Foreword

We place before you the current issue of the Tax Scout, our quarterly update on recent developments in the field of tax laws. In this issue, we have, for the first time, covered developments in the field of indirect taxes along with direct taxes.

This issue discuses in detail the much awaited indirect tax reform pertaining to the introduction of the Goods and Services Tax as the Cover Story. We have also discussed the recent guidelines issued by the Central Board of Direct Taxes in relation to the establishment of a place of effective management in case of foreign companies.

In addition to the above, we have also analyzed some of the important rulings by the Indian judiciary and certain key changes brought about by way of circulars and notifications in the past three months.

We hope you enjoy reading this newsletter as much as we have enjoyed creating it for you. Please do send us your comments and feedback to taxscout@cyrilshroff.com.

Regards,

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Indirect Tax
- Notification for levy of Swachh Bharat cess and related Frequently Asked Questions (FAQs)
The transformation of the indirect tax landscape from multiple levies for each taxable event to a single Goods and Services Tax (“GST”) has been a long awaited financial reform for the Indian polity. While the basic structure of GST stands finalized as a dual GST comprising of Central GST and State GST, the constitutional amendments required to implement the new legislation remain at the mercy of the scuffling political parties.

With the political scrimmage continuing along its own trajectory, the stage of implementation of the GST regime has achieved status of the third Indian mythological epic. Notable developments in the last quarter of 2015 such as the release of draft concept papers on business processes under GST registration, refunds, payments and returns which detail the compliance matrix under the proposed GST regime; Chief Economic Advisor's report on revenue neutral rate under GST; etc had once again reinstated the hope that GST is an idea, whose time has come. However, a review of the GST Model Law, released by the Union Government to the States and the public for comments, has once again raised concerns with respect to the efficacy of the new legislation.

The aim of this article is to analyse the key issues emerging from a review of the GST Model Law and other recent developments towards implementation of the new legislation.

GST MODEL LAW

The GST Model Law proposes three separate enactments, namely, Central GST Act, State GST Act and Integrated GST Act. The basic features of law, such as chargeability, definition of taxable event, taxable persons etc., have been kept uniform across all the three draft legislations to ensure harmonization of the tax laws and their administration processes, while maintaining fiscal autonomy of the States.

GST is proposed to be imposed on the ‘supply’ of goods and/or services, thus, the definition of ‘supply’ is of great significance. The term ‘supply’ has been accorded a very wide definition under the proposed GST Model Law whereby all forms of ‘supply’ i.e. sale, transfer, barter, exchange, license, rental, lease or disposal and importation of services carried out for a consideration would be covered within its purview. Along with these, specified transactions which take place without consideration such as permanent transfer of business assets, self-supply or stock transfers, temporary application of business assets, services to non-business/ private use or assets retained after de-registration would also be included in the definition of ‘supply’. This would result in expansion of the taxable base significantly and requires significant restructuring of business operations to account for
the tax outflows.

An area of concern which has arisen is the inclusion of securities in the definition of 'goods' under the GST Model Law. Resultantly, sale or transfer of securities could be treated as supply of goods and hence chargeable to GST. Taxation of securities, as proposed, would be a major divergence from not only the existing tax position but also from international best practices where financing transactions or transactions in money have been excluded from the tax ambit.

The GST Model Law incorporates the rules dealing with point of taxation, place of supply and input tax credit. As per the GST Model Law, the point of taxation would be determined by reference to the 'time of supply' of goods and services. Time of supply of services would be the earliest of the following events, namely, date of payment, date of invoice or the date on which recipient of service shows the receipt of the service in his/her books of account. Thus the point of taxation in the case of provisions of services between unassociated enterprises is proposed to be modeled along the lines of the point of taxation on import of service by associated enterprises in the present service tax regime.

In the case of supply of goods, the time of supply would be earliest of date of payment, date of invoice, date on which goods are removed or where goods are not removed, then the date on which they are made available to the buyer or the date on which buyer of goods shows the receipt of goods in his/her books of account. Hence, advances received for supply of goods would be subjected to GST as opposed to the present scheme of taxation under the applicable sales tax legislations. Corresponding provisions have also been incorporated in the credit rules to enable admissibility of credit on the basis of invoice of the seller of goods rather than on actual receipt of goods. This is a welcome step as it would allow unlocking of working capital. However, adequate safeguards to check the cases of fraud where credits are accumulated without receipt of goods would have to be incorporated in the legislation as well.

The place of supply rules proposed in GST Model Law are based on the understanding that GST would be a destination based consumption tax and the incidence of tax would be passed on to the consuming State. The place of supply rules are mostly in accordance with the European Directives on VAT with certain modifications for specified supplies.

The place of supply of services in case of business to business transactions, other than the specified services, shall be the location of the service recipient. In case of business to customer/consumer transactions, the place of supply shall be the location of the service provider. Conversely, in the case of goods, the place of supply shall be the place where the goods are delivered.

The concept of 'distance supply' has been introduced for the first time in the GST Model Law and the following conditions need to be satisfied to constitute a distance supply:

(a) the goods are supplied to a buyer located in another State and

(b) the supplier arranges the transport of goods.

In other words, a ‘distance supply’ of goods would be in the nature of inter-state supply of goods and hence would attract Integrated GST ("IGST").

The GST Model Law provides for the valuation of taxable supplies on the principles applicable under current regime, i.e. on the basis of the transaction value where the buyer and seller are not related and the price is the sole consideration. In other cases, such as where the parties are related or price is not the sole consideration, valuation rules have been prescribed to determine the value of taxable supply on the lines of the present rules provided under the excise and service tax laws. The newly proposed valuation rules provide that stock transfers are to be taxed on the basis of transaction value. Further, maximum retail price based valuation may continue for business to customer/consumer transactions.

A projected benefit of GST is the resolution of valuation dispute in composite transactions. However, while supply of goods and service has been treated at par in the GST Model Law, the issue of valuation of composite transaction has not been touched upon.

Deduction on account of discount allowed after the supply has taken place, is not permissible under the GST Model Law. Thus, year-end volume discounts would form part of the transaction value. However, the Report on Business Processes for Refund suggests that, price adjustment for volume based incentives provided by way of credit notes shall be allowed and hence refund shall be allowed. Thus there appears to be inconsistency between the said Report and the GST Model Law.

The success of GST lies in providing a seamless credit chain to taxpayers located across States. The GST Model Law provides for simplified input tax credit rules with a broad base. Unlike the present CENVAT credit rules, where

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2. Joint Committee on Business Processes constituted by Empowered Committee of Finance Ministers, presented a report on business processes of refund under GST on October 06, 2015.
definitions of input and input services have been provided, GST Model Law proposes to define the concept of input tax alone. Input tax has been defined to mean ‘GST charged on any supply of goods or services which are used in the course of furtherance of business’. This may result in mitigation of interpretational issues relating to admissibility of credit as inputs or input service.

The definition of capital goods proposed to be inserted is also very wide and does not include any reference to tariff headings. It provides for plant, machinery and equipments, used directly or indirectly in the course of manufacture, trade, commerce or any similar activity, to be termed as capital goods. Thus it appears that the scope of credit of capital goods would be broadened. However interpretational issues with respect to whether a particular good qualifies as a plant, machinery or equipment may arise. Secondly, it does not provide any clarity on whether aircrafts, vessels etc., would be regarded as capital goods in the GST regime. It is further disappointing to note that the issue of admissibility of credit on plant, machinery and equipments embedded to an immovable property has not been dealt with in the GST Model Law. One positive point is that, proportionate availment of credit of capital goods spread over years of usage is proposed to be done away with.

At present, services charged under reverse charge are not considered to output service for the purpose of CENVAT credit rules. Accordingly, credit cannot be utilized for payment of service tax under reverse charge. The GST Model Law proposes to include tax payable under reverse charge within the ambit of output tax. Hence, the credit would be available to set-off the GST liability under reverse charge. This would result in unrestricted credit utilization as compared to the current regime.

Provisions related to restriction of credit to the extent as is attributable to taxable supplies (including zero rated supplies) have been incorporated in the GST Model Law. It is, however, regrettable that lack of clarity continues regarding whether the proportionate credit provisions would be applicable only on common inputs and input services, or whether there would be blanket provisions of proportionate credit for all goods and services used in ‘supply’ of taxable supplies along with non-taxable supplies.

Lately, restriction of credit on invoices older than one year has resulted in loss of working capital to businesses. However, the GST Model Law does not adequately address the limitation period for availment of credit.

The GST Model Law does not provide for the concept of input service distributor. While, this appears to be a natural concomitant of the inclusion of self supplies and stock transfers within the ambit of ‘supply,’ it may result in making the concept of State-wise centralized registration redundant in GST regime, as in the absence of the concept of input service distributor, credits would not be transferrable within units whereas supplies would be subjected to GST levy.

GST Model Law provides for the zero rating of export of goods and services, and the levy of GST on all imports of goods and services into India is under reverse charge mechanism in line with the international best practices. Complete set-off of IGST paid on import of goods and services into India would be available against GST payable on domestic transactions. However, the GST Model Law does not provide any guidance with respect to tax treatment of supplies made to export oriented units, units under the Software Technology Park of India Scheme, units under the Special Economic Zones, etc.

Provisions for deducting tax at source (“TDS”) in line with works contract tax (“WCT”) under current State levies, have also been proposed in the GST Model Law. TDS at the rate of 1 per cent shall be deducted from the value of notified taxable goods and services where the value exceeds INR 10 lacs.

The GST Model Law provides for transitional provisions to carry forward the accumulated credits of excise duty, service tax and value added tax (“VAT”). However, indirect taxes which have been charged on the tax payer but which are not admissible as credits in the current regime, have not been included in transitional provisions for carry forward of credits. This position may result in inflation of prices due to higher tax rates in GST with correspondingly lower credits on transitional stock.
An essential parameter for efficient and effective GST is the tax rate. The Chief Economic Advisor Committee Report on Revenue Neutral Rate (“RNR”) and Structures of GST Rates has been submitted to the Finance Minister on December 4, 2015. The term RNR refers to that single rate which preserves revenue of the Centre and States at current levels whereas standard rate is the rate which applies to all goods and services whose taxation is not explicitly specified.

The Report recommends RNR to be between 15 per cent and 15.5 per cent, for the Centre and States combined. It also recommends lower rates to be kept around 12 per cent with standard rates varying between 17 to 18 per cent. High or demerit rate on luxury products (“RNR”), such as tobacco etc, has been recommended at 40 per cent. It may be noted that the 1 per cent origin based tax on inter-state supplies of goods, as contained in the Constitution Amendment Bill, has not been recommended in the Chief Economic Advisor Committee Report.

On structure, India should strive towards a one rate structure with reduction in exemptions and exclusion with an aim to widen the tax base. This would be essential for better administration of the tax policy.

Contrary to the experience of other jurisdictions, GST has been welcomed by the stakeholders in India with open arms. However, the proposed legislation in its current format has been panned by nearly all stakeholders as it raises potent questions with respect to the ability of the new legislation to address the concerns plaguing the current indirect tax landscape. The Government has declared that it would be releasing an amended Model Law for further public comments in the near future. It remains to be seen whether the new legislation would indeed create a business friendly environment.
The Finance Act, 2015 had brought about a significant amendment in the IT Act to amend the test for determining the residency of foreign companies in India. According to the amended definition, an acid test has been laid down by which a foreign company is said to be a resident in India in any previous year, if its Place of Effective Management ("POEM") is in India. Pursuant to this, the CBDT has recently released, for public comments, the Draft Guiding Principles for Determination of POEM of foreign companies in India ("Draft Guidelines"). This article seeks to discuss some of the important aspects of the Draft Guidelines.

ACTIVE BUSINESS OUTSIDE INDIA ("ABOI") TEST

The Draft Guidelines provide that a company shall be said to be engaged in ABOI, if –

(i) its passive income is not more than 50% of its total income; and

(ii) less than 50% of its total assets are situated in India; and

(iii) less than 50% of total number of employees are situated in India or are resident in India; and

(iv) the payroll expenses incurred on such employees situated in India are less than 50% of its total payroll expenditure.

For this purpose, passive income is defined to mean the aggregate of (i) income from both the purchase and sale of goods from/to its associated enterprise; and (ii) income by way of royalty, dividend, capital gains, interest or rental income.

It would be pertinent to note that the manner in which the term ‘passive income’ has been defined could create complications for certain foreign companies since it has failed to consider instances where such income could be active income, like intra-group trading entities, interest income for a banking entity, royalty for a research and development company or for an entity that holds intellectual property rights belonging to the group, etc.

POEM FOR COMPANIES CARRYING ON ABOI

Para 7 of the Draft Guidelines provides that, the POEM in case of a company engaged in ABOI, shall be presumed to be outside India, if the majority of the meetings of the Board of Directors ("BOD") of the company are held outside India. However, para 7.1 provides that if on the basis of the facts and circumstances, it is established that the BOD is standing aside and their powers are being exercised by either the holding company or any other person(s) resident in India, then the POEM shall be considered to be in India.

In view of this provision, the IRA could be encouraged to conduct exhaustive enquiries and investigation to ascertain how business is carried on by the taxpayer. Unless appropriate safeguard mechanisms are provided, based on

1. Section 6(3) of the IT Act.
2. Explanation to section 6(3) of the IT Act: “POEM” means a place where key management and commercial decisions that are necessary for the conduct of the business of an entity as a whole are, in substance, made.
4. For determining whether the company is engaged in ABOI, the average of the date of the previous year and two years prior to that date shall be taken into account. In case the company has been in existence for a shorter period, then the data of such period shall be considered.
past experiences, it would be fair to assume that IRA could go overboard and in certain cases, it may result in unwarranted litigation. It may be noted that in case the holding company is situated in India, it is bound to exercise certain amount of control over its subsidiaries, including approval of crucial strategic decisions pertaining to the subsidiary. Also, the BOD of the subsidiary would have to get some of their decisions vetted by the Indian holding company.

Further, even though the directors are based in India, it is not necessary that merely by virtue of their residence, decisions are taken in India. The concerned directors could visit the country in which the subsidiary operates from time to time and take decisions after appropriate consultation with the requisite stakeholders, even during the course of their visits. Thus, merely because some management control is being exercised by the holding company or any person resident in India, it should not lead to the conclusion that a company engaged in ABOI, has a POEM in India. These Draft Guidelines, if finalised in the same form and manner, could cast an onerous obligation on the taxpayer to justify and substantiate with appropriate evidence that the POEM is not situated in India.

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POEM FOR COMPANIES CARRYING ON PASSIVE BUSINESS OUTSIDE INDIA

The determination of POEM for companies carrying on passive business outside India would be a two stage process, namely:

(i) identification of persons who take key management and commercial decisions; and

(ii) determining the place where these decisions are, in fact, being made.

Further, the Draft Guidelines provide that the place where the decisions are taken would be more important than the place where such decisions are implemented. For this purpose, the substance would be considered rather than the form.

It must be appreciated that most of the above aspects are very subjective and hence, it will be very difficult to conclusively establish either way.

In the event the POEM is considered to be in India, such company would be treated to be a ‘resident’ in India for tax purposes.

Other guiding principles

The CBDT has provided certain other guiding principles which may be considered while determining the POEM, such as the location criteria, delegation of authority, location of the company’s head office, cases where modern technology is used for the purpose of arranging meetings, etc. If these principles do not lead to clear identification of POEM, then the following secondary factors can be considered:

(i) Place where main and substantial activities of the company are carried out; or

(ii) Place where the accounting records of the company are kept.

The Draft Guidelines further provide that the following factors by themselves would not establish a POEM in India:

- A foreign company is completely owned by an Indian Company (“ICO”);
- One or some of the directors of a foreign company reside in India;
- Local management being situated in India for activities carried out by a foreign company in India; and
- Existence in India of support functions, which are preparatory or auxiliary in character.

These are very important exclusions, since the IRA have relied on these aspects to contend vociferously that foreign companies have established a PE in India. The Draft Guidelines clarify that POEM is to be seen not with reference to any particular moment in time, rather, activities performed over a period of time during the previous year, need to be considered. It has also been
clarified that in case it is determined that the foreign company has established a POEM in India as well as outside India, then POEM shall be presumed to be in India if it has mainly/predominantly been in India.

**PROCEDURAL ASPECTS**

The Draft Guidelines stipulate that the AO shall have to obtain prior approvals from the Principal Commissioner of Income Tax (“PCIT”) / Commissioner of Income Tax (“CIT”), before holding that a foreign company has become a tax resident of India on the basis of its POEM. Further, a hearing shall also be provided to the Company by the PCIT/ CIT, before a final decision in this regard is taken.

**Conclusion**

POEM, for determining the residence of foreign companies, is one of the most important provisions to have been introduced into the tax legislation in the recent past. It has created tremendous amount of uncertainty amongst the taxpayers. Thus, the Indian Government has taken a right move by releasing these Draft Guidelines to reduce subjectivity and provide clarity to the taxpayers as to what would lead to the constitution of a POEM in India. However, on the negative side, the Draft Guidelines still leave ample room for the IRA because a number of conditions prescribed are very subjective in nature. The Draft Guidelines also do not provide guidance on various other issues, like entitlement of treaty benefits to the foreign company, definition of the term ‘value of total assets’ for the purpose of examining ABOI condition, applicability of the withholding tax provisions, etc.

The amended definition of residential status for a foreign company is applicable from the FY 2015-16. However, since the Draft Guidelines have not yet been finalized by the CBDT, presently, there are no binding guidelines available for the taxpayers to examine their residential status on the basis of POEM.

In view of the above, it is hoped that the applicability of POEM provisions is deferred by at least a year, and the final Guidelines are issued by the CBDT well in advance, after taking into account the above concerns, so that the taxpayers can plan their affairs appropriately.
INDIAN DISTRIBUTOR CREATES DEPENDENT AGENT PERMANENT ESTABLISHMENT FOR THE FOREIGN CHANNEL OWNER

In NGC Network Asia LLC, the Mumbai ITAT held that the Indian subsidiary of a foreign company, habitually exercising the authority to conclude contracts in India on behalf of the foreign company, constitutes dependent agent permanent establishment (“DAPE”) of the foreign company.

FACTS

NGC Network Asia LLC (“Assessee”), was a USA based company, engaged in the business of broadcasting of its channels in various countries, including India. The Assessee owned the National Geographical Channel (“NGC”) and Fox International Channel. The Assessee appointed its indirect subsidiary, NGC Network India Private Ltd. (“NGC India”), as its distributor in India to distribute its television channels and also to procure advertisements for telecasting in the channels. The Assessee generated two streams of revenues from India, i.e. (a) fees for giving distribution rights for telecasting of its channels and (b) advertisement revenues.

In FY 2006-07, in relation to the advertisement revenues, the Assessee entered into an agreement with NGC India for the month of April, 2006 (“Old agreement”), under which the Assessee paid commission of 15% of the advertisement revenues to NGC India. Thereafter, a new agreement was entered into between the parties, under which the Assessee was to receive a fixed sum from NGC India for procuring advertisements and for distribution rights. The Assessee was of the view that the income earned by it, from the services rendered by NGC India, was not taxable in India and hence, did not offer the same in the tax return.

The AO was of the view that NGC India was the DAPE of the Assessee and hence held that the advertisement revenue as well as distribution revenue were taxable in India. The AO relied upon Rule 10B(ii) of the IT Rules and accordingly assessed 25.34% of the advertisement revenues as income of the Assessee attributable to India, i.e. in the ratio of worldwide profits to worldwide revenue. The AO also held that the revenue generated on granting of distribution rights was in the nature of royalty and accordingly assessed 15% thereof as income of the Assessee as per Article 12 of the India-USA DTAA. The TPO had found this transaction to be at arm’s length.

The DRP upheld the order of the AO. Aggrieved by such order of the DRP, the Assessee appealed against it before the Mumbai ITAT.

ISSUES

(a) Whether the Assessee is having a DAPE in India in terms of India-USA DTAA and hence, the advertisement revenue is taxable in India?

(b) Whether the income from distribution of channels is covered within the meaning of “royalty” under the India-USA DTAA and the IT Act, and hence the same is also taxable in India?

ARGUMENTS/ANALYSIS

The Assessee contended that the new agreement was entered into with NGC India on a principal to principal

“In even if the Indian subsidiary has been compensated on arm’s length basis, the foreign parent would still be liable to pay tax in India.”

basis and that it was an agent of independent status. Hence, NGC India cannot be considered a dependent agent of the Assessee. Further, the advertisement activities undertaken by NGC India were on its own account and the Assessee did not have control over such activities.

It was also contended that it does not have a DAPE in India and hence, the business income from the advertisement revenue was not taxable in India. Further, the TPO has held the payments made by it to NGC India to be at arm’s length and hence no further income is required to be attributed to the Assessee. In this regard, the Assessee relied upon the rulings in Morgan Stanley6, BBC Worldwide Ltd7, and B4U International Holdings Ltd.8

With respect to royalty, the Assessee argued that distribution rights were granted to NGC India by the Assessee through a non-exclusive licence. The distribution rights which are not in the nature of copyright, but in the nature of “broadcasting reproduction rights,” which are commercial rights not covered under the definition of “royalty” as per the provisions of the India-USA DTAA or the IT Act.

JUDGMENT

The ITAT held that the relationship between the Assessee and NGC India was not on a principal to principal basis. When the relationship is on principal to principal basis, the ownership passes to the distributor from the manufacturer and the manufacturer has no further role to play. However, in the present case the relationship between the parties was on a principal-agent basis only. As per the ITAT, the sale of advertisement airtime constituted the transfer of right to procure advertisements and the same was not in the nature of ‘goods’. Hence, the concept of purchase and sale of goods could not be applied. Further, there was continuous involvement of the Assessee and, therefore, the relationship is not on a principal to principal basis.

The ITAT also observed that NGC India provided agency services to the Assessee, as it was only enabling the Assessee to procure the advertisements for telecasting them. Further, NGC India habitually exercised an authority to conclude contracts on behalf of the Assessee and the same was binding on the Assessee. Therefore, NGC India constituted DAPE of the Assessee under Article 5(4)(a) of the India-USA DTAA. It was also held that merely changing the method of payment, from payment of commission under the old agreement to a fixed consideration under the new agreement, would not be a determining factor to decide upon the nature of the relationship between the parties.

The ITAT rejected the Assessee’s contention that since the TPO has held the transaction to be at arm’s length, there would be no further attribution of profits to the Assessee. It held that when a foreign company with a PE in India receives any income sourced in India, then the taxability of such income shall be examined according to the IT Act and the relevant DTAA, irrespective of the certification of arm’s length price by the TPO. The ITAT held that the certification of ALP by the TPO would be applicable only in respect of the payments made by the foreign company to an Indian affiliate for the services availed by it and not for earning any income sourced in India.

With respect to whether the payment received by the Assessee, for granting distribution rights to NGC India, can be characterized as “royalty”, the ITAT ruled that this issue needs to be examined afresh by the AO in light of the introduction of explanation 6 to section 9(1)(v) of the IT Act (inserted retroactively by the Finance Act, 2012).

SIGNIFICANT TAKEAWAYS

In a business environment which is highly globalized, multinational companies often engage with their affiliate companies. The ruling of Mumbai ITAT could have severe consequences upon the television entertainment industry, since the presence of a distribution agent in India could lead to the foreign channel owner constituting a DAPE in India. The ITAT ruled that since the Indian subsidiary of the foreign company was engaged in concluding contracts on behalf of the foreign company, there existed a principal-agent relationship between the foreign company and its Indian subsidiary.

Moreover, even if the Indian entity is compensated on arm’s length basis, the ITAT held that the foreign parent would also be liable to pay tax in India in respect of the income attributed to the DAPE in India. By holding this, the ITAT observed that the TPO’s certification, that the compensation payable to the Indian entity was on arm’s length basis, would not preclude the foreign parent from its liability to pay taxes in India. The ITAT reached this conclusion and distinguished the cases of BBC Worldwide Ltd (supra), and B4U International Holdings Ltd (supra) on the ground that in the instant case, the foreign company received payment from its Indian PE. It will be interesting to see what position will be taken if this matter reaches the higher judiciary.

An additional aspect that needs analysis, is whether the Indian subsidiary could have been treated as the DAPE, considering the express provision of article 5(5) of the India-USA DTAA, which states that when the activities of the agent are devoted wholly or almost wholly on behalf of the enterprise and the transactions between the agent and the enterprise are not made under arm’s length conditions, he shall not be considered to have an independent status. In the instant case, since the TPO had already confirmed that the transactions between NGC Asia and NGC India were undertaken on arm’s length basis, the appropriateness of the ITAT’s decision that NGC India constituted a DAPE of NGC Asia, may have to be re-examined by the higher judicial authorities.

7. DIT v. BBC Worldwide Ltd. (2011) 203 taxmann 554 (Delhi).
**Salary Reimbursement for Seconded Employees Occupying Managerial/Executive Positions is Taxable as FTS**

In *Food World Supermarkets* the Bangalore ITAT held that reimbursement of salary cost of high level managerial and technical personnel, on secondment with an Indian company, would be in the nature of fees for technical services (“FTS”).

**FACTS**

The Food World Supermarkets (“Assessee”) was an Indian company engaged in the business of ownership and operation of a supermarket chain in India. Dairy Farm Company Ltd., (“DFCL”) was a company based in Hong Kong and was engaged in a similar business as that of the Assessee.

The Assessee entered into an agreement with DFCL on June 6, 2007, under which DFCL agreed to assign its employees to the Assessee to assist the latter in its business operations. Consequently five employees/expatriates were deputed by DFCL to the Assessee. The parties agreed that DFCL would pay salary to the assigned personnel and the Assessee would reimburse such amount to DFCL. The salary paid by DFCL to the assigned personnel was subject to TDS under section 192 of the IT Act. The Assessee reimbursed the gross salary to DFCL without withholding any tax.

The AO held that the remittance made by the Assessee was in the nature of FTS, which is taxable under section 9(1)(vii) of the IT Act. Further, since no tax had been deducted at source on such remittance, the Assessee was treated as ‘an assessee in default’ under section 201(1) of the IT Act. On appeal by the Assessee, the CIT(A) upheld the order of the AO. The Assessee appealed against such order to the Bangalore ITAT.

**ISSUE**

Whether salary reimbursement for seconded employees occupying managerial/executive positions is taxable as FTS?

**ARGUMENTS/ANALYSIS**

The Assessee contended that the remittance to DFCL was in the nature of reimbursement of salary paid to the employees, and tax on the same had been duly deducted under section 192 of the IT Act.

Alternatively, the Assessee contended that the secondees would constitute a service PE and the income would be taxable as per the provisions of section 44DA of the IT Act (i.e. only the net income, i.e. revenue less expenditure would be taxable). For this, the Assessee relied upon the decision of the SC in *Morgan Stanley* wherein it has been held that the definition of a PE under section 92F(iii) of the IT Act, includes a service PE along with other types of PE (like, agency PE, construction PE, etc.). The Assessee also stated that in the instant case, the net income would be Nil after deducting the expenditure i.e., salary of the secondees and therefore, there would be no tax liability.

The IRA argued that as per the terms of the secondment agreement, the Assessee did not have any control over the deputed personnel and these employees continued to be on the payroll of DFCL, therefore, there was no master-servant relationship between the Assessee and the secondees. The remittance to DFCL was not reimbursement of salary, but was payment for the

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services rendered by the employees on behalf of DFCL. Since, the services rendered by the secondees were in the nature of management and consultancy services, the remittance made by the Assessee for such services was in the nature of FTS.

**JUDGMENT**

**Fees for Technical Services**

The ITAT held that the reimbursement of salary costs was in the nature of FTS as per explanation 2 to section 9(1)(vii) of the IT Act.\(^1\) While coming to the conclusion, the ITAT observed the following:

- Secondees occupied managerial/executive positions and were hired for their technical and managerial skills.
- Secondment agreement was between the Assessee and DFCL only, and the secondees were not a party to the agreement.
- There was no separate employment agreement signed between the secondees and the Assessee and hence they cannot enforce any legal obligation against the Assessee. Therefore, the secondees remain to be the employees of DFCL and are performing their duties in India on behalf of DFCL.

The ITAT relied upon the Delhi HC judgment in the case of Centrica India Private Limited,\(^2\) where it was held that the services rendered by the secondees to Centrica were in the nature of managerial and consultancy services. Further, the ITAT observed that the ruling in Centrica (supra) had attained finality owing to the dismissal of the case by the SC. Therefore, the payment made to DFCL for the services of deputed personnel under the secondment agreement was in the nature of FTS and was taxable under section 9(1)(vii) of the IT Act.

It may be noted that the Assessee relied upon the rulings of the Bangalore ITAT in Abbey Business Services\(^3\) and in IDS Software Solution\(^4\), to argue that the payment made to foreign companies under a secondment agreement was in the nature of reimbursement of expenses and not FTS. However, the ITAT rejected this argument on the ground that the Delhi HC ruling in Centrica (supra) would have a higher precedential value.

**Service PE**

The ITAT also observed that India does not have a DTAA with Hong Kong and that the concept of service PE is absent under the IT Act. Further, since the argument of formation of service PE was taken for the first time before the ITAT, it remitted the issue to the AO for determining the existence of a service PE.

**SIGNIFICANT TAKEAWAYS**

The taxability of salary reimbursements relating to secondees is a highly fact specific and heavily litigated issue which is subject to contrary judicial opinions.

It may be noted that in the instant case, the secondment agreement had the following key features, viz. control and supervision of the Assessee over the seconded employees, applicability of the rules, guidelines and policies of the Assessee to the seconded employees, the cessation of DFCL’s obligation towards the seconded employees on their acceptance of the Assessee’s employment letter, etc. However, the ITAT relied upon the Delhi HC ruling in Centrica (supra) and treated these factors to be not indicative of whether the Assessee was the actual employer of the secondees. Instead, the ITAT considered factors such as the absence of an employment agreement between the Assessee and the secondees, and the continuing presence of the secondees on the payrolls of DFCL to be key factors for determining that DFCL was their actual employer.

It may be noted that the secondment agreement clearly stated that the obligation of DFCL towards the seconded employees would cease after such employees accepted the Assessee’s employment letter. Despite this specific term in the agreement, the ITAT observed that the secondees were under the legal obligation and employment of DFCL as they continued to be on the payrolls of DFCL, and also due to the absence of separate employment agreement with the Assessee.

It may be noted that the ruling in Centrica (supra) was also recently relied upon by the Mumbai ITAT in Morgan Stanley,\(^5\) to hold that the salary reimbursements of secondees, having technical skills and experience, are in the nature of FTS. However, contrary rulings have been given in Abbey Business Services (supra) and in IDS Software Solution (supra). However, it seems that the Delhi HC decision in the case of Centrica, being the decision of a higher authority, would prevail over the contrary ITAT decisions.

Given the highly fact specific nature of secondment agreements, the aggressive approach taken by the IRA and the contradictory judgments in this area, companies should take caution while drafting their secondment agreements.

11. Explanation 2 to section 9(1)(vii) of the IT Act defines FTS as any consideration for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel). The definition excludes consideration for any construction, assembly, mining or like project undertaken by the recipient, or consideration which would be income of the recipient chargeable under the head, “salaries.”


14. IDS Software Solution v. ITO 122 TTJ 410 (Bangalore ITAT).

**MERE USE OF THE TERM 'GOING CONCERN' IN A SALE AGREEMENT NOT DETERMINATIVE OF 'SLUMP SALE'**

The Kolkata ITAT in *Tongani Tea Co. Ltd.* held that a sale transaction, wherein the movable and immovable properties being transferred were separately assigned values, and no liabilities, receivables, stock and other current assets were transferred, would be considered as a split sale, even though the agreement stated that the undertaking was being transferred on a ‘going concern’ basis.

**FACTS**

*Tongani Tea Co. Ltd* ("Assessee") owned two tea estates and was engaged in the business of growing and manufacturing tea. The assessee sold one of its estates, the Nagrijuli Tea Estate ("Estate") to Russel Tea Ltd. ("Vendee") for a total consideration of INR 180 million.

In the sale agreement, the consideration amount was assigned to specific assets, viz. land, plantations, plant and machinery, furniture, etc. on the basis of a valuation report. The tax computation was made by the Assessee on the basis of the values so assigned to the different assets. The AO treated the transaction to be a slump sale as the sale agreement expressly stated that the Estate was being transferred on a going concern basis. Accordingly, the AO taxed the entire profit arising out of the sale under section 50B of the IT Act.

The CIT(A) held that the sale of the Estate was not a slump sale under section 2(42C) read with section 50B of the IT Act and accordingly, the gains were not assessable as per section 50B of the IT Act. The CIT(A) ruled that the sale agreement reflects the intention of the Assessee to transfer only the fixed assets of the Estate and accordingly, the sale consideration was apportioned between different categories of the fixed assets. There was no transfer of the business’ intangible assets, such as licenses, quotas, brand name, etc. There was no continuity in the business or management of the tea gardens before and after the sale. Accordingly, the CIT(A) held that since there was no transfer of liabilities and certain current assets of the Estate, the sale cannot be termed as a slump sale.

Further, the CIT(A) noted that as per section 50B of the IT Act, the capital gains on sale of an undertaking are to be computed by reducing the net worth of the undertaking from the total sale consideration. Moreover, the net worth was to be computed after considering the amount of liabilities transferred as a part of the undertaking. In the instant case, no liabilities were transferred and, therefore, the computation mechanism as provided under section 50B of the IT Act failed and accordingly, the CIT(A), relying upon the decision of the SC in *B.C. Srinivasa Shetty*, held that there could not be an assessment of income under the head ‘capital gains’.

**ISSUE**

Whether transfer of specified assets constitutes a slump sale, merely because the sale agreement states that the assets are being transferred on a “going concern” basis?

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17. *Section 50B of the IT Act provides for the computation of capital gains in case of a slump sale. The section, inter alia, states that any profits or gains arising from the slump sale affected in the previous year shall be chargeable to capital gains tax. Further, the section also provides the computation method for net worth of an undertaking for the purpose of calculation of capital gains on slump sale.*
18. *Section 2(42C) of the IT Act defines ‘slump sale’ as a transfer of one or more undertakings as a result of sale for a lump sale consideration without values being assigned to the individual assets and liabilities in such sales.*
ARGUMENTS/ANALYSIS

The Assessee argued that the sale agreement was for the sale of only specified assets and not for sale of business undertaking as going concern. The total consideration specified in the agreement was apportioned to the various categories of assets mentioned in the sale agreement.

Further, it was argued that to constitute a slump sale under section 50B of the IT Act, it is necessary to prove that the assets along with the liabilities are being transferred. However, in the present case the liabilities of the Estate were not transferred to the Vendee.

The IRA argued that as per the sale agreement, the Assessee had sold the Estate along with its land & plantation, plant & machinery and other accessories as a going concern. Also, the workers on the pay rolls of the Assessee had been absorbed by the Vendee along with the Estate. Hence, the transaction was in the nature of slump sale and the capital gains on such transfer were taxable under section 50B.

JUDGMENT

The ITAT upheld the decision of the CIT(A) and held that the transfer of the Estate is not taxable as slump sale, as it was a “split sale” where the sale consideration has been apportioned to specified assets. Further, in the absence of transfer of liabilities and certain current assets along with the Estate, the transaction cannot be said to be a slump sale.

The ITAT relied upon the decision of the Cochin ITAT in the case of Harrisons Malayalam Ltd, which had identical facts as the present case. In that case, it was held that expression “going concern” was a functional qualification and such functional qualification is not sufficient to decide the exact legal character of a transaction for the purpose of income tax assessment. The meaning of the expression "going concern" had to be understood in the light of the peculiar nature of the property transferred. In the present case, the undertaking being transferred was a tea plantation which requires continuous and uninterrupted activities to take place. Therefore, the expression “on a going concern basis” referred to the state of affairs of the transaction and did not create any legal proposition under the sale agreement. Hence, it was held that mere mention of the term “going concern” in the sale agreement would not characterize the sale as a slump sale and the nature of the transaction must be examined to verify whether it could be characterized as a slump sale under section 50B of the IT Act.

With respect to the continuity of the existing work force with the Vendee, it was argued that the absorption of the existing workers by the Vendee would indicate that the transaction was a slump sale. The ITAT held this was not an important factor to decide whether the sale was a slump sale or not since by the nature of the business of tea plantations it would be difficult to retrench the workers in the interest of the business.

SIGNIFICANT TAKEAWAYS

The ITAT has rightly held that in cases where values are assigned to specified assets and there has been no transfer of liabilities and certain current assets, it may not constitute transfer of an undertaking and accordingly, would not be characterized as slump sale but would constitute a split sale. Therefore, in similar cases, where specified assets have been transferred along with no transfer of liabilities it may be argued that, for the purpose of section 50B, the computation of the net worth of the undertaking would fail and hence computation of capital gain would fail. Similar views have been espoused by various ITATs.

It would be also important to note that in certain cases, the courts have held that to constitute a slump sale, it is not necessary for all the assets and liabilities of an undertaking to be transferred. It must be noted that this issue is extremely fact sensitive and the principles laid down in this case should be read in that context. Also, it would be important to note that using the term ‘going concern’ in the sale agreement, would not be conclusive to characterize the transaction as a slump sale.

21. Kampli Co-operative Sugar Factory Ltd. v. JCIT (2002) 83 ITD 460 (Bangalore Tribunal); Mahindra Sintered Products Ltd v. DCIT [2004] 279 ITR (AT) 1 (Mumbai ITAT); Accelerated Freeze Drying Co. Ltd., v. DCIT ITA No 611/Coch/08 (Cochin ITAT); DCIT v.ICI (India) Ltd. (2008) 23 SOT 58 (Kolkata ITAT).
The Karnataka HC in *Columbia Sportswear Company*\(^ {23}\) held that Liaison Office ("LO") of a non-resident, engaged in activities relating to purchase of goods in India does not constitute a business connection/ PE of the non-resident in India.

**FACTS**

*Columbia Sportswear* ("Petitioner") was a US company engaged in the business of designing, developing, marketing and distributing outdoor apparel with operations in North America, Europe and Asia.

The Petitioner did not distribute or retail its products in India. The designing of all products was exclusively undertaken from outside India as it was based on customer/user requirement arising from the market place. The Petitioner's centralized sourcing group located outside India was responsible for all key purchase functions including (a) choosing the producing country, (b) vendor selection (c) co-ordination of global production management and planning and (d) global quality assurance and strategy and policy development.

The Petitioner purchased products from third party Indian vendors on principal to principal basis, through it’s LO in Chennai. The LO was engaged only in activities relating to purchase coordination for the Petitioner. As part of its activities, the LO was involved in vendor identification, review of causing data, uploading of material prices into the Internal Product Data Management (PDM) system of the Petitioner, vendor recommendation and quality control. It also monitored vendors for compliance with Petitioner's policies, procedures and standards related to quality, delivery, pricing and labour practices. The LO did not supervise, direct or control the production facilities of the Indian vendors. Further, the LO did not undertake any activity of trading or of commercial or industrial nature. It had no revenue streams and it did not source products to be sold locally in India.

The Petitioner preferred an application before the AAR for a determination of its tax liability in India on account of the LO. The AAR held that the LO constituted a PE of the Petitioner in India as per the India-USA DTAA, and income attributable to such PE would be taxable in India. Aggrieved by the said order, the Petitioner invoked the writ jurisdiction of the Karnataka HC.

**ISSUE:**

1. Whether the LO constituted a PE of the Petitioner as per the India-USA DTAA?

2. Whether any portion of the income of the Petitioner was attributable to the LO on account of its activities and was hence liable to tax in India?

**ARGUMENTS/ANALYSIS**

The Petitioner stated that it undertook sales of its products to wholesale/retail customers wholly outside India and received the sale price also outside India. Accordingly, the LO had no income, which could be said to have been received/ accrued or deemed to have been received/ accrued in India as per section 5 of the IT Act.

\(^ {23}\) *Columbia Sportswear Company v. DIT (International Taxation) (2015) 62 taxmann.com 240 (Karnataka).*
Additionally, the Petitioner also contended that no income could be deemed to accrue or arise to it in India as per section 9(1)(i) of the IT Act since it did not have a business connection in India. The LO did not constitute a business connection since its activities were restricted to purchase of goods for the purpose of exports and such activities of the LO were covered by the specific exclusion given in Explanation 1 (b) to section 9 (1)(i) of the IT Act.24 Thus, the Petitioner was not taxable in India even as per the IT Act.

Regarding its taxability under the India-US DTAA, the Petitioner submitted that the LO only carried out purchase coordination functions, which were specifically excluded from the definition of a PE under the India-US DTAA. As per Article 5(3)(d) of the DTAA, the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise does not constitute a PE of the enterprise.

Alternatively, even if the Petitioner was held to have a PE in India by way of the LO, no profits could be attributed to it by reason of mere purchase by the LO of goods and merchandise for the Petitioner in accordance with Article 7(4) of the India-US DTAA.25

The IRA, on the other hand, argued that the LO was not engaged only in purchasing goods in India. The LO also identified the manufacturers and instructed them about the requirements of an outside purchaser. Thus, even if the Petitioner received income from outside India, it would be deemed to have accrued in India as per section 9(1)(i) of the IT Act. Accordingly, such income would be taxable in India to the extent that it could be attributed to the activities of the LO.

JUDGMENT

The HC referred to its own decision in Nike Inc.,26 wherein the LO of the non-resident assessee was performing similar functions for the assessee in that case. The HC had held in that case that “the activity of the assessee in assisting the Indian manufacturer to manufacture the goods according to their specification is to see that the said goods manufactured have an international market, therefore, it could be exported. In the process, the assessee is not earning any income in India. If at all he is earning income outside India under a contract which is entered outside India, no part of their income could be taxed in India either under Section 5 or Section 9 of the Act.”

The HC referred to another one of its decisions, Mondial Orient Ltd.,27 wherein the HC had held that it was clear from the Explanation 1 (b) to section 9(1)(i) that “if an assessee carries on operations which result in purchase of goods in India for the purpose of export, the income so accrued or arising out of such transactions are exempted from payment of income tax. The whole object of this provision being to encourage export of merchandise from India which enables an Indian manufacturer to earn, and when it is exported, the country would earn foreign export. An incentive is given to a non-resident to carry on business in India.”

In the instant case, the HC noted that it was clear from the Explanation 1 (b) to section 9(1)(i) of the IT Act that when a non-resident purchases goods in India for the purpose of export, no income accrues or arises in India to such non-resident. The HC then discussed in detail the provisions of Article 5 of the India-USA DTAA and noted that as per Article 5(3)(d) of the DTAA, if an office is established for the purpose of purchasing goods or merchandise or for the purpose of collecting information for the enterprise, it does not constitute a PE of the Assessee.

The HC observed that in the instant case, the LO of the Petitioner identified a competent manufacturer, negotiated a competitive price, helped in choosing the material to be used, ensured compliance with the quality of the material, acted as communication channel between the petitioner and the seller or the manufacturer, and even got the material tested to ensure quality in addition to ensuring compliance with its policies and the relevant laws of India by the suppliers.

The HC held that if the Petitioner had to purchase goods for the purpose of export, an obligation is cast on the Petitioner to see that the goods which were purchased in India for export outside India, were acceptable to the customers outside India. Otherwise, such goods purchased in India may not find a customer outside India. Therefore, such activities are necessary to be performed by the Petitioner before export of goods, and would be covered within the meaning of the words “collecting information” for the enterprise. Therefore, the LO would not constitute a PE of the Petitioner as per Article 5(3)(d) of the India-USA DTAA. Consequently, Petitioner would not be liable to tax in India. The HC allowed the writ petition and quashed the order of the AAR.

24. Explanation 1(b) to section 9(1)(i) of the IT Act reads as follows: No income shall be deemed to accrue or arise in India to an assessee, through or from operations which are confined to the purchase of goods in India for the purpose of export.
25. Article 7(4) of the India-US DTAA reads as follows: No profits shall be attributed to a PE by reason of the mere purchase by that PE of goods or merchandise for the enterprise.
SIGNIFICANT TAKEAWAYS

It is important to note that while the Courts have consistently held that in case the business activities of a non-resident remains restricted to purchase of goods from India for the purposes of exports, it will not result in the establishment of a taxable presence in India and it will not be liable to pay any tax in India, the tax authorities have initiated actions against a large number of LOs on the ground that even though they were set up as LOs, their actual activities on the ground were significantly more than what a LO was permitted to do.

Thus, whether a foreign company operating in India through a LO is actually involved in undertaking activities beyond the scope of activities that can be undertaken by a LO is a matter of fact that will have to be ascertained on a case by case basis. This decision of the Karnataka HC is in line with the previous decisions28 and reiterates the Court’s previous decision in *Nike Inc.* (supra)29, wherein it had held that ‘purchase of goods for export’ as an exception for constituting a PE/business connection.

It would be pertinent to note that Courts would disregard the nomenclature of LO if it is actually found to be engaged in trading or sales activities. In the case of *Jebon Corporation India* (supra), on a survey of the premises of the LO, it was found to be undertaking activities in the nature of negotiations with customers, securing orders from them, determining the sale price as well as the sales margin, and setting its annual sales target. After discussing these activities in detail, the Court held that merely because the buyers directly placed orders with and made payments to the head office, it could not be held that the LO was undertaking only liaison activities because the LO was engaged in all marketing and negotiation activities with Indian buyers on a regular basis. Accordingly, the LO was held to constitute a business connection/PE of the non-resident.

Contrary to this, in the instant case and in the cases of *Nike Inc* (supra) and *Tesco International Sourcing Ltd.* (supra), the LO merely undertook activities relating to procurement of goods for the non-resident and did not engage in any interaction with the customers or determine the sale prices of the products.

Thus, as discussed previously, a foreign company must keep close watch of its activities in India. In case the actual activities proposed to be undertaken by the LO go beyond the permissible scope of activities of a LO, then the foreign company may set up either a branch office or a project office or even a separate Indian entity (either as a wholly owned subsidiary or a joint venture entity) instead of an LO.

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28. CIT v. NK Jain 919940 206 ITR 692 (Del); Angel Garments 920060 287 ITR 341 (AAR); Ikea Trading (HongKong) Ltd 92009) 308 ITR 422 (AAR); ADIT v. M Fabrikant & Sons 2011-TII-46-IAT-Mum-Intn.
APPLICABILITY OF ‘LIMITATION OF RELIEF’ CLAUSE IN INDIA-SINGAPORE DTAA

The Rajkot ITAT in Alabra Shipping Pte. Ltd. held that shipping income, which was taxable in Singapore on accrual basis does not attract the provisions of Article 24 of the India-Singapore DTAA and, therefore, would be exempt from taxation in India, even if the amount is not received in Singapore.

FACTS

Alabra Shipping Pte. Ltd. of Singapore ("Assessee"), being the owner and freight beneficiary of MT Alabra, filed a return for AY 2012-13 under section 172(3) of the IT Act (through GAC Shipping India Pvt. Ltd) in respect of MT Alabra.

During assessment proceedings, the AO noticed that while the Assessee had claimed the benefit of India-Singapore DTAA, funds were remitted to the Assessee’s bank account in London. The AO declined the benefits of the DTAA to the Assessee on the ground that the Assessee did not meet the requirements set out in Article 2431 of the India-Singapore DTAA. Aggrieved by the order, Assessee preferred an appeal before the CIT(A), who confirmed the order of the AO. The Assessee subsequently filed an appeal with the Rajkot ITAT.

ISSUE

Whether in view of the ‘limitation of relief’ ("LOR") provisions in the India-Singapore DTAA, the Assessee can be declined the benefits of the DTAA?

ARGUMENTS/ANALYSIS

The Assessee contended that the provisions of Article 8 of India-Singapore DTAA32 would apply to its case and freight income accruing to it would not be taxable in India.

On the issue of IRA’s contention on whether LOR provisions would apply, the Assessee contended that Article 24 would not be applicable since it was a resident of Singapore and its entire freight income was taxable in Singapore. The Assessee relied on a certificate from the Singapore Inland Revenue Service ("IRAS") which stated that in the case of the Assessee, "freight income has been regarded as Singapore sourced income and brought to tax on an accrual basis (and not remittance basis) in the year of assessment". The Assessee also filed a confirmation from its public accountant that the freight amount earned on MT Alabra sailing from Sikka port had been included in the global income and offered to tax by the Assessee in Singapore.

The IRA, on the other hand, relied on the case of Abacus International Ltd.33 and contended that as per Article 24 of India-Singapore DTAA, remittance of money to Singapore was mandatory, in order to avail the benefits of Article 8. Since in the instant case the remittance was not made to a bank account in Singapore but to a beneficiary bank account in

31. Article 24(1) of the India-Singapore DTAA reads as follows: “Where this Agreement provides (with or without other conditions) that income from sources in a Contracting State shall be exempt from tax, or taxed at a reduced rate in that Contracting State and under the laws in force in the other Contracting State the said income is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the exemption or reduction of tax to be allowed under this Agreement in the first-mentioned Contracting State shall apply to so much of the income as is remitted to or received in that other Contracting State.”
32. Article 8(1) of the India-Singapore DTAA reads as follows: “Profits derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.”
London, the Assessee’s freight income, in its entirety, would be taxable in India.

JUDGMENT

The ITAT noted that shipping income earned by a non-resident would not be taxable in India as per Article 8 of the India-Singapore DTAA. The only bar to availing of the benefit of the India-Singapore DTAA was the provision of LOR set out in Article 24 of the DTAA.

The ITAT held that three conditions must be fulfilled for Article 24 to be applicable:

(i) income sourced in a contracting state is exempt from tax in the source state or is subject to tax at a reduced rate in the source state, and

(ii) the income earned in the source state is subject to tax by reference to the amount remitted to, or received in, the other contracting state, rather than with reference to full amount of such income and

(iii) treaty protection will be limited to the amount which is taxed in the source state

The ITAT observed that the effect of the LOR clause is that the benefit of treaty protection is restricted to the amount of income which is eventually the subject matter of taxation in the source country. Any other approach could result in double non-taxation of the income.

Further, the ITAT noted that the Assessee was a tax resident of Singapore and was carrying on its business in Singapore. Referring to the certificates issued by the IRAS and the public accountant, the ITAT held that it was reasonably demonstrated that the entire income was taxable in Singapore, on accrual basis. There was nothing to suggest that the income was taxable in Singapore only on receipt basis. Thus, a necessary condition for the application of Article 24 was not fulfilled. Accordingly, the Assessee could not be denied the benefits under the India-Singapore DTAA.

Regarding the reliance by the IRA on the decision of Abacus International Ltd. (supra), the ITAT distinguished that case from the instant case on the ground that firstly, it was a case rendered in context of interest income and secondly, the taxability of the income on accrual basis in Singapore had not been established. In the instant case, the Assessee had proved that the full income in question was taxable in Singapore on accrual basis and not receipt basis.

The ITAT further held that if Article 24 was claimed to be not applicable, the onus was on the Assessee to show that the amount is remitted to, or received in Singapore, but then such an onus is confined to the cases in which income in question was taxable in Singapore on limited receipt basis rather than on comprehensive accrual basis. However, in a case where it could be demonstrated that the income in question was taxable in Singapore on accrual basis and not on remittance basis, there was no such onus on the Assessee.

Thus, the ITAT held that the Assessee would be entitled to the benefits of the India-Singapore DTAA and accordingly, its freight income would not be taxable in India.

SIGNIFICANT TAKEAWAYS

This decision clarifies the scope and applicability of the LOR conditions of Article 24 of the India-Singapore DTAA. It highlighted the fact that Article 24 applied only to such income which was taxable in Singapore on a receipt basis, rather than on accrual basis. Thus, any income which was taxable in Singapore on an accrual basis need not be remitted to Singapore, in order to avail DTAA benefit/exemption in India.

However, if it cannot be established that the income in question is taxable in Singapore on accrual basis, the tax authorities could allege that such income is taxable in Singapore on receipt basis and under such circumstances, in order to avail the benefits under the DTAA, the Assessee would have to substantiate that remittance was made to Singapore by way of bank statements or similar documents.

It must be noted that the LOR provided for under the India-Singapore DTAA may have been introduced because of the quasi-territorial tax system in Singapore. The territorial nature of the tax system made it necessary to require that the income be remitted, in order for it to be subject to Singapore tax. Unless and until the income is remitted, Singapore is unable to collect its tax under its domestic law. Accordingly, since in the instant case IRAS itself certified that Assessee’s income was subject to tax on accrual, the IRA should have accepted the Assessee’s claim. Nevertheless, it is significant that the ITAT has accepted the proof provided by foreign tax authorities on the ‘subject to tax’ condition, to give relief to the Assessee. It must be noted that in Set Satellite (Singapore) Pte Ltd34 also, the Mumbai ITAT had accepted documents provided by the taxpayer as proof that the amount paid was subject to tax in Singapore under its domestic laws and accordingly Article 24 could not be invoked to deny DTAA benefits.

Reliance on the Abacus International Ltd. (supra) decision by the IRA in the instant case was perhaps incorrect since there is no discussion in that case as to whether the interest income earned by the taxpayer was subject to tax in Singapore.

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ALLOWABILITY OF BENEFIT UNDER SECTION 79 IN CASE OF CHANGE OF SHAREHOLDING

The Karnataka HC in *AMCO Power Systems Ltd.*[^35] held that change in voting power and not in shareholding, is relevant for application of section 79 of the IT Act.

**FACTS**

AMCO Power Systems Limited ("Assessee") was a company engaged in the manufacture and sale of storage batteries. Assessee was a WOS of AMCC Batteries Ltd ("ABL"), up to AY 2000-01. In AY 2001-02, ABL’s the in Assessee company was reduced to 55% and the remaining 45% stake was transferred to another subsidiary of ABL viz., AMCO Properties and Investments Limited ("APIL"). In AY 2002-03, ABL further transferred 49% of the remaining 55% stake to another company Tractors and Farm Equipments Limited ("TAFE"). Accordingly, ABL was left with only 6% stake in ABL. Similar shareholding continued for the AY 2003-04.

The Assessee filed its return of income claiming set-off of losses from the previous years. The AO disallowed the set off of previous years’ losses on the ground that there was a change in the beneficial shareholding in the Assessee. On appeal, the CIT(A) upheld the order of the AO.

Aggrieved by the order of the CIT(A), the Assessee preferred an appeal to the Bangalore ITAT. The Assessee challenged the disallowance of the benefit claimed under section 79. In its order, the ITAT allowed the appeal of the Assessee and allowed the benefit of set-off of brought forward losses. Aggrieved by the ITAT’s decision, the IRA preferred an appeal to the HC.

**ISSUE**

Whether the Assessee was entitled to carry forward and set-off of business loss under section 79 of the IT Act?

**ARGUMENTS / ANALYSIS**

The Assessee contended before the HC that what needs to be considered is not the shareholding, but the voting power which was held by a person(s) who beneficially held shares in the company. Since ABL held 100% shares and fully controlled APIL, even if the shareholding of ABL had been reduced to 6%, the voting power of ABL remained at 51% and thus, the provisions of section 79(a) of the IT Act could not be attracted.

The IRA, on the other hand, contended that since ABL transferred 49% shares of the Assessee to TAFE, and was left with only 6% shares, ABL was left with less than 51% shares of the Assessee for AY 2002-03. Consequently, ABL’s voting power in Assessee was also reduced from 55% to 6%. Thus, the Assessee was not entitled to claim carry forward and set-off of business losses for the AYs 2002-03 and 2003-04. Even though APIL was a WOS of ABL, both the companies were separate entities and could not be clubbed together.

**JUDGMENT**

Upholding the contention of the Assessee, the HC noted that the shareholding pattern is distinct from voting power of a company. It held that since ABL has

complete control over APIL, even though the shareholding of ABL was reduced to 6% in the year in question, by virtue of being the holding company, owning 100% shares of APIL, the voting power of ABL could not be said to have been reduced to less than 51%. Both the companies had the voting power of 51%.

The HC also observed that the purpose of Section 79 of the IT Act was that the benefit of carry forward and set-off of business losses for previous years of a company should not be misused by any new owner, who may purchase the shares of the company, only to get the benefit of set-off of business losses of the previous years.

The HC referred to the decision in Italindia Cotton Pvt. Ltd.36, wherein the SC had held that every change of shareholding would not trigger section 79, and the said section would be applicable only when there is such change in shareholding in the previous year in which there is a change of control in the company. Since in the instant case, the control over the Assessee, with 51% voting power remained with ABL, the HC ruled in favour of the Assessee and allowed the claim for set off and carry forward of losses in the years concerned.

**SIGNIFICANT TAKEAWAYS**

In the instant case, the HC has given a purposive interpretation to section 79 of the IT Act and resorted to the assumption that the board of a subsidiary company is considered to be effectively controlled by its parent shareholder. This will have a positive impact on companies which have undergone or are proposing to undergo an internal group reorganization involving a substantial change in shareholding.

This judgment is also in line with a decision of the Delhi ITAT in the case of Select Holiday Resorts Pvt. Ltd.37, wherein the ITAT had held that where a parent company merged with its subsidiary, the benefit of carry forward and set off of losses could not be disallowed on the ground that there was a change in the shareholding of more than 51% of the share capital of the subsidiary company, since there was no change in control and management of the amalgamated company pre and post merger.

However, it must be noted that this issue has been debatable and there have been contrary rulings on this point. In the decision of Just Lifestyle Pvt. Ltd.38, wherein a similar situation was involved, the Mumbai ITAT held that a company is a distinct legal entity and denied the benefit of carry forward and set off of business losses. This was on the ground that even if shares of up to 51% voting power remained within the same group, if there was a change in ownership of shares, section 79 would be attracted. The same conclusion was drawn in the case of Tainwala Trading and Investments Co. Ltd.39, wherein the Mumbai ITAT observed that “A person is said to be a beneficial owner of shares when they are held by someone else on his behalf, meaning thereby that the registered owner is different from the actual or the beneficial owner. Where the shares are not so held by one for and on behalf of another, the concept of beneficial ownership cannot be invoked.” Both these decisions of the Mumbai ITAT which hold the completely opposite view of the issue have not been referred to or discussed in the instant case.

It must be noted that Section 79 refers to “voting power being beneficially held by persons...” The term ‘beneficially held’ has not been defined under the IT Act. International commentaries40 have defined the term ‘beneficial owner’ as follows:

“*The beneficial owner is he who is free to decide (1) Whether or not the capital or other assets should be used or made available for use by others, or (2) how the yields*
The ‘beneficial owner’ of dividends is the person who receives the dividends for his or her own use and enjoyment, and assumes the risk and control of the dividend he or she receives.

The Bangalore ITAT in the Assessee’s own case of Amco Power Systems Limited had held, relying on the decisions of the SC in Raghuvanshi Mills Ltd and Jubilee Mills Ltd, that the word ‘beneficially’ indicated that the voting power arising from the holding of shares should be free and not within the control of some other shareholder/person.

Interestingly, the Delhi HC has taken a contrary view in a very recent case of Yum Restaurants (India) Pvt. Ltd. wherein the Delhi HC declined to allow the taxpayer carry forward and set off of unabsorbed losses on change of immediate shareholding by over 49%, despite the change being within the same group, wherein the ultimate holding company of both the transferor and transferee entity was the same. The decision of the Delhi HC does not seem to have been brought to the notice of the Karnataka HC in the instant case. Thus, this issue is far from settled.

In view of the above uncertainty, it might be helpful for taxpayers if the Government comes up with a clarification or a definition is introduced into the IT Act defining what constitutes ‘beneficial holding’ as there divergent views on this aspect, depending on facts and circumstances of the case.

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42. Amco Power Systems Limited v. ITO 23 DTR 361 (Bangalore ITAT).
43. Raghuvanshi Mills Ltd v. CIT (1961) SCR (2) 978 (SC).
The AAR in *Guangzhou Usha International Ltd.*⁴⁶ held that the fee received by a Chinese company from its Indian subsidiary for certain procurement related services rendered by it will constitute FTS as per the India-China DTAA and the same shall be taxable in India on the gross amount.

**FACTS**

Guangzhou Usha International Limited (‘*Applicant*’), a Chinese company, being a WOS of an Indian company, Usha International Limited (‘*UIL*’) had been set up to carry on the business of import and export and also to provide certain services to UIL in connection with procurement of goods by UIL from vendors in China. As per the service agreement between the two companies, the services being rendered by the Applicant to UIL included the following:

1. identifying products/ manufacturers requested by UIL and evaluating the credit, organization, finance, production facility etc of the identified manufacturer;
2. generating new products/new ideas for UIL and market research for different products;
3. market research on product for customer preference/new technology to improve efficiency of products;
4. coordinating with UIL for resolution of pricing issues and questions raised by the vendors;
5. testing of new products for introduction to the market/customers;
6. monitoring of vendors and ensuring the product meets the requisite specifications; and
7. interaction with vendors on customer feedback received from UIL for product improvement.

The service fee to be paid to Applicant was the sum of the total expenses incurred by the Applicant in rendering of the services, and a mark up of 10% on the same. The Applicant approached the AAR for a determination of its tax liability in India.

**ISSUES**

1. Whether the amount of service fee received/receivable by the Applicant from UIL was taxable in India?
2. If the service fee was held to be taxable in India, whether it was chargeable to the extent of full amount received by the Applicant or only to the extent of mark up received?
3. What would be the nature of such service fee for the purpose of taxability and at what rate of income tax would the same be chargeable?

ARGUMENTS/ANALYSIS

The Applicant contended that it was carrying on its business operations in China and its activities were being fully carried on in China only. By virtue of this, its income was neither accruing/arising in India nor could it be deemed to have accrued/arisen in India and, therefore, was not taxable in India as per section 5 of the IT Act.

Further, the Applicant contended that the service fee was not covered under the definition of FTS in Article 12(4) of the India-China DTAA because of two reasons. Firstly, the Applicant was not rendering managerial, technical or consultancy services. The services being rendered were in connection with procurement of goods as per instructions and requirements of UIL and thus, were commercial in nature. Secondly, the services were not being rendered in India. The Applicant relied, inter alia, on the decisions in Carborundum Co. and Ishikawajima Harima Heavy Industries Ltd, wherein it was observed that the services should not only be utilized in India but the same should be rendered in India to be covered under the provisions of section 9(1) of the IT Act.

The Applicant also relied upon HMS Real Estate Pvt. Ltd., to contend that even if its income was held to be taxable in India, the service fee, to the extent of representing reimbursement of cost, could not be deemed to be its income. Only the amount which was being charged by it as mark-up over and above the cost (i.e. 10%) was in the nature of income chargeable to tax in India.

The IRA, on the other hand, argued that the Applicant was providing consultancy services to UIL as it was, inter alia, required to ‘identify’, ‘evaluate’, ‘review’, ‘monitor’, ‘inspect’ and ‘test’ new products and new ideas for UIL. Further, the Applicant was also providing managerial services to UIL in its procurement work, by carrying out ‘interaction with vendors’, ‘monitoring of the vendors,’ etc. Furthermore, by carrying out ‘test’ and ‘inspection’ activities for UIL, the Applicant was also rendering technical services to UIL. The IRA placed reliance on the decision in GVK Industries, wherein it was held that where a non-resident person provided services using its skill, acumen and knowledge in the specialized field, it was acting like a consultant and the services so rendered would fall under the purview of ‘technical services’ for the purposes of section 9(1)(vii) of the IT Act.

With regard to the interpretation of the phrase ‘provision of services’ in the definition of FTS in the India-China DTAA, the IRA contended that reference had to be made to the laws governing service tax in India, according to which, generally the place of provision of a service shall be the location of the recipient of service. Since the services performed by the Applicant were received by UIL located in India, the services were provided in India. Thus, service fee received by the Applicant would be covered by the definition of FTS within the meaning of section 9(1)(vii) of IT Act and Article 12 of the India-China DTAA.

Further, as regards the amount to be taxed, the IRA contended that under the IT Act, any sum received for rendering ‘technical services’ was to be taxed at the appropriate rate on the gross amount, without giving any deduction for the expenses incurred in earning the same.

Under the DTAA also, FTS was to be taxed @ 10% on the ‘gross amount’ without giving any deduction for the expenses incurred.

As regards the reliance by the Applicant on the case of Carborundum Co. (supra), the IRA submitted that the case was not applicable in the instant case, since Carborundum Co (supra) related to the determination of a business connection of the non-resident in India and also it was in the context of Income Tax Act 1922, which did not have any provision for the taxation of services like FTS. Further, other cases cited by the Applicant had been superseded by a legislative amendment to section 9(1)(vii), which clarified that FTS would be deemed to accrue or arise in India regardless of the place where the services were rendered.

The IRA relied on the decision in Ashapura Minichem Limited, wherein an Indian company had to pay some amounts to a Chinese company in consideration of bauxite testing services undertaken by the latter in its laboratories in China, and for the preparation of test reports. The Mumbai ITAT in that case held that the expression ‘provision of services’ in Article 12(4) of the India-China DTAA was much wider in scope and would cover even those services that were not rendered in the other contracting state, as long as those services were used in the other contracting state. The Mumbai ITAT further held that this position was clarified by Article 12(6) of the Treaty, the deeming provision of which specifically included such services.

47. Article 12(4) of the India-China DTAA reads as follows: “The term ‘fees for technical service’ as used in this Article means any payment for the provision of services of managerial, technical or consultancy nature by a resident of a Contracting State in the other Contracting State, but does not include payment for activities mentioned in paragraph 2(k) of Article 5 and Article 15 of the Agreement.”
49. Ishikawajima Harima Heavy Industries Ltd. v DIT (2007) 208 ITR 408 (SC).
50. CIT v. Toshuku Ltd. (1980) 125 ITR 525 SC.
53. As per the provisions of section 115A (1)(b)(B) read with section 44D of the IT Act.
54. Ashapura Minichem Limited v. ADIT, ITA No. 2508/Mum/08.
55. Article 12(6) of the India-China DTAA reads as follows: “Royalties or fees for technical services shall be deemed to accrue in a Contracting State when the payer is the government of that Contracting State, a political subdivision, a local authority thereof or a resident of that Contracting State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for technical services was incurred, and such royalties or fees for technical services are borne by such permanent establishment or fixed base, then such royalties or fees for technical services shall be deemed to accrue in the Contracting State in which the permanent establishment or fixed base is situated.”
As regards the Applicant’s reliance on the case of Toshuku (supra), the IRA contended that it was not applicable in the instant case since it dealt with a different situation of an export agent operating on behalf of Indian exporters outside India. Further, the IRA contended that the decision in HMS Real Estate Pvt. Ltd. (supra) was also not applicable since in that case, payment that was not subjected to tax in India was in relation to the services rendered by a US based consultant to a US based company providing services in India. In the instant case, the Applicant was receiving payment for providing services to an Indian company.

In its rejoinder, the Applicant stated the IRA’s reliance on a service tax notification was not relevant in the instant case. Further, the decision in Ashapura Minechem (supra) could not be relied upon since in that case the ITAT had wrongly interpreted Article 12(4) and 12(6) of the India-China DTAA. The Applicant argued that Article 12(6) was a deeming provision and would have its applicability only if the payment was covered in the definition of FTS as given in Article 12(4).

JUDGMENT

The AAR discussed the provisions of Article 12 of the India-China DTAA and compared it with the articles in the Pakistan-China DTAA. The AAR held that in the former, the expression used is ‘provision of services of managerial, technical or consultancy nature’ and in the latter case it is ‘provision of rendering of any managerial, technical or consultancy services’. The AAR referred to its ruling in the case of Inspectorate (Shanghai) Limited wherein, it had held that as per Article 12(6) of the India-China DTAA, FTS would be deemed to have accrued in the tax jurisdiction in which person making the payment was located, irrespective of the situs of the technical services having been rendered. Further, reference was made to Ashapura Minechem (supra) to affirm that the scope of the expression ‘provision for services’ was much wider than that of the expression ‘provision for rendering of services’.

Regarding the Applicant’s reliance on the decisions in Carborundom Co. (supra) and Ishikawajima Harima Heavy Industries Ltd. (supra), the AAR upheld the contentions of the IRA and held that those cases were not applicable to the instant case since they did not deal with the provisions of the India-China DTAA.

Regarding the issue of whether the payments for services rendered by the Applicant to UIL were in the nature of FTS, the AAR observed that the Applicant was not only identifying the products, but also generating new ideas for UIL after conducting market research. It was also evaluating the credit, organization, finance, production facility etc., and based on this evaluation it was giving advice in the form of a report to UIL. These services were definitely in the nature of consultancy services. The AAR referred to the decision of the SC in GVK Industries (supra) and the decision of the Delhi HC in Bharti Cellular Limited wherein it was noted that a consultant is “a person who gives professional advice or services in a specialized field.” The AAR observed that the Applicant utilized its skill and acumen to give expert advice to UIL and thus, the services being rendered by the Applicant to UIL were in the nature of ‘consultancy services’. Accordingly, the payments for services rendered by the Applicant were in the nature of FTS.

With respect to amount which should be brought to tax, the AAR referred to its rulings in the cases of Danfoss Industries Private Limited and Timken India Limited wherein it was held that the scheme of tax withholding applied not only to amounts which would wholly bear income character such as salaries, dividends etc., but also to gross sums, the whole of which might not be income or profit of the recipient. Relying on these rulings, the AAR held that the full amount of service fee received by the Applicant would be chargeable to tax in India.

SIGNIFICANT TAKEAWAYS

This is a good ruling on the interpretation of Article 12 of the India-China DTAA. It throws light on a number of important aspects, such as the meaning of FTS, scope of ‘provision of services’ and impact of Article 12(6) of the India-China DTAA. It clarifies that Article 12 of the India-China DTAA also includes within its ambit such services that were used in one contracting state even though they were rendered elsewhere.

It should be noted that after the decision in Ishikawajima Harima Heavy Industries Ltd (supra), an amendment in the IT Act was carried out to clarify that the situs of rendering of services is not relevant in the case of payments in the nature of interest, royalty or FTS. Thus, the interpretation of the DTAA provisions in this decision is in line with the provisions of the IT Act.

56. Inspectorate (Shanghai) Limited AAR No. 1005 of 2010.
CLAIM OF CREDIT FOR TAXES PAID IN FOREIGN JURISDICTIONS WHILE ENJOYING TAX HOLIDAY IN INDIA

The Karnataka HC in Wipro Ltd. held that a company was eligible to claim Foreign Tax Credit (“FTC”) as well as a deduction under section 10A of the IT Act.

FACTS

Wipro Limited (“Assessee”) was an Indian company engaged in the business of export of computer software including services for on site development of software through its PE in many countries such as the USA, UK, Canada, Japan and Germany. The Assessee claimed a deduction in relation to its Software Technology Park undertakings under Section 10A of the IT Act. It paid taxes applicable on profits attributable to the PEs in each of the foreign jurisdictions. Further, it also received consideration from some foreign clients, net of taxes withheld by them. In respect of these foreign taxes paid and withheld, the Assessee claimed a tax credit in India.

During the relevant AYs, the Assessee claimed 100% deduction of profits from its export business under section 10A of the IT Act. The Assessee failed to claim the FTC paid on such export income for certain years under consideration while filing the return of income. Thus, at the time of assessment, a letter was filed by the Assessee requesting the AO to allow the FTC.

The AO refused the Assessee’s claim for FTC on the ground that credit could only be claimed for taxes actually “paid” in both the countries. On appeal, the CIT(A) held in favour of the Assessee. On further appeal, the ITAT ruled that no FTC could be claimed in respect of income that was exempt from tax in India. Aggrieved by ITAT’s order, the Assessee approached the HC. The Assessee also made a claim for tax relief against the state taxes paid in USA and Canada. However, such relief was not allowed.

ISSUE

Whether FTC in relation to income eligible for deduction under section 10A of the IT Act would be available under section 90 of the IT Act read with the relevant DTAA?

ARGUMENTS/ANALYSIS

The Assessee argued that though the export income was claimed as a deduction under section 10A of the IT Act, it was otherwise ‘chargeable to tax’ under the charging section of the IT Act and hence, statutory relief under section 90(1)(a) of the IT Act ought to be given. Such deduction, therefore, did not mean that the income was not chargeable to tax in India. It was also submitted that the benefit of FTC should be available under the second limb of section 90(1)(a) of the IT Act, even though it was introduced vide Finance Act, 2003 (w.e.f. April 1, 2004), since

“Benefit of tax holiday as well as foreign tax credit can be claimed simultaneously subject to the relevant DTAA”

60. Wipro Ltd. v. DCIT (2015) 62 taxmann.com 26 (Karnataka HC).
61. Section 90(1)(a)(i) of the IT Act provides that the Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India for granting of relief in respect of income on which taxes have been paid both income tax under this Act and income tax in that country or specified territory, as the case may be.
62. Relying on the judgment in the Assessee’s case itself for AY 1990-1991 and 2000-2001 where FTC was allowed.
63. The Central Government may enter into an agreement with the Government of any other country outside India or specified territory outside India,

(a) For granting of relief in respect of –
   (i) income on which have been paid both income tax under this Act and income tax in that country or specified territory, as the case may be, or
   (ii) income tax chargeable under this Act and under the corresponding law in force in that country or specified territory, as the case may be, to promote mutual economic relations, trade and investment.
the amendment was clarificatory in nature and hence, should apply retrospectively.

The Assessee also contended that credit for state taxes paid in USA and Canada should be allowed under the unilateral tax credit provision in India since it allowed credit for income tax paid in any country which includes state taxes.

Furthermore, it was submitted that the FTC could not be denied merely on the ground that the same was not claimed in the return of income or by filing a revised return of income.

The IRA argued that the Assessee was not entitled to the FTC because the Assessee was not liable to pay any taxes in India in respect of income which was covered under section 10A of the IT Act. It was submitted that the idea behind FTC was that the same income should not suffer taxation twice. When an income suffered taxation in both source and resident jurisdiction, tax paid in first jurisdiction was to be allowed as a tax credit in other jurisdiction. Consequently, if a source income was taxed only in one jurisdiction, no tax credit or relief was required for another jurisdiction. Further, it was argued that the Assessee was not entitled to the benefit under section 90(1)(a)(ii) since it came into effect from April 1, 2004 and was neither retrospective nor clarificatory in nature.

JUDGMENT

The Karnataka HC held that the Assessee was entitled to FTC in respect of income which was claimed as a deduction under section 10A of the IT Act. The Court discussed and analysed the provisions of the IT Act at length.

Firstly, it ruled that although the benefit under section 90(1)(a)(ii) came into effect from April 1, 2004, the terms of the DTAA were more beneficial than the provision of the IT Act and that the amendment was only giving effect to the terms of the agreement of 1990. Thus, the Assessee was entitled to this benefit even prior to the amendment by virtue of the DTAA.

Secondly, the Court held that the AO was not justified in rejecting the FTC claim on the ground that no revised return was filed while considering the CBDT Circular.

Thirdly, it held that the case of the Assessee falls under section 90(1)(a)(ii) of the IT Act since income under section 10A is chargeable to tax under section 4 of the IT Act and is includible in the total income under section 5 of the IT Act, but no tax was charged because of the exemption given under section 10A only for a period of 10 years. It was also remarked that merely because the exemption was granted in respect of taxability of the said source of income, it cannot be postulated that the Assessee was not liable to tax. The said exemption had the effect of suspending the collection of tax for a period of 10 years.

Fourthly, the Court held that the FTC provision under the India-US DTAA was in conformity with the second limb of section 90(1)(a)(ii) of the IT Act. In other words, where the Indian resident paid no tax on income derived in India, whereas the said income was taxed in the USA, India would allow, as a deduction from the tax on the income of that resident, an amount equal to the income tax paid in the USA. Therefore, payment of tax in India was not a pre-requisite for provisions of both India-US DTAA and under the IT Act. However, the Assessee was entitled to FTC only in respect of that income which was taxed in the USA.

Fifthly, it was held that proportionate credit of Canadian taxes paid in respect of residuary income subjected to tax in India shall be available as FTC against the Indian tax liability since the FTC article in the India-Canada DTAA is in alignment with Section 90(1)(a)(i) of the IT Act. Hence, if income tax paid in India was less than the income tax paid in Canada, then the Assessee would be entitled to relief only to the extent of tax payable in Canada. Further, in a case where the Assessee was exempt from payment of tax in India, the benefits of FTC would not be available under the India-Canada DTAA as there was no payment of tax in India. In the instant case, since the whole of the profits were not exempt

64. Section 91 of the IT Act provides that if any person who is resident in India in any previous year proves that, in respect of his income which accrued or arose during that previous year outside India (and which is not deemed to accrue or arise in India), he has paid in any country with which there is no agreement under section 90 of the IT Act for the relief or avoidance of double taxation, income-tax, by deduction or otherwise, under the law in force in that country, he shall be entitled to the deduction from the Indian income-tax payable by him of a sum calculated on such doubly taxed income at the Indian rate of tax or the rate of tax of the said country, whichever is the lower, or at the Indian rate of tax if both the rates are equal.

65. Explanation (iv) of section 91 of the IT Act: “Income-tax” includes any excess profits tax or business profits tax charged on the profits by the Government of any part of that country or a local authority in that country.

66. Section 2(45), 4, 5, 10A, 90, 91 of the IT Act.

67. Clause 2(a) of Article 25 of the Indo-US DTAA: Where a resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in the United States, India shall allow as a deduction from the tax on income of that resident an amount equal to the income tax paid in the United States, whether directly or by deduction. Such deduction shall not, however, exceed that part of the income tax which is attributable to the income which may be taxed in the United States.

68. Section 139(5) of the IT Act.

69. CBDT Circular No.14 (XL-35) dated September 11, 1966: It states that it is the duty of the AO to make available to the assessee any legitimate and legal tax relief to which the assessee is entitled but has omitted to claim for one reason or another.

70. This provision becomes necessary because the tax year in India varies from the tax year in USA. Therefore, income derived by an Indian resident, which falls within the total income of a particular tax year when it is taxed in the US, falls within two tax years in India. Therefore, while claiming FTC in India, the Assessee would be entitled to only that tax paid for that relevant tax year in USA i.e. the income attributable to that year in USA.

71. Section 90(1)(a)(ii) of the IT Act: The Central Government may enter into an agreement with the Government of any other country outside India or specified territory outside India, (a) For granting of relief in respect of –

(i) Income on which have been paid both income tax under this Act and income tax in that country or specified territory, as the case may be.
from tax, the residuary surplus that was subjected to tax would qualify for FTC.

Sixthly, it held that the state taxes paid in foreign countries shall be eligible for FTC in India under the unilateral tax credit provisions\(^\text{72}\) in India.

**SIGNIFICANT TAKEAWAYS**

This ruling of the Karnataka HC is a significant verdict dealing with FTC to Indian companies in tax holiday situations. It is likely to have a huge impact on Indian companies that have overseas operations. It lays down the law pertaining to the claim of FTC under the IT Act and the relevant DTAAAs. The HC lays down a momentous principle by ruling that though the eligible income is claimed as a deduction under section 10A of the IT Act, it is still an income which is ‘chargeable to tax’. It has also been held that merely because the Assessee’s income is exempt from tax due to a limited tax holiday provided under the IT Act, it does not mean the FTC can be denied on that basis.

This decision cannot be read on a standalone basis and needs to be read with terms of the relevant DTAAAs since several DTAAAs restrict the benefits and hence, this rule pertaining to the availability of FTC cannot be construed to be absolute. While in the India-US DTAA, there is no requirement to actually pay taxes in India, the India-Canada DTAA specifically requires that taxes must be paid in India.

Yet another aspect of essence which has been considered and decided by the Court, pertains to availability of FTC of state taxes paid in foreign jurisdictions. The Court has provided much needed clarity on this aspect. In cases where taxpayers have paid substantial amounts of state taxes, this ruling would be welcomed by them.

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\(^\text{72}\) Section 91 of the of the IT Act.
TAXABILITY OF INTEREST EARNED ON SHORT TERM DEPOSITS OF SHARE APPLICATION MONEY

The SC in the case of M/s Henkel Spic India Ltd.\textsuperscript{73} held that interest earned on share application money deposited in the bank is taxable in the year of allotment of shares.

FACTS

Henkel Spic India Ltd. ("Respondent"), a public limited company, came out with a public issue of shares on January 29, 1992, which closed on February 3, 1992. Share application money received by the Respondent was deposited in a bank account for 46 days, on which an interest income of INR 1,83,31,363 had accrued. The shares were allotted in June 1992. Those subscribers who were not allotted shares, were refunded their application money along with interest. The Respondent offered the interest income to tax and reported the same in the income tax returns in AY 1993-94. However, the AO wanted to tax the income in AY 1992-93.

ISSUE

Whether interest income on deposit of share application money in the bank account accrued in AY 1992-93?

ARGUMENTS

The AO proposed to tax the aforesaid interest income in the AY 1992-93 itself on accrual basis since the share application money was received by the Respondent between January 29, 1992 and February 3, 1992 and the interest income was earned in relation to such share application money.

The Respondent argued that since the shares were allotted in June 1992 i.e. during FY 1992-1993 (AY 1993-94), the interest accrued only on the allotment of the shares as prior to that the share application amounts were held in trust by the Respondent for the share applicants, as per the provisions of the CA. Further, it was submitted that where the shares were not issued and the respective amounts were refunded with interest to those who were not issued shares, the actual amount which was left after the refund of share application money and interest, would be the income, which accrued only in FY 1992-1993.

JUDGMENT

The SC placed reliance on the decision of the HC in the Respondent's own case wherein the HC held that there was no prohibition in section 73(3) or (3A) of the CA, 1956 against money being kept in a bank account that yields interest.

It was further held by the HC that the interest so earned could not be regarded as an amount which was fully available to the company for its own use from the time the interest was accrued. This was because, the interest was an amount that accrued on a fund that itself was held in trust on behalf of the applicants until the allotment was completed and the money had to be returned to those to whom shares were not allotted along with interest accrued on the same.

\textsuperscript{73} CIT v. Henkel Spic India Ltd. (2015) 64 taxmann.com 405 (SC).
No part of that fund, either principal or interest accrued thereon, could have been utilised by the company until the allotment process was completed and money repayable to those entitled to repayment had been repaid in full together with applicable interest. It was only after the allotment process was completed and all moneys refundable were refunded together with interest that the balance money lying in the account could be regarded as belonging to the company.

The application money along with interest accrued thereon was held in a trust in favour of the general body of applicants until the process outlined above was completed in all respects. Thus, it was held that there was no error in the order passed by the HC and that the interest income accrued only in AY 1993-1994.

**SIGNIFICANT TAKEAWAYS**

As the share application money received by the taxpayer has to be held in trust for and of behalf of the applicants of shares, it cannot be construed as income chargeable to tax in the hands of the company. Thus, any amount of interest earned on such share application money also ought to have been held for and on behalf of the subscribers. Otherwise, this leads to a situation where the applicants’ funds are utilised to earn interest income by the company.
CARRY FORWARD OF UNABSORBED LOSSES OF AN AMALGAMATING COMPANY

The Karnataka HC in *KBD Sugars & Distilleries Ltd.*,74 held that unabsorbed losses of an amalgamating company can be set off if such a company is in the business for three years or more even if its unit was engaged in the business for less than three years. It was also held that the date from which a company can be said to be ‘engaged in business’ is to be computed from the date of its setting up.

FACTS

KBD Sugars & Distilleries Ltd. ("Respondent") was engaged in the business of manufacture of beer and IML. Under an amalgamation scheme, which was approved by the HCs of Karnataka and Andhra Pradesh, Shree Vani Sugars and Industries Ltd. ("Amalgamating Company") was amalgamated with the Respondent ("Amalgamated Company") with effect from March 1, 2005.

The Amalgamating Company was engaged in the business of manufacturing and trading of sugar and generation of power. It was in the business of manufacture of sugar since 1984 and had commenced the business of power generation with effect from August 8, 2003, which was by way of expansion of its business.

During AY 2005-06, the Respondent had declared business income of INR 246,496,704, and brought forward losses of the amalgamating company being INR 213,348,234 were set off against the above business income, under section 72A(2)(a)(i)75 of the IT Act.

The AO disallowed the business loss and unabsorbed depreciation to the extent of INR 34,887,613 contending that this amount was attributable to the brought forward business loss from the power generation undertaking by the amalgamating company. Challenging the disallowance made by the AO, an appeal was filed before the CIT(A), who rejected the AO’s disallowance. The IRA then filed an appeal before the ITAT which was dismissed. Aggrieved by the order of the ITAT, the IRA filed an appeal before the Karnataka HC.

ISSUE

Whether the period of three years for the purpose of section 72A(2)(a)(i) of the IT Act has to be computed from the date of setting up of the business and not from the date of commencement of actual production?

ARGUMENTS

The Respondent argued that section 72A of the IT Act provided for the accumulated losses of the Amalgamating Company’s business as a whole and not to an individual business unit of the company. In other words, the Amalgamating Company had to be seen as a whole and not bifurcated into different business units. In the alternative, it was submitted that even if the business loss of power generation unit of the amalgamating company was treated separately, even then the benefit of section 72A of the IT Act should be available to the Respondent.

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75. Section 72A(2)(a)(i) of the IT Act: The accumulated loss shall not be set off or carried forward and the unabsorbed depreciation shall not be allowed in the assessment of the amalgamated company unless-
   (a) the amalgamated company –
      (i) has been engaged in the business, in which the accumulated loss occurred or depreciation remains unabsorbed, for three or more years.
since the power generation business had commenced in the year 2000.

Even though the commercial production or generation of power may have commenced from August 8, 2003, what was relevant was the year in which the business of power generation had actually started and not when the production began. The fact was that the business of power generation began in the year 2000 and evidence in this regard had been duly adduced before the IRA. The license for setting up the business of power generation, loans for the same, construction of the building and purchase of machinery etc., had started during 2000 itself, and this was duly reflected in the books of accounts of the Amalgamating Company.

The IRA argued that even though the Amalgamating Company had been carrying on the business of manufacturing of sugar for the past several years (since 1984), it had “commenced” the business of power generation only on August 8, 2003. Accordingly, the stipulation under section 72A(a)(i), that the benefit of carry forward of losses would be available to the Amalgamating Company provided that it was “engaged in the business” for at least three years prior to the date of amalgamation, would not be met. Thus, the Respondent could not obtain the benefit of carrying forward the losses of the Amalgamating Company. It was further contended that even though the activities for establishing the power generation unit may have commenced earlier, the benefit under section 72A of the IT Act would be granted to the Respondent only if the amalgamating company had “commenced” business, and which it did on August 8, 2003. Therefore, since the business of power generation had commenced within the stipulated period of three years prior to the date of amalgamation i.e., March 1, 2005, the losses in relation to the power generation business could not be set off by the Respondent.

JUDGEMENT

The HC rejected the appeal filed by the IRA and held that the Respondent company would be entitled to claim set off of losses of the amalgamating company under section 72A of the IT Act. The HC distinguished the terms ‘commencement of business’ and ‘engaged in business’. It observed that Section 32 of the IT Act provides that the tangible asset should be ‘used’ by the undertaking engaged in the generation of power. For claiming depreciation under Section 32 of the IT Act, the asset should be ‘used’ for the business, i.e. the asset should be used after the business commences, which was different from ‘engagement’ in business. This clarified that the terms ‘commencement of business’ and ‘engaged in business’ are different. The former may apply to Section 32 of the IT Act but only the latter would apply in the case of Section 72A of the IT Act.

The HC remarked that a party engages itself in a particular business from the day it gets involved in setting up of the business. Accordingly, in view of the facts of this case the engagement of the amalgamating company in the business of power generation had begun from the year 2000, even though the commencement of power generation business may have been with effect from August 8, 2003.

The HC also noted that even if this were not the case, the argument of the Respondent that the loss of the amalgamating company as a whole, and not of a particular unit or division, was to be seen, was a valid argument. It is the amalgamating company which should have been in business for three years or more, prior to the date of amalgamation and not a particular unit or division of that amalgamating company. In the instant case, the HC noted that the amalgamating company has been in business since the year 1984. Moreover, when a provision is for the benefit of an assessee, it should be liberally interpreted in favour of the assessee and if two views are possible, then one in favour of the assessee should be adopted. Accordingly, the Respondent was eligible to the carry forward and set off of losses of the amalgamating company.

SIGNIFICANT TAKEAWAYS

In several other decisions it was held that a business is said to have been set up as soon as the essential activities of the business had started.

In the instant case, the Karnataka HC has distinguished the terms ‘commencement of business’ and ‘engaged in business’ so as to interpret the provisions of section 72A of the IT Act. It has noted that an entity is said to be engaged in business right from the day it gets involved in setting up of the business. A question arises whether the date of incorporation of the company could be construed to be the date when the company starts engaging itself in business activities. This would, of course, depend on the facts and circumstances of the case. If it could be proved that the essential activities of the business are started on incorporation, it could be construed to be the date when the company starts engaging itself in business.

Indirect Tax

NO SALES TAX ON BRAND FRANCHISE FEE WHEN THERE IS NO TRANSFER OF EFFECTIVE CONTROL OVER THE BRAND

In United Breweries, the Karnataka HC held that sales tax would not be levied on brand franchise fee paid to the Assessee unless there is a transfer of effective control over the brand to the transferee.

FACTS

The Assessee owns the Kingfisher Brand which sold beer and also packaged drinking water. For the AY 2003-04 and 2004-05, the Assessee entered into a Brewing and Distribution agreement ("BDA") with certain Contract Bottling Units ("CBU") for manufacturing beer. As per the contract, the Assessee transferred the know-how for manufacturing beer to the CBUs and the brewing and bottling of the beer had to be done as per the Assessee’s specifications and directions. The production, trademark, the right to sell, market and distribute the beer, belonged to the Assessee and were not transferred to the CBUs. The CBUs only had the right to use the know-how on a non-assignable, non-transferable and non-exclusive basis. Further, the CBUs did not have any right over the product or the right to sell the product on their own terms or the right to fix the price of the product.

With respect to the packaged drinking water, the Assessee entered into a manufacturing agreement ("MA") with certain licensee dealers under which the latter would manufacture packaged water under the Assessee’s brand name and pay royalty to the Assessee for the use of its brand name. Under the MA, as opposed to the BDA, the manufacturers were free to sell the packaged water on their own terms and commercially exploit the brand name.

The AO treated the brand franchise fee received by the Assessee from the CBUs as royalty and levied sales tax on it. Further, the AO also treated the payment made by the packaged water manufacturers to the Assessee as royalty and levied VAT on the same.

The Joint Commissioner of Commercial Taxes(Appeals) ("JCCT") set aside the tax on the brand franchise fees received by the Assessee. However, the JCCT upheld the tax on the royalty paid to the Assessee by the manufacturers of packaged water.

On appeal, the Tribunal agreed with the JCCT with respect to the tax on the brand franchise fees received by the Assessee and further, overturned the JCCT ruling and set aside the tax on the royalty paid by the licensee dealers to the Assessee.

ISSUE

Whether sales tax can be levied on brand franchise fee when there is no transfer of effective control over the brand?

ARGUMENTS/ANALYSIS

The Assessee argued that the beer is manufactured by the CBUs in accordance with the specifications given by the Assessee and that the cost of raw material and labour is borne by the Assessee itself. The CBUs sold the beer only on the directions of the Assessee and the price for the same was fixed by the Assessee and not the CBU. The exclusive right to use the brand name remained with the Assessee. Further, the Assessee paid service tax on the brand
franchise fees received by it from the CBU. Therefore, Assessee argued that receipt of brand franchise fees did not amount to transfer of right to use goods as under Section 5C the Karnataka Sales Tax Act, 1957 (“KST Act”) and hence such payment would not be subject to sales tax.

The Sales Tax Authorities argued that under both the BDA and the MA, there was a transfer of right to use goods in the form of the Assessee’s brand name. Hence the royalty received by the Assessee from the CBUs and the licensee dealers was chargeable to sales tax.

**JUDGMENT**

The SC observed that the transfer of right to use brand name is an intangible good as per the definition of the “goods” under the KST Act. Based on this observation it ruled upon the taxability of the payment received by the Assessee from the CBUs and the licensee dealers as discussed below.

**Taxability of payment received as brand franchise fee from the CBUs under the BDA**

The SC held that the effective control of the brand name remained with the Assessee itself. In arriving at this conclusion the SC took into account the fact that CBUs had to manufacture the product only as per the directions of the Assessee and that CBUs operated as captive manufacturers of the assesse and did not obtain any right to exploit the brand name for its own use. Therefore, the SC held that there was no transfer of the right to use the intangible goods, i.e. brand name of the Assessee and hence sales tax under the KST Act will not be attracted for the payment received under the BDA. Further, it was also held that since the Assessee had already paid service tax on the brand franchise fees, levy of sales tax on the same would amount to double taxation, which is not permissible.

**Taxability of payment received as royalty for manufacture of bottled water under the MA**

The SC held that in the case of payment received under the MA for packaged drinking water, the right to use and commercially exploit the brand name or the trade mark was transferred to the licensee dealers. There was a transfer of the effective control over the brand name to the licensee dealers for them to commercially use and exploit the same. Hence there was a transfer of right to use the goods to the licensee dealers which was liable to sales tax under the KST Act.

**SIGNIFICANT TAKEAWAYS**

The taxation of transfer of right to use in the case of intangibles has been an area fraught with litigation.

Therefore, the definitive terms and conditions agreed upon between the parties are of great importance while determining whether the transaction should be characterized as transfer of right to use in goods or whether it is a service. As per the terms of an agreement between parties, if there is a transfer of a right, which is exclusive in nature and is to the exclusion of the transferee, then in such a case, it can be said to be a transfer of right to use intangible goods and accordingly subject to VAT. However, if the grant of rights under an agreement is limited in scope, non-exclusive and can be further granted to others, then in such a situation it shall be a service and not taxable under sales tax law.

The Hon’ble SC had laid down a five-prong test for the purpose of identification of a transaction amounting to transfer of right to use goods; however, those principles cannot be applied squarely for the case of intangibles since the decision was given in respect to tangible goods. However, the Karnataka HC in the present judgment has equated the right of exploitation of brand name to the right of effective control over the intangible property, which can now be used as a definitive test to identify whether transfer of right to use intangible property has been granted under the agreement. As per this judgment, the terms of an agreement which transfers the right to commercially exploit any particular intangible property shall amount to transfer of right to use that property and shall accordingly be liable to VAT / CST.

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ELIGIBILITY OF INDIAN SUBSIDIARIES OF FOREIGN COMPANIES TO AVOID SFIS BENEFITS

The Division Bench of the Bombay HC in Castrol India Pvt. Ltd., held that only “Indian brands” and not brands of Indian subsidiaries of foreign companies can avail of the SFIS benefits under the Foreign Trade Policy 2009-2014 (“FTP 2009-14”). It was held that the main object of providing SFIS benefits was to incentivize only “Indian brands.”

FACTS

The Petitioner is a Public Limited Company, registered under the Companies Act, 1956. The Petitioner has filed a petition under Article 226 of the Constitution of India challenging the legality and validity of the deficiency letters issued by the Secretary, Department of Commerce and Industry (“Respondent”). Through these deficiency letters, the Petitioner was informed that their Duty Credit Scrips for FY 2012-13 and FY-2013-14 were deficient as the Petitioner was a foreign brand (i.e., Indian subsidiary of a foreign company) and hence it was not entitled to avail of the benefits under the Served From India Scheme (“SFIS”) under the FTP 2009-14. The Petitioner also prayed for a writ of mandamus seeking a direction against the Respondent to issue the Duty Credit Scrips.

ISSUE

Whether the petitioners could be denied the benefit of the SFIS on the ground that they were subsidiaries of foreign companies?

ARGUMENTS/ANALYSIS

The Petitioner relied upon the Delhi HC judgment in Yum Restaurant India Pvt Ltd. to argue that the Respondent has arbitrarily and illegally disqualified the Petitioner on the mere basis that it is not an “Indian brand”. The Petitioner argued that there was no stipulation in the FTP 2009-14 which denied the SFIS benefit to the Petitioner. It was further argued that the DGFT did not have the jurisdiction to read/create conditions and restrictions into the SFIS policy in the garb of interpretation.

JUDGMENT

The Bombay HC looked into the objective behind the FTP and the SFIS benefits and held that the Applicant’s brand, i.e., Castrol India, is not an “Indian brand.” Hence, it was held that the Applicant cannot claim the SFIS benefit.

The HC heavily relied on the Division Bench judgment in the case of Naman Hotels Pvt Ltd. wherein it was held that Indian subsidiaries of foreign companies were not eligible to claim the Duty Credit scrip under the SFIS as they were not promoting Indian Brands. The object of the SFIS was to promote only companies which create an “Indian brand.” It was held that “the object of SFIS is to accelerate growth in export of services so as to create a powerful and unique ‘Served From India brand,’ instantly recognized and respected worldwide.’ ....The object which is sought to be achieved would be only by encouraging those entities and conferring benefits and giving incentives to such companies who create an Indian brand.”

It must be noted that, on April 29, 2011, in a meeting “Indian subsidiaries of foreign companies cannot avail SFIS benefits”

of the Policy Implementation Committee (“PIC”) it was noted that the objective of the FTP is to encourage essentially Indian brands. The FTP did not intend to incentivise any brand which is created outside India. Such Indian brand should be so unique as to be easily recognizable and create a distinct identity for itself both domestically and internationally. Essentially such a brand should enhance the Indian image and hence the Foreign Trade Policy uses the phrase “Served from India” brand. The PIC, therefore, noted that the names of companies mentioned in the agenda represent brands not identified as Indian Brands. They may be known in the global market. Accordingly, the PIC decided that grant of SFIS benefits to the above companies would not be harmonious with the intent behind the SFIS. The Naman Hotels (supra) ruling was based on these minutes of the PIC, which was further relied upon by the HC in the present case.

**SIGNIFICANT TAKEAWAYS**

There has been significant controversy pertaining to the applicability of the SFIS benefit to Indian subsidiaries of foreign companies. The Bombay HC has followed the principles of judicial discipline in relying on a similar coordinate bench ruling in Naman Hotels Private Ltd. (supra).

However, the Single Bench of the Delhi HC in Yum Restaurants (supra), had taken a contrary view that all Indian service providers complying with the eligibility criteria under the FTP were eligible to avail the SFIS benefits as there was no additional disqualification under the FTP which disqualified foreign brands to claim benefit of the SFIS. The DGFT did not have the power to read into the FTP and claim that Indian subsidiaries of foreign companies will not be eligible claim the SFIS benefits. Further, it was held that main object of granting incentive to Indian Service Providers is to incentivize export from India in order to strengthen and increase export of services from India and to establish India as a recognized destination for outsourcing of services.

It is also pertinent to mention that the Bombay HC in Naman Hotels also distinguished the Delhi HC judgment on the ground that the latter has not completely considered the objects and purpose of the FTP and has given a narrow interpretation to the term “Indian Service Providers,” by including even Indian subsidiaries of foreign companies under the said term.

An appeal against the decision in Yum Restaurants (supra) is pending before the Division Bench of the Delhi HC. Therefore, it remains to be seen as to whether the coordinate bench of the Delhi HC also follows the decision(s) of the Bombay HC in this regard.

It must be noted that present FTP 2015-20 has substituted the SFIS with the Services Exported from India Scheme (“SEIS”). Under the SEIS, export incentives are provided to service providers located in India” as opposed to “Indian Service Providers” as under the FTP 2009-14. Therefore, now, it may be argued that any service provider, whether an Indian subsidiary of a foreign company or not, may avail of the SEIS incentives as long as it is located in India. However, it needs to be seen whether the Courts will continue to rely upon the view that the object of the FTP is to provide benefits to only Indian based brands/companies which are not subsidiaries of foreign entities.
NO VAT LIABILITY ON MATERIALS SUPPLIED IN THE COURSE OF ERP IMPLEMENTATION

The Karnataka HC in *IBM India (P.) Ltd.* held that deliverable materials supplied in the course of Enterprise Resource Planning ("ERP") implementation, would not constitute commercially available software and were not liable to VAT.

FACTS

IBM India Pvt. Ltd. ("Assessee") was engaged in the business of providing business consultancy services. The Assessee's team of business consultants examined the request of the customers approaching it and then conducted a Business Process Review ("BPR") under the Business Consultancy Services ("BCS") programme. They, then, identified and recommended suitable ERP software to the customer. Based on the result of the BPR performed by the Assessee, the customer purchased the software from the software vendor and then the software vendor executed a licensing agreement with the purchaser of the software. Thereafter, ERP implementation team of the Assessee entered into contracts with the customers for ERP implementation services if the customers sought such implementation.

The ERP implementation service was independent of the earlier business consultancy service. Every customer did not contract for both the BCS and ERP implementation service together. When ERP software is purchased by the client such software needs to be installed, integrated and implemented at the client's end. The installation of ERP software was performed by the project implementation team comprising of the personnel of the Assessee company, along with the employees of the client. The members of the ERP software implementation team of the Assessee played various roles in the ERP software implementation process depending on their skills. The team ensured that the ERP software is appropriately integrated in the system of the client, and thereafter implementation of the said software was done. In this implementation process the team of the Assessee would take all necessary steps to provide functional data for the installation of the ERP software and it became useful for the client.

The Assessee had paid service tax on the turnover relating to provision of business consultancy services and ERP implementation services.

The assessment order for the assessment year 2004-05 was concluded by the assessing authority by accepting the declared turnover. However, reassessment proceedings were thereafter initiated by the assessing authority and whereby re-assessment order was issued enhancing the demand of Value Added Tax ("VAT") under the Karnataka Value Added Tax Act, 2003 ("KVAT"). The Assessee preferred a Writ Petition before the Karnataka HC challenging the re-assessment order. The Writ Petition was partly allowed by setting aside the re-assessment order and remitting the matter to the assessing authority for fresh disposal after providing a reasonable opportunity of being heard to the Assessee. After such remand, the assessing authority concluded reassessment proceedings and levied VAT under the KVAT on activities of business consultancy services and the enterprises resource planning software.

Challenging the said order, the Assessee preferred an appeal before the first Appellate Authority which thereafter confirmed the order of the assessing authority. The Assessee preferred a second appeal before the Karnataka Appellate Tribunal ("KAT"). The KAT has passed the impugned order setting aside the
levy of tax on the activities of business consultancy services and Enterprises Re-source Planning software holding that the said activities are pure services not involving any sale of goods or any transfer of property in goods in the execution of works contract. Aggrieved by the same, the revenue had preferred a revision petition before the Karnataka HC.

**ISSUE**

Whether ERP software implementation services and business consultancy services carried on by the Assessee does not involve any transfer of property in goods and accordingly be considered as sale or deemed sale in the course of execution of works contract?

**ARGUMENTS/ANALYSIS**

The Assessee argued that in the activities of BCS and ERP software implementation, the Assessee provided only services and no transfer of property in goods was involved. Further, the entire consideration received for providing services to the client were subjected to service tax as is clear from the judgment of the CESTAT in the Assessee’s own case which was affirmed by the SC while dismissing the appeal at the stage of admission itself. Therefore, no portion of the consideration received could be attributed to sale of the software and, therefore, he submits the impugned order does not call for any interference.

The VAT authorities submitted that the agreement for providing service on which reliance is placed by the Assessee includes code writing. It was further contended that the said code writing constitutes sale of software which is exigible to tax under the provisions of the KVAT. Further, the Department pointed out the letter dated 19.06.2008 of the Assessee which shows that they are involved in development of software. It was further submitted that the Assessee had admitted that 25% of the work in ERP implementation constitutes development of software. In view of the said admission, at least 25% of the consideration paid under the agreement should be treated as sales and tax is leviable under the KVAT.

**JUDGMENT**

The HC relied on its own decision in Infosys Ltd. v. DCCT & Ors. wherein it was held that a contract of software implementation does not constitute transfer of any goods or right to use any goods, but is purely, a service contract. Accordingly, the consideration received for software implementation is subject to service tax and not to VAT.

Further, the Karnataka HC pointed out that the said deliverable materials do not constitute commercially available software and that they are not marketable. They are not goods available in the market and are client specific. The said materials are required to make the ERP functional to meet the requirements of the client. Therefore, there is no sale involved in this case.

**SIGNIFICANT TAKEAWAYS**

This decision and the decision in Infosys Ltd. (supra) have come as a huge relief to information technology service companies. Customisation of software is taxed under service tax, however over the counter sale of software is taxed as a sale under the relevant sales tax legislation. Therefore, the question of taxability of software contracts has been highly litigious in the recent past. Significantly, this decision clarifies the stand taken by the Karnataka HC in Infosys Ltd. by additionally stating that software supplied by way of code during the ERP implementation process does not constitute “goods available in the market”, and is client specific and accordingly no VAT is leviable.

This finding is in sync with the settled position of law which states that the supply of goods which is incidental and ancillary to the provision of a service contract, shall not be chargeable to VAT.

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APPLICABILITY OF SERVICE TAX ON SALARY BY AN INDIAN COMPANY TO ITS SECONDED EMPLOYEE

In *North American Coal Corporation India (P) Ltd.*

the AAR held that there would be no liability to pay service tax on the salary and the allowances payable by the Applicant to the seconded employee.

**FACTS**

North American Coal Corporation India (P) Ltd. ("Applicant") is an Indian subsidiary of NAC-USA, a company incorporated in the USA. The Applicant had employed Mr. Steve Sloan ("Sloan"), an employee of NAC USA for utilizing his services in India. Sloan was an employee on the permanent roll of NAC USA.

The Applicant entered into a tripartite agreement with Sloan and NAC USA, under which the Applicant was to utilize the services of Sloan for a particular term. His salary would be paid by Applicant, however his social security interests shall be provided by NAC USA. The Applicant was not reimbursing the social security interests to NAC USA. The Applicant and Sloan also entered into a separate agreement.

Prior to introduction of the Negative List in 2012, such an arrangement was treated as manpower services. There was a specific entry- section 65(68) read with section 65(105)(k) of the Finance Act, 1994, which provided for the taxability of manpower supply services. However, after the negative list has been introduced, the taxability of services is governed by section 65B(44), which defines a service.

**ARGUMENT/ANALYSIS**

The Applicant relied upon the definition of service under section 65B(44) of the Finance Act, 1994 and argued that this section clearly excludes the provision of service by an employee to the employer in the course of or in relation to his/her employment. Relying upon the employment agreement, the Applicant argued that Sloan was an employee of the Applicant and hence his services to the Applicant are excluded from service tax.

The Service Tax Authorities argued that the payment of social security by NAC, USA amounts to a consideration paid by the Applicant for employing the services of Sloan. Therefore, this will not constitute an employer-employee relationship as under section 65B(44).

**JUDGMENT**

The AAR agreed with the argument of the Applicant. It was held that there would be no liability to pay service tax on the salary and the allowances payable by the Applicant to the employee in view of the employment agreement agreed into between the parties.

It was held that it would be against the canons of interpretation to interpret the definition of service by relying upon the entries in the Finance Act, 1994 which existed prior to introduction of the negative list regime.

Further, the AAR relied upon the employment agreement, whereby it was clearly stated that Sloan would be treated as the employee of the Applicant and would be paid salary by the Applicant itself. The AAR rejected the Service Tax Authorities’ argument regarding social security and held that the fact that

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Sloan is receiving social security from NAC USA does not negate that he is under an employer-employee relationship with the Applicant as under section 65B(44).

With respect to the RBI circular relied upon by the Service Tax Authorities prove that the current arrangement does not amount to an employer-employee relationship, it was held that the notes appended to that circular are pertaining to the pre-amendment period and hence will be not be applicable to the present case. Furthermore, it was held that “RBI’s circular will have no bearing and will be irrelevant insofar as the interpretation of the services is concerned.”

SIGNIFICANT TAKEAWAYS

The issue relating to whether secondment agreements constitute employer-employee relationships between the secondees of the foreign company and the Indian company has been a subject matter of great dispute and contradictory judgments, specifically under Income tax law.

In this regard, this judgment is important as facts such as Sloan being on the permanent rolls of NAC USA and NAC USA’s continued payment of social security to Sloan were not considered as adverse factors to hold that the arrangement to be employer-employee relationship between Sloan and the Applicant.

Post this ruling, the terms of employment agreements need to clear as to whether a particular person is intended to be treated as an employee even after secondment, for the purpose of exclusion from the definition of service.
APPLICABILITY OF VAT ON SUPPLY OF SMART CARDS

In Zylog Systems Pvt Ltd. it was held that smart cards would not constitute goods and the contract to supply smart cards would be one of service, thereby attracting service tax.

FACTS

Zylog Systems Pvt Ltd. ("Assessee") was a service provider of information technology services. The Karnataka State Transport Department ("Transport Department") entered into an agreement with the Assessee for supply and printing of smart cards, provision of data entry services, etc. Through smart cards the particulars of each driver were embedded by virtue of the software developed by the Assessee. Under the said agreement, the Transport Department had the exclusive intellectual property rights of the project and the Assessee did not get any right, title, license etc. The smart cards obtained by the Assessee were the property of the Transport Department and were never considered as the property of the Assessee.

The AO passed an order holding that the smart cards constituted “goods” and the supply of such goods to the Transport Department for consideration constituted a sale under the Karnataka Value Added Tax Act, 2003 ("Karnataka VAT Act"). The AO passed a protective assessment order under Section 38(5) imposing VAT at 12.5% on the entire consideration received by the Assessee for the period June 2009 to October 2009, interest and penalty were also levied.

On appeal before the Joint Commissioner of Commercial Taxes (A) ("JCCT"), it was held that the Assessee was not liable to pay VAT on the payment received by it from the Transport Department in lieu of the supply of smart cards. On further appeal, the Additional Commissioner of Commercial Taxes set aside the order of the JCCT and restored the order of the AO.

ISSUE

Whether the contract for supply of smart cards, entered into between the parties, is a contract for sale of smart cards or for rendering the service?

ARGUMENTS

According to the Assessee, the agreement with the Transport Department was a service contract and consumption of the smart cards was only incidental to the contract. The smart card was only a media through which the particulars of each driver were embedded by virtue of the software developed by the Assessee. There was no transfer of intellectual property to the department. The requisite information was embedded in the smart card and supplied to the Transport Department. Therefore, sales tax must not be levied on the smart card supplied by the Assessee to the Transport Department.

The VAT authorities contended that under supply of smart cards to the Transport Department amount to sale under the Karnataka VAT Act. The information embedded in the smart cards is in the nature of an intellectual property and VAT would be leviable on such transfer. Alternatively, it was submitted that the supply of smart cards falls under the definition of "works contract" and that the State has the power to levy VAT on the goods transferred under such a composite contract.

“The essential test to be satisfied for an article to be categorized as 'goods' is the test of marketability”

JUDGMENT

The HC relied on various decisions of the SC and the HCs to hold that the supply of the smart cards to the Transport Department would not amount to sale but would constitute a service.

It was held that the agreement does not provide for the sale of goods by the Assessee to the Transport Department and the intellectual property rights always remained with the Transport Department.

The HC referred to cases involving the question of whether the supply of sim cards constituted sale or service. It relied upon Idea Mobile Communication Limited,12 wherein the SC held that “the amount received by the cellular telephone company from its subscribers towards the SIM cards will form part of the taxable value for levy of service tax, as the SIM cards are never sold as goods independent of the services provided. They are considered as part and parcel of the services provided and the dominant purpose of the transaction is to provide services and not to sell the SIM card which does not have any value on its own, without the service.” The HC also relied upon SC cases of Tata Consultancy Services13 and the Bharat Sanchar Nigam Limited.,14 to arrive at the conclusion that supply of smart cards does not amount to sale of goods.

The HC observed that the essential test to be satisfied for an article to be categorized as ‘goods’ is the test of marketability. This test entails that the articles should be known to the market as goods and that such goods must be bought and sold in the market. Further, the articles must also satisfy the test of abstraction transmission, transfer, delivery, storage and possession, etc in order to be categorized as goods. It was held that the smart cards, produced by the Assessee, were being supplied only for the purpose of the Transport Department and were of no utility or value to any other person than the Transport Department. The material purchased and utilized in preparation of the smart cards was incidental to the supply of the main service of embedding the software into the smart cards.

The HC expressly held that “unless the transaction represents two distinct and separate contracts and is discernible as such, the State does not have the power to separate the ‘agreement to sell’ from the ‘agreement to render service’, and impose tax on the sale. The question is did the parties have in mind or intend separate rights arising out of the sale of goods. If there was no such intention there is no sale even if the contract could be disintegrated.” The predominant nature of the transaction in the present is the supply of services relating to smart cards and the transfer of the relevant materials was purely incidental to the transaction.

SIGNIFICANT TAKEAWAYS

This is a very important decision which clarifies that the supply of smart cards does not amount to sale of goods. In order to characterize the transaction as a sale or service, the HC has tried to draw an analogy with the case of taxability of sim cards and photo identity cards prepared for voters.15 Further, in this regard, the HC has commented that State does not have the power to extricate “agreement to sell” from an “agreement to render service”, and has considered the dominant intention of the parties in determining the nature of the contract. In doing so, the HC has clarified the tests as laid down in by the SC16 by stating that the two agreements should be distinct and clearly discernible as such, and only then can the State vivisect the contract and accordingly levy sales tax / service tax on the separate portions.

The ruling of the HC, that the predominant intention of the parties must be considered while determining whether the transaction is to be characterized as goods or services, is of great significance in light of various interpretations in the past where Courts have attempted to artificially vivisect a contract for the purposes of levy of sales tax / service tax.

TAXABILITY OF THE GOODS SOLD THROUGH E-COMMERCE COMPANIES

In the case of *Flipkart Pvt Limited*\(^{17}\), it has been held that e-commerce companies which merely facilitate sales between a third party seller and a customer, are not liable to pay VAT.

**FACTS**

*Flipkart Pvt Limited* ("Assessee 1") is an online service provider, registered as a service provider under the Finance Act, 1994. The Kerala State tax authorities issued notices to the Assessee on the ground that it was to be registered under the Kerala Value Added Tax Act, 2003 ("KVAT Act") and passed an order of penalty for the non-payment of VAT on the transactions. The Assessee filed a writ petition before the HC challenging these notices.

*Myntra*, ("Assessee 2") is another online service provider, however, unlike Assessee 1, it sells goods directly to the online customers. It was a registered dealer under the KVAT Act and paid tax in respect of the local and inter-state sales made from its business premises in the state of Karnataka. However, the VAT authorities imposed penalty on the ground that all the sales made by Assessee 2 to its customers in Kerala are local sales and hence all such goods need to be taxed under the KVAT Act.

**ISSUE**

Whether the goods sold through e-commerce websites would be liable to VAT when such goods are sold by third party sellers?

**ARGUMENTS**

The Assessee 1 argued that it is a service provider which is not engaged in the business of sale or purchase of goods. It merely facilitated the transactions of sale and purchase through its online portal. It provided an online marketplace to its customers whereby they could choose the products of their choice and the Assessee would notify such choice of the customer to the respective seller. It is the seller who raises an invoice on the customer and arranges for the delivery of the product to the customer. The seller also pays VAT or CST, depending upon whether the transaction is inter-state or intra-state. It was also contended that the sales in the present case were all inter-state sales as the sale transactions occasioned a movement of the goods from outside the State to various locations within the State of Kerala.

Assessee 2 argued that the sales made by it are inter-state sales and it had accordingly paid the necessary CST and local taxes in this regard.

The VAT Authorities argued that the sale in question was a local sale as the product was delivered to the customer in Kerala from an online portal whose situs could be traced to Kerala. It was also argued that even if the Assessee was not the seller of the product in question, it could be held liable to tax in view of the provisions of Section 16 (13) of the KVAT Act as the online portal would constitute an intangible shop and the situs of the sale would be Kerala, since the agreement to sell was made in Kerala. With respect to Assessee 2, the VAT Authorities contended that all the sales made by Assessee 2 to its customers in Kerala are local sales and hence all such goods need to be taxed under the KVAT Act.

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\(^{17}\) *Flipkart Internet Pvt Ltd v. State of Kerala (2015) TIOL 2510 (Kerala).*
JUDGEMENT

The HC held that the VAT Authorities did not take into consideration the fact that the Assessee 1 was not selling the goods to the online customers. The sale was made by sellers who were registered on its online portal, and all the said sales were inter-state sales on which the respective sellers had paid applicable tax under the CST Act.

The HC rejected the VAT Authorities’ argument that the situs of sale is in Kerala and hence VAT is to be levied under the KVAT Act. It was held that the situs of sale is wholly irrelevant to a determination of whether a sale is an inter-state sale or not.18

The HC opined that penal proceedings must not be instituted against an assessee without ensuring whether a case comes within the purview of the KVAT Act. In cases where there is uncertainty over the real nature of the transaction, for example, whether there is an inter-state sale or intra-state sale, the Intelligence officers must refer the matter to the concerned AOs before taking recourse to penal provisions.

With respect to Assessee 2, the HC held that there were no findings by the VAT Authorities that all the sales made by Assessee 2 were local sales, and hence quashed the penalty order against Assessee 2.

SIGNIFICANT TAKEAWAYS

This case is very significant for e-commerce companies. The VAT Authorities of various states have been aggressive in their approach towards levying VAT on e-commerce companies without considering that they may be only facilitators of the sale between a third party seller and a customer. This decision rightly clarifies that online portals, acting as mere facilitators of online transactions, will not be liable to pay VAT. However, it is only hoped that there is uniformity in the approach taken by the judicial fora for taxing e-commerce companies. Further, with the likely introduction of the GST this year, it is hoped that the taxation regime for e-commerce companies is less ambiguous and more uniform.

18. The HC relied upon the following cases, Union of India v K.G.Khosla & co. Ltd. (1979) 2 SCC 2421 (SC); Oil India Limited v Superintendent of Taxes & Ors (1975) 1 SCC 7331 (SC); English Electric Company of India Ltd v DCT & Ors (1976) 4 SCC 460 (SC).
SODEXO MEAL VOUCHERS ARE NOT ‘GOODS’

In Sodexo SVC India Pvt Ltd.,19 the SC held that Octroi or Local Body Tax (“LBT”) would not be levied on sodexo meal vouchers as it does not fall within the definition of ‘goods’ within the meaning of Section 2(25) of the Maharashtra Municipal Corporation Act, 1949.

FACTS

Sodexo SVC India Pvt. Ltd. (“Assessee”) was engaged in the business of providing pre-printed meal vouchers under the nomenclature of ‘Sodexo Meal Vouchers’. It entered into contracts with its customers which are established companies having employees on their rolls. Such customers undertake to provide food/ meals and other items to their employees up to a certain amount. The Assessee entered into an agreement with such customers for issuing the said vouchers.

After receiving these vouchers for a particular denomination, some are distributed by the companies to its employees. For utilisation of these vouchers by such employees, the Assessee has made arrangements with various restaurants, departmental stores, shops, etc. (“Affiliates”). From these affiliates, the employees who are issued the vouchers can procure food and other items on presentation of the said vouchers.

The Affiliates, after receiving the said vouchers, present the same to the Assessee and get reimbursement of the face value of those vouchers after deduction of service charge payable by the affiliates to the Assessee as per their mutual arrangement. In this manner, the Assessee, by issuing these vouchers to its customers, gets its service charge from the said companies. Likewise, the Assessee also takes specified service charges from its Affiliates.

ISSUE

Whether these vouchers can be treated as ‘goods’ for the purpose of levy of Octroi or LBT or the aforesaid activity only amounts to rendition of a service by the Assessee?

ARGUMENTS/ANALYSIS

The Assessee had resisted the imposition of LBT primarily on the ground that it was providing services to the establishments with whom it had entered into contracts and, therefore, such agreements were for service and not for sale of any goods. The Bombay HC had negated the contention on the ground that the scheme postulates printing of the paper vouchers by Sodexo which are sold to its customers. The said customers, in turn, provide the vouchers to their employees who use these vouchers in the restaurants or different places or outlets to get ready to eat items and beverages of the face value printed on the said vouchers. Therefore, the vouchers are used to pay the price for food items and beverages distributed to users.

The decision of the HC had also observed that these vouchers are capable of being sold by Sodexo after they are brought into the limits of the city. Therefore, the said vouchers have its utility and the same are capable of being paid or sold and same are capable of being delivered, stored and possessed. Thus, according to the HC, the cumulative test laid down by the SC in Tata Consultancy Services v. State of Andhra Pradesh20 has been satisfied. These reasons

given by the HC were adopted by the Revenue as its argument before the SC.

The Assessee referred to the intrinsic nature of the transaction with the aid of the RBI Guidelines dated March 28, 2014 on the subject and on the basis of which it was submitted that in reality it was only a service which was provided by Sodexo with no element of 'goods' involved in the transaction.

**JUDGMENT**

The SC held that the HC had erroneously perceived that the vouchers were 'sold' by the Assessee to its customers. This fundamental mistake in understanding the whole scheme of arrangement has led to a wrong conclusion by the HC. The SC held that the Assessee is only a facilitator and a medium between the Affiliates and customers. The intrinsic and essential character of the entire transaction is to provide services by the Assessee and this is achieved through the means of the said vouchers. Goods belong to the Affiliates which are sold by them to the customers' employees on the basis of vouchers given by the customers to its employees. It is these Affiliates who are getting the money for those goods and not the Assessee, who only gets service charges for the services rendered, both to the customers as well as the affiliates. It was held that the HC had also wrongly observed that vouchers are capable of being sold by the Assessee after they are brought into the limits of the city. These vouchers are printed for a particular customer, which are used by the said customer for distribution to its employees and these vouchers are not transferrable at all.

The SC further relied on its decisions in *Bharat Sanchar Nigam Ltd. & Anr*[^21] and *Idea Mobile Communication Limited*[^22] wherein it was held that sale of SIM cards is merely incidental to the provision of service. The SC drew a parallel in this case that the Sodexo Meal Vouchers are not sold as such, but are rather facilitating the provision of a service. In this regard, the SC held that the real test herein is whether these vouchers can be traded and sold separately[^23], the answer to which was firmly in the negative.

The SC further referred to Section 17 of the IT Act, which defines 'salary' in the hands of the employees, to hold that the value of free food and non-alcoholic beverage provided by an employer to an employee is treated as expenditure incurred by the employer and amenity in the hands of the employee. The Assessee’s customers seek to provide this perquisite to their employees by utilizing the food voucher services provided by the Assessee.

**SIGNIFICANT TAKEAWAYS**

This decision of the SC goes in-depth into the nature of the transaction to hold that the true essence of any sale would be whether vouchers of this nature can be bought or sold over the counter, and if the answer is in the negative, then there is no sale transaction. This ratio of the decision may give much needed relief to similar transactions such as air-miles, loyalty points, shopping points, etc. in identifying the true nature of the transaction, and discharging appropriate tax on the consideration for the same.

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FACTS

Pearey Lal Bhawan Association ("PLBA") filed two suits against Satya Developers Pvt. Ltd. ("Satya") whereas M/s Meattles Private Limited ("Meattles") filed a suit against M/s HDFC Bank Ltd. ("HDFC Bank") seeking declaration and injunction qua the service tax paid in respect of rented premises. The plaintiffs in this suit i.e. Satya and HDFC Bank sought a declaration holding the defendants i.e. PLBA and Meattles to be liable to pay the service tax leviable on the rent and the maintenance charges payable under the lease deed executed inter se the parties, recovery of amount and mandatory injunction requiring the defendants to pay to the plaintiff service tax of the amount on the lease rentals payable in future.

PLBA claimed that it was a registered society and being the owner of the building Pearey Lal Bhawan, had entered into a registered lease deed with Satya of the premises Peary Lal Bhawan. The parties entered into a further agreement for maintenance of common service and facilities. With effect from June 01, 2007 the Central Government by amending Chapter V of the Finance Act, 1994 levied service tax on renting of immovable property for business purposes. It was claimed that the service tax being an indirect tax has to be deposited by the service provider who was entitled to collect the same from the user of the service as it was a tax on the service and not on the service provider. Further, Meattles claimed to be the lessor of the demised premises leased out to HDFC Bank. The issue again raised was in relation to the service tax net w.e.f June 01, 2007 vide notification No.23/2007-ST dated May 22, 2007 and Finance Act, 2007.

In two separate judgments by two learned Single Judges of this Court the suits were decided in favor of the plaintiffs holding them entitled to recover amount payable towards the service tax from the defendants.

ISSUE

Whether the lessor is entitled to recover service tax levied on renting of immovable property for business, from the lessee?

ARGUMENTS/ANALYSIS

The plaintiff argued that the earlier decision erroneously relied upon the provisions of Sale of Goods Act, 1930 which did not have application to service tax. Section 12B of the Central Excise Act relied upon applies only to refund of duty and does not provide for the liability of the consumer to pay service tax while Section 67 of the Finance Act provides for valuation of the service tax which would be included in the “gross amount” charged by a service provider which provision had been ignored.24

The plaintiff, HDFC Bank argued that Section 68 (2) of the Finance Act provides that the Central Government is empowered to notify in the official gazette the service tax on taxable services, as notified, to be paid by such person and in such a manner as may be prescribed. However, there is no notification directing the lessee to make the payment of service tax and hence in the absence of a notification no tax liability can be fastened on HDFC.25

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24. To further this argument, the plaintiff relied upon Ultra Tech Cement Ltd. (Earlier Ultratech Comco Ltd.) v. State of Maharashtra and Anr., 2011 (13) SCC 497; Rashtriyaa Ispat Nigam Ltd. v. Dewan Chand Ram Saran, 2012 (26) STR 289 SC; Max New York Life Insurance Co. Ltd. v. Insurance Ombudsman and Ors., 2011 (22) STR 387; Ravishankar Jaiswal v. Jabalpur Development Authority and Anr. 2011 (22) STR 5 MP.

Defendant, PLBA argued that service tax is a Value Added Tax (VAT) and being a consumption tax it is not a charge on the business but on the consumer and would be thus leviable to whom the services are provided. It further contended that from the terms of the lease agreement and agreement for maintenance, the service provider has not assumed the burden of paying the service tax and the liability would be that of the service recipient.

**JUDGMENT**

The HC referred the decision of the Supreme Court in *Mafat Lal Industries* where it was held that in case of indirect tax the court would presume that excise duty or customs duty has been passed on to the consumer, until the contrary is established. Further, in *All India Federation of Tax Practitioners*, it was held that VAT was a consumption tax as it was borne by the consumer and service tax is, in turn, destination based consumption tax. Further, it was held that section 64A(1) is applicable to service tax.

The HC also observed that a contract has to be construed by looking at the document as a whole and the meaning of the document has to be what the parties intended to give to the document. It was held that the Municipal Corporation, Municipality, Gram Panchayat or local authority are distinct from the government and thus the agreement between the parties cannot be said to cover the exemption of HDFC Bank to pay to Meattles, the service tax which was paid by it to the government pursuant to the Finance Act, 2007.

Further, the lease deed and the agreement of maintenance of common services and facilities between Satya and PLBA provides that “the lessor shall continue to pay all or any taxes, levies or charges....” By use of the words “lessor shall continue to pay” it is evident that the parties contemplated the existing taxes, levies or charges and not future. Even as per the agreement of maintenance of common service facilities though the same has no application to the service tax however, still the said clause II(1) cannot be said to exclude HDFC Bank from paying service tax in the future. The decrees passed by the Single Judges were upheld.

**SIGNIFICANT TAKEAWAYS**

This decision of the SC goes in-depth into the nature of the transaction to hold that the true essence of any sale would be whether vouchers of this nature can be bought or sold over the counter, and if the answer is in the negative, then there is no sale transaction. This ratio of the decision may give much needed relief to similar transactions such as air-miles, loyalty points, shopping points, etc. in identifying the true nature of the transaction, and discharging appropriate tax on the consideration for the same.

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26. *All India Federation of Tax Practitioners & Ors. vs. Union of India & Ors.* (2007) 7 SCC 527 (SC); *Association of Leasing and Financial Service Companies vs. Union of India & Ors.* 2011 (2) SCC 352 (SC).
28. *All India Federation of Tax Practitioners & Ors. vs. Union of India & Ors.* (2007) 7 SCC 527 (SC).
Direct Tax

1. **Enhancement of the monetary limits for mandatory quoting of PAN**

   With a view to curb the circulation of black money and thus widen the tax net, the CBDT vide Notification No. 95/2015 dated December 30, 2015, has made quoting of PAN mandatory for all sales/purchase transactions of an amount exceeding INR 2 lakh regardless of the mode of payment and has also enhanced the monetary limits of certain transactions which already require quoting of PAN.

   The amendment to the IT Rules will take effect from January 1, 2016. Below is a chart highlighting the key changes as set out in CBDT Press Release dated December 15, 2015:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Nature of transaction</th>
<th>Mandatory quoting of PAN (Rule 114B)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td><strong>Existing requirement</strong></td>
</tr>
<tr>
<td>1.</td>
<td>Immovable property</td>
<td>Sale/ purchase valued at INR 5 lakh or more</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.</td>
<td>Motor vehicle (other than two wheeler)</td>
<td>All sales/purchases</td>
</tr>
<tr>
<td>3.</td>
<td>Time deposit</td>
<td>Time deposit exceeding INR 50,000/- with a banking company</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4.</td>
<td>Deposit with Post Office Savings Bank</td>
<td>Exceeding INR 50,000/-</td>
</tr>
<tr>
<td>5.</td>
<td>Sale or purchase of securities</td>
<td>Contract for sale/purchase of a value exceeding INR 1 lakh</td>
</tr>
<tr>
<td>6.</td>
<td>Opening an account (other than time deposit) with a banking company.</td>
<td>All new accounts</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7.</td>
<td>Installation of telephone/ cell phone connections</td>
<td>All instances</td>
</tr>
<tr>
<td>8.</td>
<td>Hotel/restaurant bill(s)</td>
<td>Exceeding INR 25,000/- at any one time (by any mode of payment)</td>
</tr>
<tr>
<td>9.</td>
<td>Cash purchase of bank drafts/ pay orders/ banker's cheques</td>
<td>Amount aggregating to INR 50,000/- or more during any one day</td>
</tr>
</tbody>
</table>
2. Taxation of off-shore rupee denominated bonds

Recently, Indian companies have been allowed by the RBI to issue rupee denominated bonds outside India. The CBDT vide Press Release dated October 29, 2015 has clarified the tax treatment of such off-shore rupee denominated bonds. However, legislative amendment for the same will be proposed through the Finance Bill, 2016.

Regarding the interest income arising from such bonds to non resident investors, it has been clarified that withholding tax at the rate of 5 percent, in the nature of final tax, would be applicable in the same way as it is applicable for off-shore dollar denominated bonds.

Further, the capital gains, arising in case of appreciation of rupee between the date of issue and the date of redemption against the foreign currency in which the investment was made, would be exempt from capital gains tax.
3. Relief to FII/FPIs regarding defective notices

The IRA had issued notices of defective returns under section 139(9) of the IT Act to FII/FPIs in cases where Balance Sheet and P&L account were not filed.

The CBDT vide Press Release dated December 10, 2015 clarified that such returns will not be treated as defective in cases where (i) the FII/FPI is registered with SEBI; (ii) has no PE/place of business in India and (iii) has provided basic information required under section 139(9)(f) of the IT Act, if there is business income.

4. Revision of monetary limits for filing of appeals by the IRA

The CBDT, in supersession of the Instruction No 5/2014 dated July 10, 2014, has issued Circular No. 21/2015 dated December 10, 2015, to revise the monetary limits and other conditions for filing of appeals.

No appeal/SLP shall be filed by the IRA in a case where the tax effect in an AY does not exceed the following:

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Forum of appeal</th>
<th>Monetary limit (INR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Appellate ITAT</td>
<td>10,00,000</td>
</tr>
<tr>
<td>2.</td>
<td>High Court</td>
<td>20,00,000</td>
</tr>
<tr>
<td>3.</td>
<td>Supreme Court</td>
<td>25,00,000</td>
</tr>
</tbody>
</table>

An appeal should not be filed merely because the tax effect in a case exceeds the monetary limits prescribed above. Filing of appeal must be decided on merits of the case.

‘Tax effect’ means the difference in amount of tax assessed by the taxpayer and tax determined as payable by the IRA, in respect of the issues against which appeal is intended to be filed (“disputed issues”).

The AO shall calculate the tax effect separately for every AY in respect of the disputed issues in the case of every taxpayer. If the disputed issues arise in more than one AY, appeal can be filed only for such AY in which tax effect exceeds the monetary limits specified as above.

In case of a composite order of any HC or appellate authority, which involves more than one AY and common issues in more than one AY, appeal shall be filed in respect of all such AYS even if the ‘tax effect’ is less than the prescribed monetary limits in any of the AYSs, if it is decided to file appeal in respect of the AY in which ‘tax effect’ exceeds the monetary limit prescribed.

The CIT shall make a record of the cases where an appeal before a ITAT or a Court is not filed only on account of the tax effect being less than the prescribed monetary limit. Also, not filing of appeal will not give rise to any presumption of acquiescence on part of the IRA, which will not be precluded from filing an appeal on the same disputed issue in future, if the tax effect exceeds the specified monetary limits.

The conditions relating to prescribed monetary limits shall not be applicable in the following cases:

- Where the Constitutional validity of the provisions of an Act or Rule are under challenge,
- Where Board’s order, Notification, Instruction or Circular has been held to be ultra vires,
- Where Revenue Audit objection in the case has been accepted by the IRA,
- Where the addition relates to undisclosed foreign assets/bank accounts,
- Writ matters,
- Direct tax matters other than Income tax and
- Income tax matters where the tax effect is not quantifiable or not involved.

This instruction is to apply retrospectively to pending appeals. Appeals before the SC would be governed by the instructions operative at the time when such appeal was filed.

5. Clarification of tax treatment of investment in Non-SLR securities by banks

The CBDT, vide Circular No. 18/2015 dated November 2, 2015 has clarified that the income arising to banks from investments in non-SLR securities is part of the business of banking falling under the head ‘Profits and Gains of Business and Profession’. For this, reliance has been placed on the SC decision in Nawanshahar Central Cooperative Bank Ltd.\textsuperscript{77} Section 56(2)(id) of the IT Act provides that income by way of interest on securities shall

be chargeable to income tax under the head ‘Income from Other Sources’, if, the income is not chargeable to income tax under the head ‘Profits and Gains of Business and Profession’. IRA had been taking a position that income from investment by banks in non-SLR securities is income from other sources and hence “expenses relatable to investment in non-SLR securities need to be disallowed u/s 57(i)...”

Referring to the above mentioned decision, the CBDT clarified that even though it was rendered in the context of co-operative societies/banks claiming deduction under section 80P(2)(a)(i) of the IT Act, the principle is equally applicable to all banks/commercial banks, to which Banking Regulation Act, 1949 applies.

Accordingly, the CBDT has directed that no appeals should be filed on this ground by the IRA, and the appeals already filed may be withdrawn / not pressed upon.

6. Signing of Protocol to amend the India-Japan DTAA

On December 11, 2015, the Government of India and the Government of Japan signed a Protocol for amending the existing DTAA.

The Protocol provides for internationally accepted standards for effective exchange of information on tax matters including bank information and information without domestic tax interest. It provides that the information received from Japan in respect of a resident of India can be shared with other law enforcement agencies with authorisation of the competent authority of Japan and vice versa.

The Protocol also provides that both India and Japan shall lend assistance to each other in the collection of revenue claims. The Protocol further provides for exemption of interest income from taxation in the source country with respect to debt-claims insured by the Government/Government owned financial institutions.

Indirect Tax

Notification for levy of Swachh Bharat Cess and related Frequently Asked Questions (FAQs)

The CBEC, vide Notification Nos. 21/2015 and 22/2015, both dated November 6, 2015, has made the provisions of Chapter VI of the Finance Act, 2015, providing for Swachh Bharat Cess (“SBC”), effective from November 15, 2015. With a view to provide clarity on the subject, the CBEC has also released related Frequently Asked Questions (“FAQs”). In this regard, the following updates from the FAQs are important:

- SBC would be calculated in the same way as Service tax is calculated. Therefore, SBC would be levied on the same taxable value as service tax. The CBEC vide Notification No. 24/2015 dated November 12, 2015, has clarified that reverse charge mechanism shall be applicable for the purpose of levy of SBC also.

- SBC shall be levied and collected as service tax on all the taxable services, except those fully exempt from service tax or those covered under the negative list of services, at the rate of 0.5% of the value of taxable service. It is imposed for the purposes of financing and promoting Swachh Bharat initiatives or for any other purpose relating thereto. The effective rate of service tax plus SBC would therefore be 14.5% w.e.f. November 15, 2015.

- SBC would be levied, charged, collected and paid to the Government, independent of service tax. It needs to be charged separately on the invoice, accounted for separately in the books of account and paid separately under separate accounting code. SBC may be charged separately after service tax as a different line item in invoice. It can be accounted and treated similarly to the erstwhile Education cesses.

- Taxable services, on which service tax is leviable on a certain percentage of value of taxable service, will attract SBC on the same percentage of value as provided in the CBEC Notification No. 26/2012 dated June 20, 2012.

- SBC is not integrated in the CENVAT Credit Chain. Therefore, credit of SBC cannot be availed or utilized for the payment of any duty or tax.

- As per Rule 5 of the Point of Taxation Rules, 2011, SBC will be payable on services which are provided on or after November 15, 2015, invoice in respect of which is issued on or after that date and payment is also received on or after that date. SBC will also be payable where service is provided on or after November 15, 2015 but payment is received prior to that date and invoice in respect of such service is not issued within 14 days, that is, by November 29, 2015.
<table>
<thead>
<tr>
<th>ABBREVIATION</th>
<th>MEANING</th>
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<tbody>
<tr>
<td>ACIT</td>
<td>Learned Assistant Commissioner of Income Tax</td>
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<tr>
<td>AO</td>
<td>Learned Assessing Officer</td>
</tr>
<tr>
<td>APA</td>
<td>Advance Pricing Agreement</td>
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<tr>
<td>AY</td>
<td>Assessment Year</td>
</tr>
<tr>
<td>CA</td>
<td>Companies Act</td>
</tr>
<tr>
<td>CBDT</td>
<td>The Central Board of Direct Taxes</td>
</tr>
<tr>
<td>CESTAT</td>
<td>Customs, Excise and Service Tax Appellate Tribunal</td>
</tr>
<tr>
<td>CIT</td>
<td>Learned Commissioner of Income Tax</td>
</tr>
<tr>
<td>CIT(A)</td>
<td>Learned Commissioner of Income Tax(Appeal)</td>
</tr>
<tr>
<td>DCIT</td>
<td>Learned Deputy Commissioner of Income Tax</td>
</tr>
<tr>
<td>DRP</td>
<td>Dispute Resolution Panel</td>
</tr>
<tr>
<td>DTAA</td>
<td>Double Taxation Avoidance Agreement</td>
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<tr>
<td>FM</td>
<td>Hon’ble Finance Minister</td>
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<tr>
<td>FTS</td>
<td>Fees for Technical Services</td>
</tr>
<tr>
<td>FY</td>
<td>Financial Year</td>
</tr>
<tr>
<td>HC</td>
<td>Hon’ble High Court</td>
</tr>
<tr>
<td>Hon’ble</td>
<td>Honourable</td>
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<tr>
<td>INR</td>
<td>Indian Rupee</td>
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<tr>
<td>IRA</td>
<td>Indian Revenue Authorities</td>
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<tr>
<td>ITAT</td>
<td>The Income Tax Appellate ITAT</td>
</tr>
<tr>
<td>IT Act</td>
<td>The Income Tax Act, 1961</td>
</tr>
<tr>
<td>IT Rules</td>
<td>The Income Tax Rules, 1962</td>
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<tr>
<td>MAT</td>
<td>Minimum Alternate Tax</td>
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<tr>
<td>P&amp;L</td>
<td>Profit and loss</td>
</tr>
<tr>
<td>PE</td>
<td>Permanent Establishment</td>
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<td>SC</td>
<td>Hon’ble Supreme Court</td>
</tr>
<tr>
<td>SLP</td>
<td>Special Leave Petition</td>
</tr>
<tr>
<td>TDS</td>
<td>Tax Deducted at Source</td>
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<tr>
<td>TP Act</td>
<td>The Transfer of Property Act, 1882</td>
</tr>
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<td>Transfer Pricing Officer</td>
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<tr>
<td>TRC</td>
<td>Tax Residency Certificate</td>
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<td>UK</td>
<td>United Kingdom</td>
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<td>USA</td>
<td>United States of America</td>
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<tr>
<td>VAT</td>
<td>Value Added Tax</td>
</tr>
<tr>
<td>WOS</td>
<td>Wholly Owned Subsidiary</td>
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