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Article

Obligation to tolerate an act – A declared service

By **Iype Mathew**

One of the special features of the negative list based service tax regime, introduced with effect from 1st July, 2012, is the introduction of the concept of declared services (Section 66E of the Finance Act, 1994). Declared services, which are actually described in 9 serial entries, are required to be treated as 'service' for the purposes of the Finance Act vide Section 65B(44) being the definition for service. Many of these nine entries have had the distinction of triggering intense debate in the past about the vires of the levy of service tax itself. But the most intriguing and tricky entry out of them is:

"66E (e) – agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act."

This entry is the subject matter of this article.

It will be convenient if the above entry is split into its components:

- Agreeing to the obligation to refrain from an act.
- Agreeing to the obligation to tolerate an act.
- Agreeing to the obligation to tolerate a situation.
- Agreeing to the obligation to do an act.

The above clauses, all four of them, indicate a basic structure – a request to refrain/tolerate/do and a corresponding agreement to oblige. Very clearly the person making the request is the service receiver and the person agreeing to oblige is the service provider.

In a typical situation the person who needs a service will approach a person who can provide the service. For example, a company X might approach a trader not to deal in the goods of a competitor company Y against whom it is in stiff competition in the market. And if the trader obliges to do so for a certain consideration, it will amount to agreeing to the obligation to refrain from an act. Will the above transaction be viewed differently if the trader approached company X and offered not to deal in the goods of company Y provided a certain amount is paid in return, and company X accepts the offer? It certainly will not, as the desire to stop the trader from dealing in the goods of company Y, did exist in company X, and the fact as to who approached who, is immaterial in this regard. Normally the person who needs a service approaches the person who can provide the service, but when a person who can provide a service approaches a person who might need a service, and when the person approached says yes he needs the service, then it would still result in the same transaction namely the service provider has provided service to the service receiver who needed the service.

The purpose of drawing attention to the above situation is to visit certain typical transactions that we encounter in the name of terms and conditions, damages, penalties, compensation etc. in agreements and contracts entered into between parties. Notice period and notice pay, forming part of terms and conditions settled between employer and employee, is a good example to consider. What is the implication of Section 66E (e) of the Finance Act on such clauses?

Before we start finding the answer to the above question certain fundamental concepts are

required to be understood:

- A service can be simple in the sense that the activities undertaken are minimal to meet a simple need/desire. Fixing a punctured tyre will be an example in this category.
- A service can be complex in that several elements are bundled together and offered to the client. Annual maintenance of a fleet of trucks for a transport company, which will include undertaking specific repairs of different kinds contingent upon need arising; undertaking preventive maintenance checks periodically of different parts and components; and general cleaning of the trucks for better upkeep, is an example in this category.

In the first example above there is clarity as it is simple and there should be no confusion about taxability. In the second example several questions can arise for which answers have to be found. Is there a single supply or are there multiple supplies? What happens when there is a single rate per truck per year for all the three elements – repairs, maintenance and cleaning? Will it then be a single supply? What happens when separate rates are settled for each element and the client is charged only for what he asked for as per these rates? Will it then amount to multiple supplies of services? What happens when time lines are fixed for the completion of different jobs/activities failing which a provision for payment of penalties is agreed to based on a clear formula? Will there then be a case for invoking Section 66E (e) for a separate service provided by the transport company?

In finding the answers to the questions raised above an important factor to look into is the intent and understanding between the transacting parties. This can most often be deciphered from the clauses in the agreement. When a single rate is fixed per truck per year for all the three elements without any flexibility for making any variation, then it would be correct to say that the parties visualized a single supply consisting of a bouquet of services. The provisions of Section 66F may have to be applied to settle assessment of service tax in such a situation. It will then not be necessary at all for looking at splitting the single rate for differential treatment of each of the elements.

When different rates are settled for each element and for different types of jobs within each element, and the transport company is charged as per these rates as and when jobs are undertaken on request, then the arrangement is one of, as many supplies as there are jobs. Every job undertaken has to be seen as a supply and assessed to service tax. So far so good. Now comes the problem area.

When time lines are settled for each job with further provisions for dealing with delays, there can arise two types of situations: one, where different rates are fixed for the same job completed – Rs. 100 if completed in optimum time (2 days), Rs. 90 if completed between 3 and 4 days, and Rs. 80 if completed in more than 4 days. Here the parties are settling prices. There is no scope therefore to say that there is an element of fine/penalty built into the prices. Two, where only one rate is fixed for the job, with a provision to collect a sum in the form of penalty – Rs. 100 for completing the job and a penalty of Rs. 5 per each additional day delayed beyond 2 days, payable to the transport company. Here the parties are no doubt settling only one price, but the penalty for delaying the job, clearly indicates the intent to introduce a concept of deterrence to instill promptness, which is understood as such and accepted by the transacting parties. Will this constitute a different and distinct supply, namely an obligation on the

part of the transport company to tolerate an act (failure to maintain promised deadlines) on the part of the person who undertook the job, in return for payment of the penalty amount? In my view the answer is in the affirmative.

Now coming to the question of the implication of Section 66E (e) on notice pay. The condition to pay an amount as notice pay in lieu of notice period, for the employer to agree to let go an employee, normally forms part of the terms and conditions of employment. This would mean that the employee while accepting the offer of employment, has not only understood the intent on the part of the employer in prescribing this exit condition, but has also accepted it. In other words the employee has understood and accepted the condition that in the contingency of his inability to provide the prescribed notice period, he can exercise the option of paying the notice pay as the consideration for the employer to agree to the obligation of letting him go, which the employer is bound to do as it is part of the terms and conditions already agreed to and settled between them. In my view therefore this transaction of the employer agreeing to the obligation of tolerating an act (quitting without any advance notice) on the part of the employee, for payment of a sum (notice pay), will be covered as a declared service under Section 66E (e).

The above issue is bound to be seen differently in different quarters. Grounds to say that such a transaction did not constitute a separate supply; or that it is a transaction not in the nature of a service, can and will always be found, and attempts to levy service tax will be challenged. Particularly a case can no doubt be made to argue that fines, damages, penalties etc. do not characterize a transaction of an activity for a consideration with express or implied contractual reciprocity. And furthermore as per Rule 6(2)(vi) of the Service Tax (Determination of Value) Rules, 2006 value of a taxable service does not include accidental damages due to unforeseen actions not relatable to the provision of service. We will need to wait and watch how this issue will finally be settled in the future.

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CUSTOMS

Notifications, Circulars & Public Notices

Concessional rate of CVD and exemption to BCD under different Customs notifications: An importer while availing exemption from BCD on steam coal under Notification No. 46/2011-Cus., [India-ASEAN PTA] can simultaneously avail concessional rate of CVD @ 2% under Notification No. 12/2012-Cus. Circular No. 41/2013-Cus., dated 21-10-2013 issued by CBEC points to the fact of absence of condition restricting the benefit of concessional CVD if exemption from BCD under another notification is availed.

SAD exemption to parts, components and accessories of mobile handsets: Exemption from SAD (Special CVD), under Sl. No. 1 of Notification No. 21/2012-Cus., is available to parts, components and accessories of mobile handsets on the basis of certificate issued by jurisdictional central excise authorities under Sl. No. 431 of Notification No. 12/2012-Cus. Circular No. 43/2013-Cus., dated 8-11-2013 issued by CBEC clarifies the above and states that certificate valid for claiming exemption from BCD and CVD can be taken into account for allowing exemption from SAD. While Notification

No. 21/2012-Cus., does not provide condition of producing certificate for claiming exemption under S. No. 1, it appears that this circular seeks to impose the same.

Export Obligation default cases - Procedure specified: DGFT has specified procedure for closure of EO default cases under duty exemption and EPCG schemes. DGFT Policy Circular No. 8/2009-2014 (RE 2013), dated 25-10-2013 requires that the applicant should pay customs duty and interest and provide the evidence thereof to the Regional Authority (RA) based on which the RA may issue closure letter. It has been further clarified that cases pending at adjudicating and appellate stages may also be closed under this scheme, available till 31-3-2014. Under this scheme, introduced in August this year, interest liability is limited to duty liability.

Deemed exports – Declaration on non-availment of Cenvat credit: DGFT has clarified that while giving a declaration regarding non-availment of Cenvat credit, in order to get deemed export drawback, it has to be ensured that Cenvat credit of service tax paid on input services has also not been availed. DGFT Policy Circular No. 9(RE-2013)/2009-14, dated 30-10-2013 asks the applicants to rule out availment of double benefit of Cenvat credit and duty drawback.

Advance authorization – Restriction on use of alternative inputs applicable to SEZ supplies and deemed exports: Provisions of Para 4.1.15 of Foreign Trade Policy relating to restrictions on use of generic and/or alternative inputs, are also applicable to supplies to SEZs and deemed exports. DGFT Notification No. 48(RE-2013)/2009-2014, dated 30-10-2013 in this regard amends Para 4.1.15 inserted in August this year which provides for exact match of name/description of inputs specified in the bill of entry with those endorsed on the shipping bill.

Basic Customs Duty reduced on specified goods from Malaysia: Notification No. 53/2011-Cus., dated 1-7-2011 has been amended to provide deeper tariff concessions in respect of specified goods imported from Malaysia under the India-Malaysia Comprehensive Economic Cooperation Agreement (IMCECA). Notification No. 47/2013-Cus., dated 10-10-2013 issued for this purpose substitutes the table specifying goods eligible for exemption/ concessional rate of duty.

Export obligation re-fixation - List of products and percentage reduction in EO specified: Para 5.11.2 of the HBP permits re-fixation of annual average export obligation, if export in any sector/ product group declines by more than 5% as compared to last financial year. DGFT Policy Circular No. 7(RE-2013)/2009-14, dated 23-10-2013, therefore, provides a list of such product groups showing percentage decline in exports during 2012-13 as compared to the year 2011-12.

Ratio decidendi

Additional duty of customs on imports under transferred DFIA issued prior to 2007: Additional duty of Customs or CVD is not leviable on imports made after 1-4-2007 under transferred DFIA licence if such license was issued prior to 1-4-2007. On 1-4-2007, Para 4.4.6 of the Foreign Trade Policy was amended to make imports against transferred DFIA licenses liable to additional customs duty under Section 3(1) of the Customs Tariff Act, 1975. CESTAT while allowing exemption from CVD under Notification No. 40/2006-Cus., in such cases, observed that further amendment in 2008 and Circular No. 11/2009-Cus., dated 25-2-2009 had clarified that for licenses issued prior to

amendment, exemption would continue to apply. It was also noted that the policy as on the date of the issuance of licence shall be applicable. [*Namco Steels Pvt Ltd.* v. *Commissioner* - 2013-TIOL-1522-CESTAT-DEL].

Drawback - Benefit of higher rate to merchant exporters: Higher rate of duty drawback will be available even to a merchant exporter of garments who has procured the same from open market, according to Delhi High Court. The contention of the department that it should be made available only to a manufacturer exporter or a merchant exporter tied to a supporting manufacturer was not accepted by the court relying on earlier judgement in the case of *Kultar Exports*. Further, department's contention that there was fraud and suppression involved inasmuch as the merchant exporter had declared "supplier" and not "manufacturer", was negated by the court observing that use of word 'supplier' indicates that goods were purchased from third party and hence there was no suppression. [*AKS Apparels* v. *Union of India* - 2013-TIOL-708-HC-DEL-CUS]

Settlement Commission cannot be approached for settlement of recovery notice: Recovery proceedings are not in the nature of adjudication proceeding, so as to entitle the noticee of recovery notice to make an application to the Settlement Commission for settlement under Section 127B of the Customs Act. The Calcutta High Court in this regard held that reading definition of 'case' in Section 127A(b) along with provisions of Section 127B shows that application for settlement can be filed when proceedings before the adjudicating authority are pending and that recovery proceedings under Section 142 do not contemplate any adjudication. [*Exotica Global Pvt. Ltd.* v. *Union of India* - 2013-TIOL-819-HC-KOL-CUS]

CVD assessment when weight of imported goods is less than 10 gms.: Additional customs duty on goods (fevistick/gluestick) weighing less than 10 grams each has to be assessed on transaction value and not on MRP/RSP basis. In a case pertaining to import of adhesives in 5/8 grams packing with the description 'Fevistick-5g/8g', 'Gluestick-5g/8g' and 'Prime Stick-8g', the department had contended that since the goods are sold on the basis of numbers and not on the basis of weight, they have to be assessed on basis of MRP. The CESTAT however, relying on earlier decisions on identical issue, held that since the net weight on the goods is less than 10g, the importer is exempted from declaring the RSP on the packages under Rule 26 of the Legal Metrology (Packaged Commodity) Rules, 2011. [*Pidlite Industries Ltd.* v. *Commissioner* - 2013-TIOL-1592-CESTAT-MUM].

SAD refund not deniable in the absence of declaration of non-availability of credit: Non-endorsement of non-availability of Cenvat credit of SAD (Special CVD) does not affect claim for refund of SAD under Notification No. 102/2007-Cus., dated 14-9-2007. CESTAT, Mumbai while holding so noted there was no question of buyers availing any credit as such credit was not available on cars imported in present case and that the dealers through which the cars were sold were not registered for Cenvat credit purposes. The Tribunal also observed that the bar of unjust enrichment would not apply as the amount was shown in the balance sheet as recoverable from the department and there was a certificate from chartered accountant to the effect that duty burden was not passed on. [*Maruti Suzuki India Ltd.* v. *Commissioner* - 2013 (296) ELT 100 (Tri-Mum.)] *See also May 2013 issue of Tax Amicus for case law on similar issue.*

CENTRAL EXCISE

Ratio decidendi

Interest payable on delayed refund under area-based exemption: Gauhati High Court has allowed interest on delayed refund under area-based exemption notification. The court held that Sections 11B and 11BB of the Central Excise Act, 1944 apply to all types of refund of duty and they shall equally apply to refund of duty under notification relating to area-based exemption. It was noted that Section 11B does not exclude claim of refund made in terms of Notification No. 33/99-CE. Interest on delay in payment of refund beyond 3 months was hence granted under Section 11BB. [*Amalgamated Plantations Pvt. Ltd.* v. *UOI* - 2013 (296) ELT 13 (Gau.)]

SAD on stock transfer from EOU to DTA: Non-payment of sales tax on stock transfer of goods from EOU to DTA does not mean that sales tax is exempt. Mumbai Bench of CESTAT has held that exemption from SAD would be available under Notification No. 23/2003-C.E. on DTA clearance by EOU provided the goods are not exempt from payment of sales tax. The department in this case had contended that since no sales tax was paid, in the absence of sale because of stock-transfer, SAD component should not be exempted. The Tribunal noted that the goods were not exempted from sales tax in DTA. [*VVF Ltd.* v. *Commissioner* – Mumbai CESTAT Order No. 882-883/13/EB/C-II, dated 8-10-2013]

Cenvat credit on capital goods - Provisions applicable on date of removal, relevant: Provisions applicable on date of removal of used capital goods shall be relevant for determining quantum of Cenvat credit to be reversed. In this case, the capital goods were procured during the period when there was no provision for reducing 2.5 percentage points per quarter. Such provision was inserted as proviso to Rule 3(5) of the Cenvat Credit Rules, 2004 with effect from 13-11-2007. The Tribunal in this case, granting benefit of proviso to Rule 3(5), held that provisions at the time of removal of capital goods shall be considered and hence credit taken in 1994 on capital goods has already exhausted when such used capital goods were removed in 2009. [*Panchmahal Steel Ltd.* v. *Commissioner* - 2013 (296) ELT 465 (Tri-Ahmd.)]

Cenvat credit available on MS angles, etc. used for erecting plant and machinery: Cenvat credit on MS angles, MS beams, channels, etc. used for erecting various items of capital goods viz. electrostatic precipitator for raw mills, additional fly ash handing system, etc. which had become immovable, is available. CESTAT while allowing such credit, placed reliance on decision of High Court in assessee's own case [2012 (285) ELT 341 (Mad.)] and Supreme Court Order in the case of *Rajasthan Spinning and Weaving Mills* [2010 (255) ELT 481 (SC)]. Tribunal's Larger Bench decision in the case of *Vandana Global* [2010 (253) ELT 440 (Tri-LB)] was distinguished by the Chennai Bench of the Tribunal holding that the same dealt only with inputs used for making foundation and supporting structures for machines, and hence could not be applied to decide eligibility of credit on inputs used in fabrication of machine attached to the earth. [*India Cement Ltd.* v. *Commissioner* - 2013-TIOL-1649 (Cestat-Mad.)]. *For similar Order of CESTAT New Delhi upholding availability of Cenvat credit on steel items used for*

fabrication of cooling bed for rolling mills, See Tax Amicus-July 2013 issue.

SSI Exemption - Deemed exports to be counted as home consumption: CESTAT, Chennai by a majority order has held that deemed exports cannot be equated with actual exports under excise law. It was held that for computing value of clearances under SSI Exemption to determine eligibility, only actual exports shall be excluded and hence deemed exports shall be treated at par with domestic clearances and be included in the value of clearances to determine eligibility of SSI exemption. [*Commissioner* v. *Bansal Metallic Oxides* - 2013 (296) ELT 215 (Tri-Chennai)]

Valuation - Amortized cost of moulds/ spares to be determined based on their expected life: Amortized cost of moulds/ dies, to be included in the assessable value for payment of excise duty, should be determined on the basis of their expected life and number of parts which could be manufactured during such expected life. While holding the same, CESTAT New Delhi relied on CBEC Circular No. 170/4/96-CX, dated 23-1-1996 and the Larger Bench decision of Tribunal in the case of *Mutual Industries Ltd.*- 2000 (117) ELT 578. Department's contention that amortized cost should be determined on the basis of actual period of use and number of parts manufactured during that period was hence rejected. [*Machino Plastics Ltd.* v. *Commissioner* - 2013 (296) ELT 356 (Tri-Del.)]

Cenvat credit on inputs contained in dutiable waste/scrap available even if final product is exempted: The Allahabad High Court has held that proportionate Cenvat credit on inputs contained in the dutiable plastic waste/scrap generated during manufacture of exempted final product is available. In the instant case, the appellant was engaged in the manufacture of IV fluids which were exempted from payment of excise duty, however, during the manufacturing process, plastic scrap/ waste was generated which was liable to excise duty. [*Albert David Ltd.* v. *Commissioner* - 2013 (297) ELT 24 (All.)]

DTA clearances of cut flowers by an EOU not liable to Central Excise duty: Cut flowers are non-excisable products since the rate of duty column is left blank in respect of cut flowers falling under Chapter 6 of the Central Excise Tariff. CESTAT, Mumbai observing so and also noting that even before the amendment in 2008, the Central Excise Tariff did not specify 'cut flowers' as excisable goods, held that on sale of these cut flowers by an EOU in DTA, no central excise duty will be levied under proviso to Section 3(1) of the Central Excise Act. [*Commissioner* v. *Valplus Biotech Limited* - 2013-TIOL-1547-CESTAT-MUM]

Cenvat credit on registered dealer's invoice: CESTAT, New Delhi has held that Cenvat credit on the basis of first stage dealer is not deniable when it was found that the goods were procured by the dealer on fake invoices and supplier to the dealer was non-existent. In the instant case, on enquiry, it was found that the purchases of first stage dealer were not genuine as the person from whom such purchases were made was non-existent. The Tribunal held that Cenvat credit cannot be denied on dealer's invoice as the assessee was only responsible to check the particulars mentioned by such dealer, and not the genuineness of his purchases. It was noted that there was no dispute on receipt of such inputs by the assessee and their use in factory of manufacture. [*Commissioner* v. *Juhi Alloys* - 2013 (296) ELT 533 (Tri-Del.)]

SERVICE TAX

Notification

Factory canteens exempted from service tax: Catering service provided in canteen maintained in a factory has been exempted from service tax. Notification No. 14/2013-S.T. dated 22-10-2013 has been issued to insert entry no. 19A in the mega exemption Notification No. 25/2012-ST. The new entry extends benefit of exemption to services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948, having the facility of air-conditioning or central air-heating at any time during the year. Exemption is already available to such services provided by a restaurant, eating joint or a mess if such establishment does not have air-conditioning or central air-heating facility in any part of its premises. This has been provided under entry no. 19 of the Notification No. 25/2012-S.T.

Ratio decidendi

Service tax on temporary transfer or permitting use of copyright is not unconstitutional: In the present case, the question before the High Court was whether levy of service tax on temporary transfer or permitting use or enjoyment of copyright is *ultra vires* the Constitution. The Court held that levy is not *ultra vires* as it is not on transfer of right to use goods but on temporary transfer or permitting the use or enjoyment of copyright. The Court also held transfer of copyright from the producer to the distributor and by the distributor to the exhibitor is not transfer of right to use goods liable to sales tax since even while films are in use by distributor/ exhibitor, they are under the effective control of the producer. Temporary transfer of copyright to the distributor or exhibitor is not to the exclusion of producer and therefore, the same is liable to service tax. [*AGS Entertainment Pvt. Ltd.* v. *UOI* - 2013 (32) STR 129 (Mad.)]

Access provided to one's own data may not be taxable: The appellant was provided access to their own data stored in computers maintained outside India. The department raised a demand under online information and data base access and retrieval service under reverse charge mechanism. The Tribunal granted stay, taking a prima facie view that when access is provided to one's own data, it does not amount to online information and data base access and retrieval service. [*Phillips Electronics* v. *Commissioner* - 2013-TIOL-1655-CESTAT-MAD]

Providing whole time employees by parent company is not 'manpower supply service': The appellant employed personnel belonging to the parent (German) company. The said personnel were relieved by the German company and they functioned as whole time employees of the appellant. Considering the terms and conditions of the relevant agreements and facts of the case, the Tribunal held an employer-employee relationship existed between the appellant and the personnel and hence there cannot be any manpower supply service by the German counterpart. Further, the method of disbursement of salary, being part payment of salary in the home country, cannot determine the nature of the transaction. [*Volkswagen India Pvt. Ltd.* v. *Commissioner* - 2013-TIOL-1640-CESTAT-MUM]

Franchise service – Plea of JV and service to self, when not acceptable: Examining the ingredients of 'Franchise' services, the Tribunal held that temporal transfer or permitting use of logo, motto etc would not take away the essential character of the service provided by the assessee,

which was of franchise. Also, such permission to use fell within Franchise service as an ingredient thereof. According weightage to the terms of the agreement the Tribunal held that in absence of sharing of risk / liability, the education joint venture, was not truly a joint venture and the assessee's argument of service to oneself could not be accepted. [*Delhi Public School Society* v. *Commissioner* - 2013 (32) S.T.R. 179 (Tri. – Del)]

Development charges on moulds used in manufacture – Service tax liability: The department sought service tax on design and development charges paid to upcountry manufacturers/ fabricators of moulds under reverse charge mechanism. Finding force in the assessee's contention that even if service tax is paid Cenvat credit would be available since the moulds were used in manufacture of glass bottles, the Tribunal held that *prima facie* service tax was not payable in respect of development charges. [*Pragati Glass* v. *Commissioner* - 2013 (32) S.T.R. 212 (Tri. – Ahmd)]

Refund claim allowable for entirety of transaction: At issue was the denial in part of refund of service tax attributable to freight charges paid on freight for return of empty containers to factory premises. The Tribunal emphatically held that when the entirety of an activity is in relation to the transportation for export of specified goods, refund claimed have to be allowed in entirety. [*Vippy industries* v. *Commissioner* - 2013 (32) S.T.R. 213 (Tri. – Del)]

VALUE ADDED TAX (VAT)

Notifications

Voluntary Disclosure Scheme introduced under Punjab VAT Act: Voluntary Disclosure Scheme, for waiver of penal action, has been notified by the Government of Punjab. This scheme, introduced through Public Notice dated 31-10-2013, provides for payment of tax dues and covers all dealers who have submitted incorrect returns. It covers cases relating to claims of input tax credit, concessional rate of tax in cases of branch transfer/ interstate trade and cases of zero rated sales, where the tax has not been paid, goods have not been sent outside the State or not exported, respectively. Cases where statutory form for concessional rate has been submitted but the same is not proper and genuine, are also covered for the benefit of this scheme. The dealer, in order to avail the benefit, must make an application to the designated officer clearly stating the mistakes committed by him, undertaking to deposit revised tax due along with 1.5% interest from the day the tax was due and thereafter pay 25% of the tax due as calculated by the designated officer within a month. Rest of the tax due bearing 1% interest is liable to be paid in 3 installments, by the end of June, September and December, 2014 respectively. The amount determined by the designated officer cannot be challenged by a dealer and if the liability as determined has not been discharged, the scheme provides for recovery under Punjab VAT Act. The benefit is not available in cases where notice for assessment of tax under Section 29 or notice for audit of returns under Section 28 is prior to date of application or where inspection of the business premises was carried out by the department prior to the date of application or where proceedings for investigation have been initiated and notices for producing the books of account have been issued prior to the date of application.

Entry Tax and Advance Tax in Punjab: Punjab Government has exempted all taxable persons registered under the Punjab Value Added Tax Act, 2005 from the payment of entry tax on all goods covered under Notification No. S.O.83/P.A.9/2000/S.3-A/2012, dated 18-9-2012. Notification dated 4-10-2013, issued in this regard is in exercise of power conferred under the proviso to Section 3-A of the Punjab Tax on Entry of Goods into Local Areas Act, 2000. Although the taxable persons have been exempted from the levy of entry tax, vide another Notification dated 4-10-2013 (hereinafter referred to as "Notification No. 2"), issued in exercise of powers conferred under Section 6(7) of the Punjab VAT Act, 2005, advance tax has been made leviable on import of all goods specified under Notification No. 2. Procedure for payment of advance tax has also been provided in Public Notice of the same date.

Tamil Nadu VAT Act amended: Tamil Nadu Value Added Tax (Fifth Amendment) Act, 2013 has amended Tamil Nadu VAT Act, 2006 with effect from 11-11-2013. As per the amendments, after insertion of proviso to sub-section 19(2), input tax credit shall be allowed in only in excess of 3% in respect of goods purchased for sale on inter-state sale basis against Form C. Earlier this credit was available in full. Further, according to the amendments carried out in Section 19(4), rate of reversal of input tax credit, in cases of transfer of goods to a place outside state otherwise than by way of sale; or in case of use in manufacture of other goods and transfer to a place outside the state, also otherwise than by way of sale, has been increased from 3% to 5%.

Ratio decidendi

Banks and NBFCs selling hypothecated vehicles are 'dealers': Calcutta High Court has held that banks and non-banking finance companies (NBFCs) engaged in business of granting loans to persons intending to purchase vehicles against its hypothecation by way of security under loan-cum-hypothecation agreements are 'dealers' as per the definition in Section 2(11) of the West Bengal Value Added Tax Act, 2003 and are liable to VAT in case the vehicle is sold for recovery of the loan. The court while upholding liability under West Bengal Value Added Tax Act, 2003, observed that the vehicles are sold for valuable consideration and such sales are not gratuitous sales and an element of trust is also involved as any amount received in excess of the dues has to be held by the petitioners for the benefit of the borrower. The court therefore held that the petitioners are constructive trustees and stand in a fiduciary relationship with the borrower while exercising the right to sell. The judgment in the case of *State of West Bengal* v. *O.P. Lodha* [105 STC 561], wherein the meaning of the word 'dealer' under the Bengal Finance Sales Tax Act, 1941 was found to be substantially similar to that of the Act and it was held that *an agent who sells goods on behalf of somebody else cannot escape the liability to pay sales tax on the sales made by him for and on behalf of other merely because, he was selling goods on behalf of others* is applicable in the present case. [*Tata Motors Finance Ltd.* v. *Asst. Commissioner of Sales Tax* - 2013-VIL-85-CAL]

Franchise agreement and transfer of right to use goods: Madras High Court has held in case of franchise agreement involving transfer of right to use trademark, goodwill and reputation exclusively to the franchisee in respect of particular outlet, the same would be liable to sales tax. In the instant case, the petitioner, company engaged in the business of operating supermarket, entered into a franchise

agreement giving an exclusive right to operate the super market in the location identified in such agreement. The location identified in the agreement was the address of the departmental store and the relevant clause in the agreement provided that the petitioner would not offer franchisee to others within the reasonable distance from the said location. The court held it is a case where the goods which are in the nature of intangible or incorporeal goods were available for delivery, there was consensus *ad idem* to the identity of such goods and during the period when the agreement was in force it was an exclusive right given to the transferee by the petitioner in respect of a particular store. That is to say that, during the period when the agreement was in force, the petitioner as the transferor could not transfer such goods, with reference to the particular store, to any other party. Thus, all attributes constituting transfer of right to use goods have been fulfilled and the tests laid down by the Supreme Court in the *BSNL* case stands fully satisfied. The rights given by the petitioner were hence held a transfer of right to use incorporeal or intangible goods and the franchise agreement liable to sales tax. [*Vitan Departmental Stores & Industries Limited* v. *State of Tamil Nadu* - 2013-VIL-94-Mad]

INCOME TAX

Notification

Cyprus notified as non-cooperative jurisdiction: The CBDT has, by Notification No. 86/2013, dated 1-11-2013, specified 'Cyprus' as a 'notified jurisdictional area' for the purpose of Section 94A of the Act. Thus, it would appear that Cyprus has not been providing the information requested by the Indian tax authorities, in accordance with the DTAA entered between the two countries. The major implications of this notification are that the transactions entered into by Indian residents with a person located in Cyprus shall be subject to TP regulations and no deduction for any payment made to any financial institution in Cyrus shall be allowed unless an authorization is furnished for seeking relevant information from the said financial institution. If any sum is received from a person located in Cyprus, then the onus is on the assessee to explain the source of such money. Any payment made to a person located in Cyprus shall be liable for WHT @ 30 % or a rate as per Act, whichever is higher.

Ratio decidendi

Retrospective amendment in Section 9 – Liability to deduct TDS when cannot be fastened: The assessee entered into an agreement with a non-resident entity in London to carry out work viz. technical designing and drawings in three phases. Tax was not deducted with regard to two phases on the ground that the technical designs and drawings which were prepared in London were to be transported to India under both these phases. Further, non-resident entity to whom these payments were made did not have any PE in India. However, tax with respect to third phase was deducted. The department argued that the three phases constituted one composite agreement, and in terms of the retrospective amendment vide Finance Act, 2012, TDS was to be deducted on payments made for the earlier phases. Granting relief to the assessee, the Tribunal held that since the law settled by Supreme Court in the case of *Ishikawajima-Harima Heavy Industries* was in favour of the assessee, the liability could not be created on basis of a retrospective

amendment and that if the services in phase one and two had been rendered outside India, it could not be charged to tax in India. [*New Bombay Park Hotel Pvt. Ltd.* v. *ITO,* ITA No. 7641/Mum/2011, ITAT, Mumbai, Order dated 1-10-2013]

Interest reimbursement eligible for deduction under Section 80IC: The assessee's return of income which was accepted by the AO included a business receipt, being interest subsidy received from SIDBI on account of a particular scheme which was related to business of the assessee. Subsequently, the AO treated the same to be in the nature of 'other income', not eligible for deduction under Section 80IC of the Act, holding it to be a mistake apparent from the record. The Tribunal held that since the SIDBI loan had been obtained as well as utilized for business purpose and interest thereon had been claimed as business expense, any reduction in interest on account of fulfilment of terms of a scheme formulated in this behalf would be business income. [*ITO* v. *Saara Sales (P) Ltd.*, ITA No. 3/Del/2013, ITAT, Delhi, Order dated 18-10-2013]

Losses of Section 10A unit can be adjusted against profits of non-eligible unit: The assessee had nine eligible (Section 10A) units, out of which 8 eligible units had earned profit and one unit incurred loss. In its return of income, the assessee adjusted the loss of the eligible unit against the profit of non-eligible unit. The AO held that loss in eligible unit had to be adjusted against the profit of eligible units. The Tribunal relying on the decisions in the case of *Tata Consultancy Services* (Bangalore ITAT) and the High Court of Bombay in *Black Veatch & Hindustan Unilever Ltd.* reiterated that *"the profits and gains are derived by an undertaking"* would mean the profits and gains of the assessee's undertaking and loss could be set off. [*Sonata Software Ltd.* v. *ACIT,* ITA No. 8032/Mum/2011, ITAT, Mumbai, Order dated 11-10-2013]

Voluntary surrender does not discharge the assessee from penalty: Assessee surrendered certain sum as its income in response to queries raised by the AO which related to survey proceedings that had been conducted in the business premises of its sister concern wherein certain documents viz. share application forms, bank statements, blank share transfer deeds etc. had been impounded. The AO levied penalty under Section 271(1)(c) of the Income-tax Act, 1961 for not furnishing true particulars. Upholding the stand of the department, the Supreme Court held that pleas like 'voluntary disclosure', 'buy peace', 'and avoid litigation ', 'amicable settlement' etc. cannot explain away conduct of the assessee. Explanation 1 to Section 271(1)(c) raises against the assessee a presumption of concealment, when a difference is noticed by the AO, between reported and assessed income. The law does not provide that when an assessee makes a voluntary disclosure of his concealed income, he has to be absolved from penalty. Even on facts, as the assessee did not disclose the impugned sum as its income in the return which was filed after the survey but surrendered only on being questioned, the Supreme Court held the surrender to be non-voluntary. [*MAK Data P. Ltd.* v. *Commissioner,* Civil Appeal No. 18389 of 2013, Supreme Court Order dated 30-10-2013]

Optionally Convertible Loan is quasi-capital and notional interest thereon cannot be taxed under transfer pricing regulations: Cadilla Healthcare, India had subscribed to Optionally Convertible Loan of USD 27 million issued by Zydus International, Ireland. As per the terms, no interest was payable if the amount was converted into equity, however, if the same was redeemed, interest was payable at LIBOR + 290 bps at maturity (i.e., 5 years from the date of disbursement). The TPO

considered the Optionally Fully Convertible loan as debt, accordingly computed interest thereon and added the same to assessed income. Sustaining the order of Commissioner (Appeals) the Tribunal held that since the assessee has converted the loan into equity in the immediate next year, notional interest could not be brought to tax. Also, on comparison of the transaction with the non-AEs, it was found to be at arm's length. [*DCIT* v. *Cadila Healthcare Limited*, ITA No. 2430/Ahd/2012, ITAT, Ahmedabad, Order dated 11-10-2013]

Conversion of leasehold right to freehold right does not alter period of holding: The assessee acquired a property on lease in the year 1984, which was converted later into freehold property in the year 2004 and thereafter sold. The capital gain arising therefrom was offered by the assessee as long-term capital gain (LTCG). The department argued that as the property was acquired by converting the leasehold right into freehold right and was sold within three years, gain arising there from was taxable as short-term capital gain (STCG). The court held that the conversion of the rights of the lessee from leasehold right into freehold right was only by way of improvement of his rights and would not have any effect on the taxability of gain arising from such property. Thus, gain arising from such property would be taxable as LTCG. [*Commissioner* v. *Rama Rani Kalia*, ITA No. 56 of 2013, Allahabad High Court Order dated 7-8-2013]