchange of information agreements with Monaco, the Isle of Man, the Cayman Islands, the British Virgin Islands and Argentina have been successfully concluded and are awaiting signatures.

*IBFD dated 30 November 2010*

### Treaty between India and Mexico

India and the United Mexican States have entered an agreement for avoidance of double taxation and prevention of fiscal evasion. The provisions of the agreement shall be given effect from 1 April 2011.

*Notification No. 86/2010 dated 26 November 2010*

# Indirect tax

## Excise duty



### High Court of Gujarat

Interest payable on delayed sanctioning of refund claim made under Rule 5 of Credit Rules

Central Excise Act, 1944; in favour of assessee

The question before the Court was whether the provisions of section 11BB of the Act, providing for interest on delay in granting of refund of any excise duty, would be attracted in the case of delay in sanctioning refund under Rule 5 of Credit Rules, which provides for refund of unutilized accumulated CENVAT credit. Held, that since the refund ordered under Rule 5 of Credit Rules is under the section providing for refund of any excise duty paid, interest under section 11BB is payable on delayed sanctioning of refund under Rule 5.

*In the case of CCE vs. Reliance Industries Ltd. [2010-259-ELT-35-(Guj)]*

## Sales Tax/VAT

### Mumbai Tribunal

Refund under Rule 5 not admissible for supplies made by DTA unit to SEZ unit

Central Excise Act, 1944; in favor of revenue

The question before the Tribunal was whether refund under Rule 5 of Cenvat Credit Rules of accumulated unutilized Cenvat credit on duty paid on input used for manufacturing of goods by a DTA unit, which were cleared to an SEZ unit, is admissible. Held, that the definition of "export" provided in Customs Act, 1962 should be adopted for Cenvat credit rules according to which supplies made by DTA units to an SEZ unit do not constitute physical export. Furthermore, it held that since Rule 5 covers physical export only, refund under this head is not admissible in the present case.

*In the case of CCE, Thane vs. Tiger Steel Engineering (India) Private Limited [2010-259-ELT-375-(Tri-Mum)]*

### Madras High Court

Export sale not chargeable to tax under section 3(4) of the Act

Tamil Nadu General Sales Tax Act, 1959; in favor of assessee

The question before the Court was whether export sale is also considered as sale, which attracts tax under section 3(4) of the Act. Section 3(4) of the Act provides for additional duty on materials purchased in the manufacture of goods if the purchaser, after availing the concession on the sale made by one dealer to another dealer, for use or sale in the same state, fails to perform the sale in the state but resorts to other modes of disposal of such manufactured goods. Held, that export sales were not covered under section 3(4), since the state lacks the constitutional competency to levy tax in any form on export sale, and that on application of the principle of ejusdem generis, section 3(4) could only mean dispatch to a place outside the state by branch transfer or transfer to an agent and not export sale.

*In the case of Tube Investments of India Limited vs. State of Tamil Nadu [2010-36-VST-67-(Mad)]*

# Regulatory

Foreign Direct Investment Policy

Securities and Exchange Board of India

## Government approved eight proposals of Foreign Direct Investment

Based on the recommendations of the Foreign Investment Promotion Board (FIPB) in its meeting, dated 3 December 2010, the GoI has approved eight proposals of Foreign Direct Investment (FDI) amounting to INR8831.66 million

The proposals of L&T Finance Holdings to attract INR6412.5 million through the induction of foreign equity in an investing company by way of an Initial Public Offer; Konecranes Finance Corporation, Finland for induction of foreign equity amounting to INR1690 million in a company engaged in the financing, investment and consultancy activities in the field of manufacture of cranes and Tata Advanced Systems Limited for induction of foreign equity amounting to INR438.2 million for undertaking defense production activity are leading among the proposals approved.

The GoI has deferred its decision on 14 proposals, 6 proposals have been rejected and one proposal of Enam India Infrastructure Fund Limited, Mauritius, has been referred for the approval of the Cabinet Committee of Economic Affairs.

*Press Release, FIPB unit, Department of Economic Affairs, Ministry of Finance, 14 December 2010*

## Amendments to the Equity Listing Agreement

With the objective of enhancing the quality of disclosures made by listed entities, Securities and Exchange Board of India (SEBI) has made significant amendments to the Equity Listing Agreement. The gist of the amendments includes:

- i. Amendments to Clause 35 – disclosure relating to shareholding pattern
  - a. Disclosure of shareholding pattern  
To ensure public dissemination of updated shareholding pattern, entities seeking listing of their securities after their IPO will need to submit their shareholding pattern one day before the date of listing. The stock exchanges will upload this on their websites before commencement of trading of the securities.
  - b. Disclosure of shareholding pattern pursuant to material changes in the capital structure  
In all cases where capital structure exceeds +/- 2% of the paid-up share capital of the entities, a revised shareholding pattern in the specified format will be filed with the stock exchanges within 10 days from the date of allotment of shares.
  - c. Disclosure in respect of depository receipts (DRs)  
Details of shares held by custodians, against which DRs have been issued, which are at present disclosed in Table

(l) (a) of Clause 35, will be further segregated as these pertain to the “promoter/promoter group” and to the “public.”

- ii. Amendments to Clause 5A – uniform procedure for dealing with unclaimed shares

SEBI has inserted a specific provision for the procedure to be followed in respect of unclaimed shares issued in physical form. The existing clause 5A in the equity listing agreement only addresses and resolves the practical difficulties of companies that have issued shares in electronic form.

- iii. Amendment to Clause 20, 21 and 22 – corporate announcement

To enable investors to manage their cash/securities flows efficiently and enhance process transparency, SEBI has mandated that companies have a pre-announced fixed pay date for payment of dividends and for credit of bonus shares.

Accordingly, the reference to dividend payments in clause 21 has been deleted.

- iv. Insertion of Clause 53 – disclosures relating to agreements with media companies

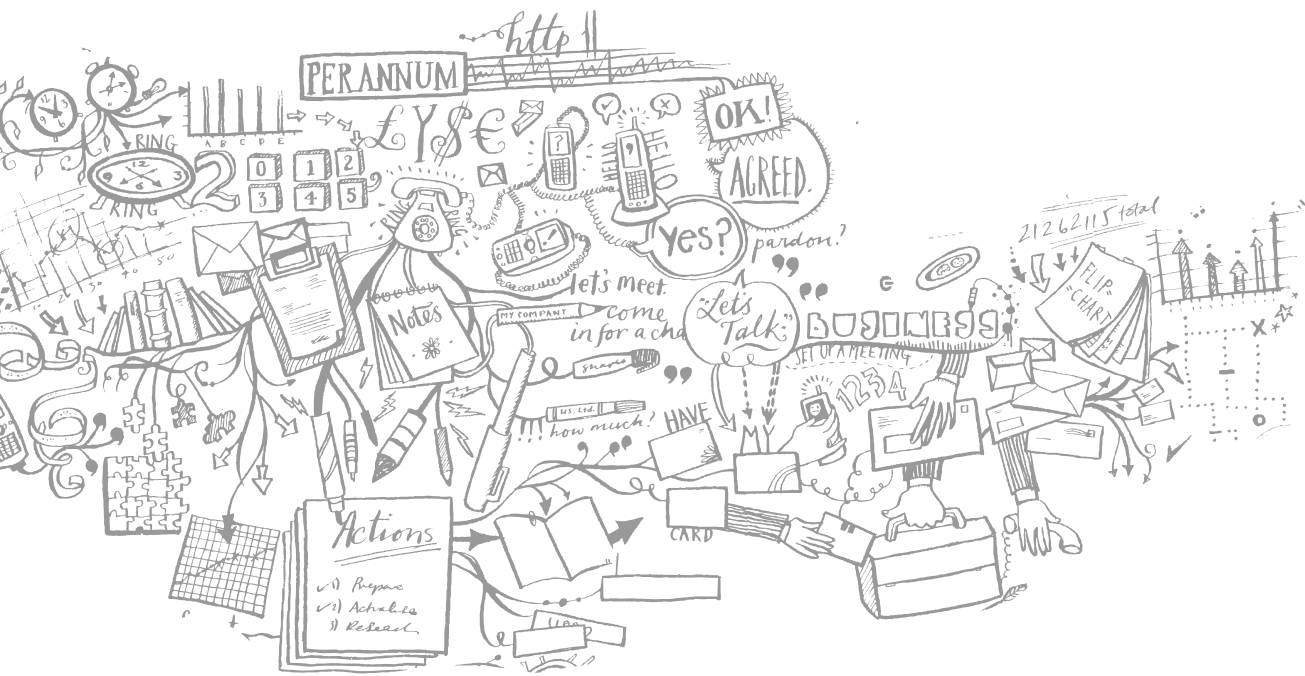
To ensure public dissemination of the details of agreements executed by corporate organizations with media companies, SEBI has directed listed entities to disclose details of such agreements on their websites and also notify the stock exchange of this for public dissemination.

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v. Insertion of Clause 54 – maintenance of a website

To ensure or enhance public dissemination of all basic information, all listed entities have been directed to maintain a functional website that contains basic information about their companies including updated statutory filings and agreements executed with media companies.

SEBI circular no. CIR/CFD/DIL/10/2010, 16 December 2010



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