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INDIA NEWSLETTER

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TAX AND REGULATORY UPDATES

SERVICE TAX

Service Tax on freight forwarders on transportation of goods from India:

The CBEC issued clarification on applicability of service tax on freight forwarders for transportation of goods from India. It states that where a freight forwarder deals with exporter as an agent of airline / carrier / ocean liner, then he may be considered as an intermediary under rule 2(f) r/w rule 9 of Place of Provision Service Rules 2012 (POPS Rules) since it is merely a facilitation of the provision of transportation service.

In such case, service of freight forwarder will be subjected to tax while service of actual transportation of goods to a place outside India will not be taxable under rule 10 of POPS Rules. Where freight forwarder undertakes all the legal responsibility for transportation of goods and undertakes all the attendant risks (viz. when he is acting as a principal), no service tax shall be payable when destination of goods is outside India in terms of rule 10.

Accordingly, directs field formations to deal with cases purely on the basis of facts, terms of contract between the entities concerned, the provisions of Finance Act and POPS Rules.

[Circular No. 197/07/2016-ST dated August 12, 2016]

Service Tax liability in case of hiring of goods without transfer of the right to use goods:

The CBEC issued clarification on service tax liability in case of hiring, leasing, licensing of goods without the transfer of right to use them, as provided u/s 66E(f) of Finance Act. It states that in such cases, it is essential to determine whether in terms of the contract, there is transfer of right to use goods and the criteria laid down by the Apex Court in BSNL should invariably be followed and applied.

Supreme Court had inter alia laid down that (i) there must be goods available for delivery, (ii) there must be consensus ad idem as to their identity, (iii) transferee should have legal right to use the goods, (iv) such right should be to the exclusion of the transferor i.e. it should not be merely license to use the goods, and (v) post transfer, owner cannot again transfer the same right to others during the period of transfer.

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Also adds that cases decided under Sales Tax / VAT legislations cannot be applied mechanically, they have to be considered against the background of those particular legislative provisions and terms of contract in that case. Some of these cases include Rashtriya Ispat Nigam Ltd, International Travel House Ltd, State Bank of India, Ahuja Goods Agency, G. S. Lamba & Sons etc.

The CBEC also mentions examples of 'financial lease' & 'operating lease', as well as 'dry leases' & 'wet leases' for aircraft industry, to emphasize the diverse nature of transactions and clarifies that in all these cases, no a priori generalizations or assumptions about service tax liability should be made and the terms of the contract should be examined carefully, against the backdrop of the criteria laid down by the Supreme Court in the Bharat Sanchar Nigam Limited case as well as other judicial pronouncements.

[Circular No. 198/08/2016-ST dated August 17, 2016]

CUSTOMS

Admissibility of un-utilized Cenvat credit of DTA unit converted into EOU:

The CBEC has allowed the transfer of unutilized Cenvat credit lying in the books of DTA unit on the date of conversion into EOU.

In this connection, the CBEC has clarified that, Rule 17 of Central Excise Rules, 2002 which deals with the removal of goods by an EOU, was amended w.e.f 06-9-2004 to allow use of Cenvat credit for payment of duty by an EOU. Rule 10 of Cenvat credit Rule, 2004 provides in unambiguous terms that if manufacturer transfers his factory on account of change in ownership or lease, then the manufacturer shall be allowed to transfer the Cenvat credit lying unutilized in his accounts to transferred entity. EOU is a manufacturer, and hence this rule apply to them. Hence on conversion from a DTA unit to EOU, the transfer of unutilized Cenvat credit lying in the books of DTA unit on the date of conversion into EOU unit is admissible.

[Circular No. 41 /2016-Customs dated August 30, 2016]

The government introduces The Taxation Laws (Amendment) Bill 2016 proposing to increase tariff rate of customs duty from 10% to WTO bound rate of 40% on all goods falling under specified tariff items under Chapters 25 & 68 including rough marble, travertine blocks / slabs and granite blocks / slabs:

The present tariff rate of customs duty under the First Schedule to the Customs Tariff Act, 1975 as well as the effective rate for marble and granite is 10%.

In order to have a greater flexibility in terms of tariffs, the Bill seeks to amend the First Schedule to the said Act so as to increase the tariff rate of customs duty from 10% to the WTO bound rate of 40% on marble and granite.

Accordingly, Bill would enable the government to raise customs duty on marble and granite from 10 to 40 per cent to protect the domestic industry from imports from countries such as China.

[The Taxation Laws (Amendment) Bill 2016]

FOREIGN TRADE POLICY

Amendment in Para 4.38 (v) of Hand Book of Procedures 2015-20 for allowing Clubbing of Advance Authorizations for Annual Requirement:

The DGFT has allowed clubbing of Advance Authorizations for Annual Requirement, wherever exports and imports has taken place as per SION norms.

Facility of clubbing is being allowed for Advance Authorisations for Annual Requirement issued during Foreign Trade Policy period 2009-14 and 2015-20 wherever exports and imports have taken place as per Standard Input output Norms (SION) notified (available in Handbook of Procedures).

[Public Notice No 24/2015-2020 dated August 04, 2016]

Special Advance Authorisation Scheme for export of Articles of Apparel and Clothing Accessories. Amendments in FTP 2015-2020:

The DGFT has introduced a new scheme called Special Advance Authorisation Scheme for export of Articles of Apparel and Clothing Accessories of Chapter 61 & 62 of ITC (HS) Classification with effect from 1st September 2016 wherein exporters are entitled for an authorisation for fabrics including inter lining on pre-import basis, and All Industry Rate of Duty Drawback for non-fabric inputs on the exports.

[Notification No 21/2015-2020 dated August 11, 2016]

CASE LAW HIGHLIGHTS

CENTRAL EXCISE

Availing benefit of rebate under Central Excise Rules and also claiming drawback on export is not tenable

M/s Raghav Industries Ltd. was a manufacturer of synthetic and blended textile yarn made out of raw materials viz. duty paid polyester staple fiber or polyester viscose staple fiber. It utilized the said duty paid inputs without availing the benefit of CENVAT credit. The Appellant exported finished goods viz. yarn, to various countries on payment of excise duty. For this purpose, the credit of duty paid on capital goods used in the manufacture of such yarn was utilized. It also claimed rebate of the duty paid on finished goods under Rule 18 of Central Excise Rules 2002. Further, the yarn exported was covered under the Duty Drawback Scheme.

The Appellant relied on SC decision in Spentex Industries Ltd. vs. Commissioner of Central Excise & Ors. [TS-551-SC-2015-EXC] wherein rebate of excise duty paid both on inputs and on manufactured product was allowed upon export.

The High Court stated that after clearing the goods on payment of duty under claim for rebate, assessee should not have claimed drawback for the central excise and service tax portions, and it should have paid back the drawback amount availed before claiming rebate. According to HC, when this was not done, availing both the benefits would certainly result in double benefit.

Also, it was observed that proviso to Rule 3 of Drawback Rules provides for reduction of drawback admissible, taking into account the lesser duty of tax paid or rebate, refund or credit obtained. In case of Spentex Industries Ltd, SC had dealt with provisions of Rule 18; while in present case the benefits claimed are covered under different statutes – Drawback Rules and Central Excise Rules. Hence, the SC decision was not applicable to facts of present case. In this view it was held that assessee was not entitled to claim both the benefits.

RAGHAV INDUSTRIES LTD VS. UNION OF INDIA & OTHERS [TS-318-HC-2016(MAD)-EXC]

Accumulated CENVAT Credit is eligible for refund on factory closure

M/s Computer Graphics Ltd. was engaged in manufacture of Konica Colour Films, Colour Paper, Graphic Art Film etc. Owing to change in technology, it was unable to carry on the operation at Athipet factory and accordingly, the Appellant closed the same in July 2009. Pursuant thereto, all the final products were cleared and there was an excess credit available to the tune of Rs. 50.45 lakhs (approx.) in the CENVAT account. The refund filed was rejected by the Revenue.

It was noted that Revenue had relied on Larger Bench decision in Steel Strips vs. Commissioner of Central Excise, Ludhiana [2011 (269) ELT 257 (Tri-Del)], wherein it was held that since there is no express provision for grant of refund except in case of exports under Rule 5, refund was not admissible on account of closure of unit.

However, the Tribunal rejected this reliance since the case law did not consider Karnataka HC judgment in Slovak India Trading Co. Pvt. Ltd. that was subsequently upheld by SC. Karnataka HC had observed that there is no express prohibition in terms of Rule 5; there is no manufacture in light of closure of the company and hence, CESTAT was fully justified in ordering refund in light of Appellant coming out of MODVAT scheme.

COMPUTER GRAPHICS LTD VS. COMMISSIONER OF CE [TS-320-CESTAT-2016-EXC]

CUSTOMS

Commissioner (Appeals) confirming demand on totally new ground not alleged in SCN - as order travels beyond SCN, same is set aside & appeal is allowed:

The appellant, M/s Indo Count Industries Ltd., an EOU, purchased Heavy Duty Furnace Oil for use as fuel for their captive power plant. Out of these fuels, some quantity of waste/ remnant was deposited at the bottom of the tank and was known as Furnace Oil Sludge. The appellant sold the F.O. Sludge without payment of duty. A demand notice was issued invoking para 7 of the Notification No. 53/97-CE dated 3.6.1997 demanding duty on the said clearance considering the same as waste/remnants/scraps. The demand was confirmed by both the lower authorities. Aggrieved by the said order, the appellants preferred an appeal before the Tribunal.

Before the CESTAT, the appellant argued that the demand was confirmed by the original adjudicating authority by holding that para 7 of the Notification No. 53/97 had been violated. However, the Commissioner (Appeals) had clearly held that para 7 of the Notification N. 53/97 is not applicable. Nonetheless, he confirmed the demand by holding that the goods cleared are not waste/scrap but remnants of the furnace oil and duty is payable on the same. Inasmuch as such a confirmation is not tenable, emphasized the appellant. However, learned AR relied on the impugned order.

After going through the rival submissions, the court observed that the Commissioner (Appeals) has clearly held that the charges made in the show-cause notice cannot be upheld. He has, however, confirmed the demand on a totally new ground not alleged in the show-cause notice. We observe that the Commissioner (Appeals) cannot travel beyond the show-cause notice and therefore, the Order-in-Appeal is set aside and the appeal is allowed.

M/s INDO COUNT INDUSTRIES LTD Vs. COMMISSIONER OF CENTRAL EXCISE, PUNE-II [2016-TIOL-1989-CESTAT-MUM]

High Court sets aside orders of Dy. Commissioner rejecting claims for refund of excess countervailing duty paid during imports:

An order passed by the Dy. Commissioner of Customs, Refund section, was challenged before Calcutta High Court by the assessees, SGS Marketing. In the impugned order, the Dy. Commissioner returned a finding that "refund of erroneous duty paid would be available only upon setting aside the said assessment order of appropriate officer by an appropriate appellate authority". Accordingly, the refund claim was rejected u/s 27 of Customs Act.

High Court observed that the amendment to Section 27 as well as Delhi HC decision in case of Micromax Infomatics Ltd. vs Union of India & Ors. [TS-61-HC-2016(DEL)-CUST] were placed before the Dy. Commissioner, but same were not considered at all. Non-application of mind by the Dy. Commissioner was thus, apparent.

Further, High Court observed, "Although an appellate remedy is available to the petitioner, this Bench is not inclined to relegate it to the appellate remedy, for, there appears to be a clear case of erroneous exercise of jurisdiction."

Accordingly, HC set aside the impugned order resulting in reviving of refund application and directed that same shall be considered and disposed of afresh by the Dy. Commissioner upon granting appropriate opportunity of hearing to assessee and by passing a reasoned order as early as possible.

M/s SGS MARKETING & OTHERS VS. UNION OF INDIA & OTHERS [TS-325-HC-2016(CAL)-CUST]

DIRECT TAX UPDATES

CIRCULARS/ NOTIFICATIONS/PRESS RELEASES

Protocol amending India-Mauritius Tax Treaty comes into force

The Protocol signed between India and Mauritius in May 2016 has come into force on 19 July, 2016. Amongst others, the main provisions of protocol and effective date are summarized below:

a. Capital Gains: Shares acquired before April 1, 2017 have been grandfathered i.e. residence based taxation will continue for capital gains arising on such shares. In case of shares acquired on or after April 1, 2017, the capital gains arising during the period from April 1, 2017 to March 31, 2019 will be taxed at 50% of Indian domestic tax rate, subject to Limitation of Benefits clause. The Capital gains arising from fiscal year 2019-20 onwards will be taxed at full Indian domestic tax rate.
b. Interest: Interest income of Mauritian resident bank in respect of debt claims existing on or before March 31, 2017 shall not be taxed in India. The interest arising in respect of debt claims or loans made after March 31, 2017 will be subject to withholding tax of 7.5% in India.
c. A new article has been inserted, namely Fees for Technical Services that provides for source based taxation @ 10%. Further, Article relating to Permanent Establishment (PE) has been amended to specifically cover service PE for furnishing of services (for same or connected projects) for more than 90 days within any 12 month period.

These provisions shall be effective from fiscal year 2017-18.

[Notification No. 68/2016 (F. No. 500/3/2012-FTD-II) dated August 10, 2016]

Cabinet approval for agreement and Protocol with Cyprus

Similar to erstwhile Mauritius Tax Treaty, Cyprus Tax Treaty provided residence based taxation of capital gains. Following the recent amendment to Mauritius Tax Treaty, the revision of Cyprus Tax Treaty has been approved by Cabinet. Pursuant to revision, capital gains will be taxed in India for entities resident in Cyprus, subject to double tax relief. This amendment will deter artificial diversion of investments for avoidance of tax. The Press Release further states that negotiations are underway for similar changes in Tax Treaty with Singapore.

[Press Release dated August 24, 2016]

Recommendations on issues relating to computation of book profit for Ind AS compliant companies

The summary of recommendations for stakeholder and general public comments, are as under:

a. The adjustments in retained earnings on first time adoption of Ind AS in respect of Property, Plant & Equipment and Intangible Assets should be ignored for computation of book profits. Depreciation, gain/loss on realisation/disposal/retirement should be computed ignoring such adjustments in retained earnings.
b. For adjustments in retained earnings pertaining to lease equalization asset/liability reserve, measurement of financial instruments at fair value, the adjustment should be included in book profit over 3 years period starting from the year of first time adoption of Ind AS.

[Press release dated August 5, 2016]

Relating to Income Declaration Scheme, 2016

Extension of due date of payment

Under the Income Declaration Scheme (IDS), a window for taxpayer to declare undisclosed income and assets, the due date for payment of tax (including interest and payment) was November 30, 2016. This deadline has been extended and the revised schedule of amount payable is as below:

Sum Payable	Due Date
Minimum of 25%	November 30, 2016
Further 25%	March 31, 2017
Balance	September 30, 2017

[Notification No .70/2016, F.No.142/8/2016-TPL dated August 12, 2016]

Period of holding and date of acquisition of asset declared under IDS

With a view to address the treatment in case of subsequent sale of asset declared under IDS, the Central Board of Direct Taxes (CBDT) has clarified that the period of holding of immovable property shall be based on its actual date of acquisition, however indexation benefit in respect of amount declared shall be available from June 1, 2016 only. For other assets, the holding period will start from June 1, 2016 for purpose of computation of capital gains.

[Circular No. 29 of 2016 and Press Release dated August 18, 2016]

JUDICIAL DECISIONS

Rental income from leasing out of house property assessable as business income

The Supreme Court dealt with a question as to whether income received by corporate taxpayer from renting out of property should be taxable as income from house property or profits and gains of business or profession. The Supreme Court, relying on earlier ruling of Chennai Properties and Investments Ltd. [373 ITR 673 (SC)] held that the business of the company is to lease its property and to earn rent and therefore, the income so earned should be treated as its business income.

[Rayala Corporation (P.) Ltd. Civil Appeal No.6437 to 6441 of 2016 (Supreme Court)]

Mauritian taxpayer not a permitted transferee, entitled to benefit of India-Mauritius Tax Treaty on capital gains arising from sale of Indian shareholding

The Authority for Advance Ruling (AAR) considered a question of taxability of Mauritius entity (taxpayer) in respect of transfer of shareholdings in Indian asset management company and Trustee company of a mutual fund. The parent entity of taxpayer was a sponsor and settlor of such mutual fund and was a party to share purchase agreement (SPA) to sell Indian shareholding of taxpayer to the buyer.

The AAR observed that taxpayer has made investment on its own, shares were subscribed in its own name as well as amount for subscription of shares was paid by it. Therefore, taxpayer cannot be termed as permitted transferee. It distinguished the ruling of Bombay High Court in the case of Aditya Birla Nuvo Ltd [342 ITR 308], wherein US entity had paid for and subscribed to Indian shares, however shares were obtained in the name of Mauritius entity as a permitted transferee. The AAR further noted that the parent entity was party to SPA only in its capacity as sponsor and in order to comply with mutual funds regulations. The taxpayer is a resident of Mauritius and has a valid tax residency certificate, therefore, as per Article 13(4) of the India-Mauritius Tax Treaty, taxpayer is not liable to tax in India in respect of transfer of Indian shareholdings.

[Shinsei Investment Limited AAR No. 1017 of 2010 (Authority for Advance Ruling)]

Exemption in regards to amalgamation under Indian tax provisions to Indian taxpayer, available to foreign taxpayer in view of non-discrimination clause in Tax Treaty

Under the provisions of section 47(vi) of the Income-tax Act (IT Act), transfer of capital asset in a scheme of amalgamation by amalgamating company to amalgamated company is not regarded as transfer, if the amalgamated company is an Indian company. Thus such transfer is not liable to capital gains tax. In a case relating to amalgamation of two foreign entities, assuming such a case is treated as transfer, the AAR dealt with the issue of discrimination as per Article 25(3) of the India-Italy Tax Treaty. The AAR noted that this Article basically means that there is no discrimination between locals and foreigners in the matter of taxation and no preferential treatment be given to local taxpayers. The exception is only in cases of personal allowances, relief, reduction etc, in context of individuals and not companies. The AAR held that if a case of amalgamation results in some special benefits to a local company and its shareholders, there is no reason to deny the same to a foreign company and its shareholders in similar case of amalgamation. Therefore, exemption under section 47(vi) is available to foreign entity also.

[Banca Sella S.p.A AAR No 1130 of 2011 (Authority for Advance Ruling)]

TRANSFER PRICING UPDATES

CBDT signs first bilateral APA having rollback provisions with Japanese company and another 20 APA

Central Board of Direct Taxes (CBDT) has concluded a bilateral Advance Pricing Agreement (APA) having rollback provisions with an Indian subsidiary of a Japanese trading company. The signing of this APA having rollback provisions, tallies the bilateral APAs to 4. Further, the CBDT has signed another 20 unilateral APAs in August 2016 which takes the total number of APAs to 98. Out of the recent lot, 2 APAs includes complex profit split formula requiring deep understanding and verification.

The signing of APAs is an essential step towards ascertaining tax certainly in transfer pricing matters of multinational companies and it also fosters the Government's mission of non-adversarial tax regime. It is contemplated that more APAs will be concluded in the near future.

[CBDT Press release dated August 4, 2016 & August 30, 2016]

JUDICIAL UPDATES

Payment to foreign Associated Enterprise below arm's length price does not call for transfer pricing adjustment for Indian taxpayer and transfer pricing adjustment for not using a part of services available to the taxpayer on a retainership basis is not tenable

The Bombay High Court observed the fact that amount paid for import of pigment by the taxpayer was below arm's length price (ALP) was undisputed by the revenue. Section 92(3) of the IT Act does not allow to make Transfer Pricing (TP) adjustment if the application of ALP reduces the taxable income of Indian taxpayer or increases the losses. The High Court ruled that the issue raised by the tax authorities does not involve substantial question of law.

Further, the High Court also rejected the tax authorities' contention to disallow a part of the expenses incurred by the taxpayer towards knowhow/consultancy expenses. The tax authorities had disallowed a part of the expenses on the basis that the taxpayer had actually used only 3 out of the 12 services agreed to be provided by the Associated Enterprise (AE).

The High Court held that the agreement being in the nature of retainer agreement, the taxpayer could avail any of the services and the payment was agreed between the taxpayer and its AE for making the 12 services available to the taxpayer. It was taxpayer's discretion to use any or all of the services agreed. Further, the tax authorities had neither specified any transfer pricing method nor conducted any benchmarking for proportionate disallowance. Therefore, the High Court held that action of the tax authorities to disallow a part of the expenses based on the services actually used by the taxpayer is not justified and liable to be deleted.

[Merck Limited ITA No. 272 (Mum.) of 2014 (Bombay High Court)]

Outsourcing cost incurred by taxpayer should form part of the cost base on which mark-up needs to be applied by taxpayer

The Chennai Tax Tribunal held that recovery of outsourcing charges along with a mark-up, from foreign AE should be considered for Profit Level Indicator (PLI) calculation. The taxpayer had outsourced a portion of the work outsourced to it from its foreign AE to local affiliate and several other independent service providers. While charging its foreign AE for the services provided, the taxpayer did not add any mark-up on the outsourcing cost incurred by it on the ground that the same be treated as "pass through cost". The Tax Tribunal analyzed the functional and risk profile of the taxpayer and concluded that the services were outsourced by the taxpayer to the local affiliate and other independent entities on its own account and not on behalf of the foreign AE. The Tax Tribunal held that the payments by the taxpayer to its Indian AE and other independent entities cannot be treated as pass through cost and should be considered for PLI calculation of taxpayer.

[Lason India Private Limited I.T.A. No. 1026 (Madras) Of 2014 (Chennai Tax Tribunal)]

Concept of foreign tested party recognised by Indian tax authorities

The Kolkata Tax Tribunal held that based on the function asset and risk analysis, the least complex entity should be selected as the tested party. The Tax Tribunal relied on the Organization for Economic Cooperation and development (OECD) guidelines and India's commentary on the UN TP manual and commented "the concept of overseas tested party and foreign comparable companies is well recognized and acknowledged by Indian Revenue". Further, the Tax Tribunal relied on the judgement of Ranbaxy laboratories Limited [(68 TAXMANN 322 of 2016 (Delhi Tribunal)], wherein the concept of overseas tested party and foreign comparable companies was founded and accepted.

[Landis+Gyr Limited I.T.A. No. 37 (Kol.) Of 2012 (Kolkata Tax Tribunal)]

THE CORPORATE LAW AMENDMENTS

The Ministry of Corporate Affairs, vide General Circular No.09/2016 dated 03rd August, 2016 and publication of the same in the Official Gazette by Central Government on 12th August, 2016, has inserted sub- rule 11 after sub-rule 10 of the Rule 18 of Companies (Share Capital and Debenture Rules), 2014 by which Rupee denominated Bonds issued exclusively to the overseas investors in terms of A.P. (DIR Series) Circular No. 17 dated September 29, 2015 of the Reserve Bank of India are being exempted from the applicability of this Rule 18 which applies to issue of Secured Debentures subject to compliance of this Rule with respect to tenure, charge, trustee, etc.

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