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Cutting Edge

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pwc

Editorial

Dear Readers,

Greetings for the New Year! I would like to take this opportunity to thank all our valued clients for your continued trust in PwC's A&D practice. Your regular feedback and support has fuelled our growth over a short period from a start up to an established and diversified practice.

I am pleased to present the 23rd edition of PwC India's Aerospace and Defence (A&D) newsletter, "Cutting Edge" that provides information on deals, news and tax updates and aims to keep you up to date with the latest developments and trends in the industry.

The Ministry of Defence has a full time and dynamic Minister whom we welcome. Under his directions, the Ministry is in the process of revising the defence procurement procedure. The new procedures are expected to simplify the complex Make procedure and may also provide level playing field to Indian players vis-à-vis foreign OEMs. The new procedures are expected to give a boost to domestic defense companies by enabling increased technological tie-ups and equity participation by foreign players and will assist in making India self reliant to fulfill its defense needs. Aerospace and defence are important sectors in the Make in India campaign launched by the Prime Minster.

PwC was the Knowledge Partner for the 7th ASSOCHAM International Conference on Aerospace, Defence and Homeland Security. The Conference was addressed by the Hon'ble Raksha Mantri Mr. Manohar Parrikar. Also present were the Secretary (Defence Production) Mr. G. Mohan Kumar and Hon'ble Member of Parliament & Chairperson, Parliamentary Standing Committee on Defence Maj. Gen. (Retd.) Shri B.C. Khanduri amongst others. In this report, we have highlighted essential ingredients of an ecosystem that facilitates building a domestic defence industrial base. It also provides the policy and other support from the Government that is needed to develop this nascent industry in India with a view to encourage manufacturing and exports. The reports can be accessed at :

http://www.pwc.in/en_IN/in/assets/pdfs/publications/2014/self-reliance-in-defence-production.pdf

This quarter brought good news for the Armed Forces with the Defence Acquisition Council (DAC) approving defence projects worth INR 80,000 crore to procure Israeli antitank guided missiles and upgraded Dornier surveillance aircraft, amongst other things. Reaffirmation of a stalled decision that the 56 transport aircrafts to replace the Avro will be built in India in partnership with a private Indian company and the decision to locally build six submarines in collaboration with a foreign partner might play a critical role in building the supply ecosystem of the aircraft and submarine manufacturing segment in India with foreign Tier I companies setting up facilities in India, either by themselves or through partnerships with Indian suppliers.

Further, India plans to kick-off its own fifth-generation fighter aircraft (FGFA) development project this year to build on the expertise gained in the long developmental saga of the indigenous Tejas light combat aircraft.

The Ministry of Defence recently issued a Request for Information (RFI) to Indian vendors to replace its existing fleet of Cheetah and Chetak helicopters with Reconnaissance and Surveillance/ RSH Helicopters). This move is a follow on of the decision taken in August 2014 to scrap the deal for 197 helicopters and go for a fresh contract under the 'Make and Buy' category of the Defence Procurement Procedure (DPP). This approach is in line with the Modi government's policy of indigenously developing military hardware and reducing dependency on imports.

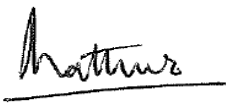
The government is also considering releasing guidelines for allowing representatives of foreign defence companies to participate in meetings to help the company they represent, since it may not be possible for official representatives to attend all meetings in India.

These are all indications that the A&D sector is in for exciting times and of the government's intent to build a domestic industrial base in India– we are very optimistic that the government will address the bottlenecks and give a fillip to the development of this critical sector in India.

With these highlights, I invite you to review our 23rd newsletter dedicated to A&D.

Your feedback is important and we look forward to it.

Sincerely,



Dhiraj Mathur

Partner and Leader, Aerospace and Defence

In this Issue

Glossary

A&D	Aerospace & Defence
AAR	Authority for Advance Rulings
BSF	Border Security Force
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise and Customs
CENVAT	Central Value Added Tax
CISF	Central Industrial Security Forces
CRPF	Central Reserve Police Force
DPP	Defence Procurement Procedure
DRP or the Panel	Dispute Resolution Panel
DTC	Direct Taxes Code
ECB	External Commercial Borrowings
FAQ.	Frequently Asked Questions
FBT	Fringe Benefit Tax
FDI	Foreign Direct Investment
FIPB	Foreign Investment Promotion Board
FTP	Foreign Trade Policy
GST	Goods and Services Tax
HC	High Court
IPO	Initial Public Offer
JV	Joint Ventures
MAT	Minimum Alternative Tax

Glossary

MHA	Ministry of Home Affairs
MTA	Multirole Transport Aircraft
NBFC	Non Banking Financial Company
NFE	Net Foreign Exchange Earnings
NSG	National Security Guard
OEM	Original Equipment Manufacturer
RBI	Reserve Bank of India
RFI	Request for Information
RFP	Request for Proposal
RIC	Resident Indian Citizen
Rules	Income Tax Rules, 1962
SEZ	Special Economic Zone
SQR	Services Qualitative Requirement
the Act	The Income-tax Act, 1961
the Tribunal	Income Tax Appellate Tribunal
TO	Tax Officer
ToT	Transfer of Technology
TV	Transaction Value
ULFA	United Liberation Front of Assam
VAT	Value Added Tax

Select News Items

After Mauritius, India to export warships to Sri Lanka

India will now export two warships to Sri Lanka after delivering a warship to Mauritius for the first time. The 83 crew capacity warship will be used by the Mauritian Coast Guard for anti-piracy and anti-poaching operations. Besides, it is also capable of search and rescue missions, transportation of small detachment of troops and helicopter operations and can handle external firefighting. The warship can also be used for cargo handling.

Government approves defence acquisition proposals worth Rs 4,444 crore

The Defence Acquisition Council (DAC) recently approved proposals worth Rs 4,444 crore, including the purchase of four helicopters for survey vessels at Rs 2,324 crore. Besides giving its go-ahead to acquire four choppers, the DAC, under Defence Minister Manohar Parrikar, also cleared the upgradation of the mobile integrated electronic warfare system, Samyukta, at a cost of Rs 1,682 crore.

India's first indigenous nuclear submarine gears up for maiden sea trials

India's first indigenous nuclear submarine INS Arihant is all set to make its maiden foray into the wide-open sea. The 6,000-tonne vessel, with an 83MW pressurized light-water reactor at its core for propulsion, is slated to begin its sea trials off Visakhapatnam within the next few days. INS Arihant, or the "annihilator of enemies", and its two under-construction follow-on vessels are the critical missing link in the country's long-standing pursuit to have an operational nuclear weapons triad — the capability to fire nuclear warhead from land, air and sea

Meeting Defence needs from Domestic Production

There has been a thrust on indigenous manufacture of defence equipment through the collaborative efforts of Defence Research & Development Organisation (DRDO), Defence Public Sector Undertakings, Ordnance Factory Board and the Indian Private Sector. The expenditure on capital acquisition in respect of direct orders placed on Indian vendors during the period 2011-12 to 2013-14 was 53.9 percent of the total.

Indian MSMEs set to battle it out for Rs 18,000-cr defence pie

The Defence Procurement Policy 2013 and the Make in India campaign have created a staggering Rs 18,000 crore ($3 billion) opportunity for the Indian defence MSME (micro, small and medium) sector as numerous offsets in the three wings of the armed forces are expected to be executed in the next five years.

India test-fires N-capable Agni-IV missile

India recently successfully test fired its 4,000 km nuclear capable Agni-IV missile in Odisha. The Agni-IV, which can carry one tonne nuclear warhead, was fired at 10.19 am from a launch pad from the Wheeler Island.

Govt clears proposal to acquire 814 artillery guns for Rs 15,570 crore

In a fresh bid to break the Bofors jinx, defence minister Manohar Parrikar recently cleared proposal to acquire 814 artillery guns for Rs 15,750 crore. The artillery guns would be procured as per the "Buy and Make" procedure introduced last year under which 100 such guns would be bought off the shelf while 714 would be made in India.

Select News Items

New defence procurement policy under consideration

Aiming for transparent but faster military procurements, the Narendra Modi government is considering rolling out a new defence procurement policy that will have fresh norms for blacklisting firms and engagement of 'agents' besides attracting investments.

Parrikar relook at agents, blacklists

The Centre is debating lifting a ban on arms agents — called “middlemen” since the Bofors kickbacks row that erupted in 1987 during the Rajiv Gandhi government’s term — in a new set of guidelines on procurement of military hardware. The new guidelines may be a part of the defence procurement policy — a manual introduced in 2004 that is revised every year — or may be publicised through a separate announcement.

India test-fires nuclear capable Agni-II missile

India recently test-fired its nuclear-capable Agni-II strategic ballistic missile from a military base in Odisha. The test was conducted from Wheeler's Island in Bhadrak district.

India Successfully Test-Fires Nuclear Capable Cruise Missile Nirbhay

India successfully test-fired its first domestically built nuclear-capable long-range cruise missile recebtly, marking another step in building up the country's defence prowess. The "Nirbhay" ("fearless") missile blasted off from a mobile launcher at the Integrated Missile Test Range in Chandipur in Odisha.

Regulatory

Streamlining procedure for grant of Industrial Licenses

With a view to attract investments in the defence sector, the Government has further liberalised the industrial licensing regime vide issue of Press Note 9 of 2014 dated October 20, 2014. It has been decided that:

- **Increase in validity period of Industrial License** - Two extensions of 2 years each in initial validity of 3 years (increased from 2 years vide Press Note 5) shall be allowed upto 7 years.

- **Removal of stipulation of annual capacity in the Industrial License** - It has been decided to deregulate annual capacity for defence items for Industrial License. However, the licensee shall submit half yearly production returns to Department of Industrial Policy & Promotion and Department of Defence Production, Ministry of Defence in the prescribed format (to be notified separately)

- **Sale of Defence items to Government entities without approval of Ministry of Defence** - The Licensee shall be allowed to sell defence items to Government entities under the control of Ministry of Home Affairs, state governments, Public Sector Undertakings (PSU) and other valid defence licensed companies without prior approval of Department of Defence Production (DoDP). However, for sale of items to other entities, prior permission would be required from DoDP, MoD.

Direct Taxes

Payment made by assessee, engaged in business of manufacturing ultrasonic meters to a US company towards calibration and testing of equipment, could not be treated as 'fee for technical services' due to non-Compliance with make available cause

The assessee, Denial Measurement Solutions (P.) Ltd., was engaged in business of manufacturing Ultrasonic Meters which is Gassflow Measurement Equipment , made certain payments to Colorado Engineering Experiments Station Inc. ('C' Inc.'), USA towards calibration and testing of equipment. No tax was deducted on the remittances made to C Inc.

- The Assessing Officer ('AO') was of the view that the payment made by the assessee were in the nature of technical work and related to engineering and technical services as defined in Explanation 2 of section 9(1)(vii) of the Income Tax Act, 1961 ('the Act') and therefore provisions of section 195 of the Act were applicable and the assessee should have deducted tax before making payment.

- Before the AO, assessee contended that the services provided by the non-resident did not made available any technical knowledge, hence the services are not in the nature of fees for included services under Article 12 of the India – USA Double Taxation Avoidance Agreement ('DTAA'). However the same was not found acceptable to the AO during the assessment proceedings and the assessee was held as assessee in default under section 201 of the Act for not deducting taxes at source.

- On Assessee's Appeal to the Commissioner of Income-tax (Appeals)('CIT(A)', the CIT(A) deleted the addition made by the AO on the ground that in the present case the assessee had not been told how to do testing and calibration and C Inc. only tested the calibration and thereafter provided a test report. Hence, CIT(A) held it to be a case of process of standardization for which expertise exists with C Inc. and no knowledge or expertise has been made available to the assessee and accordingly would not be taxable as fees for technical services under India- US Tax Treaty.

- Aggrieved by the decision of CIT(A), the Revenue filed an appeal before the Tribunal.

- Tribunal upheld the order of CIT(A) and relying on the decisions in case of Veeda Clinical Research (P.) Ltd ([2014] 52 taxmann.com 443), DIT vs. Guy Carpenter & Co. Ltd. ([2012] 346 ITR 504), CIT vs. Debeers India Minerals (P.) Ltd. ([2012] 346 ITR 467), it held that the condition precedent for invoking the 'make available' clause is that the services should enable the person acquiring the services to apply technology contained therein.

- It was further held by the Tribunal that unless there is a transfer of technology involved in technical services, the 'make available' clause is not satisfied. In the present case, since technology is not 'made available', the payment cannot be treated as fee for technical services and accordingly the assessee cannot be held to be in default for not deducting taxes at source.

Income-tax Officer (International Taxation), Vadodara vs. Denial Measurement Solutions (P.) Ltd. [2014] 52 taxmann.com 443 (Ahmedabad- Trib.)

Payments made to foreign parties for import of plant, equipment and machinery and incidental services in connection with installation and commissioning of these machines not liable to be taxed in India as 'fee for technical services' and accordingly, no tax is required to be withheld on such payments

The assessee, a unit of Birla Corporation Limited, is engaged in the business of manufacturing and selling of cement. It imported certain plant and machinery from various vendors located in different countries. These vendors also provided services for installation and commissioning of plants and machinery. Technicians of the respective vendor visited India for the purpose of the said installation/commissioning.

The assessee made remittances to the vendors, without withholding taxes in India. The assessee was of the view that the payments were for supply of plant and machinery from outside India and, hence, not chargeable to tax under the Act. Fee for installation and commissioning was paid separately at a later date and, on these payments, taxes were duly withheld at the rate of 10%.

During the course of scrutiny, the Assessing Officer ('AO – TDS') held that :

- The contracts entered into by the Taxpayer for design, manufacture, supply, installation, testing and commissioning of the plant are in the nature of "composite contracts" or ""works contracts".
- Payments made by the Taxpayer to vendors represented payment for both supply of plant and machinery, as well as for incidental services of installation and commissioning of such machinery.
- The separate payments made by the Taxpayer constituted additional remuneration to the technicians and reimbursement of certain expenditure. The actual consideration for rendition of these installation/commissioning services is not paid separately and the same is embedded in the consideration paid towards supply of this equipment, plant or machinery
- The assessee was required to approach the Tax Authority for determination of chargeable income element and the tax deductible thereon and, in the absence of the above treated the assessee as a defaulter for not withholding taxes which were computed at the rate of 42.25% on the total consideration payable for supply of plant and machinery

Aggrieved, the assessee appealed to the Commissioner of Income-tax (Appeals) ('CIT(A)'). which upheld the order of the AO-TDS. Against this order, the assessee preferred an appeal before the Tribunal.

Tribunal's Ruling:

- Tribunal settled the controversy on applicability of tax treaties by holding that once the tax treaties are notified, such treaties form an integral part of the domestic tax legislation. To the extent a tax treaty applies on the facts of a case, the provisions of the Income Tax Act, 1961 ('the Act') are applicable only to the extent that such provisions are more beneficial to the assessee.

Taxability under the Act

Part of the consideration which can be attributed to installation, commissioning or assembly of the plant and equipment, or any supervision activity in connection thereto, is taxable under the ITL. Such portion clearly accrues and arises in India, since the related economic activity is performed in India.

As the income accrues and arises in India, there is no requirement to look at the deeming fiction of the ITL, which provides for taxation of income which is deemed to accrue or arise in India.

- Additionally, the deeming provision for taxing FTS income excludes "consideration for any construction, assembly, mining or like project" from its purview. The expression "installation, commissioning or erection" of plant and equipment belong to the same genus as the expression "assembly" used in the exclusion clause and, hence, such activity would be out of the deeming provision of the Act concerning FTS taxation.

Taxability under the DTAAs

- Tribunal held that in a situation where there are specific PE clauses in relation to a particular type of service, which are also covered by the scope of services covered by FTS/ FIS, the taxability of consideration for such services must remain confined to taxability of profits under the relevant specific PE clause. In case of installation PE, no taxability shall arise under Article 7 read with article 5 of respective tax treaties, unless the installation or assembly project or supervisory activities in connection therewith cross the specified threshold time limit, the non-resident enterprise cannot be treated to have a PE in India. These payments shall not be taxed as FIS/ FTS under Article 12 or 13 of relevant tax treaties.

- To Revenue's contention that the assessee had itself withheld tax on stand alone payments being made towards installation, commissioning, etc. considering the same as FIS/ FTS, Tribunal held that taxability of income is decided based on law and not conduct of parties.

- Tribunal further held that installation or assembly activities do not involve transfer of technology , accordingly, these activities shall not constitute FTS/ FIS.

- Installation, commissioning or assembly of a plant, machinery or equipment , or any supervision activity connected therewith, is ancillary and subsidiary, as well as inextricably and essentially linked, to sale of such a plant equipment or machinery, therefore, any consideration for such payment cannot be included in FIS/ FTS. Accordingly, even if there be any income embedded in such payments, same cannot be brought to tax, in view of provisions of Article 12/ Article 13 of respective tax treaties.

- Tribunal held that the receipts in hands of vendors are in nature of business income, and such income can be taxed in India only through a PE. In absence of PE, no taxability shall arise in respect of such payments under the provisions of Article 7 read with Article 5 of the tax treaties. Further, since these payments have no tax implications in India under the scheme of relevant tax treaties, under section 90(2) of the Act, there is no occasion for the assessee to look at the provisions of the Act, for 'more beneficial' a treatment.

- Tribunal gave AO_TDS the liberty to raise a fresh demand under section 201 read with section 195 of the Act , if its is able to demonstrate that the vendors had a PE in India. In absence of the same, the demand raised is unsustainable in law.

Birla Corporation Ltd. Vs. Assistant Commissioner of Income-tax (TDS), Jabalpur [2015] 53 taxmann.com 1 (Jabalpur – Tribunal)

Lump sum payment for supply and installation of machinery which involves transfer of technical know-how could not be regarded as royalty as it is not made for any particular period

The assessee, The Andhra Petrochemicals Ltd, is in the field of petrochemicals. It entered into collaboration-cum-service agreements with a UK company to supply and install certain machinery and transfer know-how pertaining to installation of machinery and equipment for a consideration of USD 1 million.

Assessing Officer passed an order dated 19-11-1990 under section 163 of the Act treating assessee as and agent of UK Company and vide a separate assessment order treated the payments made to the foreign company as royalty income thereby imposing tax liability on the assessee.

On appeal to CIT(A), CIT(A) partly allowed the appeals. On further appeal , Tribunal allowed the appeals holding that the amounts paid to foreign country cannot be treated as royalty and thereby cannot be taxed.

On appeal by Revenue, High court held in favor of assessee as follows:

- The amount paid by the assessee to the foreign company is part of the lumpsum consideration for supply of technical know-how, machinery installation and erection and was not for any particular period. It was paid for transfer of technical know-how for limited purpose of installation and fixing of machinery. Thus, the same cannot be treated as royalty .
- The transfer was not on payment of any periodical royalty, but was only to the extent which is necessary for installation and thereby treating it as a concomitant part of the comprehensive agreement
- Even if the amount is to be treated as royalty under the Act , it stands covered by the exclusionary clause under the India- UK Treaty dated 16-04-1981* which excludes royalty payable in respect of the operation of mines or quarries or of the extraction or removal of natural resources

On the further question of liability to pay interest under section 139(8) of the Act, Revenue held in favour of assessee by holding that liability of interest cannot be fastened upon assessee for the period anterior to the date from which assessee was liable to file return of Income. In the present case, since there was no obligation on part of the assessee to file the return before being treated as representative of the foreign company, there would be no interest liability.

Commissioner of Income-tax, Rajahmundry vs. Andhra Petrochemicals Ltd. [2014] 51 taxmann.com 451 (Andhra Pradesh High Court)

*The treaty referred to in judgment has been terminated and substituted by another treaty dated 11h February 1994

Personal Tax

Case Laws

Bangalore Tribunal: Despite no employer-employee relationship, ESOP income taxable as salary

The taxpayer was in employment in India with Aerospace Systems Pvt. Ltd. (ASPL) and went on deputation as an independent consultant to SIRF Technology, USA (SIRF) for the period of 1995 to 1998. SIRF granted stock options to him on 4 October 1996 under its stock option plan. He exercised his right under the Stock Option Plan in March, 2006 and received 7,000 shares of SIRF and sold them on the same day in a 'Cashless Exercise'. He contended that since he was an employee of ASPL and not SIRF, there was no employer-employee relationship and hence the income could not be taxed as 'Salaries'. Thus, the gains were considered by him as capital gains arising on transfer of stock options. Also, he contended that the Stock Options were held for nearly ten years, i.e., from the grant date. Hence, the entire stock income of INR 12.7 million was offered as long-term capital gains. The taxpayer invested part of the consideration in the construction of a residential property and claimed benefit of INR 6.2 million under section 54F of the Act. His submissions were rejected and the TO considered that "employee" according to the ESOP plan included a consultant who performed services for the company or its subsidiaries. Further, the TO contended that the difference between the sale price of shares and the fair market value (FMV) of shares on the date of exercise was a short-term capital gain and hence denied the exemption under section 54F of the Act.

The Tribunal relied on the case of Sumit Bhattacharya v. ACIT [2008] 300 ITR (AT) 347 (Mumbai - SB) wherein it had been held that even in the absence of an employer-employee relationship, income on stock appreciation rights (SAR) was assessable under the head 'Salaries'. In the present case, the Tribunal noted that under the ESOP plan of SIRF, independent consultants had to be considered as "employees" for purposes of grant of the benefit. The Tribunal observed that the first event of taxability was triggered on the date when the option to acquire the shares was exercised. Up to that time, the taxpayer had no right to any shares of SIRF. The benefit arising to an employee (being the difference between the FMV and exercise price on the date of exercise) would be subject to tax as salary income, negating the taxpayer's arguments regarding no 'employer-employee' relationship. The Tribunal noted that the option to purchase shares could only be exercised and not be alienated. To fall under the head capital gain, there must be a transfer of a capital asset. It was concluded that exercise of options to acquire shares was not capable of being assessed under the head "Capital Gain", as there was no transfer of capital asset.

It further held that the income had to be treated as taxable under the head, Salaries. The next event of taxability under the stock options arose on sale/ transfer of shares. The difference between the sale price and the FMV on the date of exercise would be treated as capital gain. As the shares were sold on the same day that the option was exercised on, the Tribunal held the gain to be "short term". Consequently, deduction under section 54F of the Act was denied.

With regard to levy of interest under section 234B of the Act, the Tribunal ruled in favour of the taxpayer by confirming that as the income was assessed as "Salary", it was the employer's duty to deduct tax at source. The taxpayer could not be penalised for non-deduction of tax at source by the employer. The Tribunal also deleted the penalty under section 271(1) (c) of the Act as the employee had furnished all facts with regard to stock options, and the benefit he received.

ACIT v. Chittaranjan A. Dasannacharya [TS-560- ITAT-2013 (Bangalore - Tribunal)]

Personal Tax

Bangalore Tribunal: Date of 'registration deed' is relevant for property acquisition to claim the exemption under section 54F of the Act

The taxpayer filed his return for the AY 2009-10 declaring total income of INR 2.64 million. The taxpayer was joint owner of a property, which was acquired by Karnataka Industrial Area Development Board (KIADB) in August 2008 on payment of compensation of INR 8.46 million. He purchased a flat for INR 5.09 million by registered sale deed dated 11 September 2008 and claimed an exemption of INR 4.61 million under section 54F of the Act. During scrutiny proceedings, the TO observed that the flat was booked in January, 2006 and the amount was paid in FY 2006-07 (i.e. one year prior to the sale of land) and INR 0.40 million was for electrical/ water connections, which did not qualify for exemption under section 54F of the Act. Further, the taxpayer had paid INR 4 million from a housing loan and thus only INR 0.62 million qualified for exemption under section 54F. The TO further disallowed set-off of LTCL on sale of shares and STT paid against Long-term capital gain (LTCG) arising on sale of land. The CIT(A) upheld the TO's order. Aggrieved, the taxpayer preferred an appeal before the Tribunal.

The Tribunal observed that amounts paid by the taxpayer on booking of the flat in January 2006 and the housing loan of INR 4 million for investment in the purchase of the flat had not vested the taxpayer with ownership of the new asset. The taxpayer was vested with ownership of the flat only by virtue of the registered sale deed dated 11 September 2008. Thus, the Tribunal held that the taxpayer had invested in the new property within two years from August, 2008 (i.e. the date of sale of the land) and would be eligible for exemption under section 54F of the Act. Further, in respect of disallowance of set-off of LTCL against LTCG, it held that the set-off of LTCL on sale of listed securities, income from which is exempt under section 10(38) of the Act, against LTCG on an immovable property as claimed by the taxpayer, was contrary to law and the intention, object and purpose of the Legislation in introducing clause 10(38) of the Act, and hence should be disallowed.

Gopilal Laddha v. ACIT [TS 589-ITAT-2013(Bangalore – Tribunal)]

Bangalore Tribunal: The Tribunal holds the taxpayer liable for tax withholding under section 195 on non-resident seller's proportionate sale consideration

R. Prakash (the taxpayer) purchased a residential house property in Bangalore for INR 12 million during financial year (FY) 2008- 09. The property belonged to Mrs. Shyamala Vijai and her daughter Mrs. Poornima Shivaram (non-resident), both 50% co-owners of the property. Mrs. Shivaram had given a General Power of Attorney (GPA) to her mother, who executed the sale deed in favour of the taxpayer for her daughter and herself. The TO held the taxpayer to be in default under the provisions of section 201(1) of the Act on account of failure to withhold tax at source as required under section 195 of the Act at the time of paying sale consideration to the non-resident seller and raised a tax demand under section 201(1) of the Act.

Aggrieved by the order of the TO, the taxpayer filed an appeal before the CIT(A). The taxpayer contended that Mrs. Vijai was the absolute owner of the property and her daughter was shown as a joint owner only by way of abundant caution. Also, Mrs. Vijai had invested the entire capital gain for purchase of a new property and was entitled to claim exemption under section 54F of the Act and therefore, no capital gain was chargeable to tax in the hands of Mrs. Vijai. Hence, there was no requirement on the part of the taxpayer to withhold taxes under section 195 of the Act. The CIT(A), however, rejected the taxpayer's contention, observing that the sale deed in respect of the property indicated that Mrs. Vijai (resident) and Mrs. Shivaram (non-resident) were the joint owners of the

property. Also, the Sale Deed was signed by Mrs. Vijai in two capacities i.e. once for herself and again as the GPA holder of her daughter. The CIT(A) upheld the order of the TO and accordingly dismissed the appeal of the taxpayer. Aggrieved by the order of the CIT(A), the taxpayer filed an appeal before the Bangalore Tribunal.

The Tribunal noted that Mrs. Vijai and Mrs. Shivaram are entitled to equal share over the property. The share of each of the owners in the sale consideration would be INR 6 million. Mrs. Shivaram is, admittedly a non-resident and to the extent of INR 6 million paid to Mrs. Vijai (on behalf of her daughter), the provisions of section 195 of the Act are attracted and the taxpayer should have withheld tax at source while making payments to the non-resident through Mrs. Vijai. The Tribunal referred to the case of Syed Aslam Hashmi v. ITO [ITA No. 1313/Bang/2010 & 1076/ Bang/2012], wherein it was held that under section 195 of the Act, tax had to be withheld on the entire sale consideration instead of the capital gain arising out of the transfer of a capital asset. The Tribunal distinguished the above case on the fact that in the above case the payment of the entire sale consideration was made to a non-resident while in the present case, the non-resident was entitled only to half of the sale consideration. The Tribunal held that "the taxpayer can be considered as an 'taxpayer in default' only to the extent of INR 6 million paid to the non¬resident. Levy of consequential interest under section 201(1A) should be modified accordingly."

Shri R. Prakash v. ITO [TS¬605-ITAT-2014 (Bangalore - Tribunal)]

Madras High Court: Tax cannot be demanded from deductee for deductor's failure to issue tax withholding certificate

The taxpayer, a landlord, had rented out a building to Union Motors Services Limited (tenant).The tenant had withheld tax while paying the rent to the taxpayer, but failed to issue the TDS certificate and to credit the amount during AY 2001-02. The taxpayer, while filing the tax return, submitted that though the tenant had not furnished the TDS certificate according to the requirements of the Act, the taxpayer was nonetheless entitled to tax credit as INR 0.275 million had already been withheld. The TO did not give the credit of taxes withheld at source by the tenant as the appellant could not furnish the TDS certificate for this amount. The taxpayer filed an appeal against the assessment order before the CIT(A). The CIT(A) also confirmed the order passed by the TO. The taxpayer filed an appeal before the Tribunal and the Tribunal confirmed the CIT(A)'s order. However, the Tribunal modified the order to allow the taxpayer to approach the TO and file all necessary evidence to show that the tax has already been withheld at source.

Once the tax had been withheld from the income, the bar under section 205 of the Act came into operation and it was immaterial as to whether the tax withheld at source had been paid to the credit of the Central Government or not, because elaborate provisions were made under the Act for recovery of tax withheld at source from the person who had withheld such tax. The HC, relying on Smt. Ansuya Alva v. DCIT [2005] 278 ITR 206 (Karnataka), held that the provision is to provide a protection to the taxpayer and to prevent the revenue from embarking on recovery proceedings in respect of such an amount. It is not possible to understand the word 'deduct' occurring in section 205 of the Act as 'deducted and remitted'. The Act prevents the Revenue from demanding the tax withheld at source from the taxpayer who has suffered a deduction. The Revenue is at liberty to proceed against the tenant (in the hands of the official liquidator of Union Motors Services Ltd) with respect to the tax withheld in question.

Executors of the Estate of S. Shanmuga Mudalidar v. ACIT [TS-571-HC-2014(Madras)]

Indirect Taxes

Customs:

Notifications and Circulars

- The Central Government has exempted specified goods required for the Airborne Early Warning and Control System Programme of Ministry of Defence from the whole of the duties of customs on fulfilment of specified conditions.

(Notification No. 27/2014-Cus dated 18 September, 2014)

- The Central Government has notified the revised All India Rates (AIR) of Duty Drawback effective from 22 November, 2014. Some relevant changes are as under:

  - ❑ Several entries have been modified /amended to address issues brought to Ministry's notice;
  - ❑ It is clarified that "vehicles" of chapter 87 shall comprise completely built unit or completely knocked down (CKD) unit or semi knocked down (SKD) unit.

(Notification No. 110/2014-Cus(NT) dated 17 November, 2014 and Circular No.13/2014-Cus dated 18 November, 2014)

Case Laws

- The Mumbai Tribunal held in Ortiker India Pvt Ltd v CC (2014 (307) ELT 956), that royalty paid in relation to goods manufactured in India could not be added to the value of imported goods, since such royalty could not be a condition of sale of imported goods.
- The Mumbai Tribunal, in Atlas Copco India Ltd v CC (2014-TIOL-2269-CESTAT-MUM), held that royalty paid on account of technical know-how was not includible in assessable value of imported goods as the same was not a condition of sale of imported goods.
- The Supreme Court, in Bharat Diagnostic Centre v CC (2014 (307) ELT 632 (SC)), held that the benefit of exemption notification was not available in case the conditions of the notification were not fulfilled.

Foreign Trade Policy:

Notification

- The Central Government has amended the application form for IEC issuance/ amendment and has also made it mandatory to file the application form online effective from 1 January, 2015.

(Public Notice No. 76(RE-2013)/2009-14 dated 27 November, 2014)

Case Laws

- The Mumbai Tribunal, in Goan Hotels and Clubs Pvt Ltd v CC (TS-540-Tribunal-2014-CUST), held that Export Promotion of Capital Goods (EPCG) scheme benefit cannot be denied on the ground of classification of goods into a different heading since the goods are freely importable.

Indirect Taxes

- In Malik Tanning Industries v UoI (2014-TIOL-2197-HC), the Delhi High Court held that neither the Central Government nor DGFT had the power to amend the Foreign Trade Policy or withdraw any export benefit with retrospective effect. **CENVAT:**

CENVAT

Case Laws

- In CCE v Maruti Suzuki India Ltd (2014 (307) ELT 625), the Supreme Court held that retention of 50% of sales tax amount under the tax concession granted by the State had to be treated as additional consideration subject to central excise duty since deduction of sales tax was available only when such tax was actually paid to the Sales Tax Department.
- In Kent Introl Pvt Ltd v CCE (2014-TIOL-2073-CESTAT-MUM), the Mumbai Tribunal held that the goods supplied by a sub-contractor to the main contractor who was executing a mega project by International Competitive Bidding were eligible for the benefit of excise duty exemption under Notification No. 6/2002-CE dated 1 March, 2002.
- In Honest Bio-Vet Pvt Ltd v CCE (2014-TIOL-2286-CESTAT-AHM-LB), the Larger Bench of Ahmedabad Tribunal held that the appellant was eligible for remission of duty in respect of goods cleared for export under bond but which were destroyed at the port before the same could be exported.

Service Tax

News

- The Central Board of Customs and Excise (CBEC) has reallocated work/zones amongst members throughout India with effect from 11 November, 2014.

(Office Order No. 201/2014-Service Tax, dated 11 November, 2014)

Case Laws

- In Microsoft Corporation (I) (P) Ltd v CST (2014-TIOL-1964-CESTAT-DEL), the Delhi Tribunal held by majority that the business auxiliary services in the nature of technical support rendered by Indian subsidiary for the foreign holding company, including marketing of products in India, qualified as export of services as per erstwhile provisions of the Export of Services Rules, 2005 and would not be liable to tax.

VAT

Notifications/ Circulars

Jammu and Kashmir

- The due date for filing annual return and audit report for the FY 2013-14 has been extended to 31 March, 2015.

(Notifications No. SRO 397 dated 4 October, 2014 and 6 of 2014 dated 8 October, 2014)

Odisha

- Effective 1 February, 2013, VAT rate on "Aero engines including component parts and spare

parts" has been notified as 2%.

(Notification No. 28524-FIN-CT1-TAX-0011-2014 dated 30 September, 2014)

- Effective 5 November, 2014, requirement of filing information relating to statutory forms online in form CD-1 has been withdrawn.

(Notification No. F.7(450)/Policy/VAT /2014/455-466 dated 5 November, 2014)

Delhi

- Effective 17 December, 2014, State Bank of Bikaner and Jaipur located in the National Capital Territory of Delhi has been notified as 'Appropriate Government Treasury' for collection of tax, interest, penalty and any other amount due under the VAT/ CST Act.

(Notification No. F.7(400)/Policy/VAT/ 2011/600-612 dated 17 December, 2014)

- Effective 15 December, 2014 till 31 March 2015, every registered dealer can file online application in form DP-1 intimating about the change in particulars of business.

(Notification No. F.3(352)/Policy/VAT/ 2013/585-596 dated 15 December, 2014)

Tripura

- Effective 25 November, 2014, VAT rate on “aviation gasoline, aviation turbine fuel and all other varieties of fuel for air crafts” has been notified as 18%. Further, these goods will be taxable at first point of sale within Tripura.

(Notification No. F-I-4(17)-TAX/92 dated 25 November, 2014)

Sales Tax

Case Laws

- The Karnataka High Court, in State of Karnataka v Bharat Heavy Electricals Ltd and Others (TS-499-HC-2014-KAR-VAT), held that in case of non-production of C forms, interest shall be payable from the date the dealer was liable to pay tax. However, in case C forms filed are found defective at a later date, the interest shall be payable for the date of such determination during assessment.
- The Rajasthan High Court, in State of Panwar Trading Corporation v State of Rajasthan and Ors (TS-538-HC-2014-RAJ-VAT), has upheld the constitutional validity of section 18(3A) of Rajasthan VAT Act which restricts the input tax credit to the extent of the output tax payable in cases where such goods are sold at a price lesser than the purchase price of goods.
- The Madras High Court, in Elgi Equipments Ltd v Deputy Commissioner (W.P. Nos. 10446 to 10451 of 2014), held that industrial air compressors falls under the heading ‘capital goods’ and liable to concessional rate of VAT @ 4%. The Court observed that merely because machinery, spare parts and components are supplied through dealer distribution network, it will not alter the tax position.

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