Editorial

Dear readers,

We are pleased to present June 2014 edition of EY's quarterly newsletter The Tax Digest, summarizing significant tax and regulatory developments.

This newsletter is designed as a ready reckoner and covers landmark tax judgments, an update on tax treaties and alerts on topical developments in the tax arena. It provides access to “In the press” covering the published articles on various issues in the tax realm over the last quarter. It also covers the key thought leadership reports and other topics of interest to a tax professional.

We have added a new section “Viewpoint” in this edition, where we analyze whether cross border movement of employees has become a taxing arrangement in view of the recent decision in the case of Centrica.

We hope you find this edition, both timely and insightful.

Best regards,

EY Tax Update team

Contents

Direct tax

Viewpoint
• Employee secondment across borders - a taxing arrangement?

Verdicts
• Decisions supported by our Litigation team
  • Joint Venture termination amount allowable as revenue expenditure
  • Appropriate withholding tax rate to be applied for various payments
• Significant Supreme Court (SC) decisions
  • Whether deductor entitled to interest on refund of excess taxes withheld
  • Beneficiaries not taxable on ‘discretionary’ trust’s income until distributed by trustees
  • Scrap sales to be excluded while computing ‘Total Turnover’ for incentive deduction provisions
  • No carry forward and set off of losses in cases of amalgamation of cooperative societies
• Decisions on capital or business income classification
  • Profit on share transactions through Portfolio Management Scheme (PMS) taxable as Capital Gains
  • Premature mutual-fund redemption in the course of business taxable as ‘business income’
  • Share sale by promoter cannot be split into capital gains and business income
• Court decisions on allowability of expenditure
  • Expenses of temporarily terminated project allowable as deduction
  • Certain expenses allowable as revenue in a renovation exercise
  • Write-down of investment loss allowable only if a “direct and proximate” nexus exists with business
  • Non-compete fees paid allowable as revenue in certain cases
Importance of appropriate characterization of income
- Income from foreign exchange fluctuation takes the character of the underlying transaction
- Rental income from letting of industrial park along with provision of services taxable as “Business Income”

View on issues concerning withholding taxes
- Tax withholding does not apply to year end provisions in absence of payment or credit to recipient
- Expense disallowance for not withholding taxes applies to tax exempt entities as well

Certain rulings on Permanent Establishment (PE) on account of services
- Fixed Place PE on protracted presence of employees executing a consultancy project in India
- Seconded employees and Service PE in India
- PE on account of stewardship activities and technical assistance rendered in India

Other Significant decisions
- ‘Ready for use’ rigs, when not actually “used”, not to be considered to determine 120 days threshold for constituting PE under the India-USA DTAA
- Share of profits of a partner from a partnership firm having exempt income is also exempt in the hands of the partner
- Transfer of undertaking in lieu of shares / bond issue is not ‘slump sale’ but ‘exchange’
- Delhi HC rules on AOP constitution and taxability of offshore supply and services
- NR agents’ commission for engaging international artists to perform in India not taxable in India
- Taxability of allotment of “additional shares” to existing shareholders as gift
- AAR follows Delhi HC decision in Cairn UK and rules nonresident (NR) is entitled to the concessional rate of 10% on long term capital gains on sale of shares
- Loss on house property situated outside India allowed to be set off against other taxable income in India, SC decision in case of Kulandagan Chettiar distinguished
- Some key issues on which Special Leave Petitions were dismissed by the SC
- Recent decisions on taxation of Royalty/Fees for Technical Services (FTS) payments

Treaty connections
- DTAA between India and Latvia enters into force
- New DTAA between India and Romania enters into force
- New DTAA between India and Sri Lanka enters into force
- Foreign Account Tax Compliance Act (FATCA) agreement between India and USA agreed in principle
- OECD updates
  - Organisation for Economic Cooperation and Development (OECD) Issues public discussion draft on prevention of Treaty Abuse
  - OECD releases discussion draft on tax challenges of the digital economy
  - OECD releases discussion draft on neutralizing hybrid mismatch arrangements
  - 46 countries adopt Declaration on Automatic Exchange of Information (EOI) in Tax Matters
  - OECD issues new Research and Development (R&D) incentive report

Happenings across the border
- Slovakia introduces higher withholding tax rate on cross border payments for countries not featuring in the “white list”
- French Tax Administration releases draft regulations on “anti-hybrid” financing provisions
- Brazilian Federal Tax Authorities issue Normative Instruction dealing with withholding tax on transactions with NRs
- China’s State Council issues circular to improve regulatory environments for M&A transactions
- Germany’s highest Tax Court suggests that interest limitation rule may be unconstitutional
From the Tax Gatherer’s desk

• Release of the Direct Taxes Code 2013
• CBDT clarifies on tax withholding obligation in respect of payments made to non-resident
• CBDT clarifies on tax treatment of expenditure for developing infrastructure facility under BOT arrangement
• CBDT clarifies share of profits of a partner from a partnership firm having exempt income is exempt in the hands of the partner
• Scheme of Merger/Amalgamation/Demerger/Reconstruction of Companies to be filed With Ministry of Corporate Affairs (MCA)
• CBDT clarifies eligibility of successor otherwise than merger in claiming tax holiday benefit for O&M activity for unexpired period
• Constitution of Special Investigation Team (SIT) for bringing back unaccounted monies unlawfully kept in bank accounts abroad
• CBDT Notifies forms for furnishing Return of Income (RoI) for tax year 2013-14

Indirect tax

Case Laws

• Service tax
  • Payment of Value Added Tax (VAT) on sale of goods on the supply of food and beverages will not exclude the liability for the payment of Service tax in respect of outdoor catering services.
  • Services rendered to foreign importers for testing the import-worthiness of sample goods in India will be considered as exports
  • Parliament is competent to levy Service tax on the services rendered by restaurants
  • Service tax levied on food and beverages supplied in a hotel or restaurant is constitutionally valid
  • Revenue cannot be allowed to receive Service tax twice in respect of the same construction activity, once from the contractor and the second time from the person who has collected the same
  • The place of provision of marketing and sales support services shall be determined in terms of Rule 3 of the Place of Provision of Services Rules, 2012 i.e. the location of service recipient
  • Reimbursement towards social security benefits to overseas group companies, in respect of expatriate personnel employed by the Indian company, will not constitute “Manpower Recruitment or Supply Agency” service.
  • Leasing of petroleum product outlets to dealers along with storage facilities, cannot be considered as “Storage and Warehousing” service, when all the operations are under the control of the dealers.
  • Electricity supplied free of cost by the service recipient cannot be considered as an additional consideration to the service provider for providing the service of operation and maintenance.
  • No service is involved in the retention of early payment incentive as it is a discount.
  • Business auxiliary services (‘BAS’) provided to an overseas entity will qualify as “exports”
• CENVAT credit
  • CENVAT credit in respect of Service tax paid for premises taken on rent for job worker, not eligible
  • Full CENVAT credit of Service tax paid by the service provider will be available to the service recipient, who has not paid the whole value of the service received, so long as the service provider has paid the tax on the full value of the invoice
  • CENVAT credit attributable to trading activities will be reversed
• Excise duty
  • Sales tax collected but retained will form part of “transaction value” and hence, liable to Excise duty
  • “Special discount” passed on to dealers by way of reduction of transaction value of a different car model, was not a trade discount and hence, cannot be reduced from the assessable value
• Customs Duty
  • Concessional rate of duty will not be available for project imports, which were not used for the intended project, but were diverted elsewhere
  • Royalty / licence fees paid to overseas suppliers shall be included in the assessable value of the imported goods, as it is a condition of sale of such goods.
• VAT/Central Sales Tax (CST)
  ▪ Contract for supply and installation of lifts is a “works contract” and not a “contract for sale”
  ▪ Movement of goods from one state to another will be considered as inter-state movement, if it is in pursuance of a covenant in the contract or is an incident of such contract, even though it is not provided in the contract of sale.
  ▪ Cross transfer of property, without consensual agreement of sale supported by price or other monetary consideration, will not be subject to Sales tax.
  ▪ Where the element of service has been declared and brought to tax vide notification dated 6 June 2012, by which Service tax is levied on 40% of the billed value in restaurant, no VAT can be imposed thereon.
  ▪ Soft loan given by the State Government, based on the VAT/CST collected for the purpose of promoting the industrial growth of the State, does not amount to refund of tax
  ▪ Non-obstante clause in the State Special Economic Zone (SEZ) Act will have overriding effect over the State fiscal statutes, in the absence of any provision giving primacy over the State SEZ Act

Key statutory updates

• Excise duty
  ▪ Withdrawal of facilities and imposition of restrictions on contravention of provisions

• Customs Duty
  ▪ Reduction in the rate of duty on imports from Japan under preferential trade agreements

• Foreign Trade Policy
  ▪ Introduction of Online Export Obligation Discharge Certificate (EODC) / Redemption for Advance Authorization (AA) and Duty Free Import Authorization (DFIA)

• VAT – Andhra Pradesh
  ▪ FAQs on Andhra Pradesh Re-organisation Act, 2014

• VAT – Delhi
  ▪ Orders/Notice to be issued through Systems module

• VAT – Karnataka
  ▪ Karnataka Value Added Tax (KVAT) (Amendment) Act, 2014
  ▪ E-uploading of statement of purchase, sales and other details by the dealers whose total turnover is more than INR 50 lacs

• VAT – Madhya Pradesh (MP)
  ▪ Telephone, cellular handset and phablets to be considered as “single point of tax goods”

• VAT – Haryana
  ▪ Increase in rate of tax for cell phones (including their parts and accessories) exceeding INR 10,000

• VAT – Himachal Pradesh
  ▪ Draft Notification for Rate of tax @ 2% on sale of plant and machinery for use in generation of hydro power
Regulatory

• Foreign Direct Investment
  • Consolidated Foreign Direct Investment (FDI) Policy- Circular 1 of 2014
• Reserve Bank of India
  • Foreign Direct Investment into a Small Scale Industrial Undertakings (SSI)/micro and small enterprises (MSE) and in industrial undertaking manufacturing items reserved for SSI/MSE
  • Foreign Portfolio Investor - Investment under Portfolio Investment Scheme (PIS), Government and Corporate debt
  • Compounding of contraventions under FEMA
  • FDI in Limited Liability Partnership (LLP)
  • FDI in Pharmaceuticals sector
  • Reporting conditions for transfer of equity instruments acquired on stock exchange
  • Fund/Non-Fund based Credit Facilities to Overseas joint ventures/wholly owned subsidiaries (WOS) /wholly owned Step-down Subsidiaries of Indian Companies
  • ECB for Civil Aviation Sector
  • ECB Policy - Re-schedulement of ECB- Simplification of procedure
  • ECB from Foreign Equity Holder (FEH) for working capital under automatic route
  • Merchanting Trade Transactions - Revised guidelines
  • Export of Goods - Long Term Export Advances
  • Directions for acquisition / transfer of control of an NBFC

In the press

Compilation of alerts

• Direct Tax
• Indirect Tax
• Regulatory
## What's new

For the significant updates on the new Companies Act 2013:
**India Inc - Companies Act 2013 - An overview**

For the latest tax updates from across the APAC region, read our monthly newsletter: **APAC Tax Matters**

For the latest tax insights for business leaders, read our quarterly magazine: **T Magazine**

## Useful links

- Direct Taxes Code
- Tax & Regulatory Services
- Tax Library
- Doing Business in India 2012-13
- India Tax Webcast series
- [www.ey.com](http://www.ey.com)
Employee secondment across borders: a taxing arrangement?

Introduction

Globalization has driven businesses beyond national boundaries. The need to expand and grow has influenced today’s companies to look at opportunities outside home jurisdictions. Within multinational companies, cross-border movement of employees has become a common practice for varied business reasons such as transferring best practice around the world, filling of talent gaps, streamlining operations through implementation of consistent policies and motivating employees by rewarding their performance. From the employee's perspective, it provides an opportunity to acquire diverse work experience, learning and cultural understanding.

Movement of employees is done under diverse forms such as assignment, employee leasing, placement, secondment etc. “Secondment” refers to an arrangement under which an employee of a company (lending company) is temporarily assigned to work for another company (receiving company), which is often a group company or affiliate. Typically, the seconded employee (“assignee”) remains on the payroll of the lending company but works under the control, supervision and direction of the receiving company. There are various reasons for not shifting the employment to the receiving company such as continuity of social security, retirement benefits, right to return to the employment on completion of assignment, continuity to receive salary in home country etc. Salary payments disbursed during the secondment period, by the lending company, are cross charged to the receiving company. Furthermore, the receiving company would bear the risks and rewards of the work performed by the assignees during secondment. Other aspects of secondment are agreed to between the lending company and the receiving company.

Of late, secondment of employees has assumed great significance in India and it has led to a number of tax and non-tax implications for companies as well as assignees. According to EY Global Mobility Effectiveness Survey 2013, compliance issues – tax, social security and payroll – are the top mobility challenges in India. From a tax perspective, increasing scrutiny from administrative authorities creates potential risk for the lending company. Such arrangements continue to be a subject matter of litigation in India.

Key question: is there a contract of service or a contract for service?

Tax implications largely depends whether the arrangement is seen as a contract for service or a contract of service (employment). In a contract for service, presence or activities of the assignee are considered as services provided by the foreign company to the Indian company and it can result in a permanent establishment (PE) creation in India for the foreign company under the applicable tax treaty. This will further entail attribution of profits, transfer pricing implications, withholding of taxes on payments made to the foreign company that is representing cross charge of salary of the assignees etc. Such outcome is mitigated if the assignee is understood to be “economically employed” with the Indian company in which case assignee’s activities will be in employment relationship with the Indian company (“contract of service”) and not on behalf of the foreign company. Hence, the issue boils down to a key determination, i.e., who is the “employer” of the assignees – is it the foreign company, which has assignees on its payroll and pays their salary (legal employer) or is it the Indian company, which has control over the manner and mode of work, bears the risks/rewards and the salary cost?

Recent Delhi HC decision in the case of Centrica

Recently, the Delhi High Court (HC) in the case of Centrica India Offshore Pvt. Ltd. [TS-237-HC-2014-DEL], based on certain facts, held that employees seconded by foreign companies in the UK, and Canada to its Indian affiliate did not become employees of the Indian affiliate but continued to remain employees of the foreign companies during secondment. Accordingly, the arrangement involved provision of services by foreign companies to the Indian affiliate through such seconded personnel and payments for such services were regarded as Fees for Technical Services (FTS) under the India-UK Double Taxation Avoidance Agreement (DTAA) and Fees for Included Services (FIS) under the India-Canada DTAA. Furthermore, the foreign companies created a Service PE in India by virtue of services rendered through its employees present in India.

The ruling raises a number of issues related to existence of PE and characterization of income. This article seeks to address some of these issues and highlight a viewpoint, which may have bearing on the correctness of Delhi HC ruling in the backdrop of technical views emerging from the available jurisprudence on the issues.
Approach to determination of “employer”

The Indian Tax Laws (ITL) do not provide guidance on the approach to determination of “employer.” The issue has, however, been subject matter of judicial precedents. Traditionally, the Indian courts, including the Supreme Court (SC) have emphasized on the following tests to determine if there exists an employer-employee relationship:

- Authority to instruct, control and supervise the work and manner of work
- Integration in the business of the employer
- Responsibility for the work of the employee, bearing risks/rewards from such work
- Right to select the employee/suspend in case of disobedience
- Right to approve/reject the work done by the employee
- Bearing the remuneration of the employee

Similar tests are endorsed by the Organisation for Economic Cooperation and Development (OECD) in its commentary to determine the employment relationship in the context of taxation of income from employment for an individual under Article 15. Lately, Indian courts (mainly Income Tax Appellate Tribunals and Authority for Advance Rulings) have considered various other factors of a secondment arrangement (such as presence of a master service agreement, application of rules/procedures of receiving entity, charge of mark up etc.) to come to their conclusion. The issue is often a subjective analysis of the overall factors of the arrangement.

Adoption of substance over form

The Delhi HC, in the case of Centrica, has rightly noted that one needs to adopt a “substance over form” approach. This is consistent with the OECD approach of determining the real employer. The Delhi HC noted several factors in favor of the proposition that the personnel are employed by the Indian company – such as that, (i) assignees were subject to its control, supervision, direction and instructions; (ii) Indian company bore all the risks and rewards of the assignees; (iii) assignees perform their duties in accordance with the applicable laws/regulations of the Indian company etc.

Furthermore, foreign companies were not responsible for any errors or omissions by assignees. However, on an overall consideration, the following “crucial” factors, in HC’s view, indicated that the foreign companies remained the employer of the assignees:

- The Indian company was not formally obliged to pay salary to the assignees. Furthermore, the assignees could recover their salary only from the foreign companies.
- The Indian company could not terminate the legal employment of the assignees with foreign companies.
- The assignees participated in the retirement and social security plans of the foreign companies.
- The employment with foreign companies was permanent. Assignees were not “released” from it and they were to return to the foreign company after completion of secondment.
- The legal employment with foreign companies could not be disregarded as the foreign companies were not conduits and their relationship was not a false facade.

It may be fair to note that the HC came to the conclusion on an overall appraisal of various factors of the arrangement noted by it.

An analytical viewpoint on factors considered by the HC to be adverse

Some of the adverse factors noted by the HC are the inherent features of a secondment arrangement. Continuity of participation in overseas social security/retirement plans, right to return to the overseas employment are driven by commercial aspects of secondment, since an employee on temporary/short-term assignments would not prefer to give up its interests in its permanent employment. From a tax perspective also, these factors have not been considered unfavorably so far in other court rulings on secondment or in the OECD Commentary under Article 15. Such factors, though treated as relevant factors by the HC, it is submitted that they cannot be considered to be decisive or conclusive by themselves to determine economic employment during the secondment period.

Right of termination of employee

The HC noted that the Indian company did not have the right to terminate the employment of the assignees with the foreign company. Now, the Indian company had the right to terminate the secondment arrangement in case of disobedience, misconduct, etc. of the assignees. With due respect, the “right to terminate” test should be applied with respect to the secondment arrangement and not with respect to the legal employment with foreign companies.
Obligation to pay salary

In the case of Centrica, salary paid by the foreign company was recovered by the Indian company. The exact basis or the reason based on which the HC concluded that there was no obligation whatsoever on the part of Indian company to bear the cost in the name of “salary” is not very clear. On principles, it should be permissible that the salary is borne by the economic employer by way of cross-charge reimbursement. Such cross-charge arrangement is usually adopted in India due to regulatory law restrictions and for administrative convenience. While a legal obligation to pay is a very significant factor, a question arises whether it is the formal legal obligation to pay that ought to be a pre-condition. The fact of constructive payments of the salary costs should suffice, since it is emerging from the OECD commentary and Indian judicial precedents.

Is formal employment decisive in all cases, except cases of abuse?

Furthermore, the HC seems to have taken a view that an economic employment other than the legal employment can emerge only in abusive transactions and in genuine cases, legal employment cannot be ignored. While it is true that in case of abuse, legal employment can be considered as an eye wash and be ignored, it does not appear to be correct to suggest that, in the face of legal employment, the concept of real or economic employer cannot co-exist. With respect, the view of the HC on this point does not appear to be in sync with the current jurisprudence (Indian as well as international) on the aspect. With the wake of globalization, an economic employment other than the formal employment is quite possible in genuine business transactions and it is also acknowledged in international tax law as given in commentaries.

Characterization of income

According to the HC, the above arrangement amounted to “provision of services of technical or other personnel,” which is covered under FTS/FIS definition of the India-UK as well as India-Canada DTAA. Further, to determine taxability, the HC considered the “make available” condition in the India-Canada DTAA as satisfied. The HC, in its view, accored a different interpretation to the FTS provision of the India-UK DTAA to conclude that the “make available” condition in the India-UK DTAA is a separate criteria and need not be cumulatively satisfied as in the India-Canada DTAA. There can be a strong possible second view on this interpretation of the HC. The language of two DTAA is not materially different. Moreover, after observing that the services were in the nature of FTS/FIS, the HC went on to rule that there was a Service PE in India for foreign companies. The HC has not specifically addressed itself to the Service PE definition, which expressly excludes services in the nature of FTS/FIS. To that extent, the HC’s decision may be subject to re-consideration.

Existence of Service PE

The HC referred to the SC decision in the case of Morgan Stanley [292 ITR 416] wherein, as we understand, the SC had held that the following conditions need to be cumulatively satisfied to create a Service PE:

a) The foreign company is responsible for the work done by assignees and

b) Assignees are on the payroll of the foreign company or continue to have a lien on employment with foreign company

According to the HC, the ratio of Morgan Stanley ruling was satisfied and assignees created a Service PE in India as they had a lien on employment with the foreign companies. The HC’s decision may not appear to be consistent with the SC ruling if the two tests evolved by the SC in the case of Morgan Stanley are considered to be cumulative.

Way forward

Indian courts have, generally, adopted a substance over form approach for determination of employer, which was also reiterated by the HC. The current ruling may create uncertainty for taxpayers as it has overlooked some established principles in favor of certain factors of employment. While the view adopted by the HC is debatable, litigation on account of it cannot be ruled out. It is advisable for taxpayers/multinational companies to review their existing or future secondment arrangements and carry out a risk assessment in light of the issues arising from the Delhi HC ruling.

It may also be noted that a cross-border secondment arrangement has implications under regulatory, social security as well as indirect tax laws apart from direct tax, which may be kept in mind at the planning stage.
Decisions supported by our Litigation team

Joint venture termination amount allowable as revenue expenditure

In the case of CIT v. Cummins Generator Technology India Ltd. [TS-171-HC-2014 (Bom)], argued by our Litigation team before the Bombay High Court (HC), the Taxpayer paid compensation to a related company for termination of a marketing Joint Venture (JV). The Taxpayer, a manufacturer, had earlier entered an agreement with its related party for using its sales and service network for marketing the Taxpayer's products. The Taxpayer paid a lump sum amount on termination of the agreement, which was disallowed by the Tax Authority on the ground that expenditure was unreasonable and not incurred for business purposes. The Tribunal, on analysis of the factual matrix, held that the Taxpayer had considered the marketing arrangement as unprofitable and therefore, the same was terminated. The payment was a business decision meeting the “commercial expediency” test and was based on correct legal principles. Accordingly, the same had to be allowed as revenue expenditure. On appeal by the Tax Authority, the HC upheld the Tribunal's ruling.

Appropriate withholding tax rate to be applied for various payments

In the case of Bajaj Allianz Life Insurance Co. v. ITO [ITA No 116/PN/2013] the Tribunal was concerned with withholding under the ITL for various types of payment. The Taxpayer had withheld taxes at 1% on the basis that they were in the nature of contract services whereas the Tax Authority contended that the nature of work involved rendering of technical, managerial or professional services or rental services and, accordingly, tax should have been withheld at 10% according to the ITL. The Tribunal, after analyzing the nature of each payment, held that the Taxpayer had rightly withheld tax at 1% from the payments, being contract or sub-contract services.

<table>
<thead>
<tr>
<th>Nature of payment</th>
<th>Tribunal's reasoning</th>
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<tbody>
<tr>
<td>Production of advertising film</td>
<td>Reliance on Central Board of Direct Taxes (CBDT) Circular No. 714, which specifically provided so.</td>
</tr>
<tr>
<td>Payment made for sending SMS to customers</td>
<td>Recipients merely assist in sending messages without human intervention, which involved no technical or professional services.</td>
</tr>
<tr>
<td>Payment to service provider for outsourced functions like asset management, vendor management etc.</td>
<td>Services are in the nature of routine administrative assistances required for day-to-day operations and did not involve any technical or professional services.</td>
</tr>
<tr>
<td>Diesel Generator (DG) hire charges</td>
<td>Composite contract involved supply of DG sets and allied services answering to the meaning of “work” and not a rental agreement.</td>
</tr>
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</table>

Significant Supreme Court (SC) decisions

Whether deductor entitled to interest on refund of taxes withheld

In the case of Union of India v. Tata Chemicals Ltd. [TS-147-SC-2014], the issue before the SC was whether the Taxpayer, which was entitled to refund excess taxes withheld by it under the provisions of the ITL, was also entitled to interest on such refund. The SC held that obligation to refund money received and retained without right implies and carries with it the right to interest. Furthermore, there was no reason to restrict interest on refund only to taxpayers, which pay taxes on their own behalf, without extending similar benefit in respect of refund of withholding taxes.

(For more details, please refer EY Alert dated 19 March 2014)

In another case of CIT v. Gujarat Fluoro Chemicals [TS-165-SC-2014], a Division Bench of the SC set aside the Delhi HC's ruling, which allowed the taxpayer interest on delayed refund on excess taxes withheld and further running interest on such accrued interest. The SC held so in view of a Larger Bench ruling (3 judge bench) in the Taxpayer’s own case, which had denied interest on interest accrued on account of excess taxes withheld on the reasoning that...
Taxpayer is entitled to only that interest, which is permitted by the statute and not any other interest on such statutory interest.

(For more details, refer Tax and Regulatory Quarter, December 2013 Edition)

Beneficiaries not taxable on “discretionary” trust’s income until distributed by trustees

In the case of Commissioner of Wealth Tax v. Estate of Late HMM Vikramsinhji of Gondal [TS-258-SC-2014(SC)], the SC upheld HC’s order stating that the Taxpayer, who was the legal heir of the Settlor of two UK trusts and also the beneficiary of such UK trust, was not assessable to the income or wealth of trust, till such income or wealth was actually disbursed by the trustees. The SC held that the trust in question was discretionary as it did not give any right to the beneficiary to any part of income from trust’s property, but vested in trustees a discretionary power to pay the beneficiary, or apply for his benefit. As discretion was not exercised by trustees to disburse the same to the beneficiary taxpayer, no income or wealth arose to taxpayer under the trust deed.

Scrap sales to be excluded while computing “total turnover” for incentive deduction provisions

In the case of CIT v. Punjab Stainless Steel Industries [TS-256-SC-2014], the SC upheld the Delhi HC ruling, which held that proceeds generated from scrap sales of steel that could not be used in production of utensils manufactured by it, should not be included in “total turnover” for the purpose of production-linked incentive deduction. The SC observed that “turnover” would ordinarily mean only the amount of sale proceeds received in respect of goods in which taxpayer is dealing in. For this purpose, the SC placed reliance on the Institute of Chartered Accountants of India Guidance Note on Tax Audit, which contemplates non-inclusion of scrap sales in computing “turnover”.

No carry forward and set off of losses in cases of amalgamation of cooperative societies

In the case of Rajasthan R.S.S. & Ginning Mills Fed. Ltd. v. DCIT [TS-241-SC-2014], the issue before the SC was whether an amalgamated cooperative society is entitled to carry forward and set off accumulated losses of the amalgamating cooperative society. The SC ruled that, on amalgamation, the amalgamating cooperative society ceases to exist and, in the absence of a specific provision in the ITL, accumulated losses of the amalgamating cooperative society cannot be carried forward and set off by the amalgamated cooperative society. The provision in the ITL, which grants benefit of carry forward and set off of losses for companies, banks etc., does not specifically cover cooperative societies.

(For more details, please refer EY Alert dated 5 May 2014)

**Decisions on capital or business income classification**

In the case of CIT v. Devasan Investment Pvt. Ltd. [TS-224-HC-2014(Del)], the Taxpayer had transactions in sale and purchase of shares and investments, income from which was offered to tax as capital gains. The Tax Authority, observing the short duration of holding of securities, sought to tax the income as Business Income. The SC ruled that the taxpayer kept a “target” price and it would hold the shares till such target price was achieved, which incidentally happened to be within a short duration of one or two months. Therefore, based on an overall consideration of factors, the HC concluded that the nature of the transaction was essentially investment activity, notwithstanding that the purchase and sale took place within a short interval.

In the case of Gurumukh J Sukhwani v. DCIT [TS-272-ITAT-2014(PUN)], the Pune Tribunal held that transactions of short period are not in the nature of investment activity but akin to trading in shares, taxable as Business Income. The Tribunal held that where shares are held for more than 30 days, gain thereon must be treated as Capital Gains and for shares held for more than 30 days, it must be treated as Business Income.

In another case of Manish Karva & Ors v. ACIT [TS-705-ITAT-2013(Ind)], the Indore Tribunal held that certain factors had to be considered to determine characterization of share sale transactions such as intention behind investment, treatment in books of accounts, whether organized effort made to obtain profits, volume and frequency of transactions as
well as consistency in treatment by Tax Authority in proceedings for previous tax years. Merely liquidating investments within a short time for better earning could not show taxpayer’s intention as “trader” nor “investor”. On these principles, Tribunal held that gain on sale of shares had to be treated as capital gains and not business income.

Profit on share transactions through Portfolio Management Scheme (PMS) taxable as Capital Gains

In the case of Radials International v. ACIT [TS-238-HC-2014(DEL)], the Delhi HC laid down certain principles to determine characterization of share transactions under discretionary PMS. The HC held that the terms of the PMS agreement do not indicate investor’s intention to make profits. Based on various factors, such as use of surplus funds as compared to borrowed funds for investment, volume and frequency of transaction, the HC held that income from share transactions was taxable as capital gains.

(For more details refer EY Tax Alert dated 5 May 2014)

Premature mutual-fund redemption in the course of business taxable as “business income”

In the case of CIT v. Pooja Investment Pvt. Ltd [TS-217-HC-2014(P & H)], the Taxpayer was an investment company and had brought forward capital losses. It offered income arising on premature mutual-fund redemption as short-term capital gain and sought to set it off against available brought forward loss. It was held that investment made by the Taxpayer was in the normal course of business activity and was not for the purpose/intent of building capital and therefore, was taxable as business income. The HC also observed that to determine character of income, what needs to be considered is (a) pattern of investment (b) taxpayer’s behavior in conducting its business (c) outcome of transaction and of investment made by taxpayer.

Share sale by promoter cannot be split into capital gains and business income

In the case of DCIT v. Vagish Dixit (I.T.A. 314 / Hyd /2013), the Taxpayer-promoter sold shares in a company in two tranches to the same buyer within a span of seven months. The sale price of second tranche was much higher than the first. The Tax Authority sought to split the sale price of the second tranche and tax a portion thereof as business income by attributing it to transfer of management rights. The Tribunal held that the Taxpayer had satisfactorily justified increased sale price for the second tranche (which primarily was due to improved profitability following the entry of buyer) with supporting documentary evidence and hence, the whole of the sale price was assessable as capital gains. The Tribunal also accepted the alternative argument of the Taxpayer that even assuming there was transfer of management rights, income from transfer of such right being a capital asset was assessable as capital gains only.

Court decisions on allowability of expenditure

Expenses of temporarily terminated project allowable as deduction

In the case of DIT (IT) v. Bechtel International Inc. USA [TS-261-HC-2014(Bom)], the Taxpayer was involved in two projects through two project offices (PO) in India. The Tax Authority disallowed expenses relating to one of the projects on the ground that the project had been discontinued and hence, no expense was allowable as deduction. The Bombay HC held that though one project was temporarily discontinued for default in payment, the Taxpayer was present in India and continued to pursue its claim against the defaulter. This was also supported by extension of approval to operate PO in India by the Reserve Bank of India (RBI). Moreover, subsequently, the Taxpayer entered another agreement for providing services through the same PO. Hence, the HC held that expenses could not be disallowed as there was no total or complete discontinuation of business activity.
Certain expenses allowable as revenue in a renovation exercise

In the case of Joy Alukkas Pvt. Ltd. V. ACIT [TS-144-HC-2014(KER)], the Taxpayer engaged in jewellery business incurred huge expenditure on interior decoration, renovation in rented premises and creating good ambience. Such expenditure was claimed as revenue expenditure but was disallowed by the Tax Authority. The Kerala HC held that the outgoing expenditure, though forming part of profit earning exercise cannot be considered as capital expenditure in the absence of acquisition of any asset. Accordingly, the HC held that renovation items such as air-conditioners, cupboards etc. that could be retrieved at the end of lease term should be capitalized and those that cannot be retrieved, for instance room painting, flooring, etc. should be allowed as revenue expenditure.

Write-down of investment loss allowable only if a “direct and proximate” nexus exists with business

In the case of Tata Communications Ltd. [TS-210-ITAT-2014-Mum], the Taxpayer was in the business of providing international telecommunication services in India and held investments in shares of a company incorporated in the UK (UKCo), which was set up to establish and operate a satellite-based mobile telecommunication system. Due to inadequacy of funds, the UKCo filed for bankruptcy, which resulted in a decline in the value of its shares, which the Taxpayer sought to write down. The Tribunal ruled that, there was no direct and proximate nexus between the business operation and the investment in the UKCo and, accordingly, the loss arising from write down of investments is not deductible.

(For more details, refer EY Alert dated 21 April 2014)

Non-compete fees paid allowable as revenue in certain cases

In the case of Hidelberg Cement India Ltd. v. ACIT [TS-121-ITAT-2014(Mum)], the Taxpayer had taken over another company and on acquisition, paid certain sum to the key managerial personnel of the erstwhile company as non-compete fees and claimed the expense as revenue. The duration of the non-compete was one year. The Tax Authority sought to treat the payment as capital expenditure. Ruling in favor of the taxpayer, the Tribunal held that a period of one year could not be considered as a long period, which would give any enduring benefit to the Taxpayer and therefore, the payment was allowable as a revenue expense.

Importance of appropriate characterization of income

Income from foreign exchange fluctuation takes the character of the underlying transaction

In the case of CIT v. Priyanka Gems [TS-707-HC-2013(Guj)], the Taxpayer was entitled to profit-linked tax deduction from its income from exports. The Taxpayer had earned the income by way of foreign exchange fluctuation due to time lag between exports made and proceeds realized. The Tax Authority sought to tax the same as “Income from Other Sources” and not “Business Income”, thereby denying tax deduction on the same. The Gujarat HC held that the period of time and variation of rate in international currencies cannot divest the nature of income, which was derived from the Taxpayer’s underlying export business. Therefore, such income was to take its character as “Business Income” and not “Other Income” and was eligible for deduction.

In the case of Tube Investments of India Ltd. v. JCIT [TS-160-HC-2014(MAD)], the Taxpayer had borrowed loans in foreign currency for modernization of its facilities and financing capital expenditure which was approved by the RBI. The Taxpayer contended that though interest on loan had to be capitalized, foreign exchange loss arising on repayment of interest on such loans should be allowed as revenue expenditure, since there was a nexus with production of materials and exporting. The Madras HC held that as loan was obtained for capital purpose and the Taxpayer was bound by the terms of the RBI approval, loss arising as a result of exchange fluctuation was held to be capital expenditure in nature.

Rental income from letting of industrial park along with provision of services taxable as “Business Income”

In the case of CIT & ACIT v. Toyota Techno Park India (P) Ltd. [TS-190-HC-2014(Kar)], the Taxpayer was engaged
in the business of developing, operating, maintaining industrial park and providing infrastructure facilities to different companies as its business and, therefore, contended that rental income is to be taxed under the head “Business Income.” The Karnataka HC held that if renting of building and provision of facilities are inseparable and the intention is to carry on business of letting out commercial property, then rental income falls under head “Business Income” and not as “Income from House Property.”

**View on issues concerning withholding taxes**

Tax withholding does not apply to year-end provisions in absence of payment or credit to recipient

In the case of Telco Construction Equipment Co. Ltd. [ITA 476/Bang/2012], the Tax Authority sought to disallow provision for sales commission made at the year-end for failure to withhold tax under the ITL. The Tribunal held that, in the facts of the present case, year-end provision did not attract tax withholding provisions, since the Taxpayer credited the amount of commission payable to provision account and not to respective agents account as well as for the reason that the right to receive commission vests in the agent only on fulfilment of obligations according to agreement.

Expense disallowance for not withholding taxes applies to tax exempt entities as well

In the case of Municipal Committee v. ITO [TS-275-ITAT-2014(ASR)], the Taxpayer was a tax-exempt entity and did not withhold taxes on supply, erection, testing and commissioning charges paid to contractors on the ground that its income was exempt under the provisions of the ITL. The Tribunal held that the ITL is an integrated code. The provision relating to disallowance of expenses for non-withholding of taxes is a non-obstante provision, which applies not withstanding anything otherwise provided under the ITL. Hence, disallowance was triggered. Tax exemption cannot be allowed on such disallowance as no benefit of deduction or exemption could be granted for violating the provisions of the ITL.

**Certain rulings on Permanent Establishment (PE) on account of services**

Fixed Place PE on protracted presence of employees executing a consultancy project in India

In the case of Renoir Consulting Ltd. (ITA No. 4323& 4125/Mum/2011, ITA No. 5298/ Mum/2009), the Mumbai Tribunal held that a Mauritian company had a PE in India under the provisions of the India-Mauritius DTAA, on presence of its employees in India for a long duration of time to carry out a performance enhancement assignment. On the facts, the Tribunal concluded that the premises of the client or the hotel where the employees stayed could be regarded as a fixed place through which the business of the Taxpayer was carried on and a fixed place PE of the Taxpayer existed in India.

*(For more details, please refer EY Alert dated 13 May 2014)*

In the case of Huawei Technologies Co. Ltd. v. ADIT [TS-156-ITAT-2014(DEL)], the Tax Authority observed that the Chinese Taxpayer had given power of attorney in favor of employees of Indian office to prepare bidding documents and sign, negotiate and conclude contracts. These employees formed sales teams and habitually secured and concluded orders for the Taxpayer. Accordingly, the Tribunal held that the Indian office constituted a PE of the Chinese Taxpayer in India. The Tribunal further noted that, since the Indian office was economically, technically and financially dependent upon the Chinese HO, it also constituted an independent agent of the Chinese Taxpayer in India.

*(For more details, refer EY Alert dated 2 May 2014)*

Seconded employees and Service PE in India

The Delhi HC in the case of Centrica India Offshore Pvt. Ltd. [TS-237-HC-2014-Del], based on facts, held that employees seconded by overseas Group Entities (GE) to the Taxpayer in India did not become employees of the Taxpayer, but continued to remain employees of the GE during the secondment period. Hence, payments from the Taxpayer to the GE for such services would be regarded as FTS/FIS under the ITL, as well as under the relevant DTAs. The HC also concluded that the overseas GE created Service PE in India under the applicable DTAs by virtue of services rendered through its employees present in India.

*(For more details, refer EY Alert dated 2 May 2014)*
PE on account of stewardship activities and technical assistance rendered in India

The Delhi Tribunal in the case of JC Bamford Excavators Ltd. [TS-161-ITAT-2014-Del], held that activities of inspection and testing by employees of the NR Taxpayer were to ensure the quality of the licensed products and make sure they adhered to the specifications/global standards. Such activities will amount to stewardship activities and will not give rise to a PE in India.

Furthermore, technical assistance was rendered to the Indian subsidiary by employees of the Taxpayer, which resulted in a Service PE. Since such FTS was effectively connected with the Service PE, it was taxable as business profits under the India-UK DTAA.

*(For more details, please refer EY Alert dated 28 March 2014)*

**Other significant decisions**

“Ready for use” rigs, when not actually “used”, not to be considered to determine 120 days threshold for constituting PE under the India-US DTAA

In the case of DIT (International Taxation) v. R & B Falcon Offshore Ltd. [TS-233-HC-2014-UTT], the NR taxpayer brought in a rig and operated that rig for and on account of its clients in India. The rigs remained unused on the dates they were deployed on account of maintenance and repair. The Taxpayer argued that no PE was constituted, since the rig was actually “used” for less than 120 days according to Article 5(2) of the India-US DTAA. The Tax Authority, however, contended that under the ITL, the meaning of the term “use” includes “ready to use” and hence, took into account, the number of days on which the rig was not operated on account of maintenance, to compute threshold of 120 days constituting PE. The HC, ruling in favor of the taxpayer, confirmed the Tribunal’s ruling that in view of the context in which the term “used” is employed under Article 5(2) of the India-US DTAA, the Taxpayer had no PE in India as the rigs were not “used” for 120 days or more.

*(For more details, please refer EY Alert dated 28 March 2014)*

Share of profits of a partner from a partnership firm with exempt income is also exempt in the hands of the partner

The Karnataka HC, in the case of Vidya Investments and Trading Company Pvt. Ltd. [TS-117-HC-2014], ruled that share of profits received by a partner in income of partnership firm, which did not suffer tax due to exemption will be exempt in the assessment of the partner as well as according to specific provision under ITL.

*(For more details, please refer EY Alert dated 5 March 2014)*

Subsequently, the CBDT also released a Circular to this effect. Please refer, “From the Tax Gatherer’s Desk” section of this Digest for details of the Circular.

Transfer of undertaking in lieu of shares/bond issue is not “slump sale” but “exchange”

Under the ITL, “slump sale” is defined as transfer of one or more undertakings for a lump sum without assigning individual values to assets and liabilities. Computation of Capital Gains in case of slump sale is specifically provided under the ITL. In this case of CIT v. Bharat Bijlee Ltd. [TS-270-HC-2014-Bom] before the Bombay HC, the Taxpayer transferred one of its undertakings to an independent buyer and received, as consideration, shares and bonds of the purchaser company. The Bombay HC held that in absence of determination of monetary consideration, transfer of undertaking against issue of shares or bonds did not amount to “sale” but is to be treated as an “exchange” transaction and, accordingly, could not be considered as “slump sale.”

Delhi HC rules on AOP constitution and taxability of offshore supply and services

In the case of Linde AG [TS-226-HC-2014-Del], the Delhi HC, based on the facts of the case and with regard to separate and independent scope of responsibilities of the Taxpayer and Korean company, held that the consortium formed cannot be treated as an Association of Persons (AOP) under the ITL. The HC also held that income from offshore supply of equipment was not taxable in India if all the activities, in relation to the supply of equipment, are carried out overseas.

*(For more details, refer EY Alert dated 28 April 2014)*
NR agents’ commission for engaging international artists to perform in India not taxable in India

In the case of DIT (IT) v. Wizcraft International Entertainment Pvt. Ltd. [TS-240-HC-2014-Bom], the taxpayer, an event management company, had engaged the services of an NR agent to bring international artists to India. The Taxpayer paid commission to the agent and also reimbursed expenses of the artists for their visit and performance in India. The issue before the Bombay HC was with regard to withholding taxes from such payments. The HC noted that the payments toward reimbursements, in connection with the artist’s performance in India, were supported by documents. These were therefore not in the nature of income of the artists and hence, no taxes were required to be withheld from the same. Furthermore, as the agent never took part in the event, nor exercised any personal activities in India but only contacted/ negotiated with the artists outside India in terms of the authority given to him by the taxpayer, the HC held that the commission to the agent was not taxable in India.

Loss on house property situated outside India allowed to be set off against other taxable income in India; SC decision in case of Kulandagan Chettiar distinguished

In the case of Sumit Aggarwal v. DCIT [TS-300-ITAT-2014(Chandi)] the Taxpayer, an Indian resident, had claimed loss incurred on house property situated in Australia. The Tax Authority contended that income from such house property was not taxable in India under the India-Australia DTAA and accordingly, loss from such property should not be permitted to be set off against other income streams. The Tribunal, noting that such income was taxable under the ITL, observed that Taxpayer had an option to apply the more beneficial of provisions of the ITL or DTAA. The Taxpayer had exercised the option of filing the tax return according to the ITL, which cannot be refused merely because the DTAA was also available as an option. The Tribunal also distinguished the SC decision in the case of CIT v. PVAL Kulandagan Chettiar [267 ITR 645] on the grounds that the taxpayer was a tax resident of both Malaysia and India and it was the financial connection of the taxpayer with the Malaysian property, which weighed with the SC that it was held that income from Malaysian rubber plantation was taxable in Malaysia. In the facts of the Taxpayer’s case, the loss incurred on house property situated in Australia was allowed to be set off against other streams of income as claimed by the Taxpayer.
### Citation | Particulars | Ruling of HC
--- | --- | ---
CIT v. Finolex Cable Ltd. [TS-249-SC-2014] | Tax Authority preferred a Special Leave Petition (SLP) against Bombay HC’s ruling of not allowing depreciation on a new non-eligible unit to be set off against profits of an existing eligible undertaking in determining profit-linked incentive deduction. | • Taxpayer had an existing unit which was eligible for profit-linked tax deduction. It thereafter, set up a new unit, which was not eligible for profit-linked deduction for the year under consideration.  
• Tax Authority was of the view that the new unit was an extension of the earlier unit and therefore, depreciation on such unit was to be set off against profits of the eligible unit while computing the profit-linked tax deduction.  
• The Bombay HC had observed, based on facts, that the new unit was an independent and viable unit and upheld Tribunal’s order holding that depreciation on the new unit, cannot be set off against profits of the earlier unit in determining eligible profit-linked incentive deduction. |
CIT (A) v. ONGC Ltd. [TS-218-SC-2014] | Tax Authority preferred an SLP against Gujarat HC’s ruling holding taxpayer-employer to be not in default for non-withholding of taxes on certain payments to employees. | • Gujarat HC had held that Conveyance maintenance reimbursement expenditure (“CMRE”) allowance paid to employees toward running and maintenance expenditure of personal vehicles used for official work was correctly treated as exempt for withholding purpose by the Taxpayer and hence, no taxes were to be withheld.  
• CMRE allowance was paid according to policy, designation and after obtaining declaration from employees.  
• Employer could not be faulted with if, during assessment of employees, it was revealed that they did not utilize full amount received for the stated purpose. Accordingly, there was no default in withholding tax obligation on part of the employer. |
CIT v. Avadh Transformers Pvt. Ltd. [TS-215-SC-2014] | Tax Authority preferred an SLP against Allahabad HC ruling holding reopening of assessment proceedings beyond four years as invalid. | • Assessments were reopened solely based on introduction of a retrospective provision which sought to deny benefit to works contactors.  
• HC held that such retrospective provision does not amount to “deemed failure” to disclose correct facts and hence, there was no failure on Taxpayer’s part to make full and true disclosure.  
• Accordingly, reopening the assessment proceedings after the stipulated time period is not permitted. |
Parvez Nazir Hussein Jafri v. CIT & Ors [TS-187-SC-2014] | Taxpayer preferred an SLP against Bombay HC ruling disposing off Taxpayer’s writ petition on the grounds of availability of alternate, efficacious remedy of appeal. | • HC had held that if the grounds and pleas raised in writ petition before it could be raised in appeal pending before First Appellate Authority, then writ petition need not be entertained.  
• Remedy of appeal cannot be said to be inefficacious in any manner. |
CIT v. Khanna and Anadhanam [TS-184-SC-2014] | Tax Authority preferred an SLP against Delhi HC ruling holding payment for termination of work referral agreement to be a capital receipt, not chargeable to tax. | • HC had held that Taxpayer’s arrangement was a permanent source of getting referral work and existed for a long period of time, termination of which led to loss of permanent source of income, impairing profit making apparatus of Taxpayer. Hence, it was a capital receipt not chargeable to tax. |
Ravinder Kumar Gugnani v. CIT [TS-297-SC-2014] | Taxpayer preferred an appeal against Punjab & Haryana HC ruling upholding reassessment proceedings pursuant to notice issued by non-jurisdictional Tax Authority | • HC had held that Taxpayer maintained residence and bank accounts in Delhi and in the absence of information of Taxpayer being assesses elsewhere, the Tax Authority in Delhi were competent to issue reassessment notice.  
• On request of Taxpayer, the proceedings can be transferred to the jurisdictional Tax Authority.
### Overseas Trading & Shipping Co. Pte. Ltd. v. ACIT [TS-286-SC-2014]

**Particulars:**
- Taxpayer preferred an appeal against the Gujarat HC ruling upholding disallowance of “commission” paid to sister concern for transfer of contractual liability.

**Ruling of HC:**
- Taxpayer did not have legal license to import furnace oil when it entered into a contract with a foreign company.
- Taxpayer transferred the contractual obligation and paid a commission to its sister concern, which was claimed as deductible expense.
- Subsequently, Taxpayer purchased furnace oil from its sister concern.
- HC observed that the entire transaction was in contravention of law and hence, the commission payment was not allowable as a deductible business expense.

### Eleganza Jewellery Ltd v. CIT & Ors [TS-176-SC-2014]

**Particulars:**
- Taxpayer had preferred an SLP against the Bombay HC ruling wherein HC had upheld reopening of assessment of Taxpayer as it was not based on change of opinion of Tax Authority.

**Ruling of HC:**
- HC had noted that the original assessment order was silent and no query was raised during assessment proceedings on the issue, upon which reassessment notice was issued.
- As Tax Authority did not have an opportunity to apply his mind on the issue, it could not be considered as change of opinion on part of the Tax Authority.
- A prima facie view of Tax Authority that income chargeable to tax had escaped tax is sufficient to reopen the assessment.

### Recent decisions on taxation of Royalty/FTS payments

**Summarized below are some decisions on Royalty and FTS, also considering relevant DTAA provisions:**

<table>
<thead>
<tr>
<th>Case Law</th>
<th>Payment Description</th>
<th>Ruling</th>
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<tr>
<td>Steria (India) Ltd., in re (AAR) [TS-285-AAR-2014]</td>
<td>Payment for management consultancy fees to Group company in France.</td>
<td>• Such payments would fall under “managerial services,” which are covered under FTS definition under India-France DTAA. • Taxpayer’s contention that such payments cannot be taxed as FTS applying the “most favoured nation” (MFN) clause in the Protocol to India-France DTAA cannot be accepted. • MFN clause cannot be used to import words, phrases or clauses not otherwise available in the DTAA and the “make available” condition, which is not present in India-France DTAA cannot be imported from other DTAA by relying on MFN clause. • MFN clause merely limits the tax rate as evidenced by the notification issued by Government of India (GoI) pursuant to the protocol. • Therefore, payment was taxable as FTS in India.</td>
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<td>India-France DTAA (For more details refer EY Tax Alert dated 19 May 2014)</td>
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<td>Cross Tab Marketing Services Pvt. Ltd v. ITO [TS-236-ITAT-2014(Bang)]</td>
<td>Fees paid to access database maintained outside India, which contained information about online consumers.</td>
<td>• Payment constituted royalty for use of online database. • Reliance was placed upon jurisdictional HC in the case of Wipro. [ITA No 2804/2005] • However, since the expenses were “payable” and not “paid” the disallowance was not upheld.</td>
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<td>Bangalore Tribunal</td>
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<td>ADIT v. Antwerp Diamond Bank NV [TS-150-ITAT-2014(Mum)]</td>
<td>Payment to head office (HO) for data processing facilitated by software installed at the HO.</td>
<td>• Reimbursement by the Indian Branch Office (BO) toward cost of data processing, by accessing the HO’s software was held to not constitute “Royalty” as the BO did not have an independent right to use or control over such software. • Allocation of costs of license of software acquired and installed at HO where the BO did not get any right to use the software could not be considered as royalty. • Amendments to ITL cannot be read into the DTAA definition of royalty.</td>
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<td>Mumbai Tribunal (For more details refer EY Tax Alert dated 20 March 2014)</td>
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<tr>
<td>Case Details</td>
<td>Description</td>
<td>Relevant Tax Regulations</td>
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| ADIT v. DQ Entertainment (International) P. Ltd. [TS-219-ITAT-2014(Hyd)] | Payment to foreign sub-contractors for creating “production material” in relation to animation films as per taxpayer's requirements. | • Merely because foreign sub-contractor possessed relevant expertise, knowledge, technology and experience, which were utilized for rendering services to Taxpayer, it could not be held that services were technical consultancy services without making any technology available to other party.  
• Taxpayer's business with its overseas clients constituted business carried on outside India and hence, the said payments were not taxable in India by virtue of source rule of FTS. |
| DCIT v. Velti India Pvt. Ltd. [TS-2013-ITAT-2014(CHNY)] | Payment to NR for transmission of bulk-SMS. | • Services involving mere transmission of data, which requires no technical skill, no human intervention involved, cannot constitute FTS. |
| Viacom 18 Media Pvt Ltd. v. ADIT [TS-179-ITAT-2014(Mum)] | Payment for satellite transponder services | • In absence of definition of the word “process” in the context of “Royalty” in the India-US DTAA, meaning to be drawn from ITL.  
• In view of the clarificatory amendments by Finance Act 2012 with retrospective effect, the definition of “process” in ITL includes satellite transponder services, thereby constituting “Royalty” under the DTAA. |
| Huawei Technologies Co. Ltd. v. ADIT [TS-156-ITAT-2014(DEL)] | Payment for equipment including embedded software to control and operate the equipment | • Software was not separately supplied but was embedded in the equipment.  
• Buyer was granted non-exclusive, non-transferable and non-sub-licensable license to use the software and no ownership or interest in the software.  
• Though in the agreement, a separate price was mentioned for software and hardware, it was embedded in the equipment and was not separately supplied.  
• Such payments could not be regarded as royalty in view of the jurisdictional HC ruling in the case of Ericsson AB [343 ITR 470].  
• Payment held as business income taxable in view of Taxpayer’s PE in India. |
DTAA between India and Latvia enters into force

The India-Latvia DTAA, signed on 18 September 2013, entered into force on 28 December 2013. The DTAA generally applies in India for tax years beginning 1 April 2014 and for subsequent years. This is the first DTAA between India and Latvia.

(Source: Notification No. 12/2014 [F.No.503/02/1997-FTD-I]/SO 663(E), dated 5 March 2014)

New DTAA between India and Romania enters into force

The India-Romania DTAA, signed on 8 March 2013, entered into force on 16 December 2013. It applies in India for tax years beginning from 1 April 2014. This new DTAA replaces the earlier DTAA signed in 1987. The source country withholding tax rates for royalty, FTS, interest and dividend have now been reduced to 10% (earlier it had ranged from 15% to 22.5%). The new DTAA also includes an article on limitation of benefits (LOB).


New DTAA between India and Sri Lanka enters into force

The India-Sri Lanka DTAA, signed on 22 January 2013, entered into force on 22 October 2013. It is effective in India from 1 April 2014. This DTAA replaces the earlier DTAA with Sri Lanka signed in 1982. Significantly, the new DTAA includes provisions to tax FTS (the earlier 1982 DTAA did not have an article to tax FTS). Moreover, the threshold for creation of services PE has been reduced to 90 days (it was 183 days earlier) within any 12 month period. The new DTAA also includes an article on LOB.


Foreign Account Tax Compliance Act (FATCA) agreement between India and USA agreed in principle

On 11 April 2014, India and the US have agreed in principle on an intergovernmental agreement to improve international tax compliance with respect to the US FATCA. The agreement is expected to be signed soon.

(Source: IBFD)

OECD Updates

Organisation for Economic Cooperation and Development (OECD) Issues public discussion draft on prevention of Treaty Abuse

One of the Action Plans on Base Erosion and Profit Shifting (Action Plan 6 - Prevention of Treaty Abuse) published by the OECD in July 2013 aims to address treaty shopping situations and other cases of treaty abuse, which may give rise to double non-taxation. As part of the Action plan 6, the OECD has released a public discussion draft titled Preventing the Granting of Treaty Benefits in Inappropriate Circumstances.

The discussion draft proposes changes to the OECD Model Treaty and the related commentary and contains recommendations on domestic law provisions.

(Source: OECD)

(For more details please refer EY Global Tax Alert dated 24 March 2014)

OECD releases discussion draft on tax challenges of the digital economy

On 24 March 2014, the OECD released a discussion draft in connection with Action 1 on addressing the tax challenges of the digital economy under its Action Plan on Base Erosion and Profit Shifting (BEPS). The document, BEPS Action 1: Address the Tax Challenges of the Digital Economy, contains a discussion of the key features and business models in a digital economy, the opportunities for BEPS that can arise in a digital economy and some potential options to address the tax challenges raised by the digital economy.

(Source: OECD)

(For more details, please refer EY Global Tax Alert dated 7 April 2014)

OECD releases discussion draft on neutralizing hybrid mismatch arrangements

On 19 March 2014, the OECD released two Public Discussion Drafts in connection with Action 2 on hybrid mismatch arrangements under its Action Plan on BEPS. The first document, BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Recommendations...
for Domestic Laws) makes recommendations for domestic rules. The second document, BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Treaty Issues) discusses the effect those rules would have on the Model Tax Convention and proposes changes to the Convention to clarify treatment of hybrid entities.

(Source: OECD)

(For more details please refer EY Global Tax Alert dated 7 April 2014)

46 countries adopt Declaration on Automatic Exchange of Information (EOI) in Tax Matters

On 6 May 2014, 46 countries including India and Switzerland, besides the European Union, signed and adopted a Declaration on Automatic Exchange of Information in Tax Matters. The Declaration commits countries to implement a new single global standard on automatic exchange of information, which was developed by the OECD and adopted by G-20 group of countries. It recognizes that investments kept offshore by taxpayers should not go untaxed and stresses that a key aspect of cooperation between tax administrations is an effective EOI on automatic basis, subject to certain appropriate safeguards. The OECD is expected to deliver a detailed commentary on the new standard, as well as technical solutions to implement the actual information exchanges, during a meeting of G-20 finance ministers in September 2014.

(Source: Ministry of Finance Press Statement, PIB Release dated 12 May 2014, IBFD)

OECD issues new Research and Development (R&D) incentive report

The OECD has issued a new report, which provides an update on some of the available research and development (R&D) tax incentive schemes for OECD countries and selected economies. Specifically, the report contains information on the design, scope and approval processes of R&D tax incentive relief. The report is based on the results of a 2013 OECD questionnaire conducted by the OECD Working Party of National Experts on Science and Technology Indicators in 2013. For each country, the OECD provides five key areas for each available incentive, such as, general attributes, eligible R&D, incentive design attributes, pre-approval/documentation requirements and definition of R&D. The report provides details for 29 jurisdictions and indicates rapid evolution of R&D incentives.

(Source: OECD)

(For more details, please refer EY Global Tax Alert dated 10 April 2014)
Slovakia introduces increased withholding tax rate on cross border payments for countries not featuring in the “white list”

Effective 1 March 2014, Slovakia introduced an increased withholding tax rate of 35%. This rate applies to certain payments made to individuals or legal persons in a non-treaty country. For this purpose, a non-treaty country is considered as a country that is not included in the list published on the official website by the Ministry of Finance, i.e., the so called “white list.”

Currently, the “white list” consists of 64 countries that include countries that have concluded a DTAA (such as India) or a Tax Information Exchange Agreement with the Slovak Republic and countries that are parties to an international agreement providing for similar provisions on exchange of information, if such agreement is binding for both the Slovak Republic and the other country.

(For more details, please refer EY Global Tax Alert dated 28 April 2014)

French Tax Administration releases draft regulations on “anti-hybrid” financing provisions

On 15 April 2014, the French Tax Administration (FTA) released its draft regulations on the new “anti-hybrid” financing provisions included in the 2014 Finance Bill. The 2014 Finance Bill provides that interest paid by a French enterprise, subject to Corporate Income Tax (CIT) to a related French enterprise or a NR-related enterprise is no longer tax deductible for French CIT purposes if the interest paid is not subject to tax at the level of the beneficiary company at a rate of at least 25% of the French CIT that would have been due under the standard French rules. These draft regulations, which are currently binding on the FTA, were open for public consultation till 30 April 2014 and could be subject to some amendments before final guidelines are issued by the FTA.

(For more details, please refer EY Global Tax Alert dated 16 April 2014)

Brazilian Federal Tax Authorities issue Normative Instruction dealing with withholding tax on transactions with NRs

Brazilian Federal Tax Authorities (RFB) published Normative Instruction 1,455 (NI 1,455) on 7 March 2014, dealing with withholding tax (WHT) on different types of income resulting from cross-border payments made to NRs. The Instruction does not cover all types of transactions subject to withholding tax. It primarily applies to transactions with payments for services and intangibles, certain financial transactions and capital gains taxation of NRs. Major changes are in relation to capital gains, definition of technical services and export financing.

(For more details, please refer EY Global Tax Alert dated 17 March 2014)

China’s State Council issues circular to improve regulatory environments for M&A transactions

On 7 March 2014, China’s State Council issued Circular No. 14 to announce a plan to build better and more efficient economic and industrial structures by replacing less productive small business models with more sophisticated and efficient operating environments. To achieve this goal, the Chinese Government aims to improve regulatory environments by simplifying and reducing burdensome government procedures to encourage mergers and acquisitions (M&A). In addition, the Government plans to offer attractive means to finance such M&A activities.

(For more details, please refer EY Global Tax Alert dated 15 May 2014)

Germany’s highest Tax Court suggests that interest limitation rule may be unconstitutional

The first senate of the highest German Tax Court (BFH) has held in a recently published decision that Germany’s 30% EBITDA-interest limitation rule, in place since 2008, is most likely violating the constitutional principle of equality and the constitutionally mandated principle of taxation based on financial ability. Contrary to several lower tax courts, the BFH quite clearly joins the ranks of those commentators, who believe that the interest limitation rule in its existing form is not targeted enough on abusive structures, and creates unnecessary and unconstitutional “collateral damage.” The case concerned a German corporation, which, in spite of its annual operating loss, had to pay taxes because of disallowed interest expenses.

(For more details, please refer EY Global Tax Alert dated 29 April 2014)
Release of the Direct Taxes Code 2013

The Direct Taxes Code (DTC) is an attempt by the GoI, for the past many years, to revise, consolidate and simplify the language and structure of direct tax laws in India into a single legislation. DTC 2010 was introduced in the Indian Parliament in August 2010 and since then there have been recommendations from various stakeholders, as well as the Standing Committee on Finance (SCF) specifically formed for the purpose. As a follow-up on this initiative and as stated by the Finance Minister (FM) in his Interim Budget Speech in February 2014, a “revised” version of DTC 2013, after taking into account the recommendations of the SCF, has been released.

Broadly, the revised version of DTC 2013 largely aligns with the provisions of the ITL, in a sense that many of the proposals contained in the earlier version of DTC 2010 have already been introduced in the ITL as part of Finance Act (FA) 2011, FA 2012 and FA 2013 provisions. Prominent among these are the introduction of a broad-based General Anti-avoidance Rule (GAAR), provisions for taxation of indirect transfer of Indian assets and widened source rule in case of taxation of royalty and FTS.

(Source: Press Release dated 31 March 2014)
(For more details, please refer EY Alert dated 2 April 2014)

CBDT clarifies on tax withholding obligation in respect of payments made to NR

The CBDT, the apex administrative authority for direct taxes in India, issued Instruction No. 2/2014 to the Indian Tax Authority on the issue of whether tax withholding is required on the whole sum being remitted to a NR or only with reference to the portion of remittance representing the sum chargeable to tax in India under the ITL. In light of certain judicial developments in India, the CBDT has directed the Tax Authority to determine the appropriate portion of payments, which is chargeable to tax in India and, accordingly, a payer can be treated as a defaulter for not withholding tax only in respect of such portion of the payment, which is chargeable to tax in India under the ITL.

(Source: Instruction No.2/2014[F.No.500/33/2013-FTD-I] dated 26 February 2014)
(For more details, please refer EY Alert dated 11 March 2014)

CBDT clarifies on tax treatment of expenditure for developing infrastructure facility under BOT arrangement

The CBDT has issued Circular No. 9 of 2014 on the treatment of expenditure incurred by a taxpayer for developing infrastructure facility under a Build-Operate-Transfer (BOT) arrangement. While various courts have allowed depreciation on such expenditure representing “intangible asset” being a right to collect toll, the Circular clarifies that the taxpayer is not entitled to claim depreciation on such expenditure as the taxpayer is not the owner of such facility. Instead, the expenditure incurred may be amortized evenly over the period of BOT arrangement, and claimed as allowable expenditure under the ITL.

(For more details, please refer EY Alert dated 25 April 2014)

CBDT clarifies share of profits of a partner from a partnership firm, which have exempt income is exempt in the hands of the partner

The CBDT released Circular No. 8 of 2014 on the issue of whether share of profits (SOP) received by a partner from the partnership firm (firm), whose income is not taxable by virtue of an exemption or a deduction under the specific provisions of the ITL, is exempt in the hands of the partner. In terms of the current scheme of taxation of a firm (including a Limited Liability Partnership (LLP)) and its partners under the ITL, a firm, as a separate assessable entity, pays tax on its total income at the entity level. With the object of avoiding double taxation, the partner of the firm is exempt in respect of SOP received from the firm. The Circular clarifies that SOP received by the partner of a firm would be exempt from tax even if the income of the firm is not taxable due to specific exemption or deduction provisions of the ITL.

(For more details, please refer EY Alert dated 3 April 2014)
Scheme of merger/amalgamation/demerger/reconstruction of companies to be filed with Ministry of Corporate Affairs (MCA)

The MCA has issued Circular No. 1/2014 dated 15 January 2014 to its Regional Directors (RDs), which states that while furnishing any report of reconstruction or amalgamation of companies under the Companies Act, 2013, comments and inputs from the Tax Authority may be obtained to ensure that the proposed scheme is not designed in a way as to defraud the Tax Authority and consequently be prejudicial to public interest. The RDs are to invite specific comments from the Tax Authority within 15 days of receipt of notice before filing response to the High Court. While the MCA Circular was covered in the 2014 March edition of this newsletter, the CBDT has issued a directive to the Tax Authority to send their comments or objections to the proposed scheme to the RDs for incorporating them in the response to the Court.

(Source: Letter [F.No.279/MISC./M-171/2013-ITJ], dated 11 April 2014)

(For more details, please refer EY Alert dated 24 January 2014)

CBDT clarifies eligibility of successor other than merger in claiming tax holiday benefit for O&M activity for unexpired period

CBDT has issued Circular No. 10 of 2014, which clarifies that where the developer of infrastructure facility/industrial park/SEZ transfers its operation and maintenance to another person (successor) other than by way of amalgamation/merger, the successor will continue to avail benefit of tax holiday for the balance unexpired period of tax holiday. Furthermore, the Circular provides that benefit of tax holiday will not be allowed to successor in the case of amalgamation/demerger.

(Source: Circular No.10/2014 [F.No.178/84/2012-ITA-I] dated 6 May 2014)

Constitution of Special Investigation Team (SIT) for bringing back unaccounted monies unlawfully kept in bank accounts abroad

The Ministry of Finance, GoI, has constituted SIT to implement a decision of the SC on large amounts of money stashed abroad by people by evading taxes or generated through unlawful activities. The SIT has been charged with the responsibility and duties of investigation, initiation of proceedings and prosecution in cases of matters involving unaccounted money stashed away in foreign bank accounts by Indians or other entities operating in India. The SIT has jurisdiction in cases where investigations have already commenced or are pending or are awaiting to be initiated or have been completed. It will prepare a comprehensive action plan including creation of necessary institutional structure that could enable the country to address unaccounted money.

CBDT notifies forms for furnishing Return of Income (RoI) for tax year 2013-14

The CBDT has notified forms for furnishing RoI (Forms ITR 3 to ITR 7) for tax year 2013-14 that include RoI forms for corporate taxpayers. The CBDT has, vide the Notification, also amended Rule 12 of the Income Tax Rules, 1962 to provide that mandatory e-filing of Audit report (w.e.f. tax year 2013-14) has been expanded to cover additional categories of taxpayers such as (a) those claiming incentive deduction under Section 10AA of the ITL, (b) NRs covered by the special provision under Section 44DA that applies where the NR has a PE in India and earns Royalty/FTS that is effectively connected with the PE, (c) taxpayers who have undertaken a slump sale transaction and (d) taxpayers covered under the tonnage tax scheme.

(Source: Notification No. 28/2014, F.No.142/2/2014-TPL] dated 30 May 2014)
Service Tax

High Court, Allahabad

Payment of VAT on sale of goods on the supply of food and beverages will not exclude the liability for the payment of Service tax in respect of outdoor catering services.

Finance Act, 1994; in favor of revenue

The assessee entered contracts with certain companies for running and maintenance of their restaurants/canteens. The revenue contended that the activity of the assessee will be subject to Service tax as “outdoor catering services.” However, the assessee contended that it neither supplied food and beverages to these companies nor provided any service to them. It merely sold food and beverages to individual customers in a canteen operated by it. It was further contended that VAT had been paid on the supply of goods in the canteen, and hence, there is no liability to pay Service tax. Held, that the assessee was liable to pay Service tax as an outdoor caterer, because the services in connection with catering were provided at a place other than the place of the assessee. The Tribunal also rejected the contention of the assessee that it was not liable to pay Service tax since VAT had been paid on the sale involved in the supply of food and beverages. It was held that payment of VAT on the sale of goods will not exclude the liability of the assessee for payment of Service tax in respect of a taxable service provided by the assessee as an outdoor caterer.

Indian Coffee Workers Co-operative Society Ltd. v. Commissioner of Central Excise & Service tax, Allahabad [2014-TIOL-499-HC-ALL-ST]

High Court, Bombay

Services rendered to foreign importers for testing the import-worthiness of sample goods in India will be considered as exports

Finance Act, 1994; in favor of assessee

The assessee was engaged by foreign importers for the inspection and testing of samples of goods in India and for providing certificates to enable them to ascertain the quality of the goods before exporting from India. The consideration for services provided by the assessee was paid in convertible foreign exchange. The revenue sought to tax the transaction by contending that the activity was carried out within India, and hence, there was no export of service. The issue before the Court was whether the “Technical Inspection and Certification Services” and “Technical testing and Analysis Services” rendered by the assessee should be considered as export. Held, that the services rendered by the assessee were consumed abroad and the benefit of these services accrued to foreign clients. Hence, the services were exported and no Service tax was payable by the assessee.

Commissioner of Service Tax, Mumbai-III v. SGS India Pvt. Ltd. [2014-TIOL-580-HC-MUM-ST]

High Court, Bombay

Parliament is competent to levy Service tax on the services rendered by restaurants

Finance Act, 1994; in favor of revenue

The petitioners filed a writ petition challenging the constitutional validity of levy of Service tax on services provided by air-conditioned restaurants, which have the license to serve alcoholic beverages. The petitioners contended that the supply of food and beverages in a restaurant, by way of a service or as part of a service, was covered as “deemed sale” under Article 366 (29A) (f) of the Constitution read with Entry 54 of List II. Therefore, the State Legislature alone shall have the exclusive jurisdiction to levy the tax in question. The revenue contended that there was no restriction on the Parliament to legislate in relation to services provided by restaurants and that it had the power to make law relating to Service tax by virtue of its residuary powers. The issue before the Court was whether the Parliament was competent to levy Service tax on services provided by restaurants. It was observed by the Court that so long as there was no prohibition against imposition of Service tax on the services rendered, then it must be held that the Parliament was competent to impose Service tax. The tax imposed on the sale of food or drinks in a restaurant was for the sale or purchase of goods and the service element was not taxed. Therefore, it was held, that the Parliament was competent to levy tax on services provided by restaurants. The Court differed from the decision of the Kerala High Court in the case of Kerala Classified Hotels and Resorts Association v. UoI, which dealt with a similar issue.

Indian Hotels and Restaurant Association v. UoI [TS-110-HC-2014 (BOM)>ST]
High Court, Chattisgarh

Service tax levied on food and beverages supplied in a hotel or restaurant is constitutionally valid

Finance Act, 1994; in favor of revenue

The petitioner, had an air conditioned restaurant, bar and other facilities at its hotel, and was catering to persons staying in the hotel as well as outsiders. The petitioners filed a writ petition challenging the validity of Section 66E (i) of the Finance Act, 1994, which states that the service portion in an activity, which involves the supply of food or drinks, will constitute a “declared service”. The petitioners contended that in terms of Article 366 (29A) of the Constitution, the service element in serving food or drinks in a restaurant was subsumed in the definition of “sale” and that the Parliament had no legislative competence to levy Service tax on sale of food or drinks. The issue before the Court was whether Section 66E (i) of the Finance Act, 1994 was violating Article 366 (29A) (f) of the Constitution. Held, that Section 66E (i) was intra-vires the Constitution, as the main object of Article 366 (29A) was to bifurcate the sale of food and drinks from the service element, and it cannot be interpreted to mean that the service part would be subsumed in the definition of sale. The Court also observed that charging VAT on the entire bill value for supply of food and drinks was not proper and accordingly, it advised the State Government to issue a clarification/direction in this regard to ensure that the consumers are not unnecessarily doubly taxed in respect of the same amount.

Hotel East Park & Anr. v. UoI & Ors. [TS-159-HC-2014-(CHAT)-ST]

CESTAT, Delhi

Revenue cannot be allowed to receive Service tax twice in respect of the same construction activity, once from the contractor and the second time from the person who has collected the same

Finance Act, 1994; in favor of assessee

The assessee was engaged in the business of real estate development and was getting flats constructed from various contractors. Subsequent to the commencement of the project, Service tax was introduced on the construction of commercial complex and residential premises. Accordingly, the contractors were made liable to pay Service tax. When the said flats/commercial spaces were given possession to the buyers, the assessee collected such Service tax from their buyers by representing the same as “reimbursement of Service tax.” The revenue contended that according to the provisions of the Finance Act, 1994, any person who has collected any amount, which is required to be collected from any other person in any manner as representing Service tax, such person shall forthwith pay the amount so collected to the credit of the GoI. The assessee contended that after the introduction of Service tax liability, the contractors were liable to pay Service tax and the amount collected by the assessee from the ultimate buyer was reimbursed to the contractors, who deposited the same with the GoI. Held, the revenue cannot be allowed to receive Service tax twice in respect of the same construction activity, once from the contractor and the second time from the person who has collected the same. Whether the Service tax collected from the buyers was deposited directly by the assessee or deposited by the contractor was immaterial, as long as Service tax so collected is deposited.

Jaipuria Infrastructure Developers Pvt. Ltd. v. Commissioner of Service Tax, Delhi [2014-TIOL-609-CESTAT-DEL]

Authority for Advance Rulings, Delhi

Finance Act, 1994; in favor of assessee

The place of provision of marketing and sales support services will be determined in terms of Rule 3 of the Place of Provision of Services Rules, 2012, i.e., the location of service recipient

The applicant intends to enter marketing and sales support agreements with its overseas group companies for promotion of sale of their products in India. In consideration of the services to be provided, the applicant will receive fees in convertible foreign exchange. It filed an application to seek an advance ruling to determine the “place of provision” in terms of the Place of Provision of Service Rules, 2012 and whether the transaction will qualify as an export under Rule 6A of the Service Tax Rules, 1994. Held, that the “place of provision” of services rendered by the applicant shall be the location of the service recipient, which is outside India. Further held, that the transaction satisfies all the conditions under Rule 6A of the Service Tax Rules, 1994 and hence, it will qualify as an export of service.

Tandus Flooring India Pvt. Ltd. v. Commissioner of Service tax, Bangalore [2014 (33) STR 33 (A.A.R.)]
Reimbursement towards social security benefits to overseas group companies, in respect of expatriate personnel employed by the Indian company, will not constitute “Manpower Recruitment or Supply Agency” service.

Finance Act, 1994; in favor of assessee

The assessee had hired certain expatriate employees, who were either directly employed or were transferred from other group companies. During the tenure of their employment, the expatriate personnel were, for all intents and purposes, the employees of the assessee. The assessee inured expenditure for social security benefits of employees and also remitted to the overseas group companies certain amounts toward social security and other benefits payable under the respective foreign jurisdiction laws. However, no amount over and above the actual contribution was paid to the overseas group companies. The issue before the Tribunal was whether the transaction constituted a “Manpower Recruitment or Supply Agency” service, thereby making the assessee liable to pay Service tax under reverse charge mechanism. Held, that the issue was squarely covered by the decision in the case of Volkswagen India Pvt. Ltd. and the activity cannot be considered as “Manpower Recruitment or Supply Agency” service.

Indian Oil Corporation Ltd. v. Commissioner of Customs & Central Excise, Goa [2014-TIOL-729-CESTAT-MUM]

Leasing of petroleum product outlets to dealers, along with storage facilities, cannot be considered as “Storage and Warehousing” service, when all the operations are under the control of the dealers.

Finance Act, 1994; in favor of assessee

The assessee was the owner of certain petroleum products outlets and had leased out the same to their dealers for sale of their petroleum products. These outlets also had facilities for storing petroleum products. The assessee charged monthly license fee from the dealer for utilizing said facilities. The issue before the Tribunal was whether the assessee was liable to pay Service tax under the taxable service category of “Storage and Warehousing” service. It was observed by the Tribunal that the dealers did not bring their goods to the assessee for storage and warehousing purpose. Held, that since the operations of the outlets were under the control of the dealers, the transaction cannot be considered as “Storage and Warehousing” service provided by the assessee.

Indian Oil Corporation Ltd. v. Commissioner of Customs & Central Excise, Goa [2014-TIOL-729-CESTAT-MUM]

Electricity supplied free of cost by the service recipient cannot be considered as an additional consideration to the service provider for providing operation and maintenance services

Finance Act, 1994; in favor of assessee

The assessee was engaged in setting up of air separation plant at a customer’s premises. By way of a separate agreement, the assessee also undertook operation and maintenance of the said plant for which it received fixed service charges. Electricity, which was required for the operation of the plant, was supplied by the customer, for which no separate charges are payable by the assessee to the customer. The revenue contends that the cost of electricity will be included while determining the taxable value of service, since it is integral to the service of operation and maintenance provided to the customer. Held, that the price of electricity cannot be considered as an additional consideration received by the assessee from its customers for providing the service of operation of air separation plant. The assessee did not benefit from the free supply of electricity in any way and it was used as an input for operation of the plant for the customer.

Inox Air Products Ltd. v. Commissioner of Central Excise, Nagpur [2014-VIL-91-CESTAT-MUM-ST]
No service is involved in the retention of early payment incentive as it is a discount.

Finance Act, 1994; in favor of assessee

The assessee was a distributor of goods earning commission from their principal on which it was discharging Service tax liability under the category of “Business Auxiliary Services”. At the same time, the assessee was also collecting the amount due to the principal and remitting the same back to the principal after retaining an amount as early payment incentive. The revenue was of the view that such early payment incentive retained by the assessee was taxable as the same had to be passed on to the purchaser of the goods. The assessee contended that retaining early payment incentive was not for any service rendered but merely a discount to the assessee. The issue before the Tribunal was whether the early payment incentive will be liable to Service tax. Held, that no service was involved as such retention of incentive was nothing but a discount, which shall not be liable to Service tax, relying on the decision of the Ahmedabad Tribunal in the case of P. Gautam & Co. v. CST, Ahmedabad.

Business auxiliary services (BAS) provided to an overseas entity will qualify as “exports”

Finance Act, 1994; in favor of assessee

The assessee provided certain services to a resident entity of Hong Kong, UB Office Systems Ltd (UBOS), which included evaluation of market trends, identification of prospective customers in India etc., to enable UBOS to strategize its decisions for sale of products to customers. The agreement between the assessee and UBOS stated that the goods will be supplied directly by UBOS to Indian customers and the customer will remit payments directly to UBOS. The assessee was being compensated in the form of a commission in US dollar for every successful sale made by UBOS in India. The revenue contended that services of the appellant are BAS and are chargeable to Service tax. The revenue further, contended that the judgments in the cases of Paul Merchants Ltd. v. CCE, Chandigarh, and GAP International Sourcing (India) Pvt. Ltd. v. CST, Delhi, have not correctly comprehended the scope and provisions of the Export of Service Rules, 2005 (Export Rules) nor the CBEC circular no. dated 13 May 2011. The assessee argued that BAS provided to UBOS amounts to export of service since the services were used by a recipient outside India, and the payment was received in convertible foreign exchange. Held, that the BAS provided to UBOS would qualify as “export of service”. The law laid down by the Tribunal in the cases of Paul Merchants Ltd. and GAP International Sourcing was binding on the Revenue.
**CENVAT credit**

**CESTAT, Delhi**

**CENVAT credit in respect of Service tax paid for premises taken on rent for job worker, not eligible**

CENVAT Credit Rules, 2004; in favor of revenue

The assessee, engaged in the manufacture of gears and gearboxes, had provided rented premises along with machinery to its job worker. The rent was directly paid by the assessee. The issue before the Tribunal was whether the renting of premises for the job worker can be held to be an activity in relation to business of the assessee, for availing of CENVAT credit of the Service tax paid on renting activity. It was observed by the Tribunal that the job worker was an independent person working on principal-to-principal basis with the manufacturer. It was held that the expression “in relation to business” cannot be extended to such an extent to include the activities of an independent person to have a relation with the assessee’s business. Hence, CENVAT credit in respect of Service tax paid on rented premises, given to the job worker, cannot be availed.

*New Allenberry Works v. CCE, Delhi-IV* [2014-TIOL-732-CESTAT-DEL]

**CESTAT, Delhi**

**Full CENVAT credit of Service tax paid by the service provider will be available to the service recipient, who has not paid the whole value of the service received, so long as the service provider has paid the tax on the full value of the invoice**

CENVAT Credit Rules, 2004; in favor of assessee

The assessee, manufacturers of zinc, availed CENVAT credit of Service tax paid on input services according to the provisions of CENVAT Credit Rules (CCR), 2004. In accordance with the terms of contracts with service providers, while making payment to the service providers against the invoices raised by them, the assessee retained a percentage of the billed amount toward performance guarantee, which was to be paid after a certain period. The assessee took credit of full amount of Service tax shown in the invoice, even when part of the payment was made later. The assessee relied on the Central Board of Excise & Customs (CBEC) Circular dated 30 April 2010, which clarified that CENVAT credit will be allowed if the service provider had paid Service tax on the full amount receivable. The revenue contended that Service tax credit, to the extent which is proportionate to the value of service not paid by the assessee will not be admissible in terms of Rule 4(7) of the CCR, which states that CENVAT credit in respect of input services will be allowed on or after the day on which payment is made for the value of input service and Service tax. The revenue also contended that the CBEC Circular was contrary to the provisions of the CCR. Held, that the CBEC Circular was not contrary to the law and full credit of Service tax paid by the service provider will be available, even if the amount payable to the service provider was reduced. The Tribunal also observed that Rule 4(7) of the CCR will be applicable only in a situation where the service provider has issued the invoice but not paid the Service tax. However, where there was no dispute that Service tax had been paid by the service provider on the full invoice value, this rule will not be applicable.

*Commissioner of Central Excise, Jaipur-II v. Hindustan Zinc Ltd.* [2014 (34) STR 440 (Tri-Del)]

**CESTAT, Mumbai**

**CENVAT credit attributable to trading activities will be reversed**

CENVAT Credit Rules, 2004; in favor of revenue

The assessee was engaged in sale of vehicles, which were manufactured in India as well as vehicles imported from outside India. During the period between March 2005 and December 2009, the assessee availed CENVAT credit of common input services used for undertaking manufacturing and trading activities. The revenue contended that the assessee was required to reverse CENVAT credit of the common input services attributable to trading activities undertaken during the relevant period. Held, that the common input services attributable to trading activities shall not qualify as “input services”. Therefore, CENVAT credit of Service tax paid in relation thereto will not be available.

*Mercedes Benz India Pvt. Ltd. v. CCE, Pune* [2014-TIOL-476-CESTAT-MUM]
**Excise duty**

**Supreme Court**

Sales tax collected but retained will form part of “transaction value” and, hence, liable to Excise duty

Central Excise Act, 1944; in favor of revenue

The assessee, engaged in the manufacture of man-made fibre yarns, was enjoying the benefit of Rajasthan Sales Tax Incentive Scheme, 1989, that entitled it to retain 75% of the total Sales tax collected from the buyer and pay only the remaining 25%. While computing the “transaction value,” for the purpose of payment of Excise duty, the assessee claimed deduction of 100% of Sales tax collected from buyer. The revenue contended that the assessee did not pay Excise duty on the additional consideration received toward Sales tax collected but not deposited. The assessee argued that the Sales tax benefit extended was in the nature of incentive scheme and cannot be equated with exemption. The issue before the Court was whether the Sales tax collected but retained will be liable to Excise duty. The Supreme Court sought to distinguish its decision in the case of Modipon Fibre Company v. Commissioner of Central Excise, Meerut as it pertained to the period prior to the introduction of the concept of “transaction value.”

The Supreme Court observed that the purpose of defining “transaction value” was that the price or cost paid to the manufacturer would constitute assessable value on which Excise duty shall be paid. It was held that, what is not paid or payable toward Sales tax should not be charged from the customers. However, if separately charged and recovered from the customers, but not paid to the Government as Sales tax, then such amount will be an additional consideration flowing to the assessee and will form part of the transaction value. Hence, the assessee was entitled to deduct only 25% of the Sales tax, which was actually paid to the Government, from the assessable value.

**Commissioner of Central Excise v. Super Synotex India Ltd. & Ors. [TS-55-SC-2014-EXC]**

CESTAT, Mumbai

Central Excise Act, 1944; in favor of revenue

“Special discount” passed on to dealers by way of reduction of transaction value of a different car model, was not a trade discount and hence, cannot be reduced from the assessable value

The assessee, engaged in the manufacture of cars, had devised a monthly targets scheme, which was linked to the dealers’ achievement of monthly retail sales and monthly off-take targets. On the achievement of the targets, the dealers became entitled to certain incentives, which were passed on to customers. The assessee agreed to compensate the dealers in offering the schemes to the buyers by way of reduction in the value of cars sold in subsequent months, which was termed by the assessee as “special discount.”

The revenue contended that the incentive amounts earned by dealers cannot be termed as “special discount” as it had no relation with the goods under assessment and they were passed on to customers. The revenue contended that special incentives cannot be termed as a “trade discount” which can be reduced from the transaction value. The question before the Tribunal was whether the “special discount” can be termed as a permissible trade discount. Held, that the “special discount” did not conform to any of the requirements of trade discount. It was not known at the time of or prior to the removal of goods and it was merely a compensation for services rendered by the dealers on behalf of the manufacturer and it was not passed on as a price reduction of the goods to which it pertained. Therefore, the “special discount” was not eligible for exclusion from the assessable value of goods sold.

**Tata Motors Ltd. v. Commissioner of Central Excise, Pune [TS-119-Tribunal-2014-EXC]**
**Customs duty**

CEFSTAT, Mumbai

**Concessional rate of duty will not be available for project imports, which were not used for the intended project, but were diverted elsewhere**

The assessee imported certain raw material for the manufacture of transformers, on concessional rate of duty under heading 9801 of the Customs Tariff according to the Project Import Scheme. However, when an investigation was undertaken, it was found that the assessee had imported material in excess of requirements of the specific project and the imported material were not fully used for the project for which it was intended, but were diverted. The revenue contended that the concessional rate of duty will not be applicable for the project imports, as the assessee had violated the provisions of the Project Import Regulations, 1986, by misusing the benefit extended under the said scheme. The issue before the Tribunal was whether the assessee will be entitled for the concessional rate of duty for the project imports, which were not used for the intended project. On account of a difference in opinion of the Judicial and Technical member of the Tribunal, the matter was referred to a third member. It was held, by way of majority, that raw material imported under Project Import has to be used in the manufacture of machinery required for the identified project only. Hence, the assessee was not eligible for the benefit of concessional rate for project imports under heading 9801 of the Customs Tariff.

_Star Entertainment Pvt. Ltd. v. Commissioner of Customs (Adjudication), Mumbai [2014-TIOL-583-CEFSTAT-MUMBAI]_

**Royalty/license fees paid to overseas suppliers shall be included in the assessable value of the imported goods, as it is a condition of sale of such goods**

CEFSTAT, Mumbai

The assessee was engaged in the import of recorded media, containing feature films/programs and it discharged duty liability only on the cost of media on the basis of the invoice of the foreign supplier. On an investigation conducted by the revenue, it was found that the assessee also paid license fees to the overseas supplier for exploiting the intrinsic content of the said media. The revenue contended that the royalty/license fees paid to the overseas supplier will be included in the assessable value in terms of the Customs Valuation Rules. The issue before the Tribunal was whether the royalty paid will be included in the assessable value of the recorded media. On account of a difference of opinion between Judicial and Technical members, the matter was referred to a third member. It was held, by way of majority, that the royalty/license fees paid for the import of the recorded media will be included in the assessable value of the tapes, as the license fee was a condition of sale of imported goods.

_Bharat Bijlee Ltd. v. Commissioner of Customs (Import), Mumbai [2014-TIOL-374-CEFSTAT-MUMBAI]_
**VAT/CST**

**Supreme Court**

Contract for supply and installation of lifts is a “works contract” and not a “contract for sale”

Andhra Pradesh General Sales Tax Act, 1957, Tamil Nadu General Sales Tax Act, 1959; in favor of assessee

The assessee was engaged in the manufacture, supply and installation of lifts involving civil construction. The issue before the Court was whether the contract for manufacture, supply and installation of lifts in a building was a “contract for sale of goods” or a “works contract.” The revenue contended that the transaction amounted to “a contract for sale of goods” and the services provided for installation of the lifts were merely incidental to the supply, in order to make the goods deliverable. The three-judge bench of the Supreme Court, in this case, had held that the supply and installation of lifts constituted “sale” and not “works contract.” This decision was overruled by a Constitution (five-judge) bench of the Supreme Court, and it was held, by way of a majority view, that the composite contract for supply and installation of lifts has to be treated as a “works contract” and not as a “sale of goods/chattel simpliciter.”

*Kone Elevator India Pvt. Ltd. v. State of Tamil Nadu & Ors.*  
[2014-VIL-12-SC-CB]

**High Court, Karnataka**

Karnataka Sales Tax Act, 1957; in favor of the assessee

Movement of goods from one state to another will be considered as inter-state movement, if it is in pursuance of a covenant in the contract or is an incident of such contract, even though it is not provided in the contract of sale

The assessee was engaged in the manufacture and sale of compressors used in air-conditioners. When customers would approach the assessee with a defective compressor outside the warranty period, they would be given an option to either wait for 60 days to get back the repaired compressor, or to take a repaired compressor off the shelf, after paying the repair charges. The revenue sought to levy sales tax on repair charges as a consideration for sale of old, repaired compressors. The question before the Court was whether the transaction amounted to sale of old, repaired compressors, thus making the repair charges liable to Sales tax. Held, that the amount charged from the customers is for repair charges and not a price for the sale of the repaired compressor. There was a transaction of cross transfer of property between the defective compressor and the repaired compressor and therefore, there was no consensual agreement of sale supported by price or other monetary consideration. Hence, Sales tax cannot be levied on the said transaction.

*Kone Elevator India Pvt. Ltd. v. State of Karnataka*  
[2014-VIL-90-KAR]

**High Court, Bombay**

Bombay Sales Tax Act, 1959; in favor of assessees

Cross transfer of property, without consensual agreement of sale supported by price or other monetary consideration, will not be subject to Sales tax

The assessee was engaged in the manufacture and sale of compressors used in air-conditioners. When customers would approach the assessees with a defective compressor outside the warranty period, they would be given an option to either wait for 60 days to get back the repaired compressor, or to take a repaired compressor off the shelf, after paying the repair charges. The revenue sought to levy sales tax on repair charges as a consideration for sale of old, repaired compressors. The question before the Court was whether the transaction amounted to sale of old, repaired compressors, thus making the repair charges liable to Sales tax. Held, that the amount charged from the customers is for repair charges and not a price for the sale of the repaired compressor. There was a transaction of cross transfer of property between the defective compressor and the repaired compressor and therefore, there was no consensual agreement of sale supported by price or other monetary consideration. Hence, Sales tax cannot be levied on the said transaction.

*Asea Brown Boveri Ltd. v. State of Karnataka*  
[2014-VIL-90-KAR]
Additional Commissioner of Sales Tax, VAT-III, Mumbai v. Kirloskar Copeland Ltd. [TS-146-HC-2014 (BOM)-VAT]

High Court, Uttarakhand

Where the element of service has been declared and brought to tax vide notification dated 6 June 2012, by which Service tax is levied on 40% of the billed value in restaurant, no VAT can be imposed thereon

Uttarakhand Value Added Tax (VAT) Act, 2005; in favor of the assessee

The assessee was engaged in the provision of boarding and lodging facilities to customers as well as in the provision of restaurant services. Up to 1 July 2012, the assessee was subject to VAT under the Uttarakhand VAT Act, 2005 in respect of supply of cooked food in the restaurant. However, with effect from 1 July 2012, the Service Tax (Determination of Value) Rules, 2012 were amended vide which 40% of the billed value, for supply of food or drinks in a restaurant, was liable to Service tax. The assessee filed an application with the Commissioner requesting that VAT should not be charged on 40% of the billed value, which was already made liable to Service tax. The application was subsequently rejected and the appeal before the Commercial Tax Tribunal was also dismissed. Hence, revision application was filed before the Uttarakhand High Court. The Court allowed the revision application and held that where the element of service has been declared and brought to tax vide notification dated 6 June 2012, by which Service tax is levied on 40% of the billed value in restaurant, no VAT can be imposed thereon.

Valley Hotels & Resorts v. Commissioner, Commercial Tax, Dehradun [TS-129-HC2014 (UTT)-VAT]

High Court, Gujarat

Soft loan given by the State Government, based on the VAT/CST collected for the purpose of promoting the industrial growth of the State, does not amount to refund of tax

Gujarat Value Added Tax Act, 2003; in favor of the assessee

Under the New Industrial Policy, which was announced in January 2009, the State of Gujarat signed a Memorandum of Understanding (MOU) with Tata Motors Ltd. for setting up its Tata Nano car manufacturing project, as a mega project. Accordingly, a loan was sanctioned @ 0.1% per annum for amounts equal to gross VAT/CST paid by the company to the State Government. The petitioner filed a Public Interest Litigation (PIL) against Gujarat, contending that the soft loan granted by the State Government to Tata Motors Ltd. was illegal and against public interest as it tantamounts to refund of VAT. Held, that the loan granted by the State Government, which equals to the gross value of VAT and CST does not amount to refund of tax, as the same is being provided to encourage the establishment of the automobile industry in the State as a part of its industrialization policy. The Court also observed that the quantum of VAT and CST recovered was only a measure for determining the quantum of loan to be advanced. The PIL was thus, dismissed.


High Court, Gujarat

Non-obstante clause in the State Special Economic Zone (SEZ) Act will have overriding effect over the state fiscal statutes, in the absence of any provision giving primacy over the State SEZ Act

Gujarat Value Added Tax Act, 2003; in favor of the assessee

The assessee was engaged in the generation of power in its unit at Dahej SEZ area, from where it was distributed to other units in SEZ and Domestic Tariff Area (DTA). The assessee was also granted eligibility certificate allowing exemption from taxes or any other State levy as per the provisions of the Gujarat SEZ Act, 2004. However, the state authorities, by virtue of a subsequent amendment in the Gujarat Value Added Tax (GVAT) Act, sought to levy Purchase tax on certain specified purchases made by the assessee. The assessee challenged the authority of state authorities to levy VAT/Purchase tax on the specified purchases on the ground that the exemption was in accordance with the provisions of the Gujarat SEZ Act, which has an overriding effect over the state fiscal statutes. In its decision, the Court observed that the intention of Section 21 of the Gujarat SEZ Act, was to grant exemption to SEZ units/developers from various state levies. Further, the non-obstante clause in Section 22 of the Gujarat SEZ Act would have an overriding effect, not only on the existing provisions of the state legislation, but also on those made later on. It was held that, in the absence of a non-obstante clause in the GVAT Act, the overriding effect of the provisions of the Gujarat SEZ Act will prevail.

Torrent Energy Ltd. v. State of Gujarat [2014-VIL -130 (GUJ)]

Home | Previous | Next
Excise duty

**Withdrawal of facilities and imposition of restrictions on contravention of provisions**

In case of the following defaults by a manufacturer, first stage/second stage dealer, or an exporter including a merchant exporter, certain facilities may be withdrawn or restrictions may be imposed:

- Removal of goods without the cover of an invoice and without payment of duty
- Removal of goods without declaring the correct value for payment of duty
- Availing CENVAT credit without the receipt of goods specified in the invoice/document
- Availing CENVAT credit on invoices or other documents, which a person has reasons to believe as not genuine
- Issuing excise invoice without delivery of goods specified in the said invoice
- Claiming of refund or rebate based on documents which a person has reason to believe as not genuine
- Removal of inputs as such without reversal of CENVAT credit under Rule 3(5) of the CCR

The following restrictions may be imposed in case of the above offences:

- Withdrawal of monthly payment of Excise duty and assessee would be required to pay Excise duty on each consignment
- Restriction on utilization of CENVAT credit for payment of Excise duty
- Records to be maintained by the assessee with respect to inputs on which CENVAT credit has not been taken
- Intimation to Superintendent of Central Excise for receipt of principal inputs on which CENVAT credit has not been taken

**Monetary limit for the application of this notification:**

- Excise duty or CENVAT credit alleged to be involved is more than INR1 million.

**Period for which restriction to remain effective:**

- 6 months, in case the offence is committed for the first time
- For any subsequent offence, not more than 1 year

**Procedure:**

- Commissioner (Excise) or Additional Director General of Intelligence to forward the proposal for imposition of restriction to Chief Commissioner within 30 days of detection
- Chief Commissioner, post giving an opportunity to be heard to the assessee, to issue an order along with the period for which such order would remain effective

*Notification 16/2014-Central Excise (NT) dated 21 March 2014*

**Customs duty**

**Reduction in the rate of duty on imports from Japan under preferential trade agreements**

Notification no. 9/2014-Customs (NT) dated 1 April 2014 amends Notification no. 69/2011-Customs dated 29 July 2011, in terms of this Notification, the rate of duty on imports from Japan have been reduced under preferential trade agreements, with effect from 1 April 2014.

*Notification no. 9/2014-Customs (NT) dated 1 April 2014*

**Foreign Trade Policy**

**Introduction of Online Export Obligation Discharge Certificate (EODC)/Redemption for Advance Authorization (AA) and Duty Free Import Authorization (DFIA)**

The Director General of Foreign Trade (DGFT) has introduced online system for EODC/redemption for AA and DFIA with effect from 1 June 2014, to reduce the processing time and transaction cost.

In case of physical exports through Electronic Data Interchange (EDI) shipping bills, online application/filing of EODC will be mandatory for shipping bills for the period on or after 1 April 2009. However, for shipping bills prior to 1 April 2009, online filing is not compulsory as the bills may not have been transmitted to DGFT electronically.

In case of physical exports through non-EDI shipping bills, manual filing will continue as the bills have not been transmitted electronically to DGFT.

In case of Deemed Exports as well, the manual mode would continue until documents evidencing Deemed Export Supplies can be transmitted electronically to DGFT. Till then, details of Deemed Export Supplies shall be fed in EODC system online on DGFT website.

*Public Notice No.55 (RE-2013/2009-2014) dated 14 March 2014*
VAT

Andhra Pradesh

FAQs on Andhra Pradesh Reorganisation Act, 2014

The Andhra Pradesh Reorganisation Act, 2014, with effect from 2 June 2014, proposes to create Telangana as the 29th state of the Union of India. The Andhra Pradesh Commercial Taxes department has issued Frequently Asked Questions (FAQs) providing the views of the department on various aspects under the AP VAT, AP Entry Tax and CST laws.

The FAQs provide viewpoints on various issues relating to registration, VAT invoices, returns, forms, waybills, input tax credit etc. Online option for new Tax Identification Number (TIN) was available only up to 7 May 2014. After 2 June 2014, any invoice with old TIN will not be valid. In respect of “C” forms, which are issued on quarterly basis, one “C” form can be issued for the period from 1 April 2014 to 1 June 2014, and for the period from 2 June 2014 to 30 June 2014, one “C” form in the new state can be issued. It has also been clarified that input tax credit in respect of purchases prior to 2 June 2014 with invoices carrying old TIN, will not be available in the new state.

FAQs on the Andhra Pradesh Re-organisation Act, 2014 issued by Andhra Pradesh Commercial Taxes Department

Delhi

Orders/Notice to be issued through Systems module

In terms of the order issued by the Delhi VAT department, all orders, including the issuance of notice regarding objection disposal and/or assessments, will be issued by the designated assessing authority only through the relevant systems module of the official website of the Delhi VAT department. An order not issued through Systems module, that does not carry the unique reference number and bar code will be regarded as suspicious and treated as an invalid order. Such invalid order cannot be acted upon by other authorities of the VAT department.

Order No.F.PS/CTT/Misc/2014/677-85 dated 11 April 2014

Karnataka

Karnataka Value Added Tax (KVAT) (Amendment) Act, 2014

Key highlights of the Karnataka Value Added Tax (Amendment) Act, 2014, which came into force with effect from 1 March 2014:

- The threshold limit for the liability of a dealer to get registered under the KVAT Act, has been increased from INR0.5 million to INR0.75 million. The taxable turnover of a dealer in a particular month, to get registered under the KVAT Act, has been increased from INR40,000 to INR62,500.
- The registered dealers are required to furnish a statement relating to their turnover in the prescribed manner, every year.
- A registered dealer may prefer a single appeal against orders of assessment or reassessment, in respect of more than one tax periods of any year.

Karnataka Value Added Tax (Amendment) Act, 2014 vide notification dated 8 May 2014

E-uploading of statement of purchase, sales and other details by the dealers whose total turnover is more than INR5 million

From the tax period of May 2014, every dealer whose total turnover in the year 2013-14 exceeds INR5 million or whose cumulative turnover is INR5 million and above in the subsequent tax periods will furnish sales, purchases, import, export details electronically, on or before 20th day of the succeeding month.

Notification no CCW/CR44/2013-14 dated 29 April 2014

Madhya Pradesh (MP)

Telephone, cellular handset and phablet to be considered as “single point of tax goods”

“Telephone, cellular handset and Phablet” has been inserted in Part-III of Schedule II of the MP VAT Act taxable at the rate of 13%, on account of which it becomes a “single point tax” goods in the state. As a result, cellular handsets procured locally from a registered dealer will be treated as tax-paid goods on which tax shall not be charged. It also imposes restrictions on claiming of input tax credit on local procurement of the goods in the state.

Notification No.F.A-3-11-2014-1-V-(17) dated 26 April 2014
Haryana

Increase in rate of tax for cell phones (including their parts and accessories) exceeding INR 10,000

The Haryana Government has increased the rate of tax on cell phones (including their parts and accessories), exceeding retail price of INR10,000, from 5% to 8% with effect from 23 May 2014.


Himachal Pradesh

Draft Notification for rate of tax at 2% on sale of plant and machinery for use in generation of hydro power

The Governor of Himachal Pradesh proposes to levy VAT @ 2% on the sale of plant and machinery for use in generation of hydro power. The registered hydro power unit is required to furnish a certificate in duplicate, in Form HD, to the registered selling dealer.

Notification No. EXN-F(10)-5/2014, dated 27 May 2014
Consolidated Foreign Direct Investment (FDI) Policy – Circular 1 of 2014

Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry (GoI) has released Consolidated Foreign Direct Investment (FDI) Policy – Circular 1 of 2014.

The Circular updates all instructions/clarifications/press notes issued by the GoI relating to the FDI Policy, as of 17 April 2014, and has superseded the Circular 1 of 2013 issued by the GoI.

The salient features of the new scheme are:

• Defence: Investment from Foreign Portfolio Investors (FPI)/Foreign Institutional Investors (FII) in the defence sector continues to be under the prohibited list. However, the investments made by FPI/FII in the company, as on 22 August 2013, have been grandfathered.

• FPI: The definition of FPI has been incorporated in the FDI Policy and has covered, along with FII investment at various places, within the ambit of portfolio investment.

• Earlier, in case of transfer of shares from resident to NR where the investee company is in the financial sector, a no-objection certificate (NOC) was required to be obtained from the respective financial sector regulators of the investee company as well as transferor and transferee entities. Now in place of NOC, it needs to be ensured that any fit and proper due diligence requirements for NR investor, as stipulated by the respective financial sector regulator, have been complied with.

• Share swap: The valuation can be carried out by “Merchant Banker” registered with Securities and Exchange Board of India (SEBI) instead of “Category I Merchant Banker” registered with SEBI.

• Agriculture an animal husbandry: In the animal husbandry, scope of term “under controlled conditions” waste management systems as prescribed by the National Livestock Policy, 2013 and in conformity with the existing “Standard Operating Practices and Minimum Standard Protocol” has been added.

(DIPP Circular 1 of 2014 dated 17 April 2014)
FDI into a Small Scale Industrial Undertakings (SSI)/micro and small enterprises (MSE) in industrial undertaking manufacturing items reserved for SSI/MSE

Currently, a company being a SSI unit and which is not engaged in any activity or involved in manufacture of items specified for SSI sector, may issue shares or convertible debentures to a person resident outside India, to the extent of 24% of its paid-up capital provided that such company may issue shares in excess of 24% of its capital subject to certain conditions.

The RBI has decided that a company, which is an MSE (earlier SSI) in terms of MSMED Act, 2006 and not engaged in any activity/sector specified for the SSI sector may avail foreign investment according to the FDI policy subject to the limits prescribed and in accordance with the provisions and entry routes specified in the FDI Policy.

Furthermore, any industrial undertaking, with or without FDI, which is not an MSE, having an industrial license under the provisions of the Industries (Development & Regulation) Act, 1951 for manufacturing items reserved for manufacture in the MSE sector may issue shares in excess of 24% of its paid up capital with prior approval of the Foreign Investment Promotion Board (FIPB) of the GoI.


FPI - investment under Portfolio Investment Scheme (PIS), Government and Corporate debt

After review of the extant guidelines for PIS for FII and Qualified Foreign Investor (QFI), the RBI has decided a framework for investments under a new scheme called “Foreign Portfolio Investment” scheme.

The salient features of the new scheme are:

- The portfolio investor registered in accordance with SEBI guidelines will be called “Registered Foreign Portfolio Investor (RFPI)”. The existing portfolio investor being FII and QFI registered with SEBI will be subsumed under RFPI.
- RFPI may purchase and sell shares and convertible debentures of Indian company through registered broker on recognized stock exchanges in India as well as purchases shares and convertible debentures, which are offered to public in terms of relevant SEBI guidelines/ regulations.
- The individual and aggregate investment limits for the RFPIs shall be less than 10% or 24%, respectively of the total paid-up equity capital or 10% or 24%, respectively of the paid-up value of each series of convertible debentures issued by an Indian company. Furthermore, where there is composite sectoral cap under FDI policy, these limits for RFPI investment will also be within such overall FDI sectoral caps.
- RFPI will be eligible to open a Special Non-Resident Rupee (SNRR) account and a foreign currency account with authorized dealer (AD) bank and to transfer sums from foreign currency account to SNRR account at the prevailing market rate, for making genuine investments in securities. The AD bank may transfer repatriable proceeds (after payment of applicable taxes) from SNRR account to foreign currency account.
- RFPI will be eligible to invest in government securities and corporate debt subject to limits specified by the RBI and SEBI from time to time.
- The investment by RFPI will be made subject to the SEBI (FPI) Regulations 2014, modified by SEBI/GoI from time to time.
- RFPI will be permitted to trade in all exchange traded derivative contracts on the stock exchanges in India subject to the position limits as specified by SEBI from time to time.
- RFPI may offer cash or foreign sovereign securities with AAA rating or corporate bonds or domestic Government Securities, as collateral to the recognized stock exchanges for their transactions in the cash as well as derivative segment of the market.
- Any FII who holds a valid certificate of registration from SEBI will be deemed to be a RFPI till the expiry of the block of three years for which fees have been paid as per the SEBI (FII) Regulations, 1995.
- A QFI may continue to buy, sell or otherwise deal in securities subject to the SEBI (FPI) Regulations, 2014 for a period of one year from the date of commencement of these regulations, or until it obtains a certificate of registration as FPI, whichever is earlier.

A RFPI may continue to buy, sell or otherwise deal in securities subject to the SEBI (FPI) Regulations, 2014 for a period of one year from the date of commencement of these regulations, or until it obtains a certificate of registration as FPI, whichever is earlier.

However, all investments made by FII/QFI, in accordance with the regulations prior to registration as RFPI, will continue to be valid and taken into account for computation of aggregate limit.

RFPI will report the transaction to RBI as being reported by FII in LEC Form according to extant practice.

Compounding of contraventions under FEMA

The RBI has further delegated the powers of compounding in the following contraventions to Regional Offices of the RBI where the registered office of the company is situated.

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>FEMA Regulation</th>
<th>Brief Description of Contravention</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Paragraph 9(1XA) of Schedule I to FEMA 20/2000-RB dated 3 May 2000</td>
<td>Delay in reporting inward remittance received for issue of shares</td>
</tr>
<tr>
<td>2</td>
<td>Paragraph 9(1XB) of Schedule I to FEMA 20/2000-RB dated 3 May 2000</td>
<td>Delay in filing form FC(GPR) after issue of shares.</td>
</tr>
<tr>
<td>3</td>
<td>Paragraph 8 of Schedule I to FEMA 20/2000-RB dated 3 May 2000</td>
<td>Delay in issue of shares/refund of share application money beyond 180 days, mode of receipt of funds etc.</td>
</tr>
<tr>
<td>5</td>
<td>Regulation 2(ii) read with Regulation 5(1) of FEMA 20/2000-RB dated 3 May 2000</td>
<td>Issue of ineligible instruments such as non-convertible debentures, partly paid shares, shares with optionality clause etc.</td>
</tr>
<tr>
<td>6</td>
<td>Paragraph 2 or 3 of Schedule I to FEMA 20/2000-RB dated 3 May 2000</td>
<td>Issue of shares without approval of RBI or FIPB respectively, wherever required.</td>
</tr>
</tbody>
</table>

The above contraventions can be compounded by all Regional Offices (except Kochi and Panaji) without any limit on the amount of contravention. Kochi and Panaji Regional Offices can compound the above contraventions for an amount of contravention below INR10 million. The contraventions above INR10 million under the jurisdiction of Panaji and Kochi Regional Offices and all other contraventions of FEMA will continue to be compounded at Cell for Effective Implementation of FEMA (CEFA), Mumbai.


FDI in Limited Liability Partnership (LLP)

FDI in LLP was largely governed by Press Note 1 [2011 Series] issued by the DIPP. The Press Note provided that FDI in LLPs was permitted in sectors where 100% FDI is allowed under the automatic route and there are no FDI-linked performance-related conditions, subject to approval of the FIPB.

With issuance of these guidelines, the ambiguity on the reporting mechanism on FDI in an LLP has been put to rest. Moreover, there seems to be an effort to synchronise the FDI policy with the RBI guidelines to a large extent though there are certain issues, which have been further clarified in the RBI guidelines.

Key highlights
- Eligibility of accepting foreign investment
  - An LLP, existing or new, operating in sectors/activities where FDI up to 100% is allowed under the automatic route and there are no performance-linked conditions, e.g., non-banking finance companies (NBFCs), construction development sector can invite FDI with prior FIPB approval.
  - The guidelines clarify that a citizen/entity of Pakistan and Bangladesh are not eligible to invest in LLPs along with:
    i. A SEBI registered FI or
    ii. A SEBI registered Foreign Venture Capital Investor (FVCI) or
    iii. A SEBI registered QFI or
    iv. A FPI registered in accordance with Securities Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014, which have already been specified in the FDI policy

- Pricing
  - In the recently announced monetary policy, the RBI has solicited the valuation of investment as per norm, which is internationally accepted/adopted according to market practice. The same concept has been implanted in these guidelines for valuation of the capital contribution or profit share. A valuation certificate to that effect shall be issued by a Chartered Accountant or by a practicing Cost Accountant or by an approved valuer from the panel maintained by the GoI.
Reporting requirements

LLPs are required to report in Form FDI - LLP (I) within 30 days of receipt of money from the foreign investor, to the Regional Office of the RBI through AD Category - I bank, a report containing details of receipt of consideration for capital contribution and “profit shares,” along with copy of (i) FIRC (ii) KYC report on the NR investor and (iii) valuation certificate. The concerned regional office is likely to acknowledge the report and allot a unique identification number (UIN) for the amount reported.

LLPs are also required to report in Form FDI - LLP (II) within 60 days from the date of receipt of funds, any disinvestment/transfer of capital contribution or profit share between a resident and a NR or vice versa.

Furthermore, where any foreign investment was received by LLPs between 20 May 2011 to the date of instructions issued by the RBI, the LLPs are required to report to the RBI, within 30/60 days for receipt of capital contribution/transfer of profit shares, as applicable from the date of issue of these instructions.

FDI in the pharmaceuticals sector

According to the extant guidelines in the pharmaceutical sector, FDI up to 100% is permitted under the automatic route for greenfield investments and FDI up to 100% is permitted under GoI approval route for brownfield investments (i.e., investments in existing companies). The RBI has decided to continue with the existing policy with the condition that “non-compete” clause would not be allowed except in special circumstances with the approval of the FIPB of the GoI.

A format of non-compete declaration has been also prescribed by the FIPB in this regard.

Reporting conditions for transfer of equity instruments acquired on stock exchange

The RBI has rationalized reporting conditions for Nonresident (NR) and Nonresident Indian (NRI) acquiring shares on a recognized stock exchange.

In cases where the NR investor, including an NRI, acquires shares on the stock exchanges the investee company would have to file form FC-TRS with the AD Category-I bank.

(b) Furthermore, the RBI has decided that the AD Category-I bank may approach the concerned Regional Office of the RBI, Foreign Exchange Department to regularize the delay in submission of form FC-TRS, beyond the prescribed period of 60 days and in all other cases, form FC-TRS will continue to be scrutinized at AD bank level according to extant practice.

Fund/non-fund based credit facilities to overseas joint ventures/wholly owned subsidiaries (WOS)/wholly owned step-down subsidiaries (WoSDS) of Indian companies

According to the Foreign Exchange Management (Guarantee) Regulations, 2000 AD category - I banks were permitted to extend guarantees to or on behalf of overseas JV/WOS of an Indian company in connection with its business. These were measures to support the Indian companies in their overseas businesses.

The RBI has directed the banks including overseas branches/subsidiaries of Indian banks, not to issue standby letters
of credit/guarantees/letter of comforts etc., on behalf of overseas JV/WOS/WoSDS of Indian companies for the purpose of raising loans/advances of any kind from other entities except in connection with the ordinary course of overseas business.

The RBI has further advised that while extending fund/non-fund based credit facilities to overseas JV/WOS/WoSDS of Indian companies in connection with their business, either through branches in India or through branches/subsidiaries abroad, the banks should ensure effective monitoring of the end use of such facilities and its conformity with the business needs of such entities.

Currently, Indian companies in the manufacturing and infrastructure sector were allowed to avail external commercial borrowings (ECBs) for repayment of Rupee loans availed from domestic banking system and/or for fresh Rupee capital expenditure. The RBI has decided that repayment of Rupee loans availed from the domestic banking system through ECBs extended by overseas branches/subsidiaries of Indian banks will, henceforth, not be permitted.

Banks have been further advised to desist from the practice of giving export advances on strength of the guarantee issued to exporters for settling domestic rupee loans.

Further to aforesaid directions, the RBI has specified the following instances where Indian companies will not be permitted to raise ECB from overseas branches/subsidiaries of Indian banks for refinance/repayment of rupee loan raised from domestic banks:

- Scheme of take-out financing
- Repayment of existing rupee loans for companies in infrastructure sector
- Spectrum allocation
- Repayment of Rupee loans


ECB for civil aviation sector

The RBI had decided to extend its scheme of raising ECBs for working capital for the Civil Aviation Sector till 31 March 2015. Rest all the conditions, as envisaged in the circular of 24 April 2012, remain unchanged.


ECB Policy: Simplification of procedure of re-scheduling of ECB

Currently AD Banks are permitted to approve changes in the draw-down/repayment schedule of the ECBs already availed, subject to certain conditions.

The RBI has now delegated the power to AD Banks to allow re-scheduling of ECB due to changes in the draw-down and/or repayment schedule (including elongation/rollover) subject to further conditions specified in the Circular.


ECB from Foreign Equity Holder (FEH) for working capital under automatic route

The RBI has simplified the procedure of availing ECB from FEH.

According to the extant guidelines, ECBs from indirect equity holders/group companies and ECBs from direct FEH for General Corporate Purpose (Working Capital) are considered under the approval route. Furthermore any request for change of the ECB lender in case of FEH requires prior RBI approval.

As a measure of simplification, the RBI has decided to put the following cases under the automatic route.

1. Proposals for raising ECB by companies engaged in the activities of manufacturing, infrastructure, hotels, hospitals and software sectors from indirect equity holders/group companies.
2. Proposals for raising ECB for companies in miscellaneous services from direct/indirect equity holders/group companies.
   - Miscellaneous services include companies engaged in training activities (but not educational institutes), R&D activities and companies supporting infrastructure sector.
   - Companies engaged in trading activities, logistics services, financial services and
consultancy services are, however, not covered under miscellaneous services.

3. Proposals for raising ECB from direct FEH by companies engaged in manufacturing, infrastructure, hotels, hospitals and software sectors for General Corporate Purpose (Working Capital). ECB from sources other than direct FEH is not permitted.

4. Proposals involving change of lender when the ECB is from FEH – direct/indirect equity holders and group company.


Merchanting Trade Transactions: revised guidelines

The RBI has liberalized the guidelines on Merchanting Trading in light of the recommendations of the Technical Committee on Services/Facilities to Exporters.

The major changes are captured below:

- The RBI has clarified that a trade shall be a merchanting trade on satisfaction of the following two conditions:
  a. Goods acquired should not enter the DTA; and
  b. The state of the goods should not undergo any transformation
- Currently, the goods involved in merchanting trading activity were supposed to be permitted for export/import according to the Foreign Trade Policy (FTP) as on the “date of contract,” which has now been revised to “date of shipment.”
- The AD Banks have been asked to take non-negotiable copies duly authenticated by the bank if the original invoice, packing list, transport documents and insurance documents are not available. Currently, there was no express provision for taking the copies.
- It has been specified that short-term credit, by way of supplier’s credit or buyer’s credit will be available for the merchanting trade transaction “to the extent not backed by advance remittance for the export.”
- Advances received under the export leg of the merchanting trade transaction may be deployed for the intervening period in an interest bearing account.
- Merchanting traders may be allowed to make an advance payment for the import leg on demand made by the overseas seller and in case where the inward remittance has not been received before making the outward remittance, the AD bank may allow remittance up to US$200,000 and for any advance beyond the aforesaid amount it should be paid against a bank guarantee/letter of credit (LC) of an international bank of repute.
- Payment for import leg has been allowed from the balance of the EEFC account of the merchanting trader.
- Currently merchanting traders who had defaulted three times or more were considered to be recommended to the RBI to be caution listed. This aspect has been revised and the merchant trader whose outstanding is more than 5% of their annual export earnings would be caution listed.


Export of goods: long-term export advances

The RBI has permitted AD Banks to allow exporters with three-year satisfactory track record to receive long-term export advances for maximum tenor of 10 years.

The key conditions to be satisfied for availing the export advance are provided as under:

1. A firm irrevocable supply orders should be in place. The contract should clearly specify the nature, amount and delivery timelines of products and penalty in case of non-performance/cancellation.
2. The maximum rate of interest is LIBOR plus 200 basis points.
3. The export advances are not permitted to be used to liquidate Rupee loans, which are classified as non-performing asset (NPA) according to the RBI asset classification norms.
4. Issue of bank guarantee/stand-by LC for export performance should be for a maximum of two years at a time and further roll-over of not more than two years at a time.
5. Receipt of advance of US$100 million and above should be reported to the RBI in a specified format.

6. AD Banks are required to evaluate and monitor the progress on utilization of the advance and annually submit to RBI a progress report in the specified format within a month from close of each financial year.


Directions for acquisition/transfer of control of an NBFC

The RBI has issued directions for obtaining prior RBI approval in cases of acquisition/transfer of control of NBFCs keeping in purview the management of an NBFC maintains a “fit and proper” character.

Currently any takeover/acquisition of shares or amalgamation/merger of a deposit-taking NBFC with another entity that would give the other entity control of the deposit-taking NBFC, required prior permission from the regional office of the Department of Non-Banking Supervision (DNBS) of the RBI.

With the issuance of the attached circular, a prior RBI permission will be required for takeover/acquisition of shares or amalgamation/merger of both, deposit taking NBFC and a non-deposit taking NBFC.

Furthermore RBI approval will be required for:

i. Any takeover or acquisition of control of an NBFC, whether by acquisition of shares or otherwise.

ii. Any merger/amalgamation of an NBFC with another entity or any merger/amalgamation of an entity with an NBFC that would give the acquirer/another entity control of the NBFC.

iii. Any merger/amalgamation of an NBFC with another entity or any merger/amalgamation of an entity with an NBFC, which would result in acquisition/transfer of share holding in excess of 10% of the paid up capital of the NBFC.

iv. Prior approval of the RBI would also be required before approaching the Court or Tribunal under Section 391-394 of the Companies Act, 1956 or Section 230-233 of Companies Act, 2013 seeking order for mergers or amalgamations with other companies or NBFCs.

RBI/2013-14/606 DNBS (PD) CC. No. 376 / 03.10.001 / 2013-14 dated 26 May 2014
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Venkatesan B, The Financial Express

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<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Title</th>
<th>Date of the alert</th>
<th>Citation/Notification/Circular</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Karnataka HC rules that share of profits of a partner from a partnership firm having exempt income is also exempt in the hands of the partner</td>
<td>05-Mar-14</td>
<td>Vidya Investment and Trading Co. Pvt. Ltd. v. Union of India [W.P. No. 18813/2013 (T-IT)]</td>
</tr>
<tr>
<td>2</td>
<td>CBDT clarifies on tax withholding obligation in respect of payments made to non-resident</td>
<td>11-Mar-14</td>
<td>CBDT Instruction No.2/2014 [F.No.500/33/2013-FTD-I] dated 26 February 2014</td>
</tr>
<tr>
<td>4</td>
<td>Global Tax Alert : Delhi Tribunal rules on transfer pricing aspects of intra group financing transactions</td>
<td>18-Mar-14</td>
<td>Bharti Airtel [TS-76-ITAT-2014(DEL)-TP]</td>
</tr>
<tr>
<td>5</td>
<td>Mumbai ITAT rules on taxability of allotment of “additional shares” to existing shareholders under the Gift Tax provision</td>
<td>18-Mar-14</td>
<td>Sudhir Menon HUF v. ACIT [TS-146-ITAT-2014(Mum)]</td>
</tr>
<tr>
<td>6</td>
<td>Supreme Court rules interest payable to deductor on refund of taxes withheld</td>
<td>19-Mar-14</td>
<td>DIT v. Tata Chemicals Ltd. [(TS-147-SC-2014)]</td>
</tr>
<tr>
<td>7</td>
<td>Mumbai ITAT rules on payment to head office for data processing facilitated by software installed at the head office</td>
<td>20-Mar-14</td>
<td>ADIT v. Antwerp Diamond Bank NV [ITA No. 7347/Mum./2007]</td>
</tr>
<tr>
<td>8</td>
<td>Delhi Tribunal rules on Service PE trigger on account of deputation and principles for examining “effectively connected” with PE</td>
<td>28-Mar-14</td>
<td>DDIT v. J.C Bamford Excavators Ltd. [TS-161-ITAT-2014(DEL)]</td>
</tr>
<tr>
<td>9</td>
<td>Key proposals of the Direct Taxes Code 2013</td>
<td>02-Apr-14</td>
<td>Release of the “revised” version of Direct Taxes Code 2013</td>
</tr>
<tr>
<td>10</td>
<td>HC Alert : Change in the certificate of coverage application form and clarifications issued on “monthly pay” for calculation of social security contributions</td>
<td>03-Apr-14</td>
<td>Indian social security head office's circulars</td>
</tr>
<tr>
<td>11</td>
<td>HC Alert : Increased focus on social security compliance for international workers</td>
<td>03-Apr-14</td>
<td>Indian social security head office's circular directing its regional offices to coordinate with FRROs.</td>
</tr>
<tr>
<td>12</td>
<td>CBDT clarifies share of profits of a partner from a partnership firm having exempt income is exempt in the hands of the partner</td>
<td>03-Apr-14</td>
<td>CBDT Circular No. 8/2014 dated 31 March 2014</td>
</tr>
<tr>
<td>13</td>
<td>HC Alert : Social security agreement between India and Sweden</td>
<td>09-Apr-14</td>
<td>The Social security agreement expected to come into force in April 2014.</td>
</tr>
<tr>
<td>14</td>
<td>Global Tax Alert : Tribunal rules on transfer pricing aspects of corporate guarantee</td>
<td>14-Apr-14</td>
<td>Four Soft Pvt. Ltd. v. DCIT [TS-104-ITAT-2014(HYD)-TP]</td>
</tr>
<tr>
<td>15</td>
<td>HC alert : New online tool introduced for the issue of certificates of coverage</td>
<td>15-Apr-14</td>
<td>Indian social security head office's circular introducing new online tool.</td>
</tr>
<tr>
<td>16</td>
<td>Mumbai Tribunal rules write-down of investment loss allowable if a “direct and proximate” nexus exists with a business</td>
<td>21-Apr-14</td>
<td>Tata Communications Ltd. v. Addl. CIT [TS-210-ITAT-2014(Mum)]</td>
</tr>
<tr>
<td>17</td>
<td>CBDT clarifies on tax treatment of expenditure for developing infrastructure facility under BOT arrangement</td>
<td>25-Apr-14</td>
<td>CBDT Circular No. 9 of 2014 dt. 23 April 2014</td>
</tr>
<tr>
<td>18</td>
<td>Delhi HC rules on AOP constitution and taxability of offshore supply and services</td>
<td>28-Apr-14</td>
<td>Linde AG, Linde Engineering Division and Anr v. DDIT [TS-226-HC-2014(DEL)]</td>
</tr>
<tr>
<td>Sl. No.</td>
<td>Title</td>
<td>Date of the alert</td>
<td>Citation/Notification/Circular</td>
</tr>
<tr>
<td>--------</td>
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<td>-------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>19</td>
<td>Delhi HC upholds AAR ruling; rules seconded employees create Service PE in India</td>
<td>02-May-14</td>
<td>Centrica India Offshore Pvt. Ltd. v. CIT &amp; Othrs [TS-237-HC-2014(DEL)]</td>
</tr>
<tr>
<td>20</td>
<td>Supreme Court rules on carry forward and set off of losses in cases of amalgamation of cooperative societies</td>
<td>05-May-14</td>
<td>Rajasthan R.S.S Ginning Mills Fed. Ltd. v. DCIT [TS-241-SC-2014]</td>
</tr>
<tr>
<td>21</td>
<td>Delhi High Court rules income from sale of shares through Portfolio Manager is capital gains income</td>
<td>05-May-14</td>
<td>Radials International v. ACIT [TS-238-HC-2014(DEL)]</td>
</tr>
<tr>
<td>22</td>
<td>Mumbai Tribunal holds existence of fixed place PE on account of protracted presence of employees executing a consultancy project in India</td>
<td>13-May-14</td>
<td>Renoir Consulting Ltd. v. DDIT [TS-211-ITAT-2014]</td>
</tr>
<tr>
<td>23</td>
<td>AAR rules MFN clause cannot be used to import “make available” clause</td>
<td>19-May-14</td>
<td>AAR [TS-285-AAR-2014]</td>
</tr>
<tr>
<td>24</td>
<td>Karnataka High Court rules payments for customer database and trained personnel as revenue expenditure</td>
<td>19-May-14</td>
<td>CIT v. IBM Global Services India Pvt. Ltd. [TS-279-HC-2014(KAR)]</td>
</tr>
<tr>
<td>25</td>
<td>HC Alert : Clarifications from Indian Provident Fund Office on limiting contributions on INR 6,500 per month</td>
<td>29-May-14</td>
<td>EPFO Circular No. LC(637)2009/Vol. 1 dt 27 May 2014</td>
</tr>
<tr>
<td>26</td>
<td>Global Tax Alert - Delhi HC rules on TP aspects of intra-group service transactions</td>
<td>31-May-14</td>
<td>CIT v. Cushman and Wakefield (India) Pvt. Ltd. [TS-150-HC-2014(DEL)-TP]</td>
</tr>
</tbody>
</table>
### Indirect Tax

<table>
<thead>
<tr>
<th>Sl. No.</th>
<th>Title</th>
<th>Date of the alert</th>
<th>Citation/Notification/Circular</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>AP Reorganisation Act related VAT/CST implications</td>
<td>21-Apr-14</td>
<td>Key highlights of the Andhra Pradesh Reorganisation Act 2014 relating to its impact on AP Value Added Tax (APVAT)/AP Entry tax (APET) and Central Sales tax (CST) laws and Frequently Asked Questions (FAQ) issued by AP Commercial Taxes Department.</td>
</tr>
<tr>
<td>2</td>
<td>VAT not leviable on 40% of the restaurant bill, which is subject to service tax</td>
<td>29-Apr-14</td>
<td>Valley Hotel &amp; Resorts v. The Commissioner, Commercial Tax, Dehradun [TS-129-HC-2014(UTT)]</td>
</tr>
<tr>
<td>3</td>
<td>Reorganisation of Andhra Pradesh w.e.f. 2 June 2014 – Key implications from AP Value Added Tax, AP Entry Tax and Central Sales Tax Law perspective</td>
<td>06-May-14</td>
<td>Key highlights of the recently issued Frequently Asked Questions by the APVAT authorities providing the views of the department on various aspects under the AP Value Added Tax (APVAT)/AP Entry tax (APET) and Central Sales tax (CST) laws</td>
</tr>
<tr>
<td>4</td>
<td>Soft loan given by the State Government based on VAT/ CST collected for the purpose of promoting industrial growth of the State, does not amount to “refund of tax”</td>
<td>06-May-14</td>
<td>Public Interest Litigation (PIL) filed by Himanshu V. Patel against the State of Gujarat [2014-VIL-105(GUJ)].</td>
</tr>
<tr>
<td>5</td>
<td>SC on characterization of transaction of supply and installation of lifts by elevator companies</td>
<td>12-May-14</td>
<td>Kone Elevator India Pvt. Ltd. v. State of Tamil Nadu &amp; Ors.</td>
</tr>
<tr>
<td>6</td>
<td>CESTAT rules non-compete fee and trademarks licence fee shall be included while determining the assessable value of the goods, under Central Excise</td>
<td>03-Jun-14</td>
<td>Godrej Consumer Products Ltd. v. CCE, Indore [TS-181-Tribunal–2014-EXC]</td>
</tr>
<tr>
<td>S. No.</td>
<td>Title</td>
<td>Date of the alert</td>
<td>Citation/Notification/Circular</td>
</tr>
<tr>
<td>-------</td>
<td>---------------</td>
<td>-------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
</tbody>
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