

## Direct Tax

### High Court decisions

*Assessing Officer ('AO') is not bound to accept the system of accounting regularly employed by the taxpayer, the correctness of which had not been questioned in the past*

The taxpayer earned its income from manufacture and sale of vegetable oils. It valued the oil-in-process at cost plus Rs 100 for the purpose of closing stock valuation. The taxpayer contended that it had followed the same method for the past 15 years and any interference would be unjustified and could amend the previous audits as well. The AO did not accept this contention and while making an addition observed that if the actual manufacturing expenses are not considered while valuing closing stock, the entire system of valuation could go wrong and any wrong committed in the past could be amended in respective years. On appeal, the Commissioner of Income-tax (Appeals) ['CIT(A)'] deleted the addition relying on the order of the CIT for the preceding year where it was held that this method was only adopted for valuation of stock in process and not manufactured goods. On Revenue's appeal, the Income-tax Appellate Tribunal ('Tribunal') restored the order of the AO on the basis of a Supreme Court judgment in case of British Paints India Ltd. On further appeal by the taxpayer, the High Court ('HC') upheld the Tribunal's order not accepting the method of valuation adopted by the taxpayer since not considering all manufacturing costs in valuing closing stock would distort the picture of the business. Under this methodology, the profits of one year would get shifted to the next year which is incorrect. The HC also held that merely because a system of accounting has been followed for many years without being questioned does not mean that the taxpayer can continue following it even if it is incorrect. Accordingly, the appeal of the taxpayer was dismissed. Kishan Chand & Co Oil Ind Ltd v CIT (2011-TIOL-838-HC-P&H-IT) (Punjab and Haryana HC)

*When the taxpayer files its Return of Income ('ROI') online and dispatches to the Central Processing Centre ('CPC') by ordinary post as mandated by the instructions specified by the Revenue it cannot be treated as invalid if the CPC fails to trace the ROI*

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- ◆ [Getting the Deal Through – Tax on Inbound Investment 2012'](#)
- ◆ [Taxand's Global Guide to M&A Tax. Click here to view media commentary.](#)
- ◆ [Taxand voted Top Tax Planning Advisor in 32 countries in ITR's 2011 poll. Click here to view article.](#)
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The taxpayer e-filed its ROI and dispatched a duly signed copy of ITR V to the CPC by ordinary post in accordance with the instructions specified by the Revenue. Subsequently, the Revenue twice sent a communication to the taxpayer to submit the ITR V since the CPC had not received it. On both occasions the taxpayer sent a copy of the ITR V by ordinary post but never received an acknowledgment. Finally the Revenue sent a communication to the taxpayer that though the return had been uploaded correctly, it deemed never to have been filed since it was not duly verified in accordance with Section 139 of the Income-tax Act, 1961 (the 'Act') and accordingly the ROI was treated as invalid. Against this communication, the taxpayer filed a writ petition. The HC held that where there is adequate evidence to prove that the taxpayer had actually sent ITR V by ordinary post within the time specified for this purpose, the Revenue could not treat the ROI as invalid merely because it could not locate the ITR V. Further, it also held that the taxpayer should be provided an opportunity to have the ROI verified by the AO in accordance with the provisions of Section 139(9).

*M/s Crawford Bayley & Co v UOI & Ors (2011-TIOL-840-HC-MUM-IT) (Mumbai HC)*

*A secured creditor has preference compared to dues of Income-tax Department in respect of secured assets*

A company borrowed funds from the petitioner Banking Company and mortgaged land against it. The borrower defaulted in repayment and the petitioner took possession of the mortgaged land in accordance with the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 and put the property to sale. Meanwhile, the borrower's audit was completed and a tax demand was raised. Penalty proceedings were also initiated and completed. In view of the audit, the AO attached the mortgaged land under Section 281B with the approval of the CIT. The petitioner bank filed a writ before the HC to protect its interests since the Revenue claimed a preferential right to realize its dues from sale proceeds of mortgaged land, being crown debt. The HC held that there is no provision in the Act which gives preferential rights to the dues of the State under the Act as a preferential right, and observed that the petitioner as a secured creditor has preference over the dues of the Revenue in respect of the secured assets. However, the petitioner was directed to remit any excess amount after adjusting its dues to the Revenue, being preferential creditor amongst unsecured creditors.

*Axis Bank Ltd v CIT (2011-TIOL-828-HC-P&H-IT) (Punjab and Haryana HC)*

*Offshore supply of equipment comprising hardware and software is not taxable in India; revenues from software license are not taxable as royalty income; software supply is an integral part of equipment*

The taxpayer, Ericsson Radio Systems AB, a tax resident of Sweden supplied network equipment system to various Indian customers. Under the agreement the supply of integrated equipment comprising hardware and software was made overseas. The installation of the equipment was carried out by the Indian affiliate of the taxpayer

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under separate contracts. The Indian affiliate also provided marketing assistance to the taxpayer. An overall agreement was entered into, to ensure proper coordination of supply and installation contracts. The AO held that the taxpayer had a business connection and a permanent establishment ('PE') in India and that the income from sale of equipment was taxable in India – profits from sale of hardware as business income on net basis and revenue from software supply as royalty on gross basis. On appeal, the Special Bench of the Tribunal ruled in favor of the taxpayer. On further appeal, the HC held that the supply of integrated equipment was made overseas and the property of goods was transferred outside India. The place of signing the contract, place of negotiation or formal acceptance or overall responsibility are irrelevant parameters. Merely because the supply activity is to be carried out by two separate group entities, the transaction cannot be treated as a composite transaction since both perform their respective obligations. The HC further observed that the taxpayer does not have a business connection in India since the Indian customers are independent parties and no profit accrued to the taxpayer from the Indian affiliate. The software did not have any independent existence and was a part of the integrated equipment; hence it is not permissible to assess its taxability separately. The HC also made a distinction between 'copyright' and 'copyrighted article'.

Ericsson Radio Systems AB, New Delhi (2011-TII-46-HC-DEL-INTL) (Delhi HC)

*Where partnership deed does not specify quantum, amount and manner of computing remuneration to partners, no deduction could be allowed under Section 40(b)(v)*

The taxpayer was a partnership firm consisting of two partners. In its ROI for the year, the taxpayer claimed deduction towards remuneration to partners. The AO disallowed these amounts on the ground of violation of Section 40(b)(v), which allows a deduction only if the remuneration is authorized and is in accordance with the partnership deed. On appeal, the CIT(A) and the Tribunal confirmed the AO's order. On further appeal, the HC examined the 'partnership deed' and the 'supplementary partnership deed' with respect to the remuneration to partners. While the partnership deed only provided for sharing of profits and losses, the supplementary partnership deed provided that the remuneration payable is to be mutually agreed between the partners from time to time and that the remuneration to the working partners to not exceed the amount permissible as remuneration to the working partners under the Act as applicable. The HC held that since it was not possible to ascertain the quantum and amount of remuneration under the deeds and that for a particular year this could be determined only in the future, conditions of Section 40(b)(v) which requires that that a partnership deed should either specify the amount payable as remuneration or the manner of quantifying the remuneration, are not satisfied. The remuneration paid was therefore disallowed for the firm.

Sood Brij & Associates v CIT (2011) (203 TAXMAN 188/15) (Delhi HC)

*Interest and finance charges on credit facility cannot be disallowed when there is no correlation between investments made and credit facility availed*

The taxpayer borrowed money as a term loan and for working capital in preceding years on which it paid interest and finance charges. During the year under

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#### Snippet

CBDT panel for amnesty to recover black money

Based on the recommendations of a high-powered panel, the government is considering announcement of an 'amnesty scheme', for Indian citizens having unaccounted wealth abroad. Further, it is also considering a proposal to permit the Indian Revenue authorities to dig into income tax filings of past 16 years of the suspected taxpayers. The committee on black money, headed by CBDT Chairman, considered among other suggestions, an Offshore Voluntary Compliance

consideration, it hived off its distillery business to a subsidiary against which it was allotted shares in the subsidiary. The AO contended that there was a direct nexus between the money borrowed by the taxpayer and the investments made in its subsidiary and that this arrangement lacked business rationale and was a colorable device to subsist the taxpayer's subsidiary while saddling itself with a significant financial burden. The AO therefore disallowed the interest cost. On appeal, the CIT(A) as well as the Tribunal, deleted the disallowance made by the AO, and held that there was no co-relation between the utilization of the moneys borrowed and the investments in the subsidiary. On further appeal, the HC upheld the earlier orders, observing that factually, the CIT(A) and the Tribunal had noted that the taxpayer had borrowed funds as term loan and for working capital, which was not disputed. Further, the HC also observed that the AO failed to notice that interest and finance charges were paid in the preceding years as well when the distillery business was still owned by the taxpayer. Accordingly, the nexus for borrowings made for the purposes of making investments was not established and hence the HC dismissed the Revenue's appeal.

Narang Industries Pvt Ltd v CIT (2011-TIOL-849-HC-DEL-IT) (Delhi HC)

*Expenses incurred to maintain corporate status and to meet legal and statutory requirements are allowable even in the absence of business; depreciation on machinery kept ready for manufacturing is allowable*

The taxpayer, a company, filed its ROI declaring a loss after claiming various expenses and depreciation, though it did not carry on any business activity during the year. In the audit, the taxpayer submitted that the business was still going concern and that in order to keep it alive and fulfill several legal and statutory formalities, some expenditure had to be incurred. Further, the plant and machinery were kept ready to use and such passive use also amounted to use of the asset for depreciation. The AO disallowed the expenses and depreciation on the basis that no business activity was carried on. On appeal, the CIT(A) allowed the expenses claimed by the taxpayer on the basis that the taxpayer did not completely abandon or close its business forever, but upheld the AO's order on disallowance of depreciation. On further appeal by the taxpayer, the Tribunal allowed the depreciation on the basis that the plant and machinery were kept ready to use in the business once revived, which constituted passive use that fulfilled the conditions under Section 32 for depreciation. On further appeal by the Revenue, the HC held that based on the facts of the case, the taxpayer had not closed its business and had every intention to revive it and the CIT(A)'s order allowing the expenses not having been challenged by the Revenue fortifies the taxpayer's case. Further, on depreciation, the HC held that the only condition to claim depreciation on the assets which were kept ready to use was that the business should not have been completely shut down and the taxpayer should have every intention of reviving the business as soon as possible. Since the taxpayer fulfilled this condition, it was entitled to the allowance of depreciation. Accordingly, the HC ruled in favor of the taxpayer.

CIT v Integrated Technologies Ltd (2011-TIOL-849-HC-DEL-IT) (Delhi HC)

*In the absence of any straight jacket formula for apportionment of expenses, the*

scheme on the lines of that operated in the United States, United Kingdom, Germany, France, Greece, Italy and Portugal. The committee will submit its report to the Finance Minister by January 31, 2012, which may also recommend changes in the current income tax law to curb generation of black money within the country.

Source: [Business Standard](#)

#### Snippet

Income-tax department decides to reopen old tax returns

Income-tax department has decided to re-open past tax returns of some individuals to unearth black money stashed abroad. The CBDT has decided to send the names of those taxpayers to the Income-tax audit wing, who have refused holding accounts in Swiss or Liechtenstein banks after India recently obtained their names in its attempt to unearth illegal funds hidden in foreign accounts.

Source: [Business Standard](#)

*taxpayer's method of apportionment is to be accepted on the principle of consistency*

The taxpayer was engaged in the business of development and export of software, carried out through a unit situated in a Software Technological Park ('STP unit') and from a non-STP unit. Deduction under Section 10A was claimed by apportioning expenses on head-count basis, a consistently followed method. The AO enhanced the income of the non-STP unit by apportioning the expenditure on the basis of turnover. On appeal, the taxpayer submitted that the units operated on a project basis with expenditure attributable to each project and that since the taxpayer was in the service industry, head-count method was more appropriate as turnover method was more appropriate to manufacturing concerns. It was also submitted that no judicial precedent laid down the best method of apportionment of expenses and as the taxpayer's method has not been found to be unreasonable or inconsistent with commercial accounting principles, it should not be disturbed. The CIT(A) upheld the order of the AO. On further appeal by the taxpayer, the Tribunal allowing the appeal observed that the computation under Section 10A for each eligible unit had to be made separately in accordance with the provisions of Section 10A(4) and that since the consistently followed method of the taxpayer was accepted by the Revenue in the past, disturbing the method adopted was not called for. On further appeal by the Revenue, the HC observed that the formula under Section 10A(4) was for segregating profits into export and domestic profits, and that no statutory method was prescribed for apportioning expenses. Where alternative methods of apportionment of expenses are recognized and there is no statutory or fixed formula, apportionment can only be an approximation / estimation. If this be the case, it cannot be said that the profits are being distorted by consistently following the method. However, the profits would be distorted if the method which has been consistently followed and accepted is sought to be disturbed only in a few years especially in cases where the deduction sought is available for a specific period of time and the method is disturbed only in a few years out of the specified period of time. Accordingly, the appeal of the Revenue was dismissed.

CIT v EHPT India Pvt Ltd (2011-TIOL-839-HC-DEL-IT) (Delhi HC)

*Deduction under Section 54 can be claimed even if the taxpayer furnishes a belated tax return*

The taxpayer sold her house property and purchased another property jointly with her father-in-law post the due date of filing her ROI. She thereafter filed her ROI for the relevant year and claimed a deduction under Section 54 in respect of the long term capital gains on sale of original property reinvested in a new property. In the audit proceedings, the AO disallowed the deduction on the basis that the taxpayer did not purchase a new house property before the due date for filing her ROI and had also failed to deposit the amount in the Capital Gains Accounts Scheme. The AO did not accept the taxpayer's submission that the due date for filing the ROI was not as specified in Section 139(1) but as specified in Section 139(4). The AO also initiated penalty proceedings for concealment of income. On appeal, the CIT(A) agreed with the taxpayer and deleted the addition. The order of CIT(A) was also affirmed by the Tribunal. On further appeal, the HC held that Section 139(4) provides extended period of limitation as an exception to Section 139(1) and therefore, such provision is not an

#### Snippet

Economists see 6 to 7 percent fiscal deficit

Economists peg the gap between the government's expenditure and receipts to be between 6 and 7 percent for the Financial Year 2011-12. If the fiscal deficit reaches that level, it would be equal to the fiscal deficit reported for Financial Year 2009-10.

Source: [Business Standard](#)

#### Snippet

Top 100 firms' advance tax payout drops 1.4 percent

Advance tax collection from the country's top 100 companies, declined by 1.4 percent to Rs 30,763 crore in the third quarter of 2011-12, indicating sluggishness in the economy. The dip in the advance tax collections from the 100 big corporates is in sync with the drop in industrial output in the recent months.

independent provision but relates to time contemplated under Section 139(1) and that sub-section (4) has to be read along with sub-section (1). Consequently, the question of law was answered in favor of the taxpayer and deduction under Section 54 was allowed.

CIT v Ms Jagriti Aggarwal (2011) (203 TAXMAN 86) (Punjab & Haryana HC)

*CIT justified in invoking Section 263 to hold audit as erroneous and prejudicial to the interests of the Revenue where AO finalizes an audit without referring international transactions above Rs 5 crores to the Transfer Pricing Officer ('TPO')*

The taxpayer, Ranbaxy Laboratories Limited entered into international transactions with its associated enterprises ('AE') outside India for sale of pharmaceutical products and providing technical assistance and know-how. The value of international transactions exceeded Rs 5 crores. As per the Central Board of Direct Taxes ('CBDT') instruction No 3 of 2003, the AO was required to refer the issue of determination of arm's length to the TPO where the aggregate value of international transaction exceeds Rs 5 crore. The AO however did not refer the case to the TPO. The CIT thus invoked its revisionary powers under Section 263 setting aside the audit order, holding that it was erroneous and prejudicial to the interest of Revenue. The taxpayer contended that the AO was fully competent and the failure being an 'procedural irregularity' could not be a basis of revision. On appeal, the Tribunal did not agree with the contentions of the taxpayer. On further appeal, the HC upheld the order of the CIT in exercising revisionary power and in stating that the audit concluded amounted to making audit without conducting proper inquiry and investigation.

Ranbaxy Laboratories Limited (ITA No 504 of 2008) (Delhi HC)

#### Tribunal Decisions

*Sale of copyrighted articles without right to copy and duplicate is not in the nature of royalties but business income*

The taxpayer, incorporated in the US, entered into a joint venture with Onward Novell Software (India) Private Limited ('NIPL'). NIPL acted as a distributor and imported certain software from the taxpayer, which was either (a) duplicated and sold or (b) resold. Income earned in respect of software duplicated and sold was offered to tax as royalty and there is no dispute on this. The income received by the taxpayer from direct sale of software to NIPL which was subsequently resold to its end customer was claimed exempt under the India-US tax treaty in the absence of a PE in India. The AO sought to treat this income also as royalty since in his opinion there was no difference in the two situations. The CIT(A) supported the order of the AO, except that the amount collected for CD case, Compact Discs and DVDs was treated as business income not taxable in the absence of a PE. On appeal, the Tribunal appreciated the difference in the two situations – ie in the first the taxpayer did not supply its computer software but granted license to NIPL to duplicate, distribute and market the duplicated products, whereas in the second the product acquired from the taxpayer was sold by NIPL without any further modification. The Tribunal further stated that where the creator of the copyright himself exploits his work by converting it into end products

Source: [Business Standard](#)

#### Snippet

Revenue authorities asked to meet tax mop up targets

With fiscal deficit touching 68 percent of the Budget estimate in the first half of 2011-12, the Government stated that Revenue authorities have been asked to make concerted efforts to achieve the revenue targets. Instructions have been issued to concerned departments to achieve the revenue collection targets for 2011-12.

Source: [Business Standard](#)

ready for use and transfers the right to use such end products to another but not the further right to copy, it would be a case of transfer of copyrighted product. Referring to the definition of royalties in the Treaty, the Tribunal explained that the requirement is to use the 'copyright' of work and not that of the product derived from such copyright. Keeping in view the distinction between the right to use a copyright versus the right to use a copyrighted article, the Tribunal ruled in favor of the taxpayer and treated such income as business income not taxable in the absence of a PE.

M/s Novel Inc (ITA No 4368/Mum/2010) (Mumbai Tribunal)

*Transport within the country if part of international voyage will be considered as international traffic; rectification under Section 154 is not possible if question is debatable*

Taxpayer is a Singapore shipping company and its vessel had amidst its international operations undertaken a voyage between two Indian ports and claimed benefit of Article 8 of the India-Singapore tax treaty. The AO in his original order granted the benefit but subsequently issued an order under Section 154 observing that the taxpayer's vessel transported salt between two Indian ports under a different voyage charter agreement which did not qualify as international traffic, and denied benefit of Article 8 of the Treaty. The taxpayer contended that though under a separate voyage charter agreement, the voyage was very much a part of the international traffic and that whether the voyage is within the ambit of 'international traffic' is a debatable issue and cannot be a subject matter of an order under Section 154. The CIT(A) ruled in favor of the taxpayer and also declared that the order under Section 154 was void ab initio since a debatable issue cannot be an apparent mistake. On further appeal by the Revenue, the Tribunal upheld the CIT(A)'s order.

M/s Tristar Logistics India Pvt Ltd (ITA No 352/Rjt/2011) (Rajkot Tribunal)

*For a payment to qualify as fees for technical services, technical knowledge, experience, skill, know-how should be made known to the recipient of service so as to equip him to perform it independently*

The taxpayer, a company incorporated in London, operated as a recognized insurance broker, licensed to intermediate insurance business. It did not have any office in India but had strong relationships in the International reinsurance market in London and Europe. Insurance companies in India approach an intermediary in India for reinsurance, which in turn approached the taxpayer for competitive proposals from international reinsurers. The taxpayer relayed various proposals for reinsurance, basis which the insurance companies in India took final decision on reinsurance. Personnel of the taxpayer also occasionally visited the Indian insurer's office in India and were accompanied by foreign insurers / reinsurers. The taxpayer collected the reinsurance premium from the Indian insurer and remitted it to the international reinsurer net of 10 percent. The taxpayer also acted as a claim administrator. In the audit, based on information on the taxpayer's website that it provided a host of financial analysis related consultancy services, rating agency advisory services, risk based capital analysis, the AO held that the services were consultancy in nature and fell within the category of 'fees for technical services' under Section 9(1)(vii) and Article 13(4) of the

#### Snippet

CBDT to focus on big corporates to meet tax targets

With direct tax collection target of Rs 5.32 lakh crore looking difficult to meet, the CBDT stated that it will concentrate on big corporates and salaried employees to mop up the tax revenue. The economic growth slowed to 6.9 percent in the second quarter of Financial Year 2011-12 against 8.4 percent in the same period last year. The industrial growth is slowing and in October the factor output measured on Index of Industrial Production shrunk by 5.1 percent.

Source: [Business Standard](#)

#### Snippet

India-UK tax treaty. On appeal, the CIT(A) upheld the order of the AO. On further appeal, the Tribunal observed that under the normal meaning of Article 13(4)(c) of the Treaty, mere rendering of services is not roped in unless the person utilizing the services is able to make use of the technical knowledge, experience, skills, know-how or process by himself in his business or for his own benefit without recourse to the performer of the services in the future. The Tribunal added that some durability or permanence of the result of 'rendering of services' should remain at the disposal of the person utilizing the services. Since the Indian insurer is left with no such technical capability, the Tribunal held that the services would not be covered as 'fees for technical services' under Article 13(4)(c) of the Treaty.

Guy Carpenter & Co. Ltd. v ADIT (2011) (48 SOT 463) (Delhi Tribunal)

*Where TPO fails to give reasons for exclusion of comparables, they are presumed to be acceptable; a company with high brand value and much higher turnover to be excluded as comparable*

The taxpayer, Maersk Global Service Centre Private Limited was a captive service provider and rendered certain back office support services to its AE. The TPO rejected the comparables identified by the taxpayer and selected new comparables and made adjustments to the taxpayer's income on this basis. On appeal, the CIT(A) computed the Arm's Length Price ('ALP') based on the taxpayer's comparables and certain comparables identified by the TPO. On further appeal, the Tribunal held that where the TPO wants to exclude the comparables given by the taxpayer he should justify the exclusion by adducing cogent reasons. Of the comparables identified by the TPO, the Tribunal held that a company with turnover which is 11 times greater than that of the taxpayer and a high brand value had been correctly excluded by the CIT(A). Maersk Global Services Centre (India) Private Limited (ITA No 3374/MUM/2011) (Mumbai Tribunal)

*External Comparable Uncontrolled Price ('CUP') is the most appropriate method for ascertaining ALP for interest free loans; tested and comparable transactions should both be in foreign currency*

The taxpayer, Aithent Technologies Private Limited, an Indian company advanced interest free loans to its wholly-owned subsidiary in the US for funding expansion. The rationale for extending interest free loans was to promote the business interest as the taxpayer earned all its business revenues from transactions with the AE and also that the amount of interest was already included in the software development cost charged to the AE. Considering the nature of the transaction between the taxpayer and the AE, since no comparables were available in the public domain, the taxpayer adopted the transactional net margin method. The AE was funded from an amount received by the taxpayer from a Singapore based venture capital fund as investment and that the taxpayer did not bear any cost for the funds. The TPO observed that every transaction had to be analyzed separately and had to be benchmarked and therefore the factoring of notional interest in the software development cost is not acceptable. Also the monies received from the Singapore investor had remained invested in FDRs as in the beginning of the financial year. Accordingly, the AO added an amount of 10 percent of the loan as notional interest. On appeal, the CIT(A) upheld the order of the TPO / AO.

Income-tax training centre set for expansion

The Direct Taxes Regional Training Institute, Bangalore ('DTRTI'), the training arm of the Income-tax department, has initiated an expansion plan to meet the growing demands for manpower training. With the growing stature of the DTRTI and increased number of trainees and courses each year, a new campus built for Rs 30 crore has been commissioned which is spread across 125,000 square feet of built up area which can provide residential facility for 110 trainees.

Source: [Business Standard](#)

Snippet

Taxmen unearth Rs 66,000 crore black money

On further appeal, the Tribunal held that CUP was the most appropriate method in order to ascertain the ALP. For determining the ALP the relevant inputs should consider the prices prevailing in similar unrelated transactions and had nothing to do with the cost, or whether the funds are advanced out of interest bearing funds or interest free advances, or are commercially expedient for the taxpayer or not. The Tribunal also held that since the loan is in foreign currency advanced to a foreign subsidiary, the comparable transaction should be in foreign currency.

Aithent Technologies Private Limited (ITA No 3674/Del/2007) (Delhi Tribunal)

*Interest on income-tax refund taxable under Article 11 (Interest) and not Article 7 (Business Profits)*

The taxpayer a resident of Netherlands received income tax refund and offered it as income under Article 11 of the India-Netherlands tax treaty. In the reaudit proceedings, the AO issued a notice under Section 148 stating that since the taxpayer had a PE in India, the interest on tax refund was assessable under Article 7. The Dispute Resolution Panel accepted the order of the AO. On appeal, based on several precedents, the Tribunal ruled that interest on tax refund was taxable under Article 11 at the reduced rate.

M/s International Global Networks BV (ITA 6314/MUM/2010) (Mumbai Tribunal)

*Fee to a bank for strategic and financial services in connection with issue of shares is neither to be allowed as revenue expenditure under Section 37(1) nor to be amortized under Section 35D*

The taxpayer claimed a deduction for fees paid to a bank for strategic and financial services in connection with fresh issue of shares. In the audit, the AO disallowed the expenditure on the basis that it was capital in nature and also did not allow a claim for amortizing the expenditure under Section 35D. On appeal, the CIT(A) agreed with the view of the AO and also did not accept an additional contention of the taxpayer that though the expenditure was on issuance of shares, the proceeds were meant to meet working capital requirements and hence the expenditure should be treated as revenue in nature. On further appeal, the Tribunal did not accept the taxpayer's arguments and referring to a judgment of the Supreme Court in the case of Brooke Bond (India) Ltd where it was held that expenditure incurred in connection with the issue of shares is capital in nature, noted that raising of capital and its utilization are two different things and therefore application of funds does not decide the character of the money collected against the issue of shares which would always remain capital. On the applicability of Section 35D, the Tribunal held that the nature of expenditure incurred by the taxpayer does not fall within the restrictive ambit of Section 35D and hence, these expenses cannot be amortized.

Medreich Ltd. v DCIT (2011) (48 SOT 579) (Bangalore Tribunal)

*Deemed dividend can be assessed only in the hands of a person who is a registered shareholder as well as a beneficial shareholder*

The taxpayer leased its property for a period of 22 years. Pursuant to a dispute, the

Finance Minister, Mr Pranab Mukherjee, stated that the Revenue authorities have unearthed Rs 66,000 crore of unaccounted money, as part of the Government's efforts to curb tax evasion. Mr Mukherjee also said that the government has signed agreements with 60 countries to share information about tax evasion and is in the process of signing agreements with 15 more nations.

Source: [Business Standard](#)

**Snippet**

OECD may tweak laws on bank information sharing for tax evasion and black money

The Indian Government's efforts on ensuring automatic exchange of information on tax evasion and black money have been received well globally with a key body, the Organisation for Economic Co-operation and Development ('OECD'), considering amendment to the international standard, which could allow countries to get banking details with retrospective effect. OECD has set up a group to look into the changes in the international standard. Further, the Financial Action Task Force also plans to

taxpayer and the lessee entered into a new agreement to amicably settle that the lessee would pay a security deposit of a certain amount to the taxpayer which would be refunded at the end of the lease period and after handing over the possession of the property. Two individuals who held 40 percent and 12.27 percent in the capital of taxpayer also held beneficial shareholding of 60 percent and 15.48 percent in the capital of the lessee. The AO therefore treated the security deposit as advance given to the taxpayer and taxed it as deemed dividend under Section 2(22)(e) for the taxpayer, rejecting the taxpayer's submission that a security deposit paid for obtaining a lease cannot take the nature of an advance or a loan as stipulated under Section 2(22)(e). On appeal, the CIT(A) ruled in favor of the taxpayer. On further appeal, the Tribunal observed that the expression 'shareholder being a person who is the beneficial owner of shares' in Section 2(22)(e) refers to both a registered and beneficial shareholder, and that if a person is a registered shareholder but not a beneficial shareholder or vice versa, this part of Section 2(22)(e) would not apply. The Tribunal noted that Section 2(22)(e) does not mention whether the income is to be taxed to the shareholder or the concern, but that the intention is to tax amounts given as loan or advance which could have otherwise been distributed as dividend to shareholders and would have been subject to dividend distribution tax. The deeming provision as it applies to the case of loans or advances by a company to a concern in which shareholder has substantial interest is based on the presumption that the loan or advance would ultimately be made available to the shareholder. Based on this, the Tribunal held that the taxpayer being a 'concern' in the present case cannot be taxed under Section 2(22)(e).

DCIT v Madhusudan Investment & Trading Co. (P.) Ltd. (2011) (48 SOT 360) (Kolkata Tribunal)

*Under Section 80IA eligible profit has to be derived from an eligible undertaking and mere existence of some commercial connection is not sufficient*

The taxpayer engaged in the business of generation and distribution of electricity. 'Fly ash' was a by-product from the generation of electricity, which was used to make fly ash bricks in a separate 'brick making unit' of the taxpayer. The taxpayer claimed a deduction under Section 80IA in respect of both the activities – ie power generation and distribution and sale of bricks. During the audit, the AO held that the profits from sale of fly ash bricks were not eligible for deduction under Section 80IA as these were not derived from the generation and distribution of power. On appeal, the CIT(A) upheld the order of the AO. On further appeal, the Tribunal referred to a special bench judgment in the case of Rajesh Kr Drolia where the issue of direct nexus / operational income versus ancillary income was examined and it was held that mere commercial connection is not enough and the direct yield of the impugned profits derived from the undertaking is the requirement for any profits to be eligible for deduction. The Tribunal noted that the taxpayer had not sold the fly ash but used it as one of the raw materials for making of the bricks, and hence, earned profits from the sale of bricks. The fly ash was though generated by the power unit and comprised a substrate for the brick making unit, which was available in open market too and this fact only underlines the commercial connection to the power unit. The Tribunal also observed that if the fly ash was directly sold without any value addition and profits are earned, such profits could have a genesis in the power unit, but that was not the fact in the present case since

decrease tax crimes as a predicate offense by June 2012, which will make prosecution of tax offenders much easier worldwide.

Source: [The Economic Times](#)

#### Snippet

Direct Taxes Code to come into force from next fiscal

Finance Minister Pranab Mukherjee expressed the hope that the Direct Taxes Code ('DTC Bill'), which seeks to modernise tax laws in the country, will come into force from April 1, 2012. The proposed DTC Bill of 2010 contains provisions like the General Anti-Avoidance Rules ('GAAR'), Controlled Foreign Company Rules etc which are slated to change the entire landscape of the tax laws in India.

Source: [Business Standard](#)

the brick unit was a separate unit with a distinct set up and process, separate technology and manpower, etc. As regards the notional profits relating to the value of fly ash transferred by the Power unit to the Brick unit, the Tribunal set aside the matter for adjudication by the AO to determine eligibility of deduction under Section 80IA.

ACIT v Godavari Power & Ispat Ltd. (2011) (133 ITD 502) (Bilaspur Tribunal)

*Shares converted into stock-in-trade and subsequently sold would not qualify for exemption under Section 10(38) since the exemption is only available to long-term capital assets*

The taxpayer, an individual non-resident, had converted shares purchased in preceding years and held as investment, into stock-in-trade. The taxpayer sold some of these shares, paid securities transaction tax ('STT') on these and claimed the long term capital gains on conversion of investments to stock-in-trade as exempt under Section 10(38). The AO was of the view that the transfer of shares had taken place when they were converted to stock-in-trade and this conversion had not been subjected to STT. He further contended that the legislative intent of introducing Section 10(38) was to subject the long term capital gains on transfer of shares to either income-tax or STT. Accordingly, he held that the exemption under Section 10(38) was not available since the conversion of shares to stock-in-trade would be subject to neither. On appeal, the CIT(A) upheld the order of the AO. On further appeal by the taxpayer, the Tribunal held that the taxpayer is not eligible to exemption under Section 10(38) at both stages of conversion and sale since at the first stage the conversion did not suffer STT and that the subsequent sale was a business transaction as the exemption is available only to transfer of long term capital assets. Accordingly, the appeal of the taxpayer was dismissed.

Smt Alka Agarwal v ADIT (International Tax) (2011) 48 SOT 493 (Delhi Tribunal)

*Payment for taking cranes on lease on time basis did not constitute payment for work under Section 194C; taxpayer not required to deduct tax at source while making such payment*

The taxpayer was engaged in the business of installation of sugar mills on job work basis. During the audit, the AO found that the taxpayer claimed 'lease rent for crane' as deduction on which it had not withheld taxes as payments to contractors under Section 194C. The taxpayer contended that hiring cranes on time basis did not come within the ambit of Section 194C since irrespective of whether the crane was used or not, the hire charges were payable. The AO rejected the taxpayer's contention and disallowed the expenditure. On appeal, the CIT(A) held that every machinery taken on hire cannot be said to be a work contract to be covered by Section 194C and that the payments were made for services rendered by the crane owners is in the nature of hiring / rendering of machinery which is allowable as expenditure. The CIT(A) therefore deleted the disallowance. On further appeal, the Tribunal upheld the order of the CIT(A) observing that in accordance with Circular 681 dated March 8, 1994, payments made for hiring or renting of equipments etc would not be subject to

#### Snippet

Income-tax department says GAAR not to hurt current business structures

The Income-tax Department has clarified that GAAR proposed to be introduced under the DTC Bill will not apply to tax structures created, before the code comes into force. That means capital gains from such structures will be protected from GAAR. However, periodical incomes earned till disposal of the investment will not get the benefit of such an exemption and would be evaluated under the GAAR provisions.

Source: [Your Money site](#)

#### Snippet

Transfer pricing wing raises additional Rs 40,000 crore tax demand

The transfer pricing wing of the Income-tax Department has made an additional tax demand of Rs 40,000 crore for fiscal 2011-12, double of last year. Out of the Rs 40,000 crore additional tax demand, more than Rs 20,000 crore

deduction of tax at source under Section 194C.

ACIT v Sanjay Kumar (2011) 48 SOT 615 (Delhi Tribunal)

*Disallowance under Section 40(a)(i) is applicable only on non-deduction of tax and not on short deduction of tax and taxpayer is not required to again deduct tax under Section 195 at the 'time of remittance' due to exchange rate fluctuation, when tax was duly deducted at the 'time of credit' in the books of accounts*

The taxpayer, Sandvik Asia entered into a research and know-how agreement with A B Sandvik Coromant, Sweden for a period of 5 years. The fee payable was therefore apportioned over the period of 5 years. However, in the first year, the taxpayer credited the entire sum to the collaborator's account and deducted and paid tax on the entire sum. Accordingly, in fourth year, the taxpayer claimed a deduction of the fourth installment. While remitting this installment, the assessee suffered a foreign exchange fluctuation loss which formed a part of its deduction claim. The AO disallowed the claim for foreign exchange loss on the premise that no tax was deducted and thus Section 40(a)(i) was attracted. The taxpayer argued that this amount did not form part of technical fee but merely represented expenses met out by the taxpayer to remit the appropriate amount of foreign exchange to the foreign collaborator. Even if such amount partakes the character of technical fees, Section 40(a)(i) cannot be invoked since it applies to only non-deduction of tax and this was merely a case of short deduction. The CIT(A) upheld the AO's order. On further appeal, the Tribunal held that Section 195(1) does not envisage deduction of tax at two instances. Since in the present case the taxpayer deducted tax at the time of credit, it would not again attract the provisions of Section 195(1). Also, the amount of consideration stated in foreign currency did not change. The Tribunal also supported the contention of the taxpayer with regard to non-applicability of Section 40(a)(i) and based on jurisprudence concluded that the disallowance envisaged under Section 40(a)(i) can be invoked only in the event of non-deduction, but not in the event of short deduction of tax at source. Sandvik Asia Ltd (ITA No 758/PN/99) (Pune Tribunal)

Authority for Advance Rulings Decisions

*Tax treaty with the country of head office is relevant even if services are rendered through a branch in another country; provision of back-office finance services does not amount to fees for included services*

Shell Technology India, the Applicant, is an Indian company which entered into an agreement with the Philippines branch of a Netherlands company for business support services like invoice processing, monitoring operational execution, SOX and general accounting functions. The services were rendered by the Philippines branch and the Applicant contended that the relevant tax treaty to be applied was the one between India-Netherlands and not India-Philippines and that the income earned by the Philippines branch was taxable in the Netherlands. The Applicant also contended that the services were not technical or consultancy in nature and that these did not made available any technology and hence the fees did not qualify as fees for technical services under the India-Netherlands tax treaty. The Authority for Advance Rulings ('AAR') held that the tax status of the company had to be decided on the basis of the

was from the audit of 11 multinationals, including foreign banks and telecom companies, who 'mispriced' their cross-border transactions.

Source: [The Economic Times](#)

#### Snippet

Taxmen spoils Indian M&A party

Indian companies that purchased assets abroad are facing an up to 10 percent increase in their deal costs due to transfer pricing adjustments raised by the Income-tax Department. The Department is raising these adjustments on commission or fees chargeable for corporate guarantees given by the acquirers to their subsidiaries abroad.

Source: [Business Standard](#)

tax residency of the parent company and thus the India-Netherlands tax treaty was to be applied. With regard to the nature of services, the AAR noted that the output was provided to the Applicant without any involvement of the Applicant and hence the payments could not be in the nature of technical services as defined in the Treaty. Shell Technology India Pvt Ltd (AAR No 850 of 209)

*AAR observed that the protocol to the tax treaty could be relied upon to decide the scope of taxation under it*

The applicant, Poonawalla Aviation Private Limited, an Indian company purchased an aircraft from Dassault Aviation SA, France. Dassault also provided export credit facility for purchase of aircraft. Compaigne Francaise d'Assurance pour le Commerce Exterieur ('COFACE') agreed to insure the credit facility extended by Dassault. The amount loaned or in respect of which the credit facility was extended was to be repaid in monthly installments inclusive of interest. The applicant executed promissory notes for each installment payable in respect of the loan, which were later unconditionally and irrevocably assigned by Dassault to BNP Paribas. The applicant sought a ruling on the withholding tax obligations on the interest payable on the above credit facility to BNP Paribas post the assignment. The applicant's case was that the interest was not taxable in India under Article 12 of the India-France tax treaty which provided exemption in respect of interest payable to a French resident derived in connection with loan or credit facility extended or endorsed by COFACE. Without prejudice, the applicant also claimed that by virtue of the Most Favored Nation ('MFN') clause in the Treaty, the broader scope of the interest article in the India-Canada tax treaty could be imported. The India-Canada tax treaty provided exemption in respect of loans extended, guaranteed or insured by the Export Development Corporation. The AAR rejected the contention of the applicant that the interest was exempt under Article 12 of the Treaty since the term 'endorse' does not cover providing of insurance. However, ruling in favor of the applicant, the AAR held that the interest was not taxable in view of the MFN clause.

Poonawalla Aviation Private Limited (AAR No 953 of 2010)

## Notifications & Circulars

### 1. *Income-tax (9th Amendment) Rules, 2011*

A new Rule 40BA has been inserted in the Income-tax Rules, 1962 prescribing that the report of an accountant required to be submitted under Section 115JC(3) of the Act, for the computation of '*adjusted total income*' and '*alternate minimum tax*' of limited liability partnerships, shall be in Form 29C. The notification also provides the format of the new Form 29C. This amendment shall come into effect from April 1, 2012.

CBDT Notification No 60/2011 dated December 1, 2011

### 2. *Agreement between India and Cayman Islands for Exchange of Information with respect to taxes*

The Government of India signed an agreement for exchange of information with

#### Snippet

IOC seeks extension of tax holiday for refineries

Indian Oil Corporation has sought a two-year extension of tax breaks available for refineries so that its delayed Rs 29,777 crore Paradip refinery can avail of the benefit. Exemption or holiday, under Section 80IB(9), from payment of income-tax on revenues earned from refining of crude oil is available to units that are commissioned by March 2012.

Source: [Business Standard](#)

#### Snippet

Rs 10,000 crore proceeds to unburden NHAI till 2013

The National Highways Authority of India ('NHA') need not raise money till 2013 end due to inflow of Rs 10,000 crore from tax-free infrastructure bonds. There will be a requirement of Rs 24,000 crore till the end of next financial year. A senior

the Government of Cayman Islands relating to taxes, on March 21, 2011. This agreement has been now notified vide Notification No 61 dated December 27, 2011.

CBDT Notification No 61/2011 dated December 27, 2011

3. *Protocol to the India-Swiss double tax avoidance agreement ('DTAA')*

Government of India signed a Protocol amending the DTAA between India and the Swiss Confederation on August 30, 2010

The Protocol seeks to introduce, primarily, the following amendments to the India-Swiss tax treaty:

- 'International traffic' to now include transportation by a ship;
- Non-discrimination provisions: Taxation of PE not to be less favorable than the taxes applicable in the home country
- Exchange of Information with respect to taxes
- Recognized pension funds and pension fund schemes to qualify for benefits through inclusion in the definition of the term 'resident of a Contracting State'
- Anti-abuse provision for Articles 10, 11, 12 and 22: No benefits available where arrangement is a conduit arrangement

This Protocol has been now notified vide Notification no 62 dated December 27, 2011.

CBDT Notification No 62/2011 dated December 27, 2011

4. *Protocol to the India-Australia DTAA*

*Government of India signed a Protocol with the Government of Australia amending the India-Australia tax treaty on December 16, 2011. A brief summary of the amendments is as below:*

- Service PE threshold increased from 90 days within any 12 month period to 183 days;
- Enterprises carrying on activities (including the operation of substantial equipment) in the exploration for or exploitation of natural resources for a period of more than 90 days in any 12 month period shall constitute PE;
- Enterprises operating substantial equipment for a period of more than 183 days in any 12 month period shall also constitute a PE;
- Deletion of the 'Force of Attraction' rule under Article 7 of the tax treaty;
- Introduction of Non-discrimination Article in the tax treaty;
- Introduction of the definition for the term 'National';

NHAI official said that Rs 14,000 crore of the Rs 24,000 crore would come from the Government in the form of cess and toll income, while the rest was to come from sale of tax-free bonds.

Source: [Business Standard](#)

- The Exchange of Information Article is updated to internationally accepted standards for effective exchange of information on tax matters;
- Introduction of 'Assistance in collection of Taxes' Article to assist the Revenue authorities of the two countries in the collection of taxes.

The Protocol shall enter into force on the date of the later of the notification of the two Governments indicating the completion of their domestic requirements for entry into force.

Further, this Protocol shall be effective in India in respect of income derived in any fiscal year beginning on or after April 1 next following the date on which the Protocol enters into force. However, for the purpose of 'Non-discrimination' and 'Exchange of information' articles, the effective date would be the date of entry into force of this protocol.

This Protocol has not been notified by the Government of India and hence the Protocol has not entered into force and is not effective as yet.

## Instructions

### *Need to follow Rule 3(2)(ii) to (iv) of the CCS (Conduct) Rules*

CBDT has directed the AO and the Range Heads to strictly observe Rule 3(2)(ii) to (iv) of the Central Civil Services (Conduct) Rules, 1964 ('CCS (Conduct) Rules'). CBDT observed that in certain cases the AOs claim that a particular action / decision was taken after discussion with and as per the directions of their controlling Range Head, though, no such written directions were found. The CCS (Conduct) Rules prescribe that AOs shall act as per their 'best judgment' in the performance of their official duties except when they are acting under the direction of their official superior. The CCS (Conduct) Rules further provide that the direction of the official superior shall ordinarily be in writing and oral directions shall be avoided as far as possible. Oral directions, if inevitable, shall be ratified through subsequent written confirmations.

Instruction No 10/2011 dated December 7, 2011

## Indirect Tax

### Service tax

### High Court decisions

#### *Taxability of services provided by Telecommunication Service Providers (TSPs)*

In this case, the Andhra Pradesh HC analysed various income streams of TSPs and concluded on taxability of each of the revenue streams under service tax and Value Added Tax ('VAT'). Provided below is a summary of key issues decided by the HC:

#### Sale of SIM cards (pre-paid and post-paid connections) and recharge coupons

### Snippet

State FMs agree 'in principle' to negative list based taxation of services

The Empowered Committee of State Finance Ministers agreed, in principle, to the concept of levy of service tax based on a 'negative list,' provided the Centre considers certain suggestions made by the States.

It was contended by the Revenue that SIM cards have all the attributes of 'goods' and can be subjected to VAT. The HC set aside the Revenue's contention on the following basis:

- SIM card / recharge coupon is incidental to performance of telecommunication services by the TSP, since it allows a subscriber to access the TSP's network;
- Intention of the parties was not to treat SIM card / recharge coupon as a separate object of sale and there was no agreement to sell SIM cards / recharge coupons independently. Hence, there are no goods which could be treated as the subject matter of sale; and
- These cannot be treated as deemed sales (as transfer of right to use goods), as the same is limited to transactions under Article 366(29-A) of the Constitution of India and for all other composite contracts, the dominant intention would need to be examined, which in the present case was only to use these to access the TSP's network / extend talk time or validity period.

Therefore, the value for SIM cards (pre-paid and post-paid) and recharge coupons shall be liable to service tax and not VAT.

#### Fixed mobile rentals

It was contended by the Revenue that fixed monthly commitment charges, which are payable by every post-paid subscriber, form a part of the consideration for transfer of the right to use SIM cards.

Relying on the earlier part of the judgment, it was held that payment of fixed rentals was consideration for telecommunication services to be received by the subscriber and therefore, not liable to VAT but liable to service tax.

#### Value added services ('VAS')

-  
Next, it was contended by the Revenue that VAS like ringtones, music downloads etc are audio messages transmitted from the TSP to the subscribers using software in the TSP's network. Hence, proceeds received from VAS are towards supply of software, which are liable to VAT.

The HC held as follows:

- The contract between the TSP and the subscriber is to receive, transmit and deliver messages of the subscriber and not to any license software; and
- Even if VAS are considered as software, they do not constitute 'goods' since the data is not recorded in physical medium, but is only transmitted through electromagnetic waves. Transmission through electromagnetic waves also does not constitute 'goods' since electromagnetic waves are only carriers of data/

The suggestions included recommendations on the nature of services to be considered under the negative list as well as on the definition of 'services'.

Source: [Business Standard](#)

#### Snippet

No service tax on late payment by investors

Stock market investors not required to pay service tax on late payment charges, provided such fines are shown separately in the account statement. The finance ministry has clarified the matter to the Securities and Exchange Board of India (Sebi), which has, in turn, informed stock exchanges about the same.

Source: [Business Standard](#)

messages.

Therefore, VAS can only be liable to service tax.

#### Sharing of infrastructure (Towers)

It was also contended by the Revenue that sharing of infrastructure between TSPs amounts to transfer of right to use goods liable to VAT. The HC negated this contention on the following grounds:

- Telecommunication towers cannot be moved to another location for use in the same position but can only be dismantled or re-erected at such other place. Hence, telecommunication towers do not qualify as movable property; and
- Telecommunication towers always remain under the control and possession of the passive service provider. Hence, although there is use of equipment on a sharing basis, there is no transfer of right to use the goods.

State of Andhra Pradesh v Bharat Sanchar Nigam Limited 2011 (33 STT 553) (Andhra Pradesh HC)

#### *Import of services - CENVAT credit may be utilized to pay service tax*

The issue for consideration was whether, the taxpayer, a recipient of taxable services, was entitled to utilize available credit for discharging (reverse charge) service tax liability of import of services.

The High Court passed an order in favor of the taxpayer and held as follows:

- In case of import of services, the taxpayer is deemed to be service provider and is made the person liable to pay service tax by virtue of section 68(2) of the Finance Act, 1994.

In other words, the liability to pay service tax on import of services is foisted on the recipient of services in India. Hence, he is entitled to use the benefit of existing credits to discharge this service tax liability.

*(BMR Comments: The period of dispute was prior to April 19, 2006, when the definition of 'output service' under the CENVAT Credit Rules, 2004 contained an explanation deeming (reverse charge) taxable services to be 'output services')*  
CCE v Aravind Fashions Limited (2011 TIOL 748) (Karnataka HC)

Tribunal decisions

#### *CENVAT credit on input services – Debit note is a valid document for availing CENVAT credit*

The issue was whether the taxpayer could avail CENVAT credit on the basis of 'debit notes' issued by a service provider in terms of Rule 9 of the CENVAT Credit Rules,

#### Snippet

Exports from SEZs register 26 percent growth in the first half of the current financial year

The total physical exports from SEZs as on September 30, 2011 (ie, in the first half of the current financial year), has been to the tune of Rs. 1,76,479.69 crore, approximately, registering a growth of 26.20 percent over the exports during the corresponding period of the previous financial year.

Source: [Tax India Online](#)

2004. It may be noted that Rule 9 does not specifically include 'debit note' but only covers invoice raised by a service provider.

The Tribunal observed that the 'debit note' received by the taxpayer contained all details required to be mentioned on an invoice as per Rule 9 such as, name and registration number of the service provider, nature of service provided, service tax payable etc. Therefore, it was held that the debit note could be treated as an invoice for the purpose of availing CENVAT credit.

CCE v Grasim Industries Limited (2011) (24 STR 691) (Delhi Tribunal)

*Penalty – Intimation in writing is mandatory for non-levy of penalty u/s 76 of the Finance Act, 1994*

The taxpayer paid service tax and interest before a show-cause notice could be issued for non-payment of service tax. The Revenue issued a show cause notice for recovering penalty. The taxpayer contended that that no penalty should be levied by virtue of section 73(3) of the Finance Act, 1994 since the service tax was deposited *suo motu* prior to issuance of a show cause notice.

While hearing the appeal, the Tribunal noted that the section 73(3) prescribes two conditions for non-levy of penalty:

- Payment of service tax before a notice is issued; and
- Intimation in writing to the jurisdictional service tax officer of such payment.

While the taxpayer fulfilled the first condition, since it failed to intimate the jurisdictional service tax officer of such payment, the second condition was not fulfilled. Therefore, the Tribunal concluded that the show-cause notice for recovering penalty was rightly issued by the Revenue.

Sanjogita Construction v CCE (2011 TIOL 1639) (Mumbai Tribunal)

Notifications, Circulars and Orders

*Taxability of International Private Leased Circuit ('IPLC') charges paid to service providers located outside India*

The CBEC has issued a clarification that IPLC charges paid to Telecom Service Providers ('TSPs') located outside India would be outside the purview of Indian service tax as such service providers do not qualify as a 'Telegraph Authority' in terms of the Finance Act, 1994.

It may be recalled that the CBEC had earlier issued Circular dated July 15, 2011 from F No 137/21/2011-ST (the 'Earlier Circular'), wherein it was stated that IPLC charges paid to foreign TSPs are taxable under the taxable service category of Business Support Services ('BSS').

The CBEC has reviewed this position based on representations received from the

#### Snippet

Move to levy stamp duty only on the seller in stock exchange transactions

Trading costs in the capital market may come down substantially with most states agreeing to a Union Finance Ministry suggestion to levy stamp duty only on the seller of securities.

As per the existing practice, stamp duty on transactions in the stock exchange are paid by both the buyer and the seller of securities. A proposal to change the levy of tax on only the seller is being considered with a view to simplify the process and collect the duty in a centralised manner.

Source: [Business Standard](#)

#### Snippet

industry and issued the new Circular to clarify that IPLC charges can be covered only under the taxable service category of 'Telecommunication Services', which excludes foreign TSPs from its ambit.

Circular dated December 19, 2011 issued vide F No 137/21/2011-Service Tax

#### *Service tax refund for goods exported from India*

The Central Government has notified average rates of service tax refund ranging from 0.03 percent to 0.20 percent of the FOB value of export, for a wide range of goods exported from India, and also issued conditions and procedure for claiming such refund. The average rates have been notified in respect of 18 identified services used by exporters of goods beyond the factory gate like port services, customs house agent service etc.

This notification is in pursuance of the announcement made by the Union Finance Minister in his Budget Speech 2011, and supersedes notification 17/2009-ST dated July 7, 2009 (which covered 'exemption by from service tax by way of refund on taxable services received by an exporter and used for export of goods').

It is envisaged that exporters will be allowed automatic refund of service tax within a few days of confirmation of export and compliance with prescribed procedures, as the refund system is synchronized with the India Customs Electronic Data Interchange (EDI).

Notification No 52/2011-Service Tax dated December 30, 2011

VAT / CST

High Court decisions

#### *Interstate stock transfers to other branches for use in manufacture of goods cannot be treated as interstate sales*

The taxpayer was engaged in the business of manufacture and sale of defense equipment and scientific goods and transferred certain components to its branch located in Andhra Pradesh and other states for use in manufacture of goods that was sold to the end customer from such branch. While the lower authorities held such transfer of goods to the branch office to be stock transfer, the Deputy Commissioner of Commercial Taxes ('DCCT') passed a revisionary order levying CST on the stock transfers made to the units located outside the state on the premise that such transfer constituted inter-state sales.

The Revenue contended that notwithstanding the fact that the components/parts transferred to the branches were used in manufacture by such branch and subsequently sold, the goods transferred to the branches were pursuant to contracts and agreements entered into with various customers. Thus, as the goods transferred were meant to be used to fulfill such agreements, they were essentially meant to be sold to pre-identified customers and as they could neither be diverted nor used for any

Indirect tax collections to be expedited

In the first nine months of 2011-12, the government has collected indirect taxes to the tune 72.7 percent of the set target. Upon review of the tax collections, the Finance Ministry has directed its tax officers to expedite realization in the remaining part of the financial year.

Source: [Business Standard](#)

#### Snippet

GST rollout unlikely this budget

Finance minister Pranab Mukherjee is likely to disappoint those who are looking for a clear schedule for the rollout of Goods and Services Tax (GST) in Budget 2012-13.

Though Mr Mukherjee had indicated earlier that the government would introduce GST by April 2012, he is not in a position at present to give a time line as vast differences remain over the issue. The standing committee is also unlikely to submit its report to Parliament in the Budget session.

Source: [The Financial Express](#)

other purpose, the transaction amounted to an interstate sale.

On the contrary, the taxpayer argued that the goods transferred from the branch located at Andhra Pradesh, were meant to be used as components in the manufacture of larger machinery/ equipment that was sold to the end customer. The taxpayer also contended that the end customer did not contract for the goods transferred from its branch at Andhra Pradesh and the goods transferred were different from the goods that were ultimately sold. Hence, it cannot be construed that the goods were transferred pursuant to any particular contract for sale to a pre-identified customer. The taxpayer also argued that the branches located in all the states formed part of one company (ie single legal entity) and no sale can be made by the company to itself.

On revision petition to the Honourable Andhra Pradesh HC, the Court opined that the instant transaction was stock transfer on the following grounds:

- Transfer of goods from one unit of the petitioner to another is in the nature of stock transfer and would not by itself and without anything more constitute 'sale' as the taxpayer could not be said to have sold goods to itself;
- It is only if the goods which move from one state to another, are sold as they are and are not incorporated in or do not form part of other goods, would the question of such transfer of goods attracting the levy of tax as an inter-state sale shall arise; and
- In the present case, the goods supplied to the units in other states were merely components of, and were incorporated in, the goods manufacture by the other units and such manufactured goods were not sold as they were, to the Armed Forces.

Bharat Electronics Limited v DCCT & Another (2011) (46 VST 179)  
(Andhra Pradesh HC)

*Purchasing dealer cannot be denied input tax credit on account of the registered selling dealer not having paid tax unless under collusion or connivance with the registered selling dealer*

In the instant case, the taxpayer, who was a partnership firm, purchased certain goods from registered dealers against valid tax invoices and claimed input tax credit of the tax paid to the selling dealer. The selling dealer however despite having collected tax from the purchasing dealer did not discharge the same with the Government treasury.

In light of the above, the Revenue sought to deny the input tax credit availed by the purchasing dealer, as the registered selling dealer did not discharge the same to the Government. The Revenue relied on section 8(3) of the Haryana Value Added Tax Act, 2003, which states that in addition to the tax invoice issued, a certificate may also be furnished in the prescribed form and manner by the selling dealer and the Revenue may allow the claim only if it is satisfied that the particulars contained in the certificate produced before it are true and correct.

#### Snippet

State FMs propose to remove upper limit for levy of professional tax

The Empowered Committee of State Finance Ministers have demanded that the upper limit for levying professional tax be removed.

"The panel after deliberating on the issue of professional tax came to the conclusion that the upper limit of Rs 2,500 imposed by the Constitution in 1988 should be waived [removed] forever," committee Chairman Sushil Kumar Modi told reporters.

Source: [Business Standard](#)

#### Snippet

In response to the above, the taxpayer contended that that when a registered dealer makes sales and issues a valid tax invoice to the purchasing dealer, he is entitled to claim input-tax credit. Section 8(3) referred above would only be effective to the extent that the purchasing dealer can be called upon to furnish the tax invoice and the certificate in the prescribed form. In the present case, it was claimed that the selling dealer had discharged VAT by utilising the input tax credit available to them.

Hence, the purchasing dealer contended that section 8(3) referred to above and the allied rules were unconstitutional and claimed that once they had furnished the tax invoice and sufficient evidence that tax had been discharged by the selling dealer, input tax credit could not be denied on the premise that the selling dealer had not discharged the tax with the Government.

The Hon'ble High Court of Punjab and Haryana *inter alia* held as follows

- The genuineness of the certificate and declaration furnished by the selling dealer may be examined by the Revenue, but onus cannot be put on the taxpayer to establish the correctness or the truthfulness of the statements. While the Revenue can examine whether the Form VAT C4 was bogus and was procured by the taxpayer in collusion with the selling dealer, the input tax claim should be allowed once a proper declaration is furnished. In the event of the declaration being false, the Revenue can proceed against the defaulter (ie the selling dealer);
- No liability can be fastened on the purchasing registered dealer on account of non-payment of tax by the selling registered dealer unless collusion or connivance is established between the registered selling dealer or its predecessors with the purchasing registered dealer;
- Section 8(3) and the allied rules are not *ultra vires*, however, the same shall only be operative in the indicated manner, as per law.

Gheru Lal Bal Chand v State of Haryana and Another 2011 (45 VST 195) (Punjab and Haryana HC)

*Mere back to back contract does not imply a sale in the course of import*

The taxpayer had entered into a contract with Canara Bank for supply of bank note processing systems ('the Goods'). Subsequently, the taxpayer entered into a contract with a German supplier for supply of the Goods. In the bill of entry, which had been placed on record, the taxpayer had been described as the importer. Thus, the taxpayer was responsible for all customs clearance in respect of the goods imported.

On the question whether the said import and subsequent transfer/sale by the taxpayer to Canara Bank is covered under section 5(2) of the Central Sales Tax Act, 1956 (the 'CST Act'), the High Court ruled in favour of the Revenue and specifically observed as follows based on several decisions of the Hon'ble Supreme Court.

- To claim exemption/benefit under Section 5(2) of the CST Act, the following conditions have to be satisfied, namely:

State FMs to press Centre for CST compensation release

State Finance Ministers are likely to press for immediate release of Central Sales Tax (CST) compensation during their pre-Budget consultations with Finance Minister, Pranab Mukherjee.

The Finance Minister is holding pre-Budget consultations with various stakeholders, including the finance ministers of states and Union Territories, in the run up to the Union Budget. Several states have expressed unhappiness over the delay in release of funds by the Centre to compensate them for revenue losses on account of phased withdrawal of CST.

Source: [Business Standard](#)

#### Snippet

Budgetary process likely to begin on March 12

Sources indicate that Congress-led UPA government is likely to present the Union Budget on March 15 since polls and related work in the five

- (i) The import should have a direct nexus and should be connected with the transaction of sale in India;
- (ii) The sale would not be considered as covered by Section 5(2) of the CST Act if the import is effected merely by a purchase from abroad for a further sale in India but would be covered by Section 5(2) if the sale is 'in course of import'.

- Back to back transactions/contracts, (ie, the first transaction between Canara Bank, Bangalore and the subsequent transaction between the taxpayer and the German company), by themselves do not establish and prove that the first part of Section 5(2) of the CST Act is attracted and applicable in the present case;
- The import by the taxpayer may have been with the intention to supply the imported goods to Canara Bank, Bangalore but this by itself is not sufficient to satisfy the requirement of Section 5(2) of the CST Act;
- The imported goods could have been diverted to another third person, without violation/default of the contract between the taxpayer and the Canara Bank, Bangalore; and
- Pending the supply of the new machine, the taxpayer had provided a standby machine to the Canara Bank, Bangalore as per the terms of the contract. In view of the aforesaid position it cannot be said that the sale was occasioned by the import and therefore, qualifies for exemption under Section 5(2) of the CST Act.

Giesccke & Debrient India Private Limited v CST (2012 VIL 04) (Delhi HC)

*Light energy (Artificially Created Light Energy - ACLE) is one form of electromagnetic waves and is not 'goods' as defined under the Constitution of India or under the provisions of the Karnataka VAT Act, 2003*

In the present case, the question that came up for consideration was whether ACLE qualifies to be 'goods' and accordingly, the telecommunication services (rendered by the taxpayer) which involves data transfer using ACLE is liable to sales tax/VAT.

On the issue of whether ACLE is 'goods', the Court held as follows:

- It is clear that the essential test to be satisfied before an article is said to be 'goods' is the test of marketability;
- Yet another characteristic, which is recognized, is that the goods should be capable of being delivered - in the case of electricity, electricity is delivered to the customer at his residence, office or industry. ACLE is not seen by the subscriber/consumer. It never comes to the market for it to be bought or sold. It is unknown in the market. It is not capable of abstraction, consumption, delivery by subscriber/customer. Thus, ACLE does not possess the characteristic of 'goods' as understood in law;

states including Uttar Pradesh is expected to be completed only by March 9.

The whole budgetary process, which begins with Presidential address, is likely to be scheduled for March 12, followed by the Economic Survey on March 13 and Railway Budget on March 14. But a final call will be taken after the core committee meeting of the Congress, expected to be held shortly.

Source: [The Financial Express](#)

#### Snippet

MP to challenge GST concept

State finance minister through another spanner to Union government's tax reform exercise, particularly GST (goods and service tax) will challenge its service tax concept as, "It is not only violation of the constitutional provisions but, also

- ACLE is one form of electromagnetic waves and is not 'goods' as defined in article 366(12) of the Constitution of India or under section 2(m) of the Karnataka Sales Tax Act, 1957 or section 2(15) of the Karnataka Value Added Tax Act, 2003. Consequently, there is no sale of goods as held by the assessing authority. Therefore, the assessing authority has no power to levy tax.

Bharti Airtel Limited v State of Karnataka (2012 VIL 03) (Karnataka HC)

Notifications and Circulars

*Change in rate of VAT – Puducherry*

The VAT rates applicable in the state of Puducherry have been amended wef January 1, 2012. Going forward, goods falling under the Third Schedule of the Puducherry Value Added Tax Act, 2007 would be liable to tax at 5% vis a vis the earlier rate of 4%.

Goods falling under the Fourth Schedule of the Puducherry Value Added Tax Act, 2007 would be liable to tax at 14% vis a vis the earlier rate of 12.50%.

Notification GO Ms No 68/F2/2011

*Change in rate of VAT for specified goods – Puducherry*

The VAT rates pertaining to the following goods have been reduced, wef January 1, 2012

Sl No	Particulars	Existing Rate	Revised Rate
1	All kinds of industrial inputs and packing materials sold to industries	4%	3%
2	All kinds of machineries sold to industries	4%	3%
3	All kinds of two wheelers	14.50%	10%
4	Auto parts, accessories and attachments	14.50%	10%
5	Tyres and tubes	14.50%	10%

Notification GO Ms No 69/F2/2011

*Tax on high seas sales/ transit sales*

The Haryana Commercial Tax Department has observed that in case of certain contracts (including turnkey contracts), goods that are imported or procured from outside the state, are supplied to the contractee by means of a high seas sale or as an in-transit sale thereby avoiding payment of taxes in the state of Haryana.

In light of the same, the assessing authorities have been directed to exercise caution while examining such transactions and the same should be examined in their totality.

an encroachment in state tax domain.”

The long-delayed goods and service tax (GST) has already left state-central relations sour. The fresh bid to take on Union government on service tax issues is likely to add more bitterness to it.

Source: [Business Standard](#)

In case high seas sales and in-transit sales are carried out purely with the intention to evade taxes and the documents have been manipulated in support of the same, the assessing authorities are required to bring such transactions under the ambit of intra state sales.

Memo No. 256G/ST-1, dated the 11th August, 2011 issued by the Excise and Taxation Commissioner, Haryana

Customs

High Court decision

*Standing order issued by the Commissioner of Customs being an intra-departmental communication/administrative order is not liable to be challenged by way of writ petition under Article 226 of the Constitution of India*

The writ petitioner was an importer of second hand digital multifunction printing and copying machines and second-hand photocopier machines. Based on a standing order issued by the jurisdictional Commissioner of Customs, the goods imported by petitioner were *inter alia* subjected to 100 percent verification by the customs authorities and further required to be examined and certified by a Chartered Engineer as regards their residual life.

The writ petitioner challenged the standing order by way of a writ petition *inter alia* on grounds that the same was not authorized under the provisions of the Foreign Trade Policy and as being cumbersome to adhere to.

The Revenue contended that standing orders served the purpose of acting as guidance and prevented field officers from acting in an arbitrary manner. The Revenue further contended that intense verification procedure by customs authorities was required under the Hazardous Waste Rules to prevent any hazardous electronic waste from being dumped into the country.

The High Court considered the submissions of both sides and held as under:

- The Commissioner of Customs was well within his powers to issue standing orders and instructions for the guidance of his sub-ordinate officers and such orders are in line with the powers vested in the Commissioner; and
- Such standing orders being inter-departmental/internal communications of an administrative character, they would not qualify to be statutory authority orders amenable to be scrutinized, challenged and quashed by way of a writ petition before the High Court.

Based on the same, the High Court dismissed the writ petition filed by the petitioner. *Vinay Auto Copier Machine v Union of India 2011 (274 ELT 33)* (Madras HC)

Tribunal decisions

*Levy of anti-dumping duty - No restriction on Tribunal's power to remand and time limit prescribed for passing final order not to apply in case of remand by appellate authority*

Levy of anti-dumping duty ('ADD') was confirmed by a final order of the Designated Authority ('DA') pursuant to an anti-dumping investigation on the applicant's products. The applicant, an exporter based in China, challenged the order of the DA before the Tribunal, and pressed for ADD levy to be set aside *inter alia* on the following grounds:

- While the final order under challenge was passed by the DA (being the present incumbent), the actual public hearings were conducted by his predecessor. Hence, the applicant contended that the final order passed by the present incumbent without conducting fresh hearing was invalid;
- The Tribunal does not have specific powers to remand the case back to the DA for a fresh hearing in ADD matters; and
- In any event, an order of remand would be futile as the time limit of 18 months prescribed for the DA to complete ADD investigation and pass orders had lapsed.

The Tribunal considered the submissions of the applicant as well as that of the Revenue and the domestic industry and held as under:

- If the above contentions and prayer for the ADD levy to be set aside on technicalities are accepted, then the domestic industry would suffer for no fault of theirs;
- The powers of the Tribunal are very vast and there is no restriction on the Tribunal to remand a case with a view to 'secure ends of justice'; and
- The time limit of 18 months would be relevant only for the first order passed by the DA upon conclusion of investigation and same would not apply to an order passed pursuant to a remand or direction in appellate or writ proceedings.

Based on the above, the Tribunal remanded the case back to the DA with a direction to afford a fresh post decisional hearing and thereafter modify the final order as the DA deemed fit and proper.

Huawei Tech Co Ltd v Designated Authority (2011) (273 ELT 293)  
(Delhi Tribunal)

*Special Additional Duty ('SAD') exemption shall not apply where sales tax is exempt by the State Government*

The taxpayer was a 100 percent export oriented undertaking ('EOU') engaged in the manufacture of uninterrupted power supply system and accessories. The taxpayer cleared certain quantity of its final products to the domestic tariff area ('DTA') on payment of duty equal to the aggregate duties of customs in terms of Section 3 of Central Excise Act, 1944. The taxpayer claimed exemption from payment of special

additional duty of customs ('SAD') in terms of Notification No.23/ 2003 dated March 31, 2003.

The Revenue levied SAD on the goods cleared to DTA on grounds that the goods were exempted from levy of sales tax by virtue of a State Government industrial incentive scheme. It was the taxpayer's case that the State Government exemption scheme was for the industry as a whole and not to the goods in question and hence, the benefit of SAD exemption under Notification No.23/2003 had been incorrectly denied to them.

The Tribunal concurred with the view of the Revenue and held that, as the taxpayer had availed the benefit of sales tax exemption under the State Government scheme/ notification, they were not entitled for the benefit of SAD exemption under Notification No.23/2003.

American Power Conversion Company (India) Private Limited v  
Commissioner of Customs (2011 TIOL 1442) (Bangalore Tribunal)

Central Excise

Tribunal decisions

*Supplies from DTA to SEZ developers not to be treated as 'exempt' supplies wef  
September 10, 2004*

The taxpayer, a unit in the domestic tariff area ('DTA') was engaged in the manufacture and supply of goods to units in the DTA as well as to units in/ developers of special economic zones ('SEZ'). The Revenue sought to treat supplies made to developers of SEZ during the period prior to December 31, 2008 as 'exempt' supplies requiring reversal of CENVAT credit/payment of excise duty. Such stand was based on the specific amendment made to Rule 6(6)(i) of the CENVAT Credit Rules, 2004, with effect from December 31, 2008, specifying that supplies to SEZ developers did not require CENVAT reversal/tax payment.

The Tribunal, while allowing the appeal in favour of the taxpayer, held as under:

- Based on a cogent reading of the provisions under the Customs Act, 1962 as well as the SEZ Act, 2005, it is evident that the intention of the legislature is to accord supplies of goods to SEZ Developers, the status of exports;
- Applying the 'doctrine of fairness' propounded by the Supreme Court, it could be construed that the relevant amendment carried out by way of substitution Rule 6(6)(i) merits retrospective effect from the date on which the relevant provision was enacted;
- Having regard to the same, the benefit of Rule 6(6)(i) of CENVAT Credit Rules, 2004 would be available on supplies of goods to SEZ developers retrospectively with effect from September 10, 2004, being the date on which the CENVAT Credit Rules, 2004 came into effect.

Sujana Metal Products Limited v CCE (2011) (273 ELT 112) (Bangalore Tribunal)

*Unutilized CENVAT credit eligible for refund on opting out of the CENVAT scheme*

The taxpayer, a manufacturer engaged in the manufacture of yarn and textile opted for exemption from payment of excise duty by availing the benefit of Notification No 30/2004 dated July 9, 2004. Prior to such date, the taxpayer had availed CENVAT credit in respect of inputs and capital goods used in the manufacture of its final products.

At the time of opting out of the CENVAT scheme, the tax payer reversed credit pertaining to inputs, work-in-process and finished goods lying in stock as on the date of such opting out and claimed the balance amount of unutilized CENVAT balance as refund under Rule 5 of the CENVAT Credit Rules, 2004. The refund claim was rejected by the lower level authorities *inter alia* on the ground that such refund of CENVAT is available only in the case of exports.

The Tribunal relied on earlier judicial pronouncements and held that the taxpayer is eligible for refund of unutilized CENVAT credit upon opting out of the CENVAT scheme. Further, to the same, the Tribunal remanded the case back to the adjudicating authority with a direction to ascertain whether the taxpayer had reversed CENVAT on inputs, work-in-process and finished goods lying in stock and thereafter, refund the balance unutilized credit in cash.

Raymond Ltd v CCE (2011) (273 ELT 582) (Mumbai Tribunal)

*Suo motu taking of credit of refund sanctioned by an order-in-appeal incorrect and liable to be recovered with interest*

The taxpayer, a manufacturer, had claimed refund of excess interest payment and such refund was sanctioned by the Commissioner (Appeals) vide an order-in-appeal. However, refund was not actually issued by the Revenue. The taxpayer, basis the order-in-appeal, availed credit of such refund amount in their PLA, intimated the same to the Revenue and used such credit to discharge duty liability.

The Revenue objected to such *suo motu* availment of credit in the absence of a refund order and initiated proceedings to recover such credit along with interest and penalty.

On appeal, the Tribunal held that *suo motu* credit of refund without the sanction of the proper officer is bad in law and upheld the recovery order for recovery of such credit along with interest. However, given the circumstances, the Tribunal set aside the levy of penalty and further directed the Revenue to pay the refund originally sanctioned in cash along with applicable interest.

Candico (I) Ltd v CCE (2011) (274 ELT 215) (Mumbai Tribunal)

*Provisions for filing appeal before CESTAT/Tribunal on CENVAT credit related matters*

The issue that came up for consideration was whether the appeal filed by the

taxpayer, a payer of excise duty and service tax on inputs and input services respectively, should be treated as an appeal under service tax or central excise.

The Tribunal laid down the following procedure while clarifying the issue:

- CENVAT credit is available to a taxpayer from three distinct sources, ie, (a) Countervailing duty paid on imported inputs/capital goods; (b) Service tax paid on input services; and (c) Excise duty paid on input/capital goods. In other words, the CENVAT credit account is a common kitty.
- Keeping this in mind, it was held that the following practice should be followed:
  - (i) Where a taxpayer pays only excise duty, the appeal should be registered as a central excise appeal;
  - (ii) Where a taxpayer pays only service tax, the appeal should be registered as service tax appeal; and
  - (iii) Where a taxpayer pays excise duty and service tax, for administrative convenience, the appeal should be registered under central excise.

Wadpack Private Ltd v CCE (2012 TIOL19) (Ahmedabad Tribunal)

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