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VAT on developers - Certain issues

By **Chetan Agrawal & Tushar Aggarwal**

The Supreme Court in the case of *Larsen & Toubro Limited & Anr* v. *State of Karnataka & Anr.*[1] (hereafter referred to as 'judgment') has re-affirmed and upheld the legal position earlier taken by the Division Bench of the Supreme Court in the case of *K. Raheja Development*[2]. Further, the Supreme Court upheld the Constitutional validity of the expanded Section 2(24) of the Maharashtra Value Added Tax Act, 2002. Consequently, the activities undertaken by builders for construction of flat/building for or on behalf of the customers, for consideration in cash or deferred payment, will qualify as 'works contract' chargeable to VAT.

Though the true impact of the above judgment is yet to be completely understood, the uncertainties arising therefrom are spreading like a wildfire within the industry. The judgment has no doubt strengthened the hands of State Governments, in that, certain contrary judgments prohibiting levy of VAT on such construction activities now stand over ruled. However, several issues are still required to be resolved in this context. The objective of this article is to highlight and address some of such issues.

In the judgment the Supreme Court has observed that *construction work carried out by the developer is for and on behalf of the purchaser and not for himself or for the land owner.* Therefore, in a tripartite (revenue sharing model) agreement involving landowner, developer and customer, it shall be construed that the developer is undertaking construction activity for and on behalf of the customer. However, the implications under tripartite (area sharing model) agreements are yet to be settled. In such arrangements, certain States like Delhi are treating both the developer and landowner as builders and holding the transaction between the developer and the landowner, as also the transaction between the landowner and the customer, as works contract. Therefore, with respect to the sale of landowner's share of flats, will a tripartite agreement involve two works contracts?

In the judgment the Supreme Court took note of and considered the observations of the court in *K. Raheja* namely, in order to decide whether the developer was executing a works contract or not, it was necessary to examine the relevant recitals and clauses in the agreement. Therefore, it would be interesting to watch whether VAT Authorities will refer to the clauses in the sale /purchase agreements in order to decide whether it qualified as a works contract or will they conclude it as a works contract in all cases.

Interestingly, in the judgment, it has been specifically clarified by the Supreme Court that the construction activity undertaken by the developer will qualify as 'works contract' only from the stage the developer enters into a contract with the purchaser. Therefore only that part of the works contract executed after the agreement is entered into with the flat purchaser, can be charged to tax by the State Government. Further, the value of the goods should be the value at the time of incorporation of the goods. Such a stand is bound to create problems in the determination of value. Typically each unit in a project can get sold at different points in time. It is going to be extremely difficult for the VAT Authorities to complete assessments as each individual purchaser can finalize the deal and enter into agreement for a specific unit at any stage of its construction. The Supreme Court has already read down Rule 58(1) of the Maharashtra Value

[1] 2013-VIL-03-SC-LB

[2] AIR 2005 SC 2350

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Added Rules, 2005 observing that the Valuation Rules should provide for valuation of goods at the time of incorporation. It is thus indeed going to be a complex valuation exercise frustrating both the tax payer and collector.

Equally complicated will be the task of allowing input tax credit as only goods incorporated after the agreement is entered into will qualify for credit.

The problems that may arise when VAT is leviable as per the judgment do not end here. VAT enactments in most of the States make the contractees responsible for deducting and depositing TDS amount and additionally involve various compliance requirements such as registration, issuing TDS certificate, filing TDS return, etc. The buyers will now certainly face difficulties in complying with such requirements. Even individual buyers who are treated as contractee under a few state VAT enactments will face problem.

The next issue is about who is to bear the burden of this tax. Agreement in respect of ongoing projects may not have provided for such a levy at all or for the occurrence of such contingencies, and therefore the developer will naturally try to pass on the burden of VAT to the ultimate buyer resulting in escalation of costs. For projects already completed but falling within the limitation period, there can be recovery action pushing the developers to collect the tax from the buyers.

The impact of the above judgment may not get restricted to developers and builders only. The definition of 'works contract', which is almost the same in the VAT Acts of many States, includes contracts for manufacturing, processing, etc. We have to wait and see whether the department will start treating the contracts for manufacturing goods as per the specifications and standards provided by the buyer as a works contract attracting levy of VAT. Such developments are going to cause a lot of inconvenience both to the industry and the purchasers.

Payment of VAT, service tax and stamp duty, when an agreement to purchase an immovable property is entered into, is going to adversely affect the purchaser. All stakeholders have to bear this fact in mind, while addressing this confused situation. Present day laws on taxation of goods and immovable property in India, which were first promulgated in the later part of 19th century, were essentially aimed at simple and straight forward transactions existing in these areas at that time. Though the law to levy and collect tax on services in India is fairly recent, simple transaction was again perceived to be taxed. But in modern times the character of transactions entered into between parties, in industry and business, started getting complex and complicated, on account of financial, economic and technology factors. Entrepreneurs, financial institutions and consumers started seeing opportunities in these complex transactions as they were profitable to all these stakeholders. But as the present day tax laws were essentially designed to handle simple transactions, confusion gets naturally created when a complex transaction gets caught in the tax net. Even the law settled by courts in the areas of taxation until now does not seem to be adequate to find fair solutions to the problems that these complex transactions today pose.

Transactions having a combination of both service (construction) and sale (immovable property), in the housing industry, involving developers, builders, landowners, financing companies and buyers are today caught in this state of confusion. Intensive research, deep understanding, economic implications, top level expertise and above all a benevolent approach, are required to find proper solutions that will satisfy all parties to the dispute. This for sure is going to take time.

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CENTRAL EXCISE

Notifications & Circulars

Capital goods cleared as waste and scrap – Duty to be paid on transaction value: An assessee removing capital goods as waste and scrap, on which Cenvat credit was availed, shall be required to pay an amount equivalent to duty payable on transaction value of the goods. Cenvat Credit Rules, 2004 have been amended by Notification No. 12/2013-C.E. (N.T.), dated 27-9-2013 in this regard. Hitherto, any person removing such capital goods was required to pay duty on transaction value or amount equal to Cenvat credit taken reduced by specified percentage points, whichever was higher.

Arrest and bail provisions clarified: CBE&C has clarified that power to arrest, under Central Excise provisions, must be exercised with utmost care and caution and only when the exigencies of the situation demand arrest. Circular No. 974/8/2013-CX, dated 17-9-2013, issued in this regard, lists clandestine removal, taking Cenvat credit without receiving goods and issuing Cenvatable invoices without delivering goods, among non-bailable offences where Commissioner himself can take decision to arrest. Approval of Chief Commissioner would, however, be required in cases like, irregular and wrongful availment of exemption by reason of fraud, collusion, willful misstatement, suppression of facts, or contravention of the provisions with intent to evade payment of duty.

Ratio decidendi

Cenvat Credit cannot be denied on non-payment of duty by supplier: The Supreme Court has held that Modvat credit (now Cenvat credit) cannot be denied merely on the ground that supplier of inputs has not paid the duty to the exchequer. At the time of dispute, the relevant provision required that the manufacturer availing credit should take reasonable steps to ensure that appropriate duty has been paid by the supplier. In this case, though manufacturer's invoice mentioned that excise duty was paid, on verification from department, it was found that duty was not actually paid. The Court held that 'reasonable care' did not mean verification from the department as to whether duty was paid by manufacturer-seller and the assessee in this case had taken due care and caution [*Commissioner* v. *Kay Kay Industries* - 2013 (295) ELT 177 (SC)].

Refund of duty paid by mistake when credit notes issued: The Karnataka High Court has dismissed the departmental appeal against an order allowing refund wherein duty was paid by mistake. In this case, the goods were cleared under the cover of CT-3 but duty was paid by mistake. However subsequently, credit notes were issued to the customers. The High Court, relying on its order in *Sudhir Papers Ltd.* [2012 (276) ELT 304 (Kar.)], held that duty paid by mistake may be refunded if the burden of duty has not been passed on to the customers by issuing credit notes [*Commissioner* v. *Gokak Mills* - 2013 (295) ELT 392 (Kar)].

Dial printing and change of watch strap do not amount to manufacture: According to CESTAT, Delhi, the activity of printing name of the customer on the dial and changing watch strap does not amount to manufacture. It was held that activity does not result in emergence of any new commodity with a different name, character or use, as the wrist watch remains a wrist watch in spite of the fact that dial of the watch was embossed with customers' logo. In the present case, the assessee manufacturing

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watches, on request of the customer, brought back some of the watches for dial printing and change of strap. The Tribunal further observed that intermixing of parts of watches would not have any relevance on the issue [*Titan Industries Ltd.* v. *Commissioner* - 2013 (295) ELT 254 (Tri-Del.)].

No refund of duty paid on inputs in cases of export of exempted goods: Assessee's appeal against denial of refund of Cenvat credit availed on inputs in the case of export of exempted product has been rejected by CESTAT, Ahmedabad. It held that as the final products being exported by the assessee are exempt, the same could not be exported under bond. Resultantly, Cenvat credit on the inputs cannot be availed as per Rule 6 of the Cenvat Credit Rules, 2004 and refund of Cenvat credit is also ineligible. The Tribunal also observed that even though exports should be zero rated, procedure has been prescribed to claim refund of duty paid on input and if an assessee has not followed such procedure, alternate benefits cannot be given. It was also held that assessee had no locus standi to seek refund under Section 11B of the Central Excise Act, 1944. [*Bajaj Food Ltd.* v. *Commissioner* - 2013 (295) ELT 275 (Tri-Ahmd.)].

Combination of dissimilar goods - Duty to be determined separately for each product: CESTAT, Delhi has held that in cases of sale of combination of dissimilar goods, duty is payable separately on the abated MRP of each of the products separately and not on the combined MRP of the goods. In this case, the assessee was clearing dissimilar goods in combination pack where the combined MRP was less than the sum of individual MRPs of the goods and such dissimilar goods were not further packed in a bigger pack but were only tied with ribbon. The Tribunal also observed combination packs in this case have to be treated as combination sales as a marketing strategy and not 'combination pack' or packaged commodity as understood under the provisions on weights and measures. [*Videocon International Ltd.* v. *Commissioner* - 2013 (295) ELT 624 (Tri-Del.)].

Cenvat credit on bought out goods exported along with final product: The assessee in this case was procuring goods (like electric cables) to be supplied along with the goods (sugar plant) manufactured and exported by it. The bought out goods were exported as such by the assessee and Cenvat credit of duty paid on the same was availed. The Supreme Court holding that credit would not be admissible, noted that no duty was paid on the final product (sugar plant) which was exported and that the goods on which Cenvat credit was taken were not even tested or unpacked by the assessee in its factory premises and not used by appellant in its factory premises. [*KCP Ltd.* v. *Commissioner* - 2013 (295) ELT 353 (SC)].

SERVICE TAX

Notifications & Circulars

Service provided to educational institutions – Exemption clarified: Services like hostels, housekeeping, security, canteen and transport services to ferry students are exempted from service tax if provided to an educational institution. These services are exempted if the same are provided in respect of service which is exempt/not liable to service tax. CBE&C Circular No. 172/7/2013-ST, dated 19-9-2013, clarifying the issue, states that all services relating to education are exempt from service tax. It quotes Section 66D(l) of the Finance Act, 1994, along with Sl. No. 9 of exemption under Notification No. 25/2012-ST and the definition of "auxiliary educational services" as provided in the exemption notification. Section 66D specifies the negative list of services which are not liable to tax and Sl. No. 9 of notification ibid

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grants exemption to auxiliary educational services when such service is provided to an educational institution in respect of education exempted from service tax.

Exemption to hotel accommodation and restaurant services in Uttarakhand: Exemption has been granted to services of renting of room in a hotel, inn, guest house, club, campsite or other commercial place meant for residential or lodging purposes provided in Uttarakhand. Services provided in relation to serving of food or beverages by a restaurant, eating joint or mess have also been exempted from service tax. This exemption is available for the services provided during the period 17-9-2013 to 31-3-2014 [CBEC Ad-hoc Exemption Order No.1/1/2013, dated 17-9- 2013].

Restaurant service – Tax liability clarified: Clarifying applicability of service tax on non air-conditioned restaurant where such restaurant is located in a complex having air-conditioned restaurant and a common kitchen from where food is sourced, CBEC by Circular No. 173/8/2013-ST, dated 7-10-2013 has clarified that service tax is not liable to be paid by such restaurants having no air-conditioning facility or no central heating facility provided the same is clearly demarcated and separately named. It has also been clarified that services by such non air-conditioned/ non-centrally heated restaurant would be regarded as exempted services and accordingly the provisions of Cenvat Credit Rules, 2004 would apply. It has also been clarified that services provided by an air-conditioned restaurant in attached areas such as swimming pool or an open area attached to such restaurant, would be liable to service tax. Goods sold by such restaurants on MRP basis across the counter would be excluded from the total amount for determination of the value of service portion for payment of service tax thereon.

Ratio decidendi

Credit on services meant for diversification of plant, when such plan abandoned: The appellant was manufacturer of medicaments and as a part of expansion plan for their manufacturing business, they engaged the services of consultant for ascertaining the market requirement, research requirement, standardization of materials and preclinical studies and availed Cenvat credit of service tax paid to the consultant. The CESTAT held that having abandoned the plan of diversification in manufacturing herbal products, Cenvat credit of service tax paid to the consultant would not be available. Ruling against penalty sought to be imposed for wrongly availing Cenvat credit, the Tribunal held that intention to commence manufacturing activity and availing consultancy services therefor, is a ground for bonafide belief and that penalty was not warranted since at the time of availing credit they had the intention of starting manufacture [*Lyka Labs Ltd.* v. *Commissioner* – 2013 (32) S.T.R.79 (Tri.-Ahmd.)].

Service tax not payable on services provided by SEZ unit to DTA unit of same entity: In this case, the assessee, having units in SEZ and DTA, provided services from SEZ unit to the units in DTA. Service tax was demanded on the ground that such SEZ unit and DTA units are separate legal entities. The Tribunal agreed with assessee's contention that merely because invoices were issued and agreement entered into, SEZ unit would not become separate legal entity and the SEZ unit did not have separate balance sheet and audited accounts. Relying on the definition of 'person' in SEZ Act, the Tribunal held that units in SEZ and units in DTA cannot be considered as separate persons. Impugned orders demanding service tax were set aside, allowing appeals by the assessee [*Larsen & Toubro Ltd.*, v. *Commissioner* – 2013 (32) S.T.R. 113 (Tri. – Ahmd.)].

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Service rendered to international in-bound roamer treatable as export of service: In this case, telecom services were provided by the appellant to international in-bound roamers who were registered with foreign service providers. Amount was received in foreign exchange from such foreign service provider and rebate was claimed on the ground that services rendered were treatable as exports. The Tribunal noted that there was no contract between appellant and subscriber of foreign telecom service provider whereas the contract for supply of service was between the appellant and such foreign service provider and the latter was the recipient of service. Allowing the appeal, the service was held by the Tribunal as rendered to such foreign service provider located outside India and the transaction was treatable as export [*Vodafone Essar Cellular Ltd.* v. *Commissioner* - 2013 (31) S.T.R.738 (Tri.-Mumbai)].

No recovery during pendency of VCES application: The Allahabad High Court has stayed recovery proceedings including operation of notice under Section 87 of the Finance Act, 1994 till the time assessees' application under Service Tax Voluntary Compliance Encouragement Scheme is disposed by the competent authority. The court also directed the Commissioner to decide the VCES application within 60 days of the court order and directed release of all bank accounts of the petitioner. It was held that the object of the scheme would be defeated if recovery proceedings are allowed to proceed without considering the application first [*K. Anand Caterers* v. *Union of India*, Allahabad High Court Order dated 16-9-2013 in Writ Tax No. 642 of 2013].

Extra baggage charges collected by airlines – Liability under transportation of goods service: CESTAT, Mumbai has waived pre-deposit and allowed the stay application, taking a prima facie view that the excess baggage charges collected from the passengers by the airlines is not an individual or separate service liable under transport of goods services. It was observed that such service is an integral part of the principal service of transportation of passengers by air. The latter service was not taxable prior to 1-7-2010 [*Kingfisher Training & Aviation Services Limited* v. *CCE* - 2013-TIOL-1463-CESTAT-MUM].

On-site services abroad – Liability under reverse charge: CESTAT, Mumbai has held that on-site IT services rendered abroad by the assessees' related party situated abroad would not be liable to service tax in India when VAT/GST was also paid abroad for such service. The Tribunal in this regard noted that CBEC had clarified in 2009 that on-site services rendered abroad would not be considered as services provided from India and that there were earlier orders of the Tribunal holding that such service cannot be considered as exported as the same is not provided from India. The matter was however remanded by the Tribunal as the issues were not examined by the adjudicating authority [*Syntel International Private Limited* v. *CCE* - 2013-TIOL-1451-CESTAT-MUM].

Composite contracts whether divisible and service component liable before 2007 – Matter referred to 5 Member Larger Bench: Whether a composite contract, involving transfer of property in goods and services which is taxable only from 1-6-2007, onwards and not earlier thereto, in view of the provisions of Section 65(105)(zzzza) of Finance Act, 1994, could be vivisected and service component of such composite contract be subject to service tax by classification of such service component under other pre-existing taxable services? CESTAT, Delhi, finding conflict of opinion between three Member decisions in the cases of *Jyoti Ltd., Indian Oil Tanking Ltd.* and *BSBK Pvt. Ltd.*, has referred the issue to the Larger Bench of five Members [*Larsen & Toubro Limited* v. *CST* - 2013-TIOL-1458-CESTAT-DEL].

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CUSTOMS

Notifications, Circulars & Public Notices

New drawback rates notified: The Central Government has notified new All Industry Rates (AIR) of duty drawback with effect from 21-9-2013. Some of the changes made by Notification No. 98/2013-Cus. (N.T.), dated 14-9-2013 and clarified by Circular No. 37/2013-Cus., of the same date, are:

- Residuary rate provided to certain earlier nil rated items in Chapters 4, 15, 22, 24, 35 and to articles of silver, etc.;
- Higher residuary rates reduced from 1.5% to 1.3% (customs) and from 2% to 1.7% (customs);
- Rates on items realigned from DEPB scheme, generally reduced;
- Drawback caps introduced for most tariff value items with *ad valorem* rates exceeding 2%.

Warehousing – Clarification on interest free period: Period of ninety (90) days of interest free period in the case of warehoused goods is to commence from the date of deposit of goods in the warehouse. CBEC Circular No. 39/2013-Cus., dated 1-10-2013 clarifying the issue gives a harmonious interpretation to Section 61(2)(ii) of the Customs Act, 1962 and to the definition of 'warehoused goods' under Section 2(44). It notes 'warehoused goods' have been defined as 'goods deposited in warehouse'.

Option to close cases of export obligation default: DGFT by Public Notice No. 22 (RE-2013)/2009-14, dated 12-8-2013 had notified a scheme for regularization of default in fulfillment of export obligation under Advance Authorisation, DFIA and EPCG schemes whereby the interest component shall not exceed the duty payable. Relevant customs notifications have now been amended by Notification No. 46/2013-Cus., dated 26-9-2013 to give effect to this scheme. Further on 9-10-2013, CBEC has issued Circular No. 40/2013-Cus. clarifying that cases where export obligation period is yet to be over, are not covered under this scheme and that normally no refund is envisaged to arise on account of choosing this option.

Importer Exporter Code (IEC) of others not to be used: DGFT Policy Circular No. 6(RE-2013)/2009-2014, dated 16-9-2013 reiterates that effecting import/export by using IEC of others is violation of law which would attract suspension/cancellation of IEC or imposition of penalty. The circular in this regard notes that Section 7 of the Foreign Trade (Development & Regulation) Act, 1992 read with Rule 12 of Foreign Trade (Regulation) Rules, 1993 and Para 2.9.2 of Handbook of Procedures, Vol.1, 2009-14 provide that every person should make import or export only with IEC number allotted to him.

FMS and IEIS - Amendments in FTP & HBP Chapter 3: Export of cotton, cotton yarn and goods subject to minimum export price or export duty have been excluded from Focus Market Scheme and Incremental Export Incentivisation Scheme (IEIS). DGFT Notification No. 43 (RE-2013)/2009-2014, dated 25-9-2013 amending FTP Chapter 3 provisions also restricts benefits under IEIS for the year 2013-14 to Rs. 1 crore per Importer Exporter Code. Further, paras have been added in HBP by DGFT Public Notice No.28/2009-2014(RE-2013) dated 25-9-2013 for intensive scrutiny of claims beyond Rs. 1 crore. A list of documents required for such scrutiny has been prescribed. Revised Form ANF 3F for filing claims under IEIS for the period 2013-14 *vis-a-vis* 2012-13 is also notified.

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Wooden packaging material – Compliance with international standards for phytosanitary measures: CBEC has reiterated mandatory compliance of international standards of phytosanitary measures in case of export of goods packed in wooden material. Customs Instructions dated 16-9-2013 issued in this regard note that several export consignments have been found non-compliant by other customs administrations. It is reiterated that Circular No. 14/2009-Cus. provides that customs field formations should verify whether the raw/solid wood used for packing export goods comply with ISPM-15.

Ratio decidendi

Relevant date for filing refund claim for Special CVD: According to Delhi High Court in cases of provisional assessment of Special CVD, claim for refund under an exemption notification, can be made within one year from the date of finalization of such provisional assessment as provided in Explanation II to Section 27 of the Customs Act, 1962. However, in cases where goods were cleared on payment of duty and were finally assessed, refund claim shall be filed within one year from the date of payment of duties. It was noted that Central Government is not empowered to withdraw benefits or impose harsher or stricter conditions than those provided in the statute. CBEC Circular No. 23/2010-Cus., stipulating that for computing limitation period for refund claim, date of provisional payment of duty and not date of final assessment is important, was hence quashed by the court [*Pioneer India Electronics (P) Ltd.* v. *UoI* - 2013-TIOL-731-HC-DEL-CUS].

No confiscation when end-use condition not fulfilled: CESTAT, Mumbai has held that confiscation and penalty are not justified in a case involving non-fulfillment of end-use condition of exemption notification. The appellants in this case had imported naphtha under Notification 21/2002-Cus., but could not use certain quantity in generation of electricity owing to commercial reasons. The Tribunal noted that it is not the case of the department that the appellant had imported the goods in respect of which any prohibition/restriction was applicable or they have contravened any condition of the notification while importing the goods. It was further noted that the case was not of any suppression or mis-statement. Confiscation under Section 111 and penalty under Section 114 of the Customs Act, 1962 were hence set aside by the Tribunal. [*Ratnagiri Gas & Power Pvt Ltd* v. *Commissioner* - 2013-TIOL-1323-CESTAT-MUM]

Refund only after goods are finally 'assessed': Orissa High Court has held that the expression "assessed finally" in Section 18(2) of Customs Act, 1962 refers to the assessment made under Section 17 and consequently, provisions of Section 18(2) come in to play only after the final assessment is made under Section 17. It was also held that the appellate tribunal was correct in holding that when an assessee is aggrieved by the assessment order, an appeal must be filed against such assessment before the appellate forum instead of asking for refund directly by defying the appeal mechanism prescribed under the Act. [*Visa Steel Ltd* v. *Commissioner* - 2013-TIOL-730-HC-ORISSA-CUS].

VALUE ADDED TAX (VAT)

Notifications

Net tax adjustments – Delhi VAT Act amended: Delhi Value Added Tax (Amendment) Act, 2013 has been notified by Notification No. F.14 (5)/LA-2013/Cons2Law/65, dated 9-9-2013 and brought into force with effect from 12-9-2013. Section 11 of Delhi VAT Act has been amended to

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provide that a dealer shall be entitled to carry forward the amount remaining after the adjustment in the same tax period against the tax payable under the CST Act, if any, to the next calendar month or tax period, of the same year. Further, an explanation added to Section 11, provides that:

- Refund can be claimed at the end of a tax period only
- Excess tax credit should not be carried forward to the next year
- Refund of excess tax credit carried forward from previous years should be claimed in any of the remaining tax periods of year 2013-2014 but not later than the last tax period ending on 31-3-2014
- Excess tax credit remaining at the end of a tax period can either be claimed as refund or carried forward to next tax period of the same year
- Excess payment made inadvertently shall also be treated as credit in a month or tax period

Works Contracts - Delhi VAT Rules amended:

Delhi Value Added Tax (Third Amendment) Rules, 2013 have been notified vide Notification No. F.3 (16)/Fin.(Rev-1)/2013-14/dsVI/785, dated 20-9-2013. Rule 3 which provides for the determination of taxable turnover of a dealer arising from execution of a works contract has been substituted. Some of the important changes are:

- "Civil works contracts" now include collaboration agreements/joint development agreements, etc. between the land owner and the contractor/builder/developer, etc. for construction of complex or property.
- New sub-rule (1A) determines the value of the works contract carried out by the contractor for the land owner where the consideration for the construction is given by the land owner to the contractor in the form of share in the land with or without additional money exchange. The value shall be highest of the actual value of construction, value of proportionate land transferred by land owner or the circle rate of proportionate area of land transferred.
- New sub-rule (1B) provides that the tax shall be payable at the time of incorporation of goods in the execution of the works contract executed by the contractor for the land owner.
- In sub-rule (2), which provides for the percentage of charges towards labour, services and other like charges to be deducted from the total value of the contract, four new categories of contracts have been added.
- Sub-rule (3) determines the cost of land in a civil works contract carried on by the builder for the intended purchaser. As per the substituted rule, where sale deed/conveyance deed of land has been executed between the builder and the intended purchaser, the consideration for amount of land stated in that deed will be the cost of land. Where such sale deed is not executed, the value of land has to be arrived as per the specified rates.
- Sub-rule (4) provides that if only a part of the total constructed area is being transferred, the deduction towards labour, services and other like charges as well as the input tax credit shall be calculated on a pro-rata basis.
- Sub-rule (5) provides that where the agreement between the builder and intended purchaser is executed before the completion of construction, the total value of the agreement as reduced by the cost of land, and amount of labour and other like charges shall be the taxable turnover of sale. Further, tax shall be payable at the time of receipt of consideration.

Amnesty Scheme under Delhi VAT, notified:

Notification dated 20th September, 2013 has notified Delhi Tax Compliance Achievement Scheme, 2013 providing for immunity from interest, penalty and other proceedings if payment of *'tax due'* is made in

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the specified manner. 'Tax due' will include amount of tax assessed in terms of notice of assessment or assessment order and tax dues relating to defaults not covered in the notice for assessment or assessment order for the same tax period. Cases where notice of assessment of penalty has been issued without having any relation to tax deficiency have been excluded from 'tax dues'. Further, the scheme also specifies the manner for computation of tax due and for making declaration and payment of tax dues. Details of immunity from interest, penalty and other proceedings in respect of dealers opting for this scheme have also been provided. As per the scheme, declaration has to be made by 31-1-2014 in Form DSC-1 along with proof of payment of not less than 50% of the tax declared.

Assam VAT – Rate of tax increased: Rate of tax in respect of works contract and 'all other goods not covered by the First, Second, Third or Fourth Schedule to the Assam VAT Act' (residuary rate) has been increased from 13.5% to 14.5%. Notification No. FTX.55/2005/Pt/197, dated 12-9-2013 has been issued for this purpose.

Input tax credit - U.P. VAT Act amended: Notification No. 1039(2)/79-V-1-13-1-(ka)16/2013, dated 26-9-2013 has substituted entry at S. No. 3 in the table under Section 13(1)(a) of the Uttar Pradesh VAT Act, 2013 dealing with amount of input tax credit. As per the amendment, amount of input tax credit available in respect of purchased goods which are either stock transferred as such or where the taxable goods manufactured using such purchased goods are stock transferred, would be the tax paid in excess of 2%.

Ratio decidendi

Works Contracts – Supreme Court Larger Bench upholds Division Bench decision in Raheja Developers: The three Judge Bench of the Supreme Court of India has held that, where a contract comprises of a works contract and a transfer of immovable property, such contract does not denude it of its character as works contract and the goods incorporated in the course of execution will be chargeable to sales tax. The court also held that the dominant nature test has no application and the traditional decisions which have held that the substance of the contract must be seen to have lost their significance where transactions are of the nature contemplated in Article 366(29-A). However, the court clarified that, the activity of construction undertaken by the developer would be works contract only from the stage the developer enters into a contract with the flat purchaser. The value addition made to the goods transferred after the agreement is entered into with the flat purchaser can only be made chargeable to tax by the State Government. It was further clarified by the court that, if at the time of construction and until construction was completed, there was no contract for construction of the building with the flat purchaser then the goods used in the construction cannot be deemed to have been sold by the builder since at that time there is no purchaser. Division Bench decision in the case of *Raheja Development Corporation* [(2005) 5 SCC 162] was hence upheld by the larger bench of the Supreme Court. The court in this regard observed that a development agreement is followed by a tripartite agreement between the owner of the land, the developer and the flat purchaser and effectively and *de facto* it is the developer who constructs the building for the flat purchaser. It was noted that construction is done on payment of price as agreed upon between the developer and the flat purchaser and hence the same is a works contract. The Court also held that additional obligations in the contract would not alter the nature of contract so long as the contract provides for a contract for works and satisfies

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the primary description of works contract.

As regards the correctness of the decision of the Bombay High Court in the case of *Maharashtra Chamber of Housing Industry* [(2012) 51 VST 168 (Bom)], in respect of the constitutional validity of Section 2(24) of the Maharashtra VAT Act, 2002, the court held that there is no doubt that the amendment to explanation b(ii) to Section 2(24) was brought because of the judgement in the *Rajeha Development* case and as that case lays down the correct legal position, there is no merit in challenge to the constitutional validity to the said provisions. The view taken by the Division Bench of the Bombay High Court, that the provisions under challenge in the *Maharashtra Chamber of Housing Industry* case were not in breach of the constitutional boundaries, was hence held as correct by the Supreme Court in the present case. [*Larsen and Toubro Limited* v. *State of Karnataka* - 2013-VIL-03-SC-LB]

Terry towels with sides folded and stitched, are not classifiable as stitched articles: In this case the assessee manufacturing terry towels, cotton yarn and cotton waste, claimed exemption from sales tax on the ground that terry/cotton terry knitted towels fall under the Third Schedule to the TNGST Act [Entry 2(iii) of Part-A of the Third Schedule – "*Terry toweling and similar woven terry fabrics*"]. The claim was rejected considering that terry towels were folded over and stitched on both sides and hence it was only a stitched article liable to tax. Assessment was hence made under Entry 23 of Part-B of the First Schedule to the TNGST Act till 16-7-1996 and thereafter under Entry 70 of Part-B of the First Schedule to the TNGST Act [*"Stitched articles made of cloth other than articles of ready to wear apparels, hosiery goods and stitched hand loom and mill made handkerchief"].* The court, however, following the Supreme Court decision in *Commissioner* v. *Tarpaulin International* [(2010) 34 VST (SC)], accepted assessee's case and held that stitching on edges would not make any difference to the commodity so as to deny exemption under the said entry. [*Kwality Textiles* v. *State of Tamil Nadu* - 2013-VIL-78-MAD]

INCOME TAX

Notifications

Instruction regarding mandatory scrutiny:

The CBDT has, by Instruction No. 10/2013 dated 5-8-2013 and Instruction No. 13/2013 dated 20-9-2013, prescribed the criteria for manual selection of cases for scrutiny during the financial year 2013-14. The categories of cases that shall be compulsorily scrutinized are:

- Cases where value of international transaction exceeds Rs. 15 crores
- Cases involving addition in an earlier assessment year on transfer pricing issue in excess of Rs. 10 Crores
- Cases involving addition in an earlier assessment year in excess of Rs. 10 lacs on a substantial/ recurring question of law/fact
- Cases claiming exemption of income under Section 10(23C) or 11 and hit by proviso(s) to Section 2(15)
- Entities which received foreign donations in excess of Rs. 1 crore, cases in respect of which information is received from other Govt. Departments.
- All assessments pertaining to survey under Section 133A, assessment in search and seizure cases to be made under Sections 158B, 158BC,

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158BD, 153A & 153C r/w section 143(3)

- All returns filed in response to notice under Section 147/148 of the Act
- Cases where registration under Section 12AA of the Act has not been granted or has been cancelled by the CIT/DIT and the taxpayer has been claiming tax-exemption, except where such order of CIT/DIT has been reversed/set-aside in appellate proceedings.
- Cases where order denying the approval under Section 10(23C) of the Act or withdrawing the approval already granted has been passed and the taxpayer has been claiming tax-exemption.

Notification regarding reporting of foreign remittances: CBDT by Notification No. 67/2013 dated 2-9-2013 has further amended the Rule 37BB which mandates reporting of certain additional information and a new format of furnishing information in revised forms. The rules have come into effect from 1-10-12013. The new forms have categorized the information regarding remittances as below:

Part A of Form No. 15CA: The information regarding the remittances that are chargeable to tax and does not exceed Rs. 50,000 on a single occasion provided the aggregate of such payments made during the year does not exceed Rs. 250,000 needs to be furnished in Part A of Form No.15CA.

Part B of Form No. 15CA: The information regarding the remittances that are chargeable to tax and exceeds Rs. 50,000 on a single occasion or where the aggregate of such payments made during the year exceeds Rs. 250,000. The said information is to be furnished for payments other than the payments referred to above after obtaining either a certificate in Form No. 15CB from a Chartered Accountant, or a certificate from the AO under Section 197, or an order from the AO under Section 195(2)/195(3).

The remittances falling under specified list are now no more required to be reported in Form 15CA after the aforesaid amendment, however, certain categories of remittances viz. advance payment against imports, imports by diplomatic missions, payments for surplus freight or passenger fare by foreign shipping companies operating in India, freights on imports/exports – shipping companies, booking of passages abroad – shipping companies, freight on imports – airlines companies, payments on account of stevedoring, demurrage, port handling charges etc., payment for life insurance premium and other general insurance premium, have also been removed from the specified list, resultantly, which are also now required to be reported.

Safe Harbour Rules notified: CBDT had notified the Safe Harbour Rules *vide* Notification No. 73/2013 dated 18-9-2013. The said notification introduces new Rules 10TA-10TG. Safe harbour transfer price margins are optional and are subject to certain conditions. The proposed margins are as under:

Eligible International Transaction	Circumstances
Software Development service *Rule 10TC(i)*	(i) Operating Profit (OP)/Operating Cost (OC) [OP/OC] ≥ 20%, where the aggregate value of transactions does not exceed a sum of Rs. 500 Crores, and, (ii) OP/OC ≥ 22%, where the aggregate value of transactions exceeds a sum of Rs. 500 Crores.

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Eligible International Transaction	Circumstances
ITES service *Rule 10TC(ii)*	(i) OP / OC ≥ 20% where the aggregate value of transactions does not exceed a sum of Rs. 500 Crores, and, (ii) OP / OC ≥ 22% where the aggregate value of transactions exceeds a sum of Rs. 500 Crores.
KPO service *Rule 10TC(iii)*	OP / OC ≥ 25%
Intra-group loans (≤Rs. 50 Cr.) *Rule 10TC(iv)*	Interest rate ≥ Base rate of SBI plus 1.5%
Intra-group loans (>Rs. 50 Cr.) *Rule 10TC(iv)*	Interest rate ≥ Base rate of SBI plus 3%
Corp. guarantee (≤Rs. 100 Cr.) *Rule 10TC(v)*	(i) Commission/fee ≥ 2% p.a where amount guaranteed does not exceed a sum of Rs. 100 Crore, and, (ii) Commission/fee ≥ 1.75% p.a where amount guaranteed exceeds a sum of Rs. 100 Crore and credit rating by SEBI registered agency indicates highest safety [Rule 10TC(v)(b)].
Contract R&D relating to Software Development with insignificant risk *Rule 10TC(vi)*	OP / OC ≥ 30%
Contract R&D relating to generic pharmaceutical drugs with insignificant risk *Rule 10TC(vii)*	OP / OC ≥ 29%
Manufacture/Export of core auto component	OP / OC ≥ 12%
Manufacture/Export of non-core auto component	OP / OC ≥ 8.5%

The Safe Harbour Rules are applicable for AY 2013-14 and subsequent four assessment years. The rules do neither permit any adjustment on account of comparability nor provide any range of permissible variation. Tax payers are required to maintain regular TP documentation and also get certificate from practising CA as per regular TP provisions. These rules are optional and the taxpayer can exercise option for applying these rules by furnishing form 3CEFA on or before filing return of income under section 139(1). Mutual agreement procedure cannot be resorted to for a transaction which has been accepted under Safe Harbour Rules and these rules shall not apply if an AE is located in any country or territory notified under Section 94A of the Act or low tax country.

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Ratio decidendi

Section 50C is not applicable on transfer of a capital asset being a 'leasehold right': During the year 2006-2007, the assessee transferred the leasehold rights in an industrial plot. The AO applied the provisions of section 50C of the Act and assessed the capital gains arising thereon on the basis of the value adopted by the stamp valuation authority. On these facts, it was held that the assessee was having only a leasehold rights and it had no absolute right to sale, exchange or relinquish the property. As per the recitals of the lease agreement, actual rights were in the hands of the lessor. The provisions of section 50C were held to have no application in the present case as the capital asset being a leasehold right [*ITO* v. *Pashupati Electrodes Pvt. Ltd.*, ITA No. 3892/Del/2010, Order dated 8-8-2013].

Service tax not includible while reimbursement expense is includible in gross receipts under Section 44BB: The dispute was whether the receipts on account of service tax were includible in the gross receipts for the purpose of determining income under Section 44BB of the Act and whether the receipts on account of reimbursement of actual expenses by the client were includible in the gross receipts for the purpose of determining income under Section 44BB of the Act. Following its earlier decision and the decision in *Islamic Republic of Iran Shipping Lines (Mumbai Bench),* the Tribunal reiterated that service tax being a statutory liability, would not involve an element of profit and accordingly the same could not be included in the gross receipts. Relying on the decision of *Halliburton Offshore Services Inc. (Uttarakhand High Court)* it was held that the since amount on account of reimbursement expense had been received by the assessee, the same was includible in gross receipts under Section 44BB of the Act [*Sedco Forex International Drilling Inc.* v. *ADIT (Intl. Tax),* ITA No. 504/Del/2013, Order dated 2-8-2013].

No TP adjustments for notional interest on interest-free loan owing to business expediency: The taxpayer, engaged in manufacturing and selling of printer inks, to augment the business needs of its subsidiary in US advanced loans to its subsidiary. The said loan was interest free and was extended with a credit period of 165 days. The TPO made adjustments to the ALP on the ground that the taxpayer ought to have charged interest and that the credit period should not have exceeded 120 days and computed notional interest at the rate of 11% on the loan and excess credit period. Ruling in favour of the assessee the Tribunal held that the loans were in the nature of 'quasi capital' as immediately after obtaining the approval from RBI, the advances were converted into shares, the subsidiary played a significant role in the sale and distribution chain of the taxpayer, there was a significant commercial relationship between them and, the monies were given for strengthening the taxpayer's marketing apparatus in the US. Therefore it was held that even the CUP method shall not apply as the advances were made pending capital subscription and there lies no parity in the said transaction *vis-à-vis* a lending transaction. As regards the excess credit period allowed to subsidiary the Tribunal held that no adjustment could be made because it was part of the arrangement that specified credit period was allowed and cost of funds blocked in the credit period was inbuilt in the sale price [*Micro Inks Ltd.* v. *ACIT,* ITA No. 1668/Ahd./2006, Order dated 6-8-2013].

ALP should be adjusted on reimbursements with a mark-up if the activity performed is not business activity: The assessee had entered into an international transaction with its AE and received marketing commission of 15% of the gross advertisement revenue but no reimbursement

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was received in respect of advertisement expenses incurred by the assessee. The TPO observed that since the additional function was performed by assessee in regard to carrying out of advertising activity, it was to be adjusted to the extent of cost of advertisement expenses that ought to have been reimbursed and thereby added a sum of Rs. 5,400,469, being the sum of actual expenditure incurred and a mark-up of 8.53% thereon. Agreeing with the Department's view, it was held that the said activity was not a normal entrepreneur activity and generally not performed by a prudent businessman free of cost and without any mark-up. The ITAT also observed that the assessee being entitled to a reimbursement even as per the agreement, the same should be adjusted accordingly [*Television Eighteen India Ltd.* v. *ACIT, ITA* No. 4727/Del/2009, Order dated 2-8-2013].

Payments received by a Singaporean entity towards education programmes, not taxable: The applicant Eruditus Education Private Limited (EEPL) was engaged in the business of providing high quality executive education programmes. It entered into a Programme Partnership Agreement with INSEAD (a tax resident company at Singapore) wherby INSEAD was obliged to conduct teaching intervention and EEPL would assist in the marketing and facilitating to conduct the programme. EEPL compensated INSEAD for the cost involved in teaching and other incidental expenses. Ruling on whether the payments made by the applicant to INSEAD were in the nature of 'Fees for Technical Services (FTS)' within the meaning of the term in Article 12 of the India-Singapore Tax Treaty and /or under the provisions of Section 9(1)(vii) of Income Tax Act, 1961, the Authority for Advance Rulings (AAR) held that though the services were technical in nature, it would be covered by the exclusive clause 'for teaching in or by educational institutions'. INSEAD does not have a PE in India. Hence it was held that the payments received by INSEAD are not chargeable to tax [In *Re: Eruditus Education (P.) Ltd.* (2013) 37 taxmann.com 337 (AAR-New Delhi), Order dated 20-9-2013].

Section 50B is not applicable where there is no monetary consideration: The assessee had transferred its manufacturing division to Novapan Industries Limited (NPL) under a scheme of amalgamation approved by AP High Court. As a consideration for transfer of the division the amalgamated company (NPL) allotted shares and also transferred certain investments held by it. The AO invoked the provisions of Section 50B by holding that such transfer is a slump sale. The Tribunal observed that to qualify as slump sale, two conditions have to be satisfied, *first* there must be a transfer of one or more undertakings and *second* the sale should be for a lump sum consideration without values being assigned to individual assets/liabilities. In the present case no monetary consideration was received for the impugned transfer and hence it was not slump sale. [*ITO* v. *Zinger Investments (P) Ltd.*, ITA No. 275/Hyd/2013, Order dated 21-8-2013]

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