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Article

Export of Services under the new regime of Service Tax

By **Visali Kumar & Jagannadh Grandhi**

As we approach the second year in the negative list based regime in service tax, there are many issues which have not been comprehended yet. Section 66B of the Finance Act, 1994 ('the Act') is the new charging section which replaced the earlier charging section, paving way for the new and wide net of service tax. This section provides that *service tax will be levied at the rate of 12% on the value of* ***all services****, other than those specified in the negative list, provided or agreed to be provided* ***in the taxable territory*** *by one person to another and collected in such manner as may be prescribed.* Thus, it can be seen that the significant change under the new regime, *inter alia,* is that service tax shall be levied on **all services,** which are provided in the *'taxable territory'* as against *on specified services* under the earlier charging section.

The term 'taxable territory' is defined in Section 65B (52) of the Act as *"the territory to which the Act applies"* i.e. the whole of territory of India other than the State of Jammu and Kashmir. The term 'non-taxable territory' is defined in Section 65B (35) to mean territory which is outside the taxable territory. Thus, it is imperative now that a service is provided in ***the taxable territory*** in order to attract service tax levy.

Determination of place of provision of service

As a derivative of the charging section emerges the concept of Place of Provision ('POP') of a service. Accordingly, the Place of Provision of Services Rules, 2012 ('POP Rules') were framed vide the power granted under Section 66C (1) of the Act, with effect from 1-7-2012. It may also be noted that the POP Rules are issued in supersession of the Taxation of Services (Provided from outside India and Received in India) Rules, 2006 ('Import of Services Rules' or IOS Rules') and the Export of Services Rules, 2005 ('EOS Rules'). The POP Rules appear to be a conscious attempt in presenting the new service tax law as a ***destination based consumption tax*** in its true sense.

On a brief reading of the POP Rules, it can be seen that Rules 4 & 5 seem to have carried forward the treatment of services on the basis of 'performance' or 'location of immovable property', as was the case under the erstwhile EOS Rules. However, the effect of such categorisation is nullified by Rule 8 which provides that where the service provider and recipient are located in the taxable territory, the POP would be the location of the service recipient. To put it precisely, if both the parties in a service agreement are located in India which is the taxable territory, then the POP would be India irrespective of the nature of service.

Taxability of export of services under the new regime

A relook at the erstwhile EOS Rules, before venturing into the new provisions dealing with export of service brings back to our memory that in order to qualify as export, the taxable services had to fall under any of the three categories contemplated under Rule 3 of the EOS Rules based on (i) location

of immovable property, (ii) performance of service and (iii) location of recipient. In addition to the service falling under any one of these categories, the consideration for the service had to be received in Convertible Foreign Exchange (CFE).

Now coming to the new regime, along with the introduction of POP Rules, Rule 6A is introduced under the Service Tax Rules, 1994 ('ST Rules') to determine when a service shall be treated as export of service. As per this rule, provision of service shall be treated as export of service, *inter alia,* when (i) service recipient is located outside India (ii) place of provision, as per POPS Rules, is outside India and (iii) consideration for the service provided is received by the service provider in CFE. The condition of service recipient being outside India for all services is a startling departure from the erstwhile EOS Rules which did not impose it for performance based services and services relating to immovable property, to qualify as exports. This condition in fact, flows from Rule 8 of the POP Rules which provides that the POP of a service where the service provider and recipient are located in the taxable territory shall be the location of the recipient which is India. In other words, in respect of a service transaction where the service provider and recipient are located in India, the POP would automatically become India and such service would not qualify as export, irrespective of fulfilling other factors such as receipt of CFE or the service being fully performed outside India, or being in respect of an immovable property outside India. This condition of recipient being outside India arbitrarily restricts the scope of services qualifying as exports, thereby exporting taxes in respect of services which are essentially performance based/immovable property based/ event based.

Significance of receipt of CFE under the old and new regimes

Let us now analyse the significance of receipt/ non-receipt of CFE under the old & new regimes. Under the erstwhile EOS Rules, the services which were put to the export test are *taxable services per se,* which had to cross the threshold of falling under one of the prescribed categories and receipt of CFE. Therefore, even if a performance based service is fully performed outside India, it would not qualify as export if the consideration for such service is not received in CFE. Consequently, tax became payable on such a service. Furthermore, as there was already a levy on the services which had to qualify the test of export, Rule 4 of the EOS Rules specifically provided that any service taxable under Section 65 (105) of the Act *may be* exported without payment of service tax. Rule 5 of the EOS Rules in turn provided for rebate of service tax paid on such services exported or of the duty/service tax paid on inputs/input services used in providing such services. Thus, the service providers who are engaged in exporting services had an option to provide such services without payment of service tax. Also, as the services which were exported were taxable *per se* the service providers were entitled to avail Cenvat credit in respect of the goods and services used in providing such services.

In contrast to such position under the erstwhile EOS Rules, under the new regime, the test of categorisation for a service to qualify as export is replaced with the concept of 'place of provision' which incidentally is also the test of taxability. Thus, in a situation where the POP of a service is outside India the service would not be liable to service tax

even if the consideration is not received in CFE, as the service is not provided in the taxable territory. In other words, a service in respect of which the POP is outside India and where the consideration is received in Indian currency, such service would neither be an export nor a taxable service. In such a case, the service provider would not even be entitled to avail Cenvat credit on the goods and services used by him, the service being a non taxable service. Some re-thinking on the part of CBEC, on the treatment of such services which are neither taxable services nor export services would be welcome, as the Cenvat Credit chain in respect of inputs/input services used in providing such services would be broken and become a cost to the service providers due to the non-availability of credit.

The only silver lining under the new provisions dealing with export is that the Cenvat Credit Rules, 2004 ('CCR Rules') have taken care of the credit aspect of goods/services used in providing services which qualify as exports under Rule 6A of the ST Rules. This has been done by amending the definition of 'exempted service' which excludes a service exported in terms of Rule 6A of the ST Rules, giving a sigh of relief to the exporters of services who successfully cross the hurdles of POP Rules and Rule 6A.

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CUSTOMS

Notifications & Circulars

TED refund where excise duty exempted: DGFT has clarified that for certain deemed export supplies under Chapter 8 where outright exemption from excise duty is available, reimbursement of terminal excise duty from DGFT shall not be available. DGFT Policy Circular No.16 (RE-2012/2009-14), dated 15-3-2013 issued in this regard also states that in case duties have been paid, agency collecting the duty would refund it.

"Write-off" of unrealized export bills: Reserve Bank of India has further liberalised the procedure for write-off of unrealised export bills, subject to certain conditions relating to surrender of incentives prior to "write-off". Exporters other than status holders are eligible for self write-off up to 5% of total export proceeds realized during the previous calendar year while this limit will be 10% for status holder exporters. Authorised dealer banks can write-off up to 10% of such total export proceeds. As per RBI Circular A.P. (DIR Series) Circular No. 88, dated 12-3-2013 these limits would be cumulatively available in a year.

SCOMET list amended: Several amendments to the Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) list have been notified. DGFT Notification No. 37(RE-2012)/2009-2014, dated 14-3-2013 issued in this regard, also adds Polymeric substances; thermal batteries designed or modified for complete rocket systems or complete unmanned aerial vehicles; and three axis magnetic heading sensors having specified characteristics, in the list of SCOMET items.

Japan - Concessional rates of duty for specified imports from Japan reduced – Concessional rates of duty as applicable to specified imports from Japan have been further amended as

per the provisions of General Note 1 & 5 of Annex 1 to the Comprehensive Economic Partnership Agreement between India and Japan, which provides for annual reduction in the concessional rates of duty. As per Notification No. 17/2013-Cus., dated 26-3-2013 the new rates are effective from 1-4-2013.

Export of perishable agricultural goods – 24X7 customs clearance at air cargo complexes: 24x7 Customs clearance for export consignments of perishable agricultural export goods will be available at all air cargo complexes across the country. CBEC Circular No. 12/2013-Cus., dated 2-4-2013 issued to this effect instructs that such export consignments should not be examined in a routine manner, be cleared on the same day itself and should not be unduly held up.

Low Noise Block (LNB) down converter – Classification of: Separately presented LNB down convertors designed to be mounted on aerial (dish) of a system for receiving satellite broadcasts (Satellite Television Reception System), for amplification of weak signals and for converting frequencies from very high levels to levels within the VHF and UHF range, are to be classified under Tariff Item 8543 70 99 of the Customs Tariff. CBEC Circular No. 13/2013-Cus., dated 5-4-2013 applies GRIs 1 [Note 2 (a) to Section XVI] and 6 in this regard.

Ratio decidendi

No time limit prescribed for filing bill of entry: Gujarat High Court has held that Section 46 of Customs Act, 1962 does not provide any time limit for filing of bill of entry and that the period of 30 days prescribed under Section 48 for disposal of goods by the authorities in case of non-clearance, is not applicable to filing of bill of entry. It was further held that in such cases penalty under Section 117 would not be imposable. [*Commissioner* v. *Shreeji Overseas (India) Pvt. Ltd.* - 2013 (289) ELT 401 (Guj.)].

Unjust enrichment not applicable to refund of cash security: Provisions relating to unjust enrichment in case of refund of duty or interest, under Section 27(2) of the Customs Act, 1962, are not applicable to refund of cash securities. The assessee had made deposits in terms of CBEC Circular No. 89/95-Cus., calling for 2% security deposit for provisional assessment of bills of entry in case of project imports. The Tribunal while allowing assessee's appeal noted that said circular made it clear that it was only a cash security and not any other payment. [*IDMC Ltd.* v. *Commissioner* – 2013 (289) ELT 389 (Tri. – Mumbai)].

Appeal against provisional release order not maintainable before CESTAT: CESTAT Mumbai by its majority order has held that appeal against the provisional release order of the Commissioner under Section 110A of the Customs Act is not maintainable before the Tribunal. The assessee had contended that appeal before the Tribunal would be maintainable against any order passed by Commissioner as adjudicating authority but the CESTAT held that the order of provisional release is an interim order pending adjudication and therefore, challenge to the same would not be within its jurisdiction. [*Akanksha Syntex Pvt. Ltd.* v. *Commissioner* – 2013 (289) ELT 186 (Tri. – Mumbai)].

Imported goods and smuggled goods – Distinction in case of import as baggage: CESTAT, Ahmedabad has held that the Tribunal does not have jurisdiction in case where the baggage

goods are seized at the customs port itself before its clearance for non-declaration or any other reason. Contention of the assessee that the Tribunal had jurisdiction because the goods were 'smuggled goods' and not 'imported goods' as no declaration was submitted by the passenger, was rejected by the Tribunal. It was noted that goods when imported into India, whether as baggage or otherwise, till they are cleared for home consumption, are to be treated as imported goods and can be considered as smuggled goods only when they are brought out of customs area without payment of duty and seized thereafter. [*Prakash Chandra Shantilal* v. *Commissioner* - 2013 (290) E.L.T. 125 (Tri-Ahmd.)].

Refund of SAD – Relevant date for limitation: CESTAT, New Delhi has held that refund of special additional duty (SAD or Special CVD) cannot be denied on the ground of limitation in circumstances where the Department itself was of the view that relevant date for limitation would be the date of finalization of bill of entry and not the date of payment of SAD. In this case, refund applications were earlier not processed by the authorities on the ground that the bills of entry were provisionally assessed, but subsequently refund was denied when the applications were filed after finalization of the bills of entry. The Tribunal however, referring to CBEC Circular No. 23/2010-Cus., dated 29-7-2010 held that prior to issue of this circular, the Department itself was taking a view that wherever the assessments are provisional, refund claims have to be filed within a period of one year of the finalization of the same and therefore, refund claim cannot be rejected on the point of time bar. [*Singla Trading Co.* v. *Commissioner* - 2013-TIOL-522-CESTAT-DEL.].

Drawback – Power to condone delay in filing application: The Delhi High Court has held that in case the CBEC was competent to condone the delay in filing of drawback application by the exporter, the exporter should have been asked to approach the Board and that the Assistant Commissioner should not have taken up the jurisdiction to condone the delay in an application addressed to Commissioner. The Court noted Rule 7A of the Re-export of Imported Goods (Drawback of Customs Duties) Rules, 1995 to observe that the power to condone delay beyond three months is with the CBEC. [*Ilpea Paramount Ltd.* v. *Joint Secretary, Department of Revenue* – 2013 (289) ELT 151 (Del.)].

CENTRAL EXCISE

Circular

Area based exemption – Expansion by acquiring adjacent plot, clarified: Units which undertake expansion by acquiring the adjoining plot with at least one common boundary with the existing plot and merge it with the existing plot/premises to make it one unit, will be eligible for exemption under Notification Nos. 49 & 50/2003-C.E. By its Circular No. 968/2/2013-CX, dated 1-4-2013, the CBEC clarifies this point as noted in its earlier Circular No. 960/3/2012-CX which used the word 'adjacent'. The present clarification has been issued to set at rest the doubt as to whether the term 'adjacent' would also include a plot which is not immediately adjoining the existing plot.

Ratio decidendi

Valuation – Transportation charges from factory gate to railway station when not includible: CESTAT, Mumbai has held that transportation charges from factory gate to the railway station are not includible when manufactured goods are delivered at the railway station, at the request of some buyers, for onward transportation to other cities. The Department had sought to include the said charges, recovered separately from the customer, stating that the assessee had delivered the goods as per the purchase order. The Tribunal however upheld order passed by Commissioner (Appeals) which held that Rule 5 of the Central Excise Valuation Rules was not applicable as goods were not sold at a place other than the place of removal. [*Commissioner* v. *Star Oxochem Pvt. Ltd.* – 2013 (289) ELT 165 (Tri.-Mumbai)].

Samples cleared without packing, dutiable: Samples of tablets cleared from the factory, though without packing, are liable to duty. The assessee had contended that analytical samples cleared from the factory were not excisable as the same were cleared without package and were not marketable. CESTAT Mumbai while holding that the goods were dutiable took note of the assessee's letter submitting that samples were in the form of unpacked tablets drawn from bulk prior to packing. [*Fredun Pharmaceuticals Ltd.* v. *Commissioner* – 2013 (289) ELT 185 (Tri. – Mumbai)].

Rebate on exports by unit availing SSI exemption: Gujarat High Court has held that SSI exemption under Notification No. 8/2001-CE was applicable to clearances for home consumption only and the same was not applicable to clearance for exports and hence assessee could pay duty on such clearances while also utilizing Cenvat credit on capital goods. It was noted that limitation on utilization of Cenvat credit on capital goods for payment of duty was only for goods cleared for home consumption and not for exports. The court deliberated upon interpretation of phrase "on the aforesaid clearance" appearing in clause 2(iv) of the said notification and held that the same was with reference to goods cleared for home consumption. [*Gujarat Woolen Felt Mills* v. *Joint Secretary* – 2013 (289) ELT 250 (Guj.)].

Rebate when export proceeds not realised: CESTAT, New Delhi has waived the condition of pre-deposit in a case pertaining to rebate on export of goods where the export proceeds were not realized. It noted that Notification No. 19/2004-C.E. (N.T.) which prescribes conditions subject to which rebate is granted contains no condition of realization of export proceeds. The contention of the assessee that the difference in the export proceeds and the export value was due to exchange rate fluctuations, was also prima facie accepted by the Tribunal as correct. [*Jindal Stainless Ltd.* v. *Commissioner* – 2013 (289) ELT 321 (Tri. – Del.)].

Cenvat re-credit to merged unit: CESTAT, Ahmedabad has allowed taking of Cenvat credit in the accounts of the merged unit in case exports were made by a particular unit which claimed rebate and the same was sanctioned by way of Cenvat credit. By the time rebate was sanctioned, the appellant-unit had merged with an EOU of the same company. Department's appeal was earlier allowed by Commissioner (Appeals) holding that Rule 10 of the Cenvat Credit Rules, 2004 was not applicable. The Tribunal while allowing

assessee's appeal observed that cash refund could have been allowed and the merged unit could not be deprived of the benefit of Cenvat credit due to the unit which merged with it. [*Kirti Dyes & Chemicals Ltd.* v. *Commissioner* – 2013 (289) ELT 347 (Tri. – Ahmd.)].

Interest on delayed payment of interest: Gujarat High Court has granted interest on delayed payment of interest while it noted that there is no statutory provision providing for interest in case of delay in payment of interest. The Court observed that the authorities had acted unjustly by initially delaying refund and thereafter withholding the interest payable. It was noted that at all stages the assessee had to approach the higher authorities in further appeals. The Court however granted interest @ 9% only observing that such claims did not fall within the statutory provisions contained in Section 11BB of the Central Excise Act, 1944. [*Shri Jagdamba Polymers Ltd.* v. *Union of India* – 2013 (289) ELT 429 (Guj.)].

Unjust enrichment when duty paid under protest during investigation: CESTAT Ahmedabad has held that the fact that the amount was paid under protest during the course of investigation and not collected as part of duty by showing in the invoice is to be considered for non-invocation of provisions of unjust enrichment. The Tribunal while rejecting the department's appeal also noted evidences like balance sheet and the Chartered Accountant's certificate to consider discharge of obligation cast on the claimant. [*Commissioner* v. *Parle International Ltd.* – 2013 (289) ELT 494 (Tri. – Ahmd.)].

Penalty imposed under wrong provisions not sustainable: Penalty imposed under Rule 15 of the Cenvat Credit Rules, 2004 in a case where cenvatable invoices were issued without supply of materials specified in the invoice, was held as not sustainable by CESTAT Bangalore. The Tribunal noted that though this legal error was rectifiable and that there was no limitation for imposing penalty, corrigendum should have been issued by the Department before adjudication. Penalty was set aside by the Tribunal while it also held that department cannot be permitted to issue corrigendum or a fresh SCN after adjudication of the case. [*Cauvery Iron & Steel (India) Ltd.* v. *Commissioner* – 2013 (289) ELT 502 (Tri. – Bang.)].

SERVICE TAX

Ratio decidendi

Technical testing and analysis services availed in respect of samples – Credit admissible: Deciding on Cenvat credit admissibility of a host of services, the Gujarat High Court upheld, *inter alia,* the admissibility of technical testing and analysis services availed in respect of clinical samples and inspection and checking of instruments. The department contended, in case of clinical samples that the services had neither been used for manufacture of final product nor for clearance of final product from place of removal. The High Court held that since without approval by licensing authority, the assessee cannot manufacture the drug for sale, technical testing and analysis service

would be covered by the means part of definition of input service and is in relation to the activity of manufacture. Reasoning that proper checking, calibration and certification of instruments like gauges, scales and thermo hygro meters was a statutory requirement, the High Court held that service of technical inspection and certification agencies would be covered under the definition of input service. [*Commissioner* v. *Cadila Healthcare Ltd* – 2013 (30) S.T.R. 3 (Guj.)]

Sales office can be an input service distributor: Sales office can be treated as premises of Input Service Distributor (ISD). Holding against the denial of credit, to one of the authorised service stations of the assessee - an authorised distributor, the Tribunal stated that in terms of the definition of ISD, sales office could be 'an office' of the manufacturer/ producer of final products or provider of output service. In the instant case, the registration of the sales office as ISD had been revoked and the department sought to recover credit to one of the authorised service stations. [*Commissioner* v. *Varun Motors* – 2013 (30) S.T.R. 31(Tri. - Bang.)]

Providing vehicles on call basis not covered under rent-a-cab service: Drawing distinction between providing vehicles on call basis – suitable notice for local and outside journeys and renting of vehicles, the Tribunal held that the arrangement between the assessee and his client was not taxable under rent-a-cab service. As per the terms of the agreement, the taxi was not in exclusive control of the hirer and the Tribunal observed that there was only a permanent arrangement of providing transport service without renting the vehicle. [*Commissioner* v. *Singh Travels* – 2013 (30) S.T.R. 96(Tri. - Del.)]

GTA Service - Transportation not covered when consignment note not issued: Examining the exigibility to service tax under GTA service, the Tribunal held that where no consignment note had been issued the operator cannot be considered as a goods transport agency. The appellant hired transit mixers to transport readymix concrete. The department contended that since payment was made on the basis of kilometres run and operators were responsible for delivery of goods and maintained logs (equivalent to consignment notes in the department's opinion), the service was one of GTA and not supply of tangible goods for use. However, the Tribunal took a view that the mere fact that the operator is undertaking transportation cannot make him a goods transport agency. Also, log books cannot be considered as consignment notes. Consignment notes are document of title to goods, and in the instant case since the appellant was responsible for the goods, no custodial rights or responsibilities were vested in the operator. [*Birla Ready Mix* v. *Commissioner* – 2013 (30) S.T.R. 99 (Tri. –Del.)]

VALUE ADDED TAX (VAT)

Notifications

WCT-TDS rate for unregistered contractors/ sub-contractors in Delhi, increased: From 1st April, 2013 the rate of WCT-TDS is 6% under the Delhi VAT Act, 2004 for unregistered contractors/ sub-contractors. Notification No. F.3 (17)/Fin. (Rev.1)/2012-13/dsVI/263, dated 30-3-2013 brings into force provisos to sub-sections 36A(1) and 36A(1A) of the Delhi Value Added Tax Act, 2004

which were inserted by Section 10 of the Delhi Value Added Tax (Amendment) Act, 2013 and communicated through Notification No. F.14(4)/LA-2013/cons2law/11, dated 28-3-2013.

Form T-2 – Online submission of, from 1-4-2013: Dealers in Delhi having GTO ≥ Rs.10 crores, except those exclusively dealing in tax-free goods are, from 1-4-2013, required to file return under new Form T-2, online. Notification No. F.7 (433)/Policy-II/VAT/2012/1429-38, dated 21-3-2013 requires that such return about details of invoice and Goods Receipt Note in respect of all goods purchased/received as stock transfer from outside Delhi will have to be submitted before the goods physically enter Delhi. If the vehicle number is not available in advance, this form needs to be filed without such number and the number updated within 24 hours of receipt of the goods by the Delhi dealer. Notification No. F.7 (433)/Policy-II/VAT/2012/464-74 dated 30-3-2013 also states that in cases where the complete information in Form T-2 is not filed online before the goods enter Delhi, the dealer shall not dispose of/sell/dispatch such goods till the vehicle number is updated online.

West Bengal VAT - Rate of tax and rate of WCT-TDS increased: Rate of VAT and rate of TDS under works contract in West Bengal has been increased. Notification Nos. 364 F.T., 365 and 369 F.T., all dated 28-3-2013, make following changes with effect from 1-4-2013:

Changes in rates:

Names of items/schemes	Rates till 31-3-2013	Rates from 1-4-2013
Items specified under Schedule C of the WBVAT Act, 2003	4%	5%
All unspecified items coming under Schedule CA of the WBVAT Act, 2003	13.5%	14.5%
Chewing tobacco, and pan masala of any type, when sold in a packaged condition, Cigar, Cheroot, and Cigarettes	20%	25%
Composition scheme for works contractors [S.18(4)]	2%	3%
Composition scheme for resellers [S.16(3)]	0.25% for dealers paying tax on turnover of sales	a) 0.25% of dealers paying tax on turnover of sales; OR b) (i) Rs. 7,000/- for the year 2013-14 if turnover of sales for 2012-13 does not exceed Rs. 30 lakh. (ii) Rs. 12,000/- for the year 2013-14 if turnover of sales for 2012-13 is more than Rs. 30 lakh and below Rs. 50 lakh.

Tax to be deducted at source by the contractee:

Status of a contractor	Rates till 31-3-2013	Rates from 1-4-2013
When a contractor is a registered dealer	2%	3%
When a contractor is a dealer not registered under the Act	4%	5%

Ratio decidendi

Refund when tax deposited by agent and not by dealer himself: Allahabad High Court has allowed refund of amount which was not deposited by the dealer himself but by his agent with the return in view of Section 42(4) of the U.P. Value Added Tax Act, 2008. Section 42(4)(d) of the U.P. VAT Act provides that the industrial unit availing or granted benefit of exemption or reduction in the rate of tax on the turnover of the sale before the commencement of the U.P VAT Act, under erstwhile Act or the CST shall be entitled to exemption by way of refund of the net tax paid along with the return of the tax for the period concerned, provided the tax has been deposited along with return in the prescribed manner. In this case, the net tax payable was deposited by the agent on behalf of the assessee, along with the return of the tax. The court while allowing refund held that Section 42(4) of the U.P. VAT Act contemplated payment of tax along with the return of tax for the purposes of exemption by way of refund and that only payment of tax as prescribed is relevant and not by whom actually paid or deposited. It held that it is immaterial as to whether the tax has been paid by the assessee himself or by his agent. [*Commissioner, Commercial Tax* v. *U.P. Petrochemicals Complex GAIL (India) Limited* - 2013-VIL-24-ALH]

INCOME TAX

Circulars

Conditions to identify low risk Indian contract R&D centre: By way of Circular No. 2/2013 dated 26-3-2013, CBDT has clarified conditions relevant to identify development centres engaged in contract R&D services with insignificant risk. As per the circular, the following conditions need to be borne out by the conduct of the parties. Most of the economically significant functions should be performed by the principal. Secondly the Indian development centre does not use any other economically significant assets including intangibles in research or product development. The foreign principal is capable of and actually controls and supervises product development and research though its strategic decisions. The Indian development centre should not assume nor have economically significant realised risks. In case the foreign principal is located in a country/ territory which is or is perceived to be a low tax jurisdiction, it will be presumed that the foreign principal is not controlling the risk. The fifth condition is that the Indian development centre should have no

ownership right over the outcome of the research.

Directive regarding adjustment of refund against demand: The Directorate of Income-tax (Systems) has issued a letter dated 21-3-2013 drawing attention to the judgment of the Delhi High Court in *Court on Its Own Motion* v. *CIT* where directions were issued that the department has to follow the procedure prescribed in Section 245 before making any adjustment of refund payable. In this regard, the Assessing Officers have been directed to comply with the said order and communicate their findings on adjustable demand to the CPC which will then process the refund and adjust the demand. [*F.No. DIT(S)-III/CPC/2012-13/Demand Management dated 21-3-2013*]

Ratio decidendi

Payment not qualifies as 'fees for technical services' when human intervention absent: The assessee made payment to a laboratory in Germany for carrying out certain tests on circuit breakers manufactured by him and to certify that such circuit breakers met with international standards. An application under Section 195 (2) was made with a claim that as the said tests were carried out by sophisticated machines without human intervention, the amount paid towards such services did not constitute *fees for technical services* and accordingly no tax was required to be deducted. However, the contention was rejected by the AO and CIT(A). Placing reliance on the Delhi High Court's judgment in the case of *Bharti Cellular* wherein it was held that as the word '*technical*' is preceded by the word 'managerial' and succeeded by the word 'consultancy' which have a definite involvement of a human element, the word *'technical'* has to be construed in the same sense involving direct human involvement, ITAT Mumbai held that the services provided by the German laboratory for testing the circuit breakers was a standard service done automatically by machines and not requiring human intervention and accordingly would not qualify as 'fees for technical services'. [*Siemens Limited* v. *CIT(A),* ITA No. 4356/Mum/2010 dated 12-2-2013(ITAT Mumbai)].

Circular disallowing expenditure on freebies to medical practitioners is valid: The assessee challenged the validity of the circular issued by CBDT wherein the expenditure incurred on freebies issued to medical practitioners was disallowed under Section 37 (1) of Income-tax Act, 1961 on the ground that Indian Medical Council had imposed a prohibition on medical practitioners taking any gift, travel facility, hospitality, cash or monetary grant from pharmaceutical and allied health sector industries. The Himachal Pradesh High Court rejected the contention on the ground that the regulation of the Medical Council prohibiting medical practitioners from availing of freebies was a salutary regulation, in the interest of the patients and the public. It observed that it was aware of the increasing complaints that the medical practitioners do not prescribe generic medicines and prescribe branded medicines only in lieu of the gifts and other freebies granted to them by some particular pharmaceutical industries. Accordingly, the circular was held to be valid. [*Confederation of Indian Pharmaceutical Industry* v. *CBDT,* CWP No. 10793 of 2012-J decided on 26-12-2012 by Himachal Pradesh High Court]

Expenditure on corporate membership of club is revenue expenditure: The assessee obtained corporate membership of the golf club on payment of Rs.6 lakhs and claimed the same as revenue expenditure which was disallowed by Department on the ground that it was capital

expenditure. On appeal by the assessee, this was reversed by the CIT(A) and Tribunal. On appeal by department, the Punjab & Haryana High Court observed that expenditure should be looked at from commercial point of view to decide whether it is revenue or capital in nature and every advantage of enduring nature do not constitute capital expenditure. The full bench further observed that nature of the advantage in a commercial sense was relevant and it is only where the advantage is in the capital field that the expenditure would be disallowable. It was held that the corporate membership was for a limited period of 5 years and the same was obtained for running the business with a view to produce profit. Such membership does not bring into existence an asset or an advantage for the enduring benefit of the business and by subscribing to the membership of a club, no capital asset was created but a privilege to use facilities of a club alone, were conferred on the assessee and that too for a limited period. Accordingly, it was held that such expenses cannot be treated as capital asset. [*CIT* v. *Groz Beckert Asia Limited,* ITA No. 366 of 2008 decided on 24-1-2013 by Punjab & Haryana High Court].

Disallowance under Section 14A read with Rule 8D(2)(ii) and 8D(2)(iii) does not apply to shares held as stock-in-trade: The assessee, dealer in shares, received dividend, however, did not offer any disallowance under Rule 8D on the ground that the said Rule is not applicable to shares held as stock-in-trade. The Assessing Officer rejected the claim and computed the disallowance under Rule 8D. On appeal, the CIT (A) held that even if Rule 8D was not applicable to shares held as stock-in-trade, a disallowance had still to be made under Section 14A. ITAT Kolkata observed that even though Section 14A applies to shares held as stock-in-trade, disallowance under Rule 8D (2) (ii) and (iii) cannot apply in respect of shares held as stock-in-trade since one of the variables on the basis of which disallowance under Rules 8D(2)(ii) & (iii) is to be computed is the *value of investments, income from which does not or shall not form part of total income* and if there is no such *investments,* the rule cannot have any application. Placing reliance on a precedent case the tribunal held that when the computation provisions under Rule 8 D (2) (ii) and (iii) fail, disallowance thereunder cannot also be made as the said provision is rendered unworkable. ITAT observed that Rule 8D(2) (i) will however apply in cases where the shares are held as stock in trade. [*DCIT* v. *Gulshan Investment Co. Ltd.*, ITA No 666(KOL.) 2012, decision dated 11-3-2013 (ITAT Kolkata)].

Forfeiture of bank guarantee is compensatory in nature: The assessee, a garment manufacturer, was granted an entitlement by the Apparel Export Promotion Council ('APEC') for export of garments and knit wares. In this regard, the assessee furnished a bank guarantee in connection with fulfillment of export obligation. The assessee did not utilize the export entitlement as it was incurring losses and it led to the encashment of the bank guarantee by APEC. The assessee claimed deduction u/s 37(1) in respect of the said payment, however, recorded the same as penalty in its books of account. As the payment was by way of 'penalty', the Assessing Officer rejected the claim relying on explanation to Section 37 (1). The Bombay High Court observed that the assessee took a business decision not to honour its commitment of fulfilling the export entitlement in view of the loss suffered and the genuineness of the claim of expenditure being for business purpose was not disputed. It held that forfeiture of the bank guarantee was compensatory in nature and did not attract explanation to Section 37(1). Accordingly, the appeal was allowed. [*CIT* v. *Regalia Apparels*

Pvt. Ltd., ITA No 88/2013, decision dated 7-3-2013 (Bombay HC)].

No restriction on powers of TPO to carry out fresh search: The Transfer Pricing Officer (TPO) included 22 fresh comparables to compute ALP after rejecting three out of the eleven comparables used by the assessee and determined ALP based on 30 comparables. The assessee, a provider of ITES, objected to these on four major grounds being (i) there was no justification for carrying out a fresh search, (ii) special circumstances of demerger in the year had not been considered (iii) certain comparables had unusually high profits and (iv) other comparables had very high turnover. Ruling in favour of the department, ITAT, Mumbai held that there was no such provision or law which restricted the powers/jurisdiction of the TPO to carry out the fresh search, if the comparables included by the TPO were found as good comparables for determination of the ALP. The number of comparables may be one or more than one; but no upper limit has been prescribed under Section 92C of the Income Tax Act, 1961. On demerger, the Tribunal held that while merger or demerger could have an effect on financial results, merger of two functionally similar companies by itself cannot be a factor for exclusion.

On using a comparable which had super profits and others with high turnover, the Tribunal held that these are not specific factors provided under Rule 10B(2) or 10B(3) of Income Tax Rules, 1962. The Tribunal opined that effect of high or low turnover on margins had to be demonstrated and that the larger turnover and size of the entity impacted cost of production in the manufacturing industry rather than service industry. It also held against use of fixed slabs of turnover (INR 1-200 Crores for instance) as upheld by other tribunal decisions. [*Willis Processing Services (I) (P.) Ltd.* v. *Deputy Commissioner,* [2013] 30 taxmann.com 350 (Mumbai - Trib.)]

Determining whole or part ownership of assets to claim depreciation: Emphasising that deduction for depreciation can be allowed only when assets are wholly or partly owned by the assessee ITAT, Hyderabad ruled in favour of the department. The assessee contended that as per contract to buy two dredgers, he had possession and exercised dominion over the same. In the alternate, the assessee stated that the charges paid towards lease rentals should be allowed as expenditure. However, the Tribunal held on facts that since the seller retained the right to repudiate the contract and the assessee could create a charge on the assets only after obtaining a no dues certificate, title in goods passed only on payment of last instalment. The alternate plea also failed since the contract did not suggest any transaction of hire. The sale could not be completed since conditions as to payment schedule were not complied with. This could not convert the transaction to one of hire. Also the assessee had not deducted TDS on amounts paid to the foreign seller. [*Dharti Dredgers & Infrastructure Ltd* v. *Asst. Commissioner,* ITAT Hyderabad Order dated 21-1-2013]