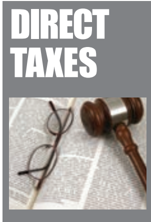
Legal Decisions[1]

DIRECT TAXES



Income Tax

LD/64/89
Hero Cycles P. Ltd.
vs.
Commissioner of Income Tax (Central), Ludhiana
5th November, 2015(SC)

Section 36(1)(iii) of Income-tax Act, 1961: Deduction of interest paid in respect of capital borrowed.

Loans to subsidiary satisfies 'commercial expediency' test and so deduction of interest is allowed.

SC observed that loan advanced to subsidiary company was imperative as business expediency in view of undertaking given to the financial institutions for providing additional margin for subsidiary's working capital requirements; Reliance was placed on co-ordinate bench ruling in S.A. Builders Ltd. and Delhi HC ruling in Dalmia Cement (B.) Ltd

The assessee is a manufacturing concern. It claimed deduction of interest paid on borrowed sums u/s 36(1)(iii). The AO rejected assessee's claim noting that assessee had advanced interest free loan to Hero Fibers Ltd, its subsidiary company and that assessee had also advanced loans to its director on which it charged interest @10%. Further interest payable on loans from Banks carried an interest @18%.

Assessee, being a promoter having controlling interest in its subsidiary, had given an undertaking to the financial institutions to provide its subsidiary company with an additional margin to meet working capital for meeting any cash loses. The amount advanced by the assessee was in compliance of the stipulation laid down by the financial institutions and it became possible for the financial institutions to advance a loan to Hero Fibres Ltd only because of the aforesaid undertaking given by the assessee. Assessee also stated that no interest was to be paid on this loan unless dividend was paid by the subsidiary company. With regard to the loan advanced to the directors assessee submitted that these loans were never given out of any borrowed funds.

Both CIT(A) and ITAT ruled in assessee's favour. However, Punjab and Haryana HC referring to its own ruling in Abhishek Industries Ltd. [ITA No. 110/2005] held that when loans were taken from the banks at which interest was paid for business purposes, interest thereon could not be claimed as business expenditure.

SC referred to co-ordinate bench ruling in S.A. Builders Ltd. wherein SC had allowed deduction of interest on borrowed loan advanced to sister concern out of commercial expediency. SC further referred to Delhi HC ruling in Dalmia Cement (B.) Ltd. [2002 (254) ITR 377], wherein it was stated that Revenue cannot assume the role of businessmen to decide the reasonableness of an expenditure. It was also stated that businessman could not be compelled to maximise his profit and that the income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act.

SC observed held that advance made to Hero Fibres Ltd. became imperative as business expediency in view of the undertaking given to the financial institutions by the assessee to the effect that it would provide additional margin to Hero Fibres Ltd. to meet the working capital for meeting any cash loss. SC observed the fact that subsequently, the assessee had off-loaded its share holding in the said Hero Fibres Ltd. to various companies, it not only refunded back the entire loan given to Hero Fibres Limited by the assessee but this was refunded with interest. In the year in which the aforesaid interest was received, same was shown as income and offered for tax.

With respect to advance made to director, SC observed that Revenue failed to prove that such advance was not made out of borrowed funds and noted that the assessee company had reserves/ surplus to the tune of almost 15 crores and, therefore, the assessee company could in any case, utilise those funds for giving advance to its Directors.

LD/64/90
State Bank of Patiala
vs.
Commissioner of Income Tax, Patiala
18th November, 2015 (SC)

Section 2(28A) of Income-tax Act, 1961 - Section 2(7) of Interest tax Act, 1974.

Interest received by banks for delay by parties to fulfil their payment obligations on discounted bills of exchange is not chargeable to tax under

[1] Contributed by CA. Sahil Garud and ICAI's Editorial Board Secretariat.
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Interest Tax Act; Definition of interest u/s 2(7) of Interest Tax Act is narrow and exhaustive, unlike Sec. 2(28A) of Income Tax Act.

The question before the Court was whether interest received by Banks as compensation after bills of exchange have been discounted by them and a party defaults, was liable to tax under the Interest Tax Act, 1974.

The petitioner was engaged in the business where it purchases Bills of Exchange from its customers and charges commission. Subsequently, these bills are presented before parties and in case the amount is not realised on time, a certain amount in the form of interest is charged by the bank on a fixed percentage basis for every day of default. The petitioner-bank received such an interest upon delay by parties to fulfill their payment obligations. Such compensation received as "interest" was made liable to tax under the Interest Tax Act, 1974.

SC analysed the definition of interest as defined u/s 2(7) of the Interest Tax Act and opined that owing to the use of expression *"interest means ...but does not include",* the definition of interest under the said Act was a narrow one. SC referred to a co-ordinate bench ruling in *P. Kasilingam vs. P.S.G. College of Technology* wherein it was held that the expression "means and includes" was exhaustive. SC took note of Section 32 of the Negotiable Instruments Act which casts obligation on acceptor of a Bill to compensate party to the Bill for loss or damage sustained by it owing to the failure of acceptor to pay the amount on maturity.

As per Section 2(7) of Interest Tax Act was chargeable on interest only when same arise out of loans and advances made in India. SC observed that *"discount on bills of exchange would obviously not come within the expression 'loans and advances made in India', and consequently any amount that becomes payable by way of compensation after a bill is discounted by the Bank would not be an amount which would be on loans and advances made in India".*

SC stated that Section 2(7) itself made a distinction between loans and advances made in India and discount on bills of exchange drawn or made in India. SC therefore rejected the view expressed by the Karnataka HC in *State Bank of Mysore vs. CIT* wherein HC had held that Discounting of Bills was a form of advance or loan, and hence compensation paid on delayed payment of money due thereon was interest on loans and advances since interest is damages or compensation for delayed payment of money due. SC therefore stated that *"If discounted bills of exchange were also to be treated as loans and advances made in India there would be no need to extend the definition of "interest" to include discount on bills of exchange".* SC observed that "loans and advances", as a concept, is different from commitment charges and discounts and thus legislature has specifically included commitment charges as well as discounts in the definition u/s 2(7).

The right to charge for overdue interest by banks arose on account of default in the payment of amounts due under a discounted bill of exchange and not on account of any delay in repayment of any loan or advance made by the said banks. SC thus stated that since tax can be levied only under express authority of law and since u/s 2(7) tax is levied only on interest arising directly from loan, Interest payable "on" a discounted bill of exchange could not be equated with interest payable "on" a loan or advance.

SC observed that definition of "interest" as defined u/s 2(28A) of Income-tax Act is much wider than that contained in Section 2(7) of the Interest Tax Act. The expression used in Section 2(28A) is *"payable in any manner in respect of any moneys borrowed".* Under the said definition, expression "in respect of" includes interest arising even indirectly out of a money transaction. The expression "any moneys borrowed" is different from the words "loan or advances" used in interest tax act.

SC concluded that the Interest Tax Act, unlike the Income-tax Act, has focused only on a very narrow taxable event which does not include within its scope interest payable on default in payment of amounts due under a discounted bill of exchange.

LD/64/91
Pradip Burman
vs.
Income Tax Office
2nd December, 2015(DEL)

Section 276D, Income-tax Act, 1961-Failure to produce accounts and documents.

Pendency of appellate proceedings has no bearing on initiation of prosecution under the Act; Age at the time of commission of offence relevant; Prosecution against assessee was upheld.

The assessee had a foreign bank account in HSBC [Zurich] which was not disclosed in the income tax return for 2007-08. The assessee addressed a letter

to DGIT (Investigation) and submitted that said account outside India was as per FEMA Regulations. Revenue issued notice summons u/s 131 and also initiated proceedings for levy of penalty u/s 271. Further, prosecution proceedings were initiated against assessee.

The assessee challenged the prosecution on the grounds of age and appeal pendency.

The assessee submitted that Instruction No. 5051/1991 dated 07.02.1991 mandates that no prosecution could be initiated against a person who is above the age of 70 years, conveniently leaving out the expression *'at the time of commission of offence'.* Revenue argued that the said instruction refers to the age at the time of commission of offence and since assessee filed return in 2006 & 2007, his age were 63 years and 64 years respectively for AY 2006-07 and 2007-08.

HC distinguished assessee's reliance on co-ordinate bench ruling in Arun Kumar Bhatia [Criminal Revision Petition No.36/2011]. In that case, Revenue's counsel conceded that no prosecution could be initiated against a person who is above the age of 70 years. Thus, that said order was not passed on merits but was based on the precise statement made by Revenue's counsel and thus benefit of the same cannot be given to assessee. HC noted that at the time of commission of alleged offence assessee had not reached the age of 70 years and therefore the concerned instruction was not applicable to the assessee.

The assessee had further submitted that an appeal against AO's order was pending and thus prosecution could not be initated. Revenue submitted that at the time of filing of Complaint No. 70/04, the assessee had not filed any appeal and that the same had been filed as an afterthought with a view to thwart the criminal proceedings pending against him. Revenue also contended that pendency of appeal cannot be ground for stay of the proceedings if the same had no bearing on the complaint.

HC noted that the appeal had been filed challenging the AO and consequential outcome of imposition of penalty U/s 271(1)(c), Income-tax Act. Thus, at any count, the outcome of the appeal filed on behalf of the petitioner will have no bearing on the present complaint at least in respect of offence U/s 276D Income-tax Act. Moreover, no prayer for quashing of the proceedings was made by the petitioner in the application.

Relying on rulings in Sasi Enterprises [(2014) 5 SCC 139] and *B. Premanand & Ors* [(2011) 4 SCC 266], HC stated that pendency of appellate proceedings has no bearing in initiation of prosecution under the Income-tax Act.

HC noted that proceedings once initiated in a warrant trial case, there is no provision under the Code of Criminal Procedure, 1973, except U/s 258 Cr.P.C., where the proceedings of the case can be stayed by the Magistrate *suo moto* or upon the application filed on behalf of the accused.

HC thus ruled in favour of the Revenue.

Service Tax

LD/64/92
Kailash Chawla.
vs.
Commissioner of Service Tax, Delhi
6th November, 2015 (DEL)

Section 35F of the Central Excise Act, 1944 read with Section 83 of the Finance Act, 1994.

Civil work undertaken for Airports Authority of India-Tax computed on cost of materials supplied-service component involved of 25% to 44%- Tribunal order directing pre-deposit of ₹17.5 lakhs with interest modified-Appellant to make pre-deposit of ₹5 lakhs by 30.11.2015 consequent upon which Tribunal to hear appeal on merits-Appeal/applications disposed of.

The assessee is a contractor engaged in undertaking civil work primarily for the Airports Authority of India [AAI]. The assessee contended that works undertaken for the airports, road, railways *etc.* were excluded from service tax liability as they formed part of the infrastructure development of the country. A notice was issued by Revenue proposing to levy service tax on all contracts executed by the Assessee, which included the contracts undertaken for the AAI. The adjudicating authority upheld the demand categorising the service under "management, maintenance or repair service". Before CESTAT, the assessee pointed out that the adjudicating authority had computed the demand by taking the entire turnover of the Assessee which included the cost of the materials supplied. According to the Assessee the service component was between 25% and 44% of the turnover during the period in question.

The assessee submitted that in real terms the highest possible service tax demand worked out was ₹26.8 lakh whereas the CESTAT had asked the Assessee to deposit ₹17.5 lakh (along with

proportionate interest) which was about 65% of the highest possible service tax demand. Assessee had already deposited a sum of ₹4.17 lakh.

Delhi HC modified the impugned order of the CESTAT and directed the assessee to deposit a sum of ₹5 lakh before the CESTAT, after which CESTAT would consider assessee's appeal on merits.

Excise

LD/64/93

Commissioner of Central Excise.

vs.

M/s Nestle India Ltd.

24th November, 2015 (SC)

Rule 8 of Central Excise Valuation Rules.

Excise duty for purpose of application of exemption Notification Nos. 8/97-CE & 23/2003-CE should be arrived at in accordance with Rule 8 of Central Excise Valuation Rules, and not FOB export price of similar goods; Goods were captively consumed and not sold to sister units or actually sold in wholesale market, and thus Rule 8 of Excise Valuation Rules would have to be followed to determine amount equal to excise duty leviable on like goods.

The Assessee is a 100% EOU engaged in the manufacture of instant tea which falls under Chapter 2101.20 of Central Excise Tariff Act 1985. The present appeal is concerned with clearances of their product to two sister units on payment of duty in terms of Notification No.8 /97 - CE dated 1.3.1997 and Notification No.23/2003 CE dated 31.3.2003. The first notification would cover the period 1.11.2000 to 30.3.2003 and the second notification would cover the period 31.3.2003 to 31.5.2005.

A show cause notice was issued dated 23.09.2005 stating that ordinarily Rule 8 of Central Excise Valuation (Determination of Price of Excisable Goods) Rules, 2000 would apply and that tea being captively consumed and not sold, should be valued at 115% of the cost of production or manufacture of such goods. However, the show cause notice then goes on to say that as the said tea is transferred only to two sister concerns and no sale is involved, the assessable value of instant tea removed to the respondent's own units would be determined on the basis of the export price of similar goods and not 115% of the cost of production. The Additional Commissioner upheld the show cause notice and confirmed duty amount, interest and penalty. Commissioner (Appeals) confirmed the demand stating that Sec 3(1) *proviso* (ii) of Central Excise Act would apply to facts of the case and that being so, it was clear that basis for valuation had to be the FOB value of export of similar goods and not the cost of production under Rule 8 of Central Excise Rules.

However, CESTAT set aside the appellate order by reasoning that since the exemption Notifications applied and since what had to be determined was excise duty payable, such duty could only be arrived at by applying Rule 8 in cases of captive consumption and therefore the basis of show cause notice and the decisions by original and appellate authority were incorrect.

Notification No. 8/97-CE exempts finished goods and rejects and waste/scrap produced wholly from indigenous raw materials by EOU and allowed to be sold in India, from so much of excise duty leviable u/s 3 of Central Excise Act, as is in excess of amount equal to excise duty leviable on like goods, produced/manufactured in India other than in EOU or FTWZ, if sold in India.

SC observed that the object of the Notification is that so far as the product in question is concerned, so long as it is manufactured by a 100% EOU out of wholly indigenous raw materials and so long as it is allowed to be sold in India, the duty payable should only be the duty of excise that is payable on like goods manufactured or produced and sold in India by undertakings which are not 100% EOUs.

SC observed that whatsoever that the duty of excise leviable under Section 3 would be on the basis of the value of like goods produced or manufactured outside India as determinable in accordance with the provisions of the Customs Act, and the Customs Tariff act. However, the notification states that duty calculated on the said basis would only be payable to the extent of like goods manufactured in India by persons other than 100% EOUs. This being the case, it is clear that in the absence of actual sales in the wholesale market, when goods are captively consumed and not sold, Rule 8 of the Central Excise Rules would have to be followed to determine what would be the amount equal to the duty of excise leviable on like goods. Thus the basis of show cause notice itself was flawed.

According to SC, the expression "settled law" used by Revenue in the show-cause notice referred to CBEC Circular No. 268/85-CX.8 dated September 29, 1994 dealing with valuation of goods manufactured by units working under 100% EOU scheme. The said Circular referred to Rule 8 of

Customs Valuation Rules and not Central Excise Valuation Rule. SC observed that *"the application of this circular and consequently any FOB export price would be wholly irrelevant for the purpose of this case and as has been held above, is only for arriving at the duty of excise leviable under Section 3(1) Proviso (ii) of the Central Excise Act. On the facts of the present case, it is clear that the said duty of excise arrived at based on Section 3(1) Proviso (ii) is more than the duty determinable for like goods produced or manufactured in India in other than 100% EOUs. Since the notification exempts anything that is in excess of what is determined as excise duty on such like goods, and considering that for the entire period under question the duty arrived at under Section 3(1) proviso (ii) is in excess of the duty arrived at on like goods manufactured in India by non 100% EOUs, it is clear that the whole basis of the show cause notice is indeed flawed."*

Sc observed that the test to be applied under notification 8/97-CE was whether goods in question were "allowed to be sold" in India, which expression was different from the term "sold". Hence, to attract the Notification, actual sale was not required. It is clear that the said notification attempts to levy only what is levied by way of excise duty on similar goods manufactured in India, on goods produced and sold by 100% EOUs in the domestic tariff area if they are produced from indigenous raw materials. If the revenue were right, logically they ought to have contended that the notification does not apply, in which event the test laid down under Section 3(1) proviso (ii) would then apply.

SC thus ruled in favour of the assessee.

Customs

LD/64/94
GMR Energy Ltd
vs.
Commissioner of Customs, Bangalore.
27th October, 2015 (SC)

Rule 4 and Rule 9 of Customs Valuation Rules

Customs duty demand quashed on import of replacement/refurbished parts of Gas Turbine Hot Section of a naphtha based power plant, under Long Term Assured Parts Supply Agreement (LTAPSA) with associated foreign entity; Rule 4 r/w Rule 9 of Customs Valuation Rules inapplicable since there was no "sale" of goods for export to India or direct/indirect accrual of proceeds to seller from subsequent re-sale, disposal or use of the very goods imported by buyer; Once State Govt. authorities are satisfied that goods are required for renovation, Customs Dept. need not go deep into the matter and deny the benefit of exemption Notification.

The assessee is aggrieved by the valuation of import of parts of Gas Turbine Hot Section of a naphtha based power plant, whereas the Revenue is aggrieved whether assessee was entitled to benefit of Notification No. 21/2002 dated March 1, 2002 in respect of goods imported under 2 bills of entry (BOE) dated June 25, 2003.

Assessee, GMR Energy Ltd., had imported a naphtha based power plant with 5 Gas Turbines, which was mounted on a barge which floated in a river at a village near Mangalore for purposes of power generation. The capacity of the said power plant is 220 MW and entire power generated is uploaded into the grid of the Karnataka Power Transmission Corporation Limited (KPTCL).

Assessee entered into an agreement for service and supply of parts with GE, USA being a Long Term Assured Parts Supply Agreement (LTAPSA) dated December 12, 2000. As per the said agreement, assessee was to make payments based on either fired hour charges or maintenance charges. Various parts of Gas Turbine Hot Section of the said plant, which had to be imported under LTAPSA, were imported under 2 BOE dated June 25, 2003 after 12,500 fired hours had come to an end. The parts that were identified as having to be replaced were re-exported back to GE, USA under cover of shipping bills of May, 2003, before the 2 BOE were presented for import of the replaced parts to Customs authorities. Assessee-appellant paid customs duty based on the value declared in said bills of entry but did not make any payment to GE, USA based on these invoices since their payments had already been made based on fired hour charges. The assessment of the said import was completed by Customs Dept. after due verification of the documents produced at the time of import.

A show cause notice (SCN) was issued on the taking reference of Rule 4 and Rule 9 of the valuation rules and it was sought that 1/3rd of the value of imported items be added to the invoice value as that was said to represent the amount of parts that were replaced and re-exported back to GE, USA. A demand ₹4.20 crore and proposed confiscation of goods was made vide the notice.

The ld. Commissioner specifically found that as per the LTAPSA since the assessee has declared only the differential value of the returned parts and the parts imported, 1/3rd of the invoice value of the imported parts needs to be added to arrive at the correct assessable value. Thus, it confirmed the demand made in the show cause notice. CESTAT confirmed the order of the commissioner.

CESTAT dismissed assessee's appeal, thus confirming the order of Commissioner. In addition, CESTAT additionally found that there is no transaction value at all and, therefore, Rule 8 will have to be referred to and relied upon and a best judgment assessment was to be made.

SC perused the relevant provisions and observed that Rules 4 & 9 would apply only in case imported goods are "sold" for export to India. The expression "shall be the price actually paid or payable for the goods when sold for export to India" would necessarily postulate that transaction value would be based upon goods that are sold in the course of export from a foreign country to India. Admittedly there was no sale. All that happened under LTAPSA was that parts were replaced without any further charge after a certain number of hours of running of the power plant. SC accepted assessee's contention that neither Rule 4 nor Rule 9 applied.

SC further noted that Rule 4(2)(g) and Rule 9(1)(d) refer only to the very goods that are imported and not to goods which may have been imported much earlier to the imported goods. Therefore, what would be necessary is that there should be proceeds which arise from re-sale, disposal, or use of the very imported goods by the buyer, which in the instant case did not occur.

Equally, SC stated that Rule 9(1)(e) would not apply as there was no other payment actually made or to be made as a condition of sale of imported goods by the buyer to the seller.

Based on facts, SC concluded that Rule 5 would have no application in the facts of present case. Consequently, SC proceeded on the footing that Rule 8 alone applies and best judgment assessment made by Commissioner would have to be reasonable and not arbitrary.

SC accepted assessee's contention that in terms of clause 2.8, seller was only to furnish the buyer with "information" regarding the incremental value of each refurbished part so that customs duty may be limited to the incremental value of each such refurbished part. SC found that the assessee had made it more than clear that the price of imported goods was a rotable exchange programme price, which was common uniform price for supplies by GE, USA worldwide. Thus, SC stated, SC observed that prices stated in the invoices accompanying the bills of entry in the present case were list unit prices or catalogue prices and so by no stretch of imagination can they be said to be prices after re-exported items' value has been taken into account. Thus, both Commissioner and CESTAT were wrong in arriving at a conclusion that invoice price was only an incremental value price and not the price of articles supplied by GE, USA.

SC noted that conjoint reading of Section 46(4) of Customs Act & Rule 10(1)(a) of the Rules makes it incumbent on the importer while presenting a BOE to subscribe to a declaration as to the truth of its contents and in addition, to produce to the proper officer the invoice relating to imported goods. There was no doubt that assessee had fulfilled this condition. According to SC, LTAPSA would be a document which would fall within Rule 10(1)(b) r/w Sec 17(3) of the Act as it then stood. A conjoint reading of of Section 17(3) and Rule 10(1)(b) made it clear that the proper officer may require the importer to produce any contract with reference to the imported goods consequent upon which the importer shall produce such contract. In the instant case, the proper officer had not called upon the assessee to produce any contract in relation to the imported goods, and thus there was no infraction of Rule 10.

As regards Revenue appeal, SC observed that both the requisite certificates as well as recommendation of Principal Secretary, Govt. of Karnataka, had been dealt with in the proper perspective. The CESTAT was correct in its finding that once the authorities were satisfied that the impugned goods were required for renovation, the Customs Dept need not go deep into the matter and by hair-splitting and semantic niceties, deny the benefit of exemption Notification. SC thus dismissed Revenue appeal.

LD/64/95

Cargill India Pvt. Ltd

vs.

Commissioner of Customs and Central Excise

28th October, 2015 (SC)

Section 50 and 113 of the Customs Act.

Conversion of free shipping bills into drawback shipping bills–Conversion permissible only

when claim for duty drawback was beyond the control of the exporter; Drawback on All industry rates can be considered without converting the Shipping Bill.

The assessee is an exporter of a variety of food and agriculture related products. During the period 08.11.2007 to 23.01.2008, the appellant had filed as many as 14 shipping bills for export of Soyabean meal through Visakhapatnam Port to Vietnam and Japan. While filing the shipping bills, the appellant did not claim any duty drawback and instead free shipping bills for export were filed. The appellant submitted an application to the Commissioner (Customs) for conversion of the said free shipping bills into drawback shipping bills under Rule 12(1)(a) of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995. The Commissioner rejected the request of conversion on the ground that under Rule 12(1)(a) of the Rules, the request could be made for change/conversion only for the reasons because of which the shipping bills filed earlier were beyond the control of the exporter and since the appellant could not satisfy this requirement, it was not permissible for him to seek conversion of the free shipping bills into duty drawback bills under the aforesaid Rules. Further the Commissioner noted that that at the time when the appellant had sought the duty drawback, the goods could not be physically examined. CESTAT reversed the order of the Commissioner, however HC ruled in favour of the assessee.

Issue before the SC was that whether the appellant is entitled to claim conversion of free shipping bills into drawback shipping bills on the basis of Rule 12(1)(a) of the Rules?; If no, whether the appellant is entitled to the benefit of duty drawback on the strength of Circular No. 04/2004 dated 16.01.2004 even without seeking conversion?

SC analysed the provisions of Rule 12 and observed that a bare reading of the aforesaid Rule demonstrates that such conversion is permissible only when the exporter is able to satisfy the Commissioner that "for reasons beyond his control" drawback was not claimed. Merely because the appellant was not aware of the correct legal position would not afford any such ground that it was beyond his control.

With respect to Circular No. 04/2004, SC observed that this Circular referred to the discussion that was held in the Conference of Chief Commissioner on Tariffs and allied matters held on 25th/26th September, 2003 and notes that in the said conference it was felt that in cases where the exporters had filed free shipping bills on their own, it would not be advisable to permit such conversion. This view of the Commissioner's Conference was deliberated by the Central Board of Excise & Customs and the issue was re-examined, which resulted in the issuance of the aforesaid circular. After taking note of the provisions contained in Rule 12(1)(a) of the Rules which undoubtedly state that *"no provision exists for permitting conversion of free shipping bills into drawback shipping bills"*, the Board was still of the opinion that it was permissible for the Commissioner to examine and consider individual requests on merits and facts in terms of the aforesaid provisions and the relaxation shall only apply in respect of drawback claims pertaining to All Industry Rates of drawback and it would not apply to brand rate of duty drawback, where rate is claimed in terms of Rule 6 or Rule 7 of the Customs & Central Excise Duties Drawback Rules.

SC perused Section 50 and 113 of the Customs Act and observed that the proper officer is to satisfy itself only to the extent that the goods which are entered for export are not prohibited goods and the exporter has paid the duty at the time of clearance of the goods meant for export and therefore, the inspection is confined to the aforesaid aspect viz. the goods are not prohibited. Since in the present case, goods are not dutiable, no duty has to be paid. Therefore, there was no reason for denying the benefit only on the ground that at the time when the appellant had sought the duty drawback, the goods could not be physically examined.

SC concluded that provisions of Circular No. 04/2004 dated 16.01.2004 would be applicable in the instant case. SC remitted the matter back to Commissioner directing him to examine and consider the request of the appellant on merits as per the stipulation contained in Circular No. 04/2004 dated 16.01.2004

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International Taxation

LD/64/96

Columbia Sportswear Company vs. DIT (Karnataka HC)

DTAA India–USA, Explanation 1(b) of Section 9(1)(i) of the Income Tax Act, 1961.

Procurement activity carried out by liaison office in India is not taxable.

The assessee, a company incorporated in and a tax resident of the US, was engaged in the business of designing, developing, marketing and distribution of outdoor apparel with operations in North America, Europe and Asia. The assessee had set up a Liaison Office ('LO') in India for undertaking liaison activities for purchase of goods in India. The LO was engaged in the purchase coordination activities i.e., vendor identification, review of causing data, uploading of material prices into the internal product data management system, ensuring vendor recommendation and quality control, monitoring vendor compliance with policies, procedures and standards related to quality, delivery, pricing and labour. Specifically, the LO did not supervise, direct or control the production facilities of the Indian vendors. Its activities were consistent with the approval granted by the Indian Regulatory Authority to it. The LO also did not distribute or retail its products in India. It had no revenue streams in India and also did not source products for local sales in India. Additionally, designing of all the products was undertaken outside India.

The assessee had applied to the AAR to adjudicate upon this issue. The AAR held as under:

- A portion of the income of the business of designing, manufacturing and sale of the products imported by the applicant from India accrues to the applicant in India.
- The applicant has a business connection in India being its liaison office located in India.
- The activities of the Liaison Office in India are not confined to the purchase of goods in India for the purpose of export.
- The Income-taxable in India will be only that part of the income that can be attributed to the operations carried out in India. This is a matter of computation.
- The Indian Liaison Office involves a 'Permanent Establishment' for the applicant under Article 5.1 of the DTAA.
- In terms of Article 7 of the DTAA only the income attributable to the Liaison Office of the applicant is taxable in India.

Assessee's Contentions:

The assessee contended that no income would be deemed to accrue or arise in India through or from operations which are confined to the purchase of goods for exceptional purpose of exports as per the exceptions carved out in Explanation 1(b) of Section 9(1)(i). It does not undertake any activity of trading, commercial or industrial in nature in India. The expenditure of the liaison office is entirely met by remittances made by the assessee. Further, it also submitted that there exists no permanent establishment ('PE') in India as per the Double Taxation Avoidance Agreement ('DTAA') entered with USA. The assessee carries out only purchase co-ordination functions which are covered by the specific permanent establishment exclusionary clause specifically covered under the PE Article of the DTAA.

Revenue's Contention:

The designing and the manufacturing of products was carried out by the assessee in India and hence a portion of the income relating to these activities accrued to the assessee in India. The LO constitutes a permanent establishment of the assessee under the article 5 of the DTAA and hence in terms of article 7 of the DTAA, the income attributable to the Indian LO from the Indian activities would be taxable in India.

The High Court ('HC') held as under:

Article 7(1) of the DTAA applies if a PE carries on business of sales in India or other business activities of the same or similar kind. Therefore, there is no tax liability if purchase is made for the purpose of export.

Furthermore, if the PE is established for the purpose of purchasing goods or merchandise or for collecting information for the enterprise, it is not a PE as defined in Article 5 read with Article 7 of the DTAA.

The LO of the assessee identifies a competent manufacturer, negotiates a competitive price, helps in choosing the material to be used, ensures compliance with the quality of the material, acts as a go-between and involves itself in testing of the material for ensuring quality and compliance with the relevant laws and policies.

If the assessee has to purchase goods for the purpose of export, an obligation is cast on it to see that the goods, which are purchased in India for export, is acceptable to the customer outside India.

Therefore, the AAR was not justified in recording a finding that these acts amount to involvement in all the activities connected with the business, except the actual sale of the products outside the country.

All these acts are necessary to be performed by the assessee before export of goods. Consequently, the reasoning that the LO would qualify to be a PE is erroneous.

The LO was established only for the purpose of carrying on business of purchasing goods for the purpose of export and all that activity also falls within the meaning of the words "collecting information" for the enterprise.

Under the facts of this case, the HC reached a conclusion that, as the LO is engaged in activities that are connected to and necessary for the purchase activity, it satisfies the requirement of PE exclusion under the DTAA provisions. Hence, it does not result in a taxable presence for the assessee in India.

Therefore, the assessee is eligible for the DTAA PE exclusion.

LD/64/97

Food World Super Markets Ltd

vs.

DDIT (Bangalore ITAT)

Section 9(1)(vii), Section 44DA of the Income Tax Act, 1961.

Salary reimbursement for seconded employee taxable as FTS.

The assessee, Food world Supermarkets Ltd. is company engaged in the business of ownership and operation of supermarket chain in India. The assessee entered into a secondment agreement with Diary Farm Company Ltd. ('DFCL') which is a company based in Hong Kong under which DFCL assigned 5 personnel/employees to assessee. The salaries of these employees were paid by DFCL which was subjected to TDS u/s 192. The assessee reimbursed the amount paid towards the salary to DFCL but did not deduct tax u/s 195 on the same as it was in the nature of reimbursement. AO however initiated proceedings u/s 201 as it was of view that remittance made by assessee constituted Fees for Technical Services ('FTS') u/s 9(1)(vii) and thus was chargeable to tax on gross basis. AO in addition to tax @ 10% also levied interest u/s 201(1A). CIT(A) upheld AO's order

Assessee's Contention:

The remittance to DFCL is nothing but reimbursement of remuneration paid to the employees under seconded agreement and said salary was chargeable to tax in India. Therefore, the assessee was under the liability to deduct tax at source u/s 192 of the Act which was discharged by the assessee and hence it cannot be regarded as FTS.

Revenue's Contentions:

The assessee did not have any control over deputed personnel.

The seconded employees were still on the pay role of DFCL and, therefore, there was no relation of master and employees between the assessee and these employee seconded.

DFCL was the actual employer hence the services rendered by this employees were actually rendered on behalf of DFCL.

The remittance was not towards reimbursement of salary but for the services rendered by the expatriates on behalf of DFCL.

The ITAT held as under:

ITAT noted that the employees deputed by DFCL were high level officials which were deputed because of their expertise and managerial skills in the field. ITAT also noted that the employee seconded were assigned by DFCL and there was no separate contract of employment between assessee and the employee seconded.

As employee seconded further claimed salary from DFCL, ITAT concluded that expatriates were performing their duties for and on behalf of the DFCL and thus were rendering managerial and highly expert services to assessee. ITAT thus noted that these payments were within the ambit of FTS as defined in Explanation 2 to Section 9(1)(vii). ITAT pointed out that ***Delhi HC in Centrica India Offshore Pvt. Ltd. W.P.(C) No.6807/2012*** had in similar facts held that services of the personnel deputed under the secondment agreement were in the nature of managerial consultancy services to the assessee.

Though said ruling was in context of India UK DTAA, HC therein held that the provision of services of technical or other personnel is common in both definition provided under Explanation 2 to section 9(1)(vii) of the Act as well as in the Article 13(4) of the India UK DTAA, noted ITAT. ITAT

noted that SLP against the said ruling was dismissed by Supreme Court ('SC') and thus view taken by HC attained finality.

ITAT further observed that concept of income includes positive as well as negative income or nil income and in case of FTS payments it was irrelevant whether any profit element was present in the income or not. ITAT held "If the payment being FTS or royalty is made to nonresident, then the concept of total income becomes irrelevant and the provisions of section 44D recognise the gross payment chargeable to tax. Thus, all the payment made by the assessee to non-resident on account of FTS or royalty an chargeable to tax irrespective of any profit element in the said payment or not".

With regard to assessee's argument that secondment of employees constitute a service Permanent Establishment ('PE') and thus amount paid was chargeable as per Section 44DA, ITAT noted that there was no DTAA between India and Hong Kong and Income-tax act did not provide for the concept of service PE.

The assessee in this regard placed reliance on ***SC ruling in DIT(E) vs. Morgan Stanley and Co. Inc. [292 ITR 416]*** wherein while interpreting the definition of PE as provided u/s 92F(iii), SC had observed that definition of PE covers services PE, agency PE, Software PE, construction PE *etc.*

ITAT thus noted that since the assessee took this plea for the first time before ITAT, concept of service PE required proper examination and thus remanded the matter to AO for adjudication that whether secondment of the employees constitutes a service PE and that whether Section 44DA would be applicable.

Transfer Pricing

LD/64/98

Johnson Matthey India Private Limited

vs.

DCIT

(Del HC) (ITA 14/2013)

Rule 10B of the Income-tax Rules, 1962 – OECD Transfer Pricing Guidelines.

'Pass through' costs not having effect on profits can be excluded from PLI denominator.

The Assessee, Johnson Matthey India Private Limited ('JMIPL') is engaged in the business of manufacture and sale of automobile exhaust catalysts. 90% of the shares of the Assessee are held by Johnson Matthey Plc. UK ('JMUK') through Matthey Finance, BV, Netherlands. JMIPL's manufacturing unit is located at IMT, Manesar in Haryana. Maruti Udyog Limited ('MUL') is a major customer of JMIPL accounting for most of its sales. JMIPL and MUL agreed on an arrangement where JMIPL would sell finished catalysts to the vendors of MUL under the instructions of MUL. JMIPL used two basic raw materials for the manufacture of the catalyst. The raw materials were procured from its associated enterprises (AEs) JMUK (for precious metals) and Johnson Matthey Malaysia (JMM) (for wash coated substrates). With respect to precious metals, JMIPL entered into a Forward Cover Agreement (Agreement) with MUL, agreeing to provide a quote for purchase on a specified day in future. The Agreement also states that the quote shall be an invitation to treat only and not an offer and in the event that MUL wishes to make an offer for the purchase of the precious metal on the basis of the quote, an authorised employee of MUL would place a firm and binding order with JMIPL by fax within the specified period in a set form. JMIPL will use these precious metals bought in manufacture of auto catalyst for MUL. In addition to a fixed manufacturing charge, JMIPL recovers the entire cost of raw material consumed in the manufacture of the catalyst from MUL.

The Profit Level Indicator ('PLI') in the TP Report was as under:

- Return on capital employed ('ROCE') was selected as (PLI) for all international transactions except for the sale of catalysts to AEs.
- For sale of catalysts to AEs, net profit margin i.e. profit after tax (operating profits less operating cost) as a percentage of sales was selected as the PLI.

The transfer pricing officer ('TPO') rejected ROCE and held that Operating Cost/Total Cost (including cost of raw materials) as the appropriate PLI. The CIT(A) rejected the Assessee's appeal on the basis that JMIPL is engaged in manufacturing and not any seasonal business. This view was also upheld by the Delhi ITAT which observed that the cost of purchase of precious metals cannot be treated as pass through cost based on the accounting followed by the assessee and its AE.

The assessee then appealed to the Delhi High Court ('HC') with two grounds

- Replacement of the assessee's PLI without providing cogent reasons and;

- Not treating the cost of raw materials as pass through cost in the alternate PLI and rejecting the Assessee's contention that cost of the raw material should be excluded from the total cost if the alternate PLI is adopted

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Assessee's Contentions:

The assessee contended that it being a contract manufacturer in a highly capital intensive industry, an asset based PLI would be appropriate. The same contention was accepted by the Revenue in AY 2002-03 to AY 2011-12.

In support of this contention, the assessee relied on the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010, the United States Regulation on Transfer Pricing and the Taxation Ruling TR 97/20 issued by the Australian Tax Office and the ICAI Guidance note on Transfer Pricing. Further, no cogent reasons was provided for rejection of ROCE as the PLI.

With respect to the alternate PLI, the assessee submitted that no function was performed by JMIPL, no risk was undertaken and no assets were employed and hence the cost of raw materials should be reduced from the total cost.

It was further reiterated that JMIPL could not earn any profit based on percentage of raw material used since the purchase was based on instructions and order placed by MUL, which is unrelated *vis-à-vis* JMUK.

Therefore, the price was already at arm's length and routing of transaction through the assessee was only for administrative reasons.

Revenue's Contentions:

The revenue, on the other hand out rightly rejected ROCE as being inconsistent with Rule 10B(1)(e)(i) and asset employed had no relation to purchase transactions.

Further for treating the raw material cost as a pass through cost, the revenue's contention was that the accounting entries do not show that the materials purchased were to be treated as a pass through cost and highlighted the absence of any agreement between MUL and JMUK to rule out any value addition by JMIPL.

The HC held as under:

- HC noted that the Rule 10B envisages computing the net profit margin realised by the enterprise from an international transaction entered into with an AE in relation to costs incurred, or sales effected, or assets employed or to be employed by the enterprise, or having regard to "any other relevant base."
- HC further noted that ICAI Guidelines state that ROCE is computed with respect to operating assets. Explaining the relevance of ROCE as PLI, the HC agreed with the TPO's observations that "reliability of ROCE as a PLI depends upon the extent to which the composition of assets/capital deployed by the tested party and their valuation is similar to that of comparables.
- If operating assets reported in balance sheet do not reliably measure the capital employed, ROCE would be less reliable than financial ratios. If the balance sheet does not accurately reflect the average use of capital throughout year, ROCE would be less reliable".
- Further noting that JMIPL has itself understood the limitations and changed the PLI to operating cost/ (total cost-raw materials cost) for subsequent AYs, the HC rejected ROCE as the PLI and ruled in favour of the Revenue.
- The HC rejected the Revenue's arguments by stating that it failed to consider the actual arrangement. HC accepted JMIPL's argument that its profit is not at all affected by the cost of raw materials. HC noted that exclusion of pass through cost from total cost has been recognised in Para 2.93 of OECD Transfer Pricing Guidelines.
- HC observed that in the absence of any reliable comparable data, and in the absence of proper reasons, it would not be justified for the Revenue to simply reject a financial ratio adopted by the assessee for computing the net profit margin by excluding a pass though cost from the TC in the denominator.
- The expression "any other relevant base" occurring in Rule 10 (1) (e) (i) of the Rules is

wide enough to encompass a denominator that excludes pass through costs as long it is demonstrated to be at arm's length.

- HC also held that there was merit in Assessee's contentions that the arrangement is for administrative convenience. HC held, "If MUL had bought the PGM (Platinum Group Metals) directly from JMUK there would have been no application of transfer pricing since MUL and JMUK are unrelated entities. MUL would have purchased the PGM just like JMIPL did on negotiated prices."
- Thus, HC held Revenue's contentions were merely based on suspicion. Also noting that the said PLI has been accepted by the Revenue in subsequent years, the HC ruled in favour of the assessee.

LD/64/99

ADIT

vs.

ABB Lummus Heat Transfer BV

(Delhi ITAT) (ITA No.2763/Del/2013)

Rules 10B & 10C of the Income Tax Rules, 1962.

Hourly rates can be considered for internal CUP if similar services are rendered to Non AE.

The assessee, ABB Lummus, is the Indian branch office of a company incorporated in the Netherlands, and is engaged in the designing of engineering and construction projects in the power, oil and gas, fertiliser and petrochemical sectors. During AY 2005-06, the assessee reported an international transaction of rendering `Services' to its AEs and also earning of revenue from `Equipment supply'. The assessee also declared transactions with non-AEs, and used the Transactional net margin method ('TNMM') as the most appropriate method to demonstrate that its international transactions were at arm's length price (ALP). The assessee computed its operating profit margin at 10.81% from the international transactions as against loss of 17.89% from unrelated transactions. The AO applied Comparable Uncontrolled Price ('CUP') Method, and applied the hourly rate charged by the assessee to from its non-AEs to compare the rates charged to the AE.

The ITAT held as under:

- ITAT observed that the assessee had applied TNMM as the most appropriate method on both transactions of 'Service revenue' and 'Equipment supply revenue'. ITAT also noted that it rendered similar services to AEs and independent third parties.
- ITAT observed that when the services provided to the AEs are similar to those provided to non-AEs, the CUP method cannot be ignored.
- ITAT held that the internally uncontrolled comparable transactions of rendering similar
- services as provided to the AEs are available and accordingly, CUP should be considered as a the most appropriate method.
- ITAT thus approved AO's view in determining the ALP of the international transaction of `Service' revenue from its AE on the basis of CUP method as against TNMM applied by the assessee.
- Further, the ITAT observed that the area of dispute is also related to the determination of the correct hourly rate charged by the assessee from unrelated parties.
- The ITAT observed that the assessee had charged the AEs at an hourly rate of ₹1,135 per hour.
- Referring to Rule 10B(1)(a), ITAT observed that if there is only one comparable uncontrolled transaction, then such sole transaction should be considered as a benchmark and whereas in case of plurality of the comparable uncontrolled transactions, their average price is to be taken as benchmark, and AO/TPO cannot resort to cherry-picking.
- Applying the same, ITAT observed that AO had ignored 5 invoices representing service charges for the actual work done by the assessee to unrelated parties, and had only picked up 3 invoices of ₹24,000/- each for determining the benchmark rate of ₹1,500/- per hour, which, merely represented site visiting charges undertaken by the assessee's employees.
- It was observed that considering all 8 invoices raised in non AEs and not resorting the cherry picking undertaken by the AO, the average hourly rate came to ₹717/-, or by ignoring the 3 invoices from computation of revenue as well as number of hours, the average hourly rate was ₹682/-.
- Accordingly, ITAT held that, "the price charged by the assessee from its AEs at ₹1,135/- per hour is definitely at arm's length". ITAT thus upheld CIT (A)'s deletion of TP addition. ■