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ADVOCATES & SOLICITORS

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PREFACE

Dear Reader,

This edition of ELP's Tax Newsletter for 2015 highlights the key recent developments (judicial and legislative) on Direct and Indirect Tax laws in India.

We trust you will find this an interesting read.

As always, we look forward to your comments and feedback.

Warm Regards,

The Tax Team

Our Achievements

Winner of Best Tax Firm in India Award - ***LegalEra Awards 2014***

Recommended as a Band 1 firm for Tax in India - ***Chambers Asia-Pacific 2011, 2012, 201, 2014 & 2015***

Recommended as a Tier 1 firm for Tax in India - ***The Legal500 Asia-Pacific 2014 & 2015***

Recommended as a Tier 1 law firm in Mumbai, India - ***Tax Director's Handbook 2014***

Highly Recommended for Tax in India - ***Asialaw Profiles 2011, 2012, 2013, 2014 & 2015***

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Winner of Taxation Firm of the Year Award - ***India Business Law Journal's Indian Law Firm Awards 2009, 2010, 2011, 2012 & 2013***

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FOREIGN TRADE POLICY

AUTHORIZATION OF OFFICERS TO FUNCTION AS APPELLATE AUTHORITY AGAINST ORDERS PASSED BY ADJUDICATING AUTHORITIES

Pursuant to Section 13 of the Foreign Trade (Development and Regulation) Act, 1992, the Central Government has empowered specified officers to function as Appellate Authority against orders passed by the adjudicating authorities. The Notification *inter alia* provides that decisions of specified adjudicating authorities – (a) Additional Director General of Foreign Trade, (b) Development Commissioner, Special Economic Zones, and (c) Designated Officer, Department of Electronics & Information Technology would be heard by a bench comprising the Director General of Foreign Trade and one Additional Director General of Foreign Trade instead, of being heard by a bench comprising two Additional Director General of Foreign Trade. *[Notification No. 101 (RE-2013)/2009-2014 dt. 5-12-2014]*

DEFERMENT OF APPLICATION OF THE NEW PROCEDURE FOR EXPORT OF CERTIFIED ORGANIC PRODUCTS

New procedures for export of certified organic products had been laid down by the Director General of Foreign Trade *vide* Public Notice No. 73 (RE-2013)/2009-2014 dt. 18-11-2014. However, as greater time was required for transition, the implementation of these procedures is deferred to a later date. *[Public Notice No. 77 (RE-2013)/2009-2014 dt.1-12-2014 and Public Notice No. 78 (RE-2013)/2009-201 dt. 18-12-2014]*

AMENDMENT TO SECTION ON – 'DETAILED GUIDELINES FOR ISSUE / MODIFICATION OF IEC NUMBER' IN FORM ANF 2A

The format of Form ANF 2A ("Form") for grant/modification of the Importer Exporter Code ("IEC") had been replaced vide Public Notice No. 76 dt. 27-11-2014. Part V of this new Form has been amended to provide for inclusion of certain additional documents which would have to be uploaded at the time of filing the Form. Further, while Para 9.1 of Chapter 9 (Miscellaneous Matters) of the HBP, had been amended to provide that an amount of Rs. 500 is payable as application fee for modification in IEC, the same has now been corrected to read as Rs. 250. *[Public Notice 79/ (RE-2013)/2009-2014 dt. 31-12-2014 and Public Notice No.85 (RE-2013)/2009-2014 dt. 13-2-2015]*

OPERATIONALIZATION OF ONLINE APPLICATION FOR IEC

While operationalization of the mandatory system of online application in Form ANF 2A, required for issuance / modification of IEC had been postponed, the same would be operationalized from 1-2-2015. In this regard, applicants who have access to net banking facility provided by notified bank are required to file their applications in the new format of Form ANF 2A, provided *vide* Public Notice No. 76(RE-2013)/2009-2014 dt. 27-11-2014 and subsequently amended. Other applicants who do not have access to the net banking facility with the notified banks have to submit Form ANF 2A in the earlier format (existing prior to 1-1-2015) in physical form along with the requisite documentation and fees to the concerned jurisdiction authority. *[Public Notice 80 / (RE-2013)/2009-2014 dt. 6-1-2015, Public Notice No. 83/ (RE-2013)/2009-2014 dt. 30-1-2015]*

NEW FORMAT FOR ISSUE OF IEC NUMBERS IN ELECTRONIC FORM

Pursuant to the aforesaid operationalization of the online application for IEC, a new format for issuance of IEC Number in electronic form, i.e. e-IEC, has been introduced as Appendix 18 B1. In this regard, the decision regarding grant / refusal of IEC would be communicated though SMS on the registered mobile number and through e-mail. While this format would only be applicable for IEC number for which an online application is filed as per the new procedure, the existing format of certificate would continue to be in force for IEC numbers for which a manual application form is filed in the old format. *[Public Notice No. 84 (RE-2013)/2009-2014 dt. 10-2-2015]*

REVISED POLICY CONDITION IN RESPECT OF RADIO NAVIGATION EQUIPMENT UNDER ITC (HS) 4 DIGIT CODE 8526

Pursuant to the amendment made to the policy condition in respect of Radio Navigation Equipment under ITC (HS) Code 8526 91 90 (Other) under Chapter 85 of ITC (HS), 2012 – Schedule –I (Import Policy), license is no longer required for import of GSM / CDMA based vehicle tracking system having a valid International Mobile Station Equipment Identity/Electronic Serial Number/Mobile Equipment Identifier Number. *[Notification No. 105/(RE-2013)/2009-2014 dt. 1-1-2015]*

REVISED POLICY CONDITION IN RESPECT OF MOBILE HAND-SETS UNDER ITC (HS) 4 DIGIT CODE 8517

Pursuant to the amendment made to the Import Policy Condition under ITC (HS) 4 digit code 8517 of Chapter 85 of ITC (HS), 2012 – Schedule- 1 (Import Policy), the following are now added in the list of prohibited items:

(a) 'GSM Mobile Handsets' without International Mobile Equipment Identity Number (IMEI), with all zeroes IMEI, duplicate IMEI or fake IMEI; and

(b) 'CDMA Mobile Handsets' without Electronic Serial Number (ESN) / Mobile Equipment Identifier (MEID), with all zeroes as ESN/MEID, with all zeroes as ESN / MEID, duplicate ESN / MEID or fake ESN / MEID. *[Notification No. 107/(RE-2013)/2009-2014 dt. 16-1-2015]*

CUSTOMS

RETROSPECTIVE APPLICATION OF PROVISIONS RELATING TO RELINQUISHMENT OF TITLE TO THE GOODS

The issue involved was whether the proviso to Section 68 of the Customs Act (allowing the relinquishment of title to the goods) inserted w.e.f. 14-5-2003 could have retrospective application.

The imported goods were imported in 2001 and the importer warehoused the same by filing a Bill of Entry for Warehousing and on execution of suitable bond. The warehousing period expired in January, 2002. Thereafter, the importer applied to the Chief Commissioner of Customs (Chennai) to abandon the goods in terms of Section 23(2) of the Customs Act *vide* a letter citing financial / operational reasons. The Chief Commissioner accepted the request and directed the Commissioner of Customs (Seaport) to take possession of the goods for the purpose of auction.

In utter disregard of the said direction, the Superintendent of Customs (Pondicherry) issued an SCN to the importer demanding Customs Duties along with interest and penalty under Section 72(1) of the Customs Act, on the ground that the importer had not removed the goods from the private bonded warehouse at the time of expiration of the warehousing period.

The Department's contention before the Madras Bench of the Tribunal was that in the absence of any enabling provision for relinquishing the title to the warehoused goods prior to 14-5-2003; the goods could not have been so relinquished. Accordingly, the SCN was valid in law.

The Tribunal ruled that the relinquishment of the title to the goods was valid in terms of the proviso to Section 68 of the Customs Act on the following counts:

- While issuing the SCN, the Superintendent of Customs had not taken into consideration the permission of the Chief Commissioner of Customs to take possession of the goods for auctioning;
- In similar facts, the Hon'ble Karnataka High Court in *CC, Bangalore vs. PSI Data Systems Limited [2010-TIOL-477-HC-KAR-CUS]* ruled that there could not be a bar on the assessee availing the benefit of the amended provisions since the matter was still pending before the authorities. Moreover, the application of the amended provisions would ensure the benefit to the assessee, which was the very intention of the legislature; and
- Board Circular dt. 15-7-1972 clarifies that "*since under Section 23(2) duty liability gets extinguished no duty continues to remain chargeable. As such, the Board is of the view that no duty can be recovered even in terms of bond under Section 72 (1) in respect of goods abandoned under Section 23 (2) of the Customs Act".*

The matter was accordingly disposed of in favour of the importer. *[Commissioner of Customs, Trichy vs. Caterpillar India Private Limited 2014-TIOL-2640-CESTAT-MAD]*

BASIS OF ASSESSMENT IN CASE OF IMPORTED LIQUID AND / OR GASES

The issue involved was whether the assessment of imported Liquefied Natural Gas ('LNG') could be on the basis of transaction value worked out as per the Contract (i.e. on the basis of Ex-Ship delivered quantity and the unit price declared in the final invoices).

The importer's stand was that assessment was to be carried out on the basis of both the quantity of LNG actually delivered and the consideration paid, as determined *vide* the Contract between the importer and the supplier. Therefore, the applicable Customs Duties were correctly paid on the basis of the transaction value worked out as per the quantity actually delivered and the price reflected in the final invoices.

On the other hand, the Revenue's contention was that the quantity of LNG declared in the Bills of Lading and the Load Port Ullage Report had to taken as the quantity imported into India.

The Tribunal relied upon certain judicial precedents to emphasize that in case of liquids / gases, the quantity actually delivered had to be the basis for assessment of imported goods (i.e. for computation of transaction value). Further, the Tribunal perused the Contract between the parties and held that the transaction value had to be determined on the basis of the LNG actually delivered and the price shown in the final invoices. Also, the Tribunal noted that there was no evidence on record to show that any amount over and above the transaction value had been repatriated by the importer to the exporter outside India.

Accordingly the appeal filed by the Revenue was rejected. *[Commissioner of Customs, Ahmedabad vs. Reliance Industries Limited 2015-TIOL-358-CESTAT-AHM]*

EXPORT OF NUCLEAR GRADE GRAPHITE WITHOUT A LICENSE IS PROHIBITED

The issue involved was whether graphite blocks of 'nuclear grade' could be exported to Iran without obtaining a specific export license.

The appellant contended that as the Customs authorities had already allowed export of two of its earlier consignments; it was under a *bona fide* belief that the graphite blocks were permissible items for export. Also, nuclear grade graphite was prohibited for export if it exceeded 30 metric tonnes in any period of 12 months – however, the appellant's consignment was much less than the limit so prescribed, *vide* Notification No. 47 (RE-2006)/2004-2009 dt. 2-2-2007 (items listed in INFCIRC/254/Rev8/Part I read with S/2006/815). Further, the appellant had sought clarification from Bhabha Atomic Research Centre ('BARC') and the DGFT on whether the subject goods were covered under the scope of the SCOMET list, but never received any response.

The Revenue's stand was that the appellant had the knowledge of procedures to be undertaken for export of nuclear grade material, and therefore the appellant could not take the plea of ignorance to escape the consequences of its actions. Further, the aforesaid Notification clearly prohibited nuclear items being exported to Iran without a specific export license. The Revenue also brought on record Resolution No. AEA/27(1) 2005-ER dt. 1-2-2006 ('Resolution') passed by the Department of Atomic Energy prescribing guidelines for nuclear exports viz. *"export of any prescribed substance, prescribed equipment or related technology shall be permitted only against an export license issued in this behalf unless export is prohibited...".*

The Mumbai Bench of the Tribunal noted that:

- The graphite blocks were certified by BARC as 'nuclear grade' and the same was not disputed by the appellant;
- The fact that the Customs authorities had allowed export of similar consignments earlier was not a tenable argument as the doctrine of estoppel did not apply in Customs transactions;
- The mere fact of the Customs authorities having committed an error in allowing some transactions in the past could not be a reason for repeating the error; and
- The appellant's plea of *bona fide* conduct by seeking clarification from the DGFT and BARC was merely an attempt to mislead, and the appellant could not take shelter of the fact that the authorities did not provide any clarification.

Accordingly, the Tribunal held that as the export of nuclear grade materials to Iran was prohibited *vide* the aforesaid Notification, and the export could only be authorised on obtaining a specific licence (as evident from the said Resolution), in absence of such compliance, the goods became 'prohibited goods' and were, accordingly, liable to be confiscated under Section 113(d) of the Customs Act (goods attempted to be exported contrary to any imposed prohibition). The Tribunal also added that the subject offence assumes a significant dimension in the context of nuclear terrorism. *[Nickunj Eximp Enterprise Private Limited & Others vs. Commissioner of Customs (Export) ACC, Mumbai 2015-TIOL-357-CESTAT-MUM]*

CENTRAL EXCISE

TERMINAL EXCISE DUTY REFUND ON DEEMED EXPORTS TO EOU

The appellant was engaged in the manufacture of printed coffee cans which were cleared to an EOU on payment of applicable Excise Duty. Such supplies to EOU being deemed exports in terms of Para 8.2 of the FTP, the appellant filed a refund claim of the Terminal Excise duty ('TED') paid on the goods cleared to an EOU in terms of Para 8.3 of the FTP with the DGFT. The DGFT rejected the refund claim on the ground that supplies made to an EOU were exempted from payment of TED under CT-3 procedures. Being aggrieved, the appellant filed a representation before the Policy Interpretation Committee ('PIC').

The PIC opined that no interpretation was required in the said matter as the manufacturer was not required to discharge TED on clearance of goods to EOU based on the fact that a supply of goods to an EOU was exempted from payment of TED in terms of Para 6.11 of the FTP read with CBEC Circular No. 851/9/2007 dt. 3-5-2007 and that import of goods by an EOU from a DTA is permitted without payment of duty in terms of Para 6.2 of the FTP. Being aggrieved, an appeal was filed before the High Court.

The Hon'ble High Court allowed the refund claim by relying on the decisions passed by the Delhi High Court in *Kandol Metal Powders Manufacturing Company Pvt. Ltd. v. UOI & Others [2013-TIOL-230-HC-DEL-EXIM]* and Calcutta High Court in *JDGFT vs. IFGL Refractories Ltd. [2002 (143) ELT 294 (Cal.)]*, wherein it was observed that supplies made to EOUs in terms of Para 8.2(b) would be considered deemed exports and the DTA unit would be entitled to exemption from TED where supplies are made against International Competitive Bidding ('ICB'). Further, it was also held that in cases where the assessee had not made supplies against ICB, such cases would be covered by Para 8.3(c) of the FTP, and refund of TED would be provided. *[M/s.Raja Crowns and Cans Pvt. Ltd. vs. UOI TS-660-HC-2014(MAD)-EXC]*

CLARIFICATION ON MANDATORY PRE-DEPOSIT OF DUTY OR PENALTY FOR FILING APPEAL

CBEC has issued following the clarifications / instructions in respect of provisions with respect to mandatory pre-deposit for appeals filed on or after 6-8-2014:

- The authorities are required to maintain a register containing various specified columns in respect of each appeal filed before CESTAT and Commissioner (Appeals);

- The Tribunal registry is directed to send a copy of the appeal memorandum filed on or after 6-8-2014 to the Departmental Representative as well to the Executive Commissionerate in terms of Rule 17 of the CESTAT (Procedure) Rules, 1982. Similarly, the Commissioner (Appeals) is directed to send such appeals to the concerned Commissionerate.

- Duty Drawback being akin to rebate of duty suffered on exported goods, the mandatory pre-deposit would be payable in terms of Section 129E of the Customs Act, upon filing of appeal with the Commissioner (Appeals) in cases of demand of Duty Drawback. However, as the ambit of Section 129E is not extendable to appeals filed

under Section 129DD, no pre-deposit would be payable while filing appeal before Joint Secretary (Revision Application). *[Circular No. 993/17/2014-CX dt. 5-1-2015]*

SERVICE TAX

GUIDELINES ON ISSUANCE OF SUMMONS IN CENTRAL EXCISE AND SERVICE TAX MATTERS

The CBEC has laid down guidelines on issuance of summons, emphasising that summons should be the last resort and should be opted for only if necessary. Officers are urged to ordinarily issue a *'simple letter, politely worded'* for the purpose of securing documents relevant to an investigation.

Further, officers issuing summons are required to adhere to the following guidelines:

(a) Prior written permission from an officer not below the rank of an Assistant Commissioner to be obtained by Superintendents, in which the reasons for issuance of summons are recorded in writing. In certain exceptional situations, oral / telephonic permission would suffice, provided the same is reduced to writing and intimated to the concerned officer at the earliest.

(b) In all cases, the officer issuing a summons should submit a report / record a brief of the proceedings in the case file and submit the same to the officer who had authorised the issuance of summons.

The CBEC has also instructed that summons should not be issued at first instance to senior management officials (such as CEO / CFO / General Managers of a large company / PSU), and such personnel should be summoned only when there are indications in the investigation of their involvement in the decision-making process, which resulted in loss of revenue to the exchequer. *[Instruction F. No. 207/07/2014-CX-6 dt. 20-1-2015]*

ELP Comments

The instructions may be seen as a small step towards a non-adversarial tax administration system, which was also emphasised by the Finance Minister in his 2015 Budget Speech.

The instructions are a breather for senior officials of companies who are summoned by officers regardless of whether or not they are involved in the decision-making pertaining to tax-related issues.

At the same time, it may be noted that similar instructions have previously been issued by the CBEC vide Circular F. No 208/122/89-CX.6 dt. 13-10-1989 in respect of Central Excise and Circular F. No. 137/39/2007-CX.4 dt. 26-2-2007 in respect of Service Tax matters; however, these have not been strictly followed by officers issuing summons.

NON-TAXABILITY OF SPONSORSHIP SERVICES RECEIVED FROM BCCI IN RESPECT OF IPL MATCHES

An appeal was filed by the Revenue against the order of the Mumbai Bench of the Tribunal, setting aside the Service Tax demand on sponsorship services received from the BCCI in respect of IPL matches. The dispute was in the context of the exclusion for 'sport events' from the erstwhile taxing entry for 'sponsorship service'.

The Revenue's appeal was dismissed by the Hon'ble Supreme Court, thereby upholding the non-taxability of such sponsorship services.

The Mumbai Bench had relied upon a decision of Delhi Bench of the Tribunal in *Hero Honda Motors Ltd vs. CST, Delhi [2013 (31) S.T.R. 162 (Tri. - Del.)]* wherein it was held that IPL is a 'sports event', and accordingly observed that *"The charging provision clearly excludes from chargeability to service tax, sponsorship in relation to sports events. The expression 'in relation to' connotes activities associated with sports events."*

On a perusal of the sponsorship agreement, the Mumbai Bench observed that the agreement is in relation to cricket tournaments conducted by BCCI / IPL, and cricket being a 'sport', the IPL will qualify as a sports event. Adopting a wide interpretation of the expression 'in relation to', the Tribunal observed that the expression connotes activities associated with sports events. Accordingly, even when payments were made to BCCI / IPL for the latter's intrinsic brand image, and not for or in relation to the tournament (i.e. T-20, which is the subject matter of the sponsorship agreement), the same will be excluded from the chargeability of Service Tax. *[Commissioner of Service Tax, Mumbai vs. Citi Bank N.A. 2015-VIL-04-SC-ST]*

ELP Comments

There are various conflicting decisions by the High Court and Tribunal benches on this issue, including the aforementioned judgement, and assessees will accordingly at the very least have the ability to argue that the issue is an interpretational one, and therefore dispute the imposition of penalty / invocation of extended period of limitation.

SUPPLY OF READY MIX CONCRETE NOT A TAXABLE SERVICE

The Larger Bench of the Hon'ble Supreme Court has upheld the order of the Delhi Bench of Tribunal wherein the supply of ready mix concrete was ruled to be a transaction of sale and not service. The Apex Court observed that the Revenue's appeal against the order of the Tribunal was devoid of any merit, and was accordingly liable to be dismissed. *[CST, Delhi vs. GMK Concrete Mixing Pvt. Ltd. 2015-TIOL-05-SC-ST-LB]*

PROVISION OF COMMON EFFLUENT TREATMENT FACILITY BY COOPERATIVE SOCIETY TO ITS MEMBERS NOT TAXABLE

The Gujarat High Court held that services in relation to a facility of common effluent treatment plant provided by a cooperative society to its members were not liable to Service Tax, in light of the decision of the previous decision of the High Court in *Sports Club of Gujarat Ltd. vs. UoI and Ors. [2013-TIOL-528-HC-AHM-ST]*. The latter decision had held that services by an association to its members could not be brought to tax on account of the principle of mutuality.

In coming to the aforesaid conclusion, it was also noted that vide the Finance Act, 2012, such services had been retrospectively exempted w.e.f. 16-6-2005. *[Green Environment Services Cooperative Society Ltd. and Anr. vs. UoI and Anr. 2014-TIOL-2355-HC-AHM-ST]*

NO SERVICE TAX ON SERVICES PROVIDED BY FOREMAN IN A BUSINESS CHIT FUND

Recently, the Hon'ble Supreme Court of India dismissed the Special Leave Petition filed by the Union of India, against the decision of the Hon'ble High Court of Andhra Pradesh in *A.P. Federation of Chit Funds vs. Union of India [2009 (13) S.T.R. 350 (A.P.)]*.

The Hon'ble High Court of Andhra Pradesh vide its decision had quashed Circular No. 96/7/2007-ST dt. 23-8-2007 ('Circular') issued by the CBEC, which had confirmed the chargeability of Service Tax on the consideration received by the foreman of chit fund, under the erstwhile taxing entry for 'Banking and Other Financial Services'. *[Union of India and Another vs. The Andhra Pradesh Federation of Chit Fund and Others 2014-TIOL-97-SC-ST]*

ELP Comments

While the aforesaid decision pertains to the period prior to the introduction of the negative list w.e.f. 1-7-2012, post this date the term 'service' has been defined under the Act to specifically exclude a mere 'transaction in money'. Paragraph 2.8.2 of the 'Taxation of Services – An Education Guide' dated 20-6-2012 clarifies that services provided by the foreman of a chit fund would not qualify as a transaction in money, and would be liable to tax.

However, the Delhi High Court in the case of *Delhi Chit Fund Association v Union of India [2013 TIOL 331 HC DEL ST]* held that services provided by a foreman of a chit fund, being an activity in relation to a transaction in money, would be excluded from the ambit of 'service'.

Most recently, vide Union Budget 2015-16, the definition of 'service' is proposed to be amended to affirm that the activities of a foreman of a chit fund for conducting or organising a chit in any manner, do not amount to a 'transaction in money' and are therefore liable to Service Tax. This proposed amendment, once enacted, will effectively overcome the aforementioned decision of the Hon'ble Supreme Court.

SUPREME COURT STAYS THE DECISION OF DELHI HIGH COURT IN CASE OF TRAVELITE (INDIA)

The Delhi High Court had struck down Rule 5A of the STR as *ultra vires* the rule-making powers under Section 94 of the Act. Consequently, any audit by a Departmental officer or Comptroller and Auditor General ('CAG') of an assessee's Service Tax records was held to be untenable. In a Special Leave Petition filed by the Revenue, the Supreme Court has granted a stay on the operation of the said order. *[UoI & Ors vs. Travelite (India) 2014-TIOL-101-SC-ST-LB]*

ELP Comments

It would be relevant to note that Rule 5A(2) of the STR has been amended (vide Notification No. 23/2014-ST dt. 5-12-2014) to make it obligatory for an assessee to furnish specified records to an officer empowered under Rule 5(1) of the STR, or an audit party deputed by the Commissioner, or the Comptroller and Auditor General, or a cost accountant/ chartered accountant nominated under Section 72A of the Act, within such time period specified by them. The records specified in the amended Rule are as under:

- Records maintained in terms of Rule 5(2) of the STR;
- Cost audit report; and
- Income tax audit report.

Further, the CBEC has clarified vide Circular No. 181/7/2014-ST dt. 10-12-2014 that, pursuant to the insertion of new sub-clause (k) in Section 94(2) of the Act effective 6-8-2014, the decision of the Delhi High Court in case of *Travelite (India) vs. UoI and Ors. [2014-VIL-209-DEL-ST]* may be distinguished since statutory backing now exists by way of Section 94(2)(k) in respect of Rule 5A(2) of the STR.

PRINCIPLES FOR WAIVER OF PRE-DEPOSIT

The Allahabad High Court, in considering an appeal filed against a pre-deposit order of the Tribunal, succinctly summed up the principles to be applied in such cases. At the outset, it was observed that the High Court cannot interfere in such matters unless unreasonable restrictions have been placed on the right of appeal so as to render it almost illusory.

As regards the requirement of establishing a *prima facie* case, it was held that it is not necessary for the appellant to demonstrate that his case is foolproof, and an arguable case which is fit for trial would constitute a strong *prima facie* case. The requirement of pre-deposit should be dispensed with where the appellant's case is *inter alia* squarely covered by the decision of a competent court which is binding on it. In such cases, ordering a pre-deposit to be paid by the appellant would cause undue hardship. In other words, undue hardship need not be limited to economic / financial hardship.

In the facts of the case, the pre-deposit order was held to be cryptic and lacking in reasons for its conclusions. In particular, the issues of *prima facie* case and undue hardship had not been examined by the Tribunal, and the matters were remanded for fresh consideration in line with the principles as outlined. *[M/s. Shukla and Brothers vs. CESTAT and Ors. 2014-TIOL-2412-HC-ALL-ST]*

CENVAT CREDIT

100% CREDIT AVAILED OF CAPITAL GOODS IN THE FIRST YEAR-REVERSAL OF CREDIT AND IMPOSITION OF PENALTY NOT WARRANTED

In the said case, the assessee had availed 100% credit of capital goods, and, consequently, proceedings were initiated against the assessee and CENVAT credit was denied to the extent of 50%, interest was demanded and penalty was also imposed. This was challenged before the Tribunal. The Tribunal noted that in terms of Rule 4(b) of the Credit Rules, for the first year, availment of CENVAT credit is restricted to 50% of the duty paid, but the assessee is entitled to take the remaining 50% CENVAT credit in the subsequent year.

The Tribunal held that in these circumstances, at most, interest for the intervening period was required to be demanded from the assessee, and accordingly confirmed the demand of interest for the intervening period, while setting aside the demand of duty and imposition of penalty against the assessee.

The Tribunal distinguished the decision in *SRF Ltd. vs. CCE, Chennai [2012-TIOL-695-CESTAT-MAD]*, in which case penalty was imposed in a situation where the assessee had availed 100% of the credit of capital goods but reversed 50% prior to issuance of Show Cause Notice. The Tribunal observed that in *SRF (supra)*, penalty was imposed under Section 11AC of CE Act read with Rule 15 of the Credit Rules, for contravening of Rule 3(4) of the Credit Rules, but in the present case before the Tribunal, duty was demanded under Section 11A of the CE Act and penalty under Section 11AC was not imposable. *[M/s Bombay Paints Ltd vs. Commissioner of Central Excise, Mumbai 2015-TIOL-142-CESTAT-MUM]*

ELP Comments

Rule 15 of the Credit Rules provides for the levy of penalty in terms of Section 11AC in the event of fraud, collusion, wilful mis-statement, suppression of facts etc. It is noteworthy that in *SRF (supra),* the Tribunal had categorically noted that the case before it did not involve fraud, mis-statement etc, but had still upheld the imposition of a part of the penalty demand under Rule 13(i) of the CENVAT Credit Rules, 2002 (in *pari materia* with Rule 15(i) of the Credit Rules which does not cover instances of fraud, collusion etc). Therefore, the distinction made in the decision of *Bombay Paints (supra)*, as regards applicability of Section 11AC in the facts in *SRF (supra)*, appears to be ill-founded. Notably, the Karnataka High Court in *CCE, Belgaum vs. Elveety Industries Pvt. Ltd [2014 (306) E.L.T. 174 (Kar.)]* and the Tribunal in other decisions such as *Aims Industries Ltd vs. CCE, Vadodara 2014 [(307) E.L.T. 889 (Tri. - Ahmd.)]* have set aside penalty demands in similar situations where 100% credit of capital goods was taken inadvertently in the first financial year.

CREDIT OF INPUTS USED IN THE MANUFACTURE OF FINISHED GOODS DESTROYED IN FIRE PERMISSIBLE IN TERMS OF RULE 57A OF CE RULES

The issue before the Hon'ble Bombay High Court was whether credit may be availed on duty paid inputs used for manufacture of finished goods which have not come into existence due to destruction in fire. The allegations were that once the finished goods had not come into existence, the MODVAT credit on inputs was not admissible and was liable to be reversed. There were also consequential demands of interest and imposition of penalty. The Hon'ble High Court read Section 57A to hold that what the legislature at that time envisaged was that so long as the goods styled as inputs have been brought in for the purpose of usage in or in relation to the manufacture of the said final products, the credit can be claimed and in terms of the Central Excise Rules, 1944, as applicable. There was nothing in the Rules which would mandate that the credit of duty can be claimed and in relation to such inputs only if there is emergence of a final product or that the manufacture of the final product is complete. The Hon'ble High Court on a plain reading of Section 57A held that the intent of the rule makers was not to disallow credit merely because a contingency over which the assessee had no control takes place. The Hon'ble Bombay also endorsed the view of the Tribunal in *CCE vs. Indchem Electronics [2002-TIOL-181-CESTAT-MAD],* later also affirmed by the Supreme Court, which adopted a similar view on the issue. *[CCE vs. M/s Asian Paints India Ltd. 2015-TIOL-369-HC-MUM-CX]*

THOUGH PROCEDURE UNDER RULE 6(3A) NOT FOLLOWED, REQUIREMENT TO PAY 6%/8% OF VALUE OF EXEMPTED SERVICES UNDER RULE 6(3)(II), NOT TRIGGERED

The appellant was a partnership firm of chartered accountants, rendering both taxable and exempted services. They had availed credit of services such as telephone services, insurance, repair and maintenance of motor car etc. It was detected during audit that the appellant did not maintain separate accounts for services used in providing taxable and exempted service as required under Rule 6(2) of the Credit Rules. Upon such detection, the appellant paid proportionate credit of Rs. 927 as required under Rule 6(3)(ii) before the issuance of show cause notice. The appellant however did not follow the procedure prescribed under Rule 6(3A), i.e. it did not intimate in writing to the Superintendent of Central Excise, as regards exercising the above option. It was the contention of the Department that payment under Rule 6(3)(ii) can be allowed only when the procedure under Rule 6(3A) is followed, and on this basis, demand of Rs. 24,197 along with interest was raised and penalty under Rule 15 of the Credit Rules was imposed.

ELP Comments

Though the decision has adopted a favourable stand for the assessee, it is however required to be understood in the facts in which it was rendered (including the quantum of demand involved). The Tribunal in fact categorically notes that the assessee is required to fulfill the "conditions" of Rule 6(3A) and one cannot draw a conclusion from the judgement that Rule 6(3A) is procedural in nature.

The Tribunal, upon an evaluation of the conditions under Rule 6(3A), found that the prescribed details that are required to be submitted, i.e. intimation of the appellant exercising option to avail the facility, name, address, registration no. etc., are mostly factual details which are available from records. The Tribunal further held that it was not in dispute that the appellant paid the amount under Rule 6(3A), i.e. Rs. 927, and in such circumstances, it would be too harsh to enforce payment of Rs. 24,197 only because of non-payment of the due amount of Rs. 927 on time as per

the procedure prescribed in Rule 6(3A). The Tribunal categorically noted that the conditions do require that the option should be exercised in writing to avail the facility and the amount of CENVAT credit attributable to exempted goods must be paid provisionally for every month, which was done by the appellant. The Tribunal however gave relevance to the fact that the no assessee would intentionally evade payment of Rs. 927 and the fact that the appellant pleaded ignorance of the relevant law. The Tribunal accordingly set aside the demand, interest and penalty. *[M/s Rathi Daga vs. CCE, Nashik Order No. A/119/15/SMB dt. 14-1-2015]*

CREDIT CANNOT BE DENIED IF FINAL PRODUCT BECOMES EXEMPT SUBSEQUENTLY

The issue of availability of CENVAT credit on inputs used in the manufacture of final products that are subsequently exempted has been recently dealt with by the Himachal Pradesh High Court along the lines of the decision passed in case of *C.Ex., Chandigarh vs. Saboo Alloys Pvt. Ltd. [2010 (249) E.L.T. 519 (H.P.)]*. The facts of the matter have not been discussed in the instant judgement but are noted to be identical to the facts in case of *Saboo Alloys (supra)*, wherein the issue involves the reversal of CENVAT credit availed by the manufacturer in respect of inputs which are proved to have been used in the manufacture of goods which are subsequently exempted from Excise Duty in view of the provisions of Rule 6(1) of the Credit Rules. In the case of *Saboo Alloys (supra)*, the assessee availed CENVAT credit on inputs used in the manufacture of final products which were exempted subsequently, and upon insistence by the relevant authorities, the assessee reversed the credit lying in the accounts prior to the availment of exemption,. A refund claim was filed by the assessee for the said amount, on the ground that it was not required to reverse the credit taken on the inputs purchased prior to it opting for the benefit of the exemption notification. The denial of refund claim was the issue for consideration before the High Court of Himachal Pradesh.

ELP Comments

This is the most recent decision on this issue which has been met with diverse views in the past. The Supreme Court has also upheld a contrary judgement passed in the case of *Albert David Ltd. vs. Commissioner of Central Excise [(2014) 43 GST 30 (Allahabad)]*, wherein the CENVAT credit on inputs contained in the final product which has been exempted subsequently is liable to be reversed if unutilized and to be recovered if utilized.

In the case of *Saboo Alloys (supra)*, the High Court upheld the Order of the Tribunal and allowed such credit. The Tribunal had relied on the decision of the five-member Bench in *CCE, Rajkot vs. Ashok Iron & Steel Fabricators [2002-TIOL-274-CESTAT-DEL-LB]*, which held that there was no rule which permitted the Department to seek reversal of MODVAT credit. The Tribunal also relied on the judgement of the Hon'ble Apex Court in case of *C. Ex, Pune and Ors. vs. Dai Chi Karkaria Ltd. & Ors. [2002-TIOL-79-SC-CX-LB]*, wherein a similar question relating to the reversal of MODVAT credit under Rule 57H (5) of the CE Rules was considered, and it was held that such credit availed by the manufacturer is indefeasible and the final product on which credit is taken should not necessarily bear a nexus to the raw material to which such credit is related. It was further held in *Dai Chi (supra)* that the credit may be taken against the Excise Duty on a final product manufactured on the very day that it becomes available. Therefore, in view of the Hon'ble Apex Court judgement in case of *Dai Chi Karkaria Ltd.* (*supra*), the Tribunal held that even though the final product manufactured by the assessee became exempted subsequently, the MODVAT credit already availed by it prior to the exemption coming into effect is not required to be reversed. The judgement of the Tribunal was endorsed by the High Court. *[Commissioner of Central Excise, Chandigarh vs. M/s Saboo Ispat Pvt. Ltd. 2015-TIOL-38-HC-HP-CX]*

ONCE THE DEPARTMENT HAS COLLECTED DUTY ON FINAL PRODUCTS, CENVAT CREDIT CANNOT BE DENIED IN RESPECT OF THE INPUTS USED IN THE MANUFACTURE OF SUCH FINAL PRODUCTS

The assessee was denied CENVAT credit taken on inputs and capital goods on the ground that the process of converting black rods / bars into bright bars does not amount to manufacture. The Hon'ble Tribunal while relying on the decisions in case of *Super Forgings and Steels Ltd. vs. CCE, Chennai [2007 (217) ELT 559 (Tri-Chennai)]* and *CCE, Indore vs. M.P. Telelinks Ltd. [2004(178) ELT 167 (Tri-Delhi)]*, held that there is no question of recovery of CENVAT credit which has been utilized towards payment of duty of the final products even when the process does not amount to manufacture. It was also held that if the Department levies and collects the Excise Duty on the goods removed from the factory, they cannot claim that the process does not amount to manufacture for the purpose of allowing the CENVAT credit. *[M/s. R B Steel Services, Shri Mahavir Bright Steel Udhyog, Punch Ratna Steel (P) Ltd. vs. Commissioner of Central Excise and Service Tax, Rohtak 2015-TIOL-43-CESTAT-DEL]*

Similarly, in another recent decision, the Tribunal set aside the order denying the CENVAT credit availed by the assessee and held that once the Department has collected the duty from an assessee considering the product as manufactured, CENVAT credit cannot be denied on the inputs consumed for manufacture of the said final products. It further held that the fact that the authorities did not disturb the classification of the final product, as adopted by the assessee, while denying the credit on the ground that the activity does not amount to 'manufacture', indicates that the final product is distinct from that of the inputs procured by the assessee. *[Foam Techniques Mfg. (I) Pvt. Ltd. vs. C.Ex, Thane-I 2015-TIOL-156-CESTAT-MUM]*

GOODS RETURNED UNDER RULE 16 OF THE CE RULES HAVE TO BE TREATED LIKE OTHER FRESH INPUTS AND THERE IS NO SPECIFIC REQUIREMENT TO MAINTAIN SEPARATE RECORDS FOR SUCH RETURNED INPUTS, WHILE THEY ARE ISSUED FOR FURTHER PROCESSES / RE-CLEARANCE

The respondent, being a manufacturer of aluminum foils, had received back certain defective goods from their customers and availed CENVAT credit on the said goods in terms of Rule 16 of the CE Rules. No separate accounts were maintained by the respondent for such returned goods and details in relation to the same were entered in the input receipt register as typically prepared for fresh inputs. Subsequently, the returned goods were subjected to other processes, viz. re-annealing, slitting, edge trimming, lamination, etc. before re-clearance of the same.

The Revenue raised demand (along with penalty) attributable to 80% of such returned goods on the basis of certain statements of assessee's officials that 80% of the manufactured goods were cleared as scrap. It was alleged that in terms of Rule 16(2) of the CE Rules, as the goods were not subjected to any process of manufacture, the assessee is liable to pay an amount equal to the CENVAT credit taken on said returned goods under Rule 16(1) of the CE Rules. The Commissioner (Appeals) at the first appellate level, held that the duty demand raised by the revenue was not sustainable for various reasons, the key among which were that : (a) no requirement had been stipulated in the Rules for maintenance of separate accounts for returned goods; (b) as goods were returned for not meeting the purchase specifications, the processes incidental / ancillary to render the goods marketable would qualify the application of manufacture, (c) levy of demand on 80% of sales return is based on assumptions / presumptions as the revenue itself concluded that the assessee was not maintaining separate accounts for the returned goods.

Considering the above, the Hon'ble Tribunal upheld the decision of the Commissioner (Appeals) and *inter alia* reiterated that the provision of Rule 16 of the CE Rules does not require maintenance of any records and the returned goods have to treated as inputs, and that the assessee having shown the issuance of the said inputs from their RG-1 had deemed to have manufactured their final product. The Tribunal also observed that the submission of the Department that returned goods were cleared as scrap was made without verifying whether the waste / scrap so cleared had emerged during the course of remanufacture or not. *[Commissioner of Central Excise, Jaipur vs. M/s Amco India Ltd. SH S P Dhingra, Vice President (Operations) 2015-TIOL-128-CESTAT-Del]*

ELP Comments

In this context, it is pertinent to note the decision of the Hon'ble Tribunal in the case of *Menon Piston Rings Pvt Ltd vs. Commissioner of Central Excise, Pune-II [2007-TIOL-309-CESTAT-MUM],* wherein goods manufactured and initially cleared on payment of duty were brought back, and, post availment of credit under Rule 16(1) of the CE Rules, the said goods were removed as scrap after undertaking a cutting and scrapping exercise. In the said case, it was held that the reducing of the defective goods to scrap did not amount to manufacture, and, therefore, as per Rule 16(2), the assessee is required to pay an amount equal to CENVAT credit taken under sub-rule 16(1) of the CE Rules.

VAT / CST AND OTHER STATE LEVIES

SUPREME COURT UPHOLDS STATE GOVERNMENT'S RIGHT TO LEVY SALES TAX ON PHOTOGRAPHIC SERVICE AS A 'WORKS CONTRACT'

The issue in the instant case arose in the context of Entry 25 of Schedule VI of the erstwhile Karnataka Sales Tax Act, 1957. This entry provided for the levy of tax by the State for sale of goods under a works contract for 'processing and supply of photographs, photo prints and photo negatives'.

As a brief background, the validity of the said Entry 25 was challenged by means of a writ, in the case of *Kershoram Surindranath Photo – Bag (P) Ltd. and others. vs. Assistant Commissioner of Commercial Taxes (LR), City Division, Bangalore and Others [121 (2001) STC 175*], where the High Court declared the said entry to be unconstitutional on the ground that contract for processing and supplying photographs, photo frames and photo negatives was predominantly a service contract with negligible component of goods / material and therefore, it was beyond the competence of the State Legislature to impose Sales Tax on such a contract. The Special Leave Petition filed by the State of Karnataka in this regard was dismissed by the Hon'ble Supreme Court, following its judgement in the decision of *Rainbow Colour Labs and Another vs. State of Madhya Pradesh and Others [(2000) 2 SCC 385].* The decision of *Rainbow Colour Labs (supra)*, however, was doubted in the case of *ACC Ltd. vs. Commissioner of Customs [(2001) 4 SCC 593]*.

Post the decision of *ACC Ltd. (supra)*, a Circular was issued by the Commissioner of Commercial Taxes to the assessing authorities to proceed with the assessments as per Entry 25. The Circular was challenged in the case of *Golden Colour Labs and Studio and others vs. The Commissioner of Commercial Taxes [(2003)-VIL-01-Kar]* vide a writ petition. The High Court of Karnataka allowed the writ petition on the basis that a provision once declared unconstitutional cannot be brought to life by mere administrative instructions. Further that, the said provision cannot be revived automatically unless there is a re-enactment made by the State Legislature to this effect. As a result, the State Legislature enacted the Karnataka State Laws Act, 2004 wherein Section 2(3) of the said Act re-introduced Entry 25 in identical terms with retrospective effect. The amendment was again challenged by the assessee and others, before the Karnataka High Court and *vide* its judgment dated 19-8-2005, the amendment was declared unconstitutional. Being aggrieved, the State of Karnataka approached the Supreme Court.

It was contended on behalf of the Respondent before the Hon'ble Supreme Court as under:

- Processing of photographs, etc. was a essentially a service wherein the cost of paper, chemical or other material used in the processing and developing photographs, photo prints etc. was negligible.
- Photographic service can be exigible to Sales Tax only when the same is classifiable as 'works contract', i.e. involving both goods and services, and that the said transaction involves only service.
- Even if Entry 25 is held to be valid, the same should be made prospective.

The Hon'ble Court referred and relied upon various decisions such as *Builders Association of India and Others vs. UOI and Others [2002-TIOL-602-SC-CT], Larsen Toubro and Another vs. State of Karnataka and Another [2013-TIOL-46-*

SCCT-LB], Kone Elevator India Pvt. Ltd. vs. State of Tamil Nadu and Others [(2014) 7 SCC 1], ACC Ltd. vs. Commissioner of Customs (supra) and held as under:

1. After insertion of Clause 29-A in Article 366 of the Constitution, the works contract is permitted to be bifurcated into two: one for 'sale of goods' and other for 'services', thereby making the goods component of the contract exigible to sales tax.
2. Dominant intention behind a contract, i.e. whether the same is for goods or service, is otiose or immaterial in cases covered under Article 366(29A). As a sequitur, that by virtue of Clause 29-A of Article 366, the State Legislature is empowered to segregate the goods part of a works contract and impose sales tax thereupon.
3. The judgement in *Rainbow Colour Labs (supra)* did not lay down the correct law as it referred to the pre 46th amendment judgements in arriving at its conclusion, and accordingly, cannot be relied upon.
4. Entry 54, List II of the Constitution of India empowers the State Legislature to enact a law taxing sale of goods. Sales Tax, being a subject matter in the State List, the State Legislature has the competency to legislate over the subject.
5. It is a settled position in law that the legislature is competent to pass amendments with retrospective effect. This principle that such a power exists with the legislature has been reiterated time and again by the Courts in various decisions.

ELP Comments

It is of critical importance to identify whether or not a transaction qualifies as one of 'works contract' or falls within the scope of 'deemed sale' under Article 366(29A) of the Constitution of India. Recently, the Punjab and Haryana Court in the case of *Fortis Healthcare and Another vs. State of Punjab 2015-VIL-73-P&H]* held that the supply of drugs, medicines, implant, stents, valves and other implants are integral to medical services / procedures and cannot be severed to infer a sale, and therefore, are not exigible to Value Added Tax. Hence, depending on the facts of the case, the applicability of Sales Tax, or Service Tax or both, will have to be determined.

In view of the above, allowing the appeal of the State of Karnataka, the Hon'ble Supreme Court held Entry 25 of Schedule VI of Karnataka Sales Tax Act as constitutionally valid. *[State of Karnataka vs. Pro Lab & Ors 2015-VIL-06-SC-LB]*

ZERO-RATED BENEFIT NOT FOR WORKS CONTRACT EXECUTED IN SEZ – MADRAS HIGH COURT

The issue involved in the instant case is whether a works contract effected by the petitioners for SEZ units, developers or co-developers are zero-rated and entitled to the benefit of input tax credit in terms of Section 18 of the Tamil Nadu Value Added Tax Act, 2006 ('TNVAT Act'). Consequently, the petitioners also challenged Circular No. 9 of 2013 dt. 24-7-2013 ('the Circular') issued by Commissioner of Commercial Taxes, Chepauk, Chennai denying input tax credit on such transactions, which states that works contracts executed for SEZ units cannot have the benefit of zero-rating, since goods transferred by a contractor are neither exported as such nor used in the manufacture of other goods which are exported as required under Section 18 of the TNVAT Act.

The nature of sale effected by the various petitioners in this case primarily involved sale of goods in the execution of works contract to a SEZ unit / developer / co-developer. The petitioners contend that:

1. Section 18(1)(ii) of the TNVAT Act, on a plain reading, states that a sale of goods to any registered dealer in an SEZ shall be entitled for input tax credit. Accordingly, benefit of input tax credit cannot be denied;
2. Deemed sale or works contract executed by the petitioners are 'export' in light of the fact that a) 'sale' includes deemed sale and b) 'export' in the SEZ Act is defined to mean supply of goods or providing services from the Domestic Tariff Area to a unit or developer. Further, that since the SEZ Act has over riding effect over other laws, the transaction must be treated as an export and benefits thereof must be granted;
3. There is no condition that a sale of goods involved in the execution of a works contract should be exported as such or consumed or used in the manufacture of other goods that are exported as stated in the Circular issued by the Commissioner.

ELP Comments

This decision reinforces the principle that in trying to interpret a statutory provision, attention should be given to the setting in which the provision occurs and regard must be had to the language of the entire group of connected provisions which may form an integral whole.

It was contended by the respondents that Section 18 of the TNVAT Act was to be construed in entirety. Section 18(2) specifically deals with entitlement to refund of input tax credit, to relation to goods which are exported as such or used in the manufacture of other goods that are exported. The respondents state that Section 18 cannot be divested or segregated to be read only with sub-section (1) or (2), and therefore to state that conditions stipulated under Section 18(2) will not apply to Section 18(1), will amount to the insertion of a new provision in the statute when the statute does not contemplate such situation / contingency.

The Hon'ble High Court noted that the issue involved the interpretation of Section 18 of the TNVAT Act, and held that to state that sub-section (2) of Section 18 will not apply to clause (ii) of Section 18(1) amounted to inserting a new provision to the statute, which is not contemplated. Reliance was placed on the decision of the Hon'ble Supreme Court in the case of *Kerala State Co-operative Marketing Federation vs. CIT [(1998) 231 ITR 814 (SC)]* wherein it was held that in trying to interpret a statutory provision, attention should be given to the setting in which the provision occurs and regard must be had to the language of an entire group of connected provisions which may form an integral whole. Therefore, nothing is to be read in, nothing is to be implied etc. Accordingly, the Hon'ble High Court upheld the validity of the Circular stating that works contracts executed for SEZ units cannot have the benefit of zero-rating since goods transferred by a contractor are neither exported as such nor used in the manufacture of other goods which are exported, as not being *ultra vires* the provisions of the TNVAT Act. *[Tulsyan NEC Limited vs. The Assistant Commissioner (CT) 2015-VIL-24-MAD]*

INTERPRETATION OF SECTION 5(3) OF THE CST ACT

The assessee was engaged in the manufacture of hydraulic power units, hydraulic cylinders and spares.

An exporter, Flat Products Equipments (I) Ltd, entered into a contract with a foreign buyer in Bangladesh for designing and engineering, manufacture, assembly, supply, erection and commissioning of equipment of 'continuous galvanising mills complex' on 11-9-2002. In pursuance of an order received from the foreign buyer, the exporter placed a letter of intent on the assessee for the supply of hydraulic power system. Subsequent to this letter of intent, the assessee manufactured the hydraulic system based on the specification provided by the exporter, raised an invoice on the

exporter on 5-3-2003 and despatched the system for delivery at Mumbai port for further shipment. Subsequently, the exporter raised an invoice on the foreign buyer and shipped the hydraulic power system along with certain other equipments to Bangladesh and treated the same as sale in the course of export under Section 5(3) of the Central Sales Tax Act, 1956 ('CST Act'). The said transaction was initially allowed as exempt as per Section 5(3) of the CST Act; thereafter, the assessing authority rectified the order of assessment and levied the tax thereon as a local sale under the Bombay Sales Tax Act, 1959 ('BST Act'). The assessee preferred an appeal before the Joint Commissioner of Sales Tax who concluded that the hydraulic power system is not exported.

Before the Tribunal, it was contended on behalf of the assessee that the agreement of the foreign buyer with the exporter describes the equipments to be supplied for execution of the works contract in Bangladesh. As per the said agreement, the exporter was under an obligation to export the hydraulic power system and it was only for the compliance with the agreement that the same was manufactured and exported. In their support, various documents such as the agreement between the exporter and foreign buyer, letter of intent, purchase order etc. were submitted.

ELP Comments

Establishing an inextricable link between the local sale and corresponding export has constantly remained a challenge for assessees. The High Courts in the past, through various decisions such as *Exide Industries vs. State of Maharashtra [TS-315-HC-2014(BOM)-VAT]*, have attempted to re-affirm that as long as an inextricable link between the local sale of goods and their export is proved, exemption under Section 5(3) cannot be denied. Accordingly, such claim for exemption needs to be established through robust documentation.

It was submitted on behalf of the respondent that the goods were not exported and the decision in the case of *State of Karnataka vs. Azad Coach Builders Pvt. Ltd. and another [(2010) 36 VST 1 (SC)*] was relied upon.

The Tribunal observed that on a conjoint reading of the documents submitted by the assessee, the exporter had provided a technical specification to the appellant for manufacture of hydraulic system as per the requirement of the foreign buyer. Additionally, the assessee has also agreed with the exporter to supervise the commissioning of the hydraulic system at the time of commissioning of the said system into the works contract at Bangladesh. The Tribunal also observed that there existed an inextricable link between the manufactured equipment and the agreement to export, causing such export. Accordingly, the Tribunal held that the sale of hydraulic system is manufactured by the assessee as per the technical specification provided by the exporter, which is the requirement of the foreign buyer and therefore, would be a deemed sale in the course of export under Section 5(3) of the CST Act, which is not liable for levy of tax under the BST Act. The Tribunal also observed that decision of *Azad Coach Builders (supra)* was in no way helpful to the revenue to support their case but in fact favoured the assessee. *[Vickers Systems International Ltd vs. The State of Maharashtra 2014-VIL-14-MSTT]*

MOBILE CHARGER IS NOT A PART OF CELLPHONE FOR THE PURPOSES OF VAT: SC

Nokia India Pvt. Ltd ('respondent') was engaged in the sale of cell phones and their accessories in Mohali, Punjab. During FY 2005-06, the company effected sales of 1,072,679 cell phones with battery chargers and paid tax at the rate of 4% on the sale value of the battery chargers, the same rate at which tax on the cell phone was paid. During scrutiny proceedings it was observed that the battery charger was an accessory chargeable to tax at the rate of 12.5%.

Accordingly, the differential tax at 8.5% was demanded from the respondent along with interest, by the assessing authority.

The respondent contended that the charger was being sold as a mobile / cellular phone under a single solo pack and that no separate amount for battery was being charged from the customer and the only amount charged was for handsets. It was also submitted that for subsequent sale of the battery charger, VAT at the rate of 12.5% was levied and collected.

Vide a detailed order, the assessing authority held that the battery charger being a separate item, was liable to be taxed at 12.5% and not at a concessional rate applicable to the cell phones on the premise that more than one product was being sold in a single pack. In addition, it was admitted by the respondent that if separately sold, VAT on the charger was paid at 12.5%.

The appeals filed by the respondent in this regard were rejected at two levels, both by the Deputy Excise and Taxation Commissioner (Appeals), Patiala Division and the Chandigarh Tribunal. The Division Bench of the High Court of Punjab and Haryana however, allowed the appeals holding that the battery charger is part of the composite package of the cell phone.

On appeal to the Hon'ble Supreme Court, it was contended by the Respondent that the charger is an integral part of the cell phone and when any person buys a cell phone, the same comes with a charger and no amount is separately charged. However, when separately sold, VAT is levied at the rate of 12.5%. On the other hand, the Appellants argued that when the relevant entry of the VAT schedule does not mention 'accessories' for the purposes of taxing the item/ product at 4%, the same needs to be charged at 12.5% as a separate commodity.

The Hon'ble Court held that the lower courts / authorities rightly held that the battery charger was not a part of the cell phone. If the charger was part of the cell phone, the phone could not have operated without using the charger, operationally, which is not the case. Even in common parlance, the charger is understood to be an accessory to the mobile phone. In addition, the charger can be used with various phones of Nokia and is not limited to a particular model of the phone. Even for the purposes of interpretation, it was held that a mobile phone and charger in a single pack cannot be treated as a composite good. The Hon'ble Court therefore affirmed the order passed by the Tribunal and set aside the order passed by the High Court. *[State of Punjab vs. Nokia India Pvt. Ltd. 2014-VIL-23-SC]*

ELP Comments

This is a significant decision of the Hon'ble Supreme Court and raised industry wide concerns on issue. In fact, subsequent to this decision, in respect of the past sales effected by various companies, States such as Andhra Pradesh (*vide* Circular No. E3/ 268/2015 dt. 26-3-2015) and Karnataka (*vide* Circular No. FD 40 CSL 2015 dt. 31-3-2015) have issued directions for the levy of VAT separately on the chargers sold along with mobile phones.

This position also requires to be contrasted with the position under Customs and Excise Law wherein, in terms of Rule 3(b) of the General Rules of Interpretation of the First Schedule to the Customs / Excise Tariff, composite goods, mixtures and goods put up in sets have to be classified on the classification of that material or component which gives to the product their essential character.

INTER-STATE TRANSFER OF GOODS FROM FACTORY TO DEPOTS BASIS TENTATIVE ASCERTAINMENT OF MARKET REQUIREMENTS AMOUNTS TO SALE

The appellant (Kimberley Clark Lever (P) Ltd.) was a joint venture between Kimberley Clark Corporation, USA and Hindustan Lever Ltd. ('HLL'). The appellant manufactured goods in Maharashtra. The appellant operated a network of buffer depots in other States, to which depots the manufactured goods were transferred. Some of these depots stock the appellant's, as well as HLL's goods. The depots were run by staff common to the appellant and HLL. Therefore, sometimes, on receipt of the appellant's goods, the staff used the rubber stamp of HLL to acknowledge receipt. These transfers from the appellant's factory to the depots were made on the basis of estimated market requirements and not basis any specific order / agreement to sell. Stocks from buffer depots were then transferred to satellite depots, wherefrom sales were made to customers. The issue before the Tribunal was whether the movement of goods from the factory in Maharashtra to buffer depots (run and maintained by HLL for the appellant) in another State against 'F' Forms were branch transfers or were pursuant to sales.

ELP Comments

This decision is directly in line with the judgement of the Andhra Pradesh High Court in Hyderabad Engineering Industries Limited v. State of Andhra Pradesh [(2002) 128 STC 1 (AP)], in which case inter-state transfers were made from the factory to depots, wherefrom sales were made to customers with whom the manufacturer had a long term sales agreement, supported by monthly indents / purchase orders, and it was held that such transfers were taxable as inter-State sales.

The appellant argued that the transfers were merely stock transfers, based on tentative ascertainment of market requirements and not against any firm orders of purchase, and HLL received the stocks at its buffer depots as a distributor of the appellant, in terms of their agreement. The revenue on the other hand contended that the movement was occasioned by agreements to sell by HLL and was therefore a sale.

The Tribunal held in favour of the revenue, and in doing so observed that as per the agreement between HLL and KCLL, the transaction was one of sale, thus sending the products to depots, entering the same as stock transfer in the register and earmarking of the product, was irrelevant. The appeal was partly allowed and the matter was remanded to the AO for quantification purposes, and to verify those transactions made to customers other than HLL. *[M/s Kimberley Clark Lever (P) Ltd. vs. State of Maharashtra 2015-VIL-04-MSTT]*

SUPPLY OF MEDICINES DURING A MEDICAL PROCEDURE DOES NOT AMOUNT TO 'SALE' OF GOODS

The issue which arose was whether medicines, drugs, stents, valves, implants and other consumables and incidentals provided to patients during a medical procedure, amounts to 'sale' under VAT enactments in Punjab and Haryana. While the assessees argued that the supply of consumables incidental to the provision of medical services did not amount to a sale, the revenue argued that the activities of the assessees were composite arrangements for the provision of services and supply of goods, and the supplies of goods were chargeable to VAT as sales.

The Punjab & Haryana High Court held that the supply of goods did not amount to a sale and made the following observations:

- That the power obtained under Entry 54 of List II of Seventh Schedule to the Constitution is restricted to the taxation of 'sales' of goods;

- That Article 366 (29-A) of the Constitution contemplates only two situations of composite contract which may be artificially vivisected for tax purposes, viz. works contracts and catering contracts, and this deeming fiction does not extend to medical procedures by hospitals;

- That the Supreme Court in *Bharat Sanchar Nigam Limited and another vs. Union of India [2006 (3) SCC 1]* has interpreted Article 366(29-A) of the Constitution, and, in this context has stated that the sale of goods by a doctor, when he writes out and hands over a prescription, in the course of providing service does not involve a sale for the purposes of Entry 54 of List II because unless the transaction in truth represents two distinct and separate contracts and is discernible as such, the State would not have the power to separate the agreement to sell from the agreement to render service, and impose tax on the sale.

ELP Comments

This case reiterates the position in law that the incidental supply of goods in the course of provision of a service is not a 'sale' as contemplated under Article 366(29A) of the Constitution. It has been clarified that the deeming fiction allowing the dissection of a composite contract for tax purposes only extends to works contracts and catering contracts.

- That other High Courts in *M/s Tata Main Hospital [2007-VIL-11-JHR]* and M*/s International Hospital Pvt. Ltd. [2014-VIL-48-ALH]* have in similar factual matrices held that the purview of Article 366(29-A) does not extend to medical contracts. The facts in the present case were specifically distinguished from a situation involving the supply of medicines at a pharmacy;

- That in the present case, the supply of consumables was incidental to and an intrinsic part of the provision of medical services, which was the dominant nature of the arrangement and therefore, no sale can be said to have taken place.

[M/s Fortis HealthCare Ltd and Anr. vs. State of Punjab and Ors. 2015-VIL-73-P&H]

NON-EXCLUSIVE TRANSFER OF RIGHT TO USE TRADEMARKS LIABLE TO VAT

The issue for consideration before the Bombay High Court was as regards whether a Brand Equity and Business Promotion Agreement entered into between Tata Sons (the assessee) and other Tata group entities contemplated a transfer of right to use goods (brand / trademarks) in consideration for royalty. In terms of the language adopted in the said Agreement, the assessee granted to its group entities / subscribers a personal but non-exclusive and non-assignable subscription to a scheme which covered the right to use the Tata business name, marketing indicia etc.

The High Court, having considered and appreciated a line of judgments of the Supreme Courts and various High Courts harmoniously with the relevant clauses of the said Agreement, held that the said Agreement envisaged a transfer of right to use intangible / incorporeal goods. The most pertinent aspects of this decision are as under:

- The High Court deviated from the view of the Supreme Court in *Bharat Sanchar Nigam Limited vs. Union of India [(2006) STC (195) 91]*. In *BSNL (supra)*, the Supreme Court had established the test of exclusivity for determining

the applicability of VAT on a transfer, i.e. only exclusive transfers were considered as contemplating a transfer of right to use and consequently liable to VAT. The High Court further factually distinguished the decision of the Supreme Court in *BSNL (supra)* since the issue in that case was as regards electromagnetic waves, which were held to be services and not goods.

- However, as regards the applicability of the dominant intention test, which also was discussed in *BSNL (supra)*, the High Court held that this aspect was not in question in the present decision.

- The High Court *inter alia* placed reliance on the decision of the Andhra Pradesh High Court in *Nutrine Confectionery Co. Pvt. Ltd. vs. State of Andhra Pradesh [(2011) 40 VST 327(AP)]* where also the non-exclusive transfer of the right to use a trademark was held to be liable to VAT. In that decision, the Andhra Pradesh High Court observed that, had the Legislature intended that the exclusive transfer of right to use goods is alone taxable, the legislature would have stated so.

[Tata Sons Ltd vs. The State of Maharashtra 2015-VIL-69-BOM]

ELP Comments

The court deviated from the exclusivity test enunciated in *BSNL (supra)* to state that the levy of Sales Tax did not warrant unconditional or exclusive transfer, much less to the exclusion to the transferor. This view is directly at variance with the view adopted by various other High Courts, namely the (i) Allahabad High Court in *Commissioner of Commercial Tax vs. Seagram India Pvt Ltd [2014-VIL-30 ALH]*; (ii) Delhi High Court in *Indus Towers vs. Deputy Commissioner of Commercial Tax [TS-34-HC-2013-(DEL)-VAT]*; (iii) Kerala High Court in *Malabar Gold Pvt. Ltd. vs. Commercial of Tax Officer [TS-64-HC-2013-(KER)-VAT]*; and (iv) the Madras High Court in *Vitan Departmental Stores and Industries Ltd vs. State of Tamil Nadu [TS-195-HC-2013-(MAD)-VAT]*, which unanimously endorsed and upheld the exclusivity test.

Since the view taken by the High Court in this case is divergent from the Maharashtra VAT Tribunal decisions in the case of *M/s Smokin' Joe's Pizza Pvt. Ltd. vs. State of Maharashtra [2008-(ST1)-GJX-0291-STMAH]* and *M/s. Diageo India Pvt. Ltd. vs. State of Maharshtra [2009-(ST1)-GJX-0074-STMAH]*, which till date held the field on issue and are currently pending before the Bombay High Court, it is expected that this decision will unsettle the till now settled position.

TRANSFER PRICING

CBDT NOTIFIES SAFE HARBOUR RULES FOR SPECIFIED DOMESTIC TRANSACTIONS OF ELECTRICITY COMPANIES RUN BY THE GOVERNMENT

With a view to reducing the transfer pricing litigation, the Government had notified *'Safe Harbour Rules'* for international transactions on 18-9-2013 as per *Notification No. 73/2013 [F.No.142/28/2013-TPL]*. On 4-2-2015, vide *Notification No. 11/2015 [F.No.142/7/2014-TPL]*, the CBDT notified Safe Harbour Rules for Specified Domestic Transactions ('SDT') undertaken by Government companies engaged in the business of generation, transmission or distribution of electricity. The key highlights have been captured below:

Sr.No.	Particulars	Applicability of Safe Harbour Rules
1	**Nature of Electricity Companies**	Government companies engaged in the business of generation, transmission or distribution of electricity (i.e. eligible assessee) can opt for the Safe Harbour Rules.
2	**Eligible SDTs**	The Safe Harbour Rules are applicable to *'eligible SDTs'* undertaken by *'an eligible assessee'* and which comprises: – a. Supply of electricity by a generating company; *OR* b. Transmission of electricity; *OR* c. Wheeling of electricity.
3	**Circumstances in which the transfer price declared by the assessee will be accepted by the tax authorities**	Tariff in respect of supply of electricity, transmission of electricity, wheeling of electricity, as the case may be, is determined by the Appropriate Commission (as defined under Section 2(4) of the Electricity Act, 2003.
4	**Comparability adjustment and tolerance range**	No comparability adjustment and allowance of tolerance range under the second proviso to Section 92C(2) of the IT Act (CBDT has prescribed tolerance range of 1% in respect of wholesale trading and 3% in other cases) shall be made to the transfer price declared by the eligible assessee.
5	**Maintenance of documents**	An eligible assessee who has entered into an eligible SDT shall keep and maintain the following information and documents for a period of 8 years from the end of the relevant assessment year: ▪ Description of the ownership structure of the assessee's enterprise with details of shares and other ownership interests held therein by other enterprises; ▪ Broad description of the business of the assessee and the industry in which it operates and of the business of associate enterprises with whom the assessee has transacted;

Sr.No.	Particulars	Applicability of Safe Harbour Rules
		▪ Nature, terms (including prices), quantum and value of SDTs entered into with each AE; ▪ Record of proceedings, if any, before regulatory commission and orders of such commission relating to SDTs; ▪ Record of actual working carried out for determining transfer pricing of SDTs; ▪ Assumptions, policies and price negotiation, if any, which have critically affected the determination of transfer price; ▪ Any other information or data which may be relevant for determination of transfer price.
6	**Filing of audit report**	Eligible assessee shall file the transfer pricing audit report electronically in the Form No. 3CEB along with the return of income up to November 30th of the relevant Assessment Year.
7	**Procedure to opt for Safe Harbour Rule**	▪ Eligible assessee can furnish application to the AO in the Form No. 3CEFB to opt for Safe Harbour Rules in respect of eligible SDTs. ▪ Such application is required to be furnished on or before September 30th of the relevant assessment year, provided that the return of income is furnished by the assessee on or before the date of furnishing the Form No. 3CEFB. ▪ Form No. 3CEFB can be furnished on or before 31-3-2015 in respect of eligible SDTs undertaken during the previous years, i.e. FY 2013-14 and FY 2014-15. ▪ Before the option for Safe Harbour is treated to be validly exercised, the AO, on receipt of the Form No. 3CEFB, shall verify whether: ◆ the assessee qualifies as an eligible assessee; and ◆ the transaction qualifies as an eligible SDT. ▪ If the AO doubts the valid exercise of the option for Safe Harbour by an assessee, he may require the assessee to furnish such information or documents as he may consider necessary. ▪ The AO can declare the option exercised by the assessee as invalid after giving an opportunity of being heard to the assessee, by an appropriate Order within a period of 3 months, if :

Sr.No.	Particulars	Applicability of Safe Harbour Rules
		◆ The assessee does not furnish the information or documents required by the AO; *OR* ◆ The AO finds that the assessee is not an eligible assessee; *OR* ◆ The transaction in respect of which option has been exercised is not an eligible SDT; *OR* ◆ The tariff is not determined by commission. ▪ If the assessee objects to the order of the AO, he may file his objections within 15 days of receipt of the AO's order. ▪ On receipt of the assessee's objections, the Principal CIT *OR* CIT *OR* Principal Director or Director, as the case may be, shall after providing an opportunity of being heard to the assessee, pass the appropriate Order within a period of two months.

ELP Comments: Safe harbours in some advanced countries (e.g. United States, Australia for non-core services) as well as in developing nations (Brazil, Mexico) have been known to ease compliance pains to a large extent. Worldwide, safe harbour rules have mostly been in the domain of intra-group services wherein threshold mark-ups have been prescribed like in Australia, Singapore and New Zealand to certain developed countries that have introduced more advanced rules of thin capitalization as in Australia, New Zealand and Switzerland.

Safe harbours can be a successful part of any sound tax administration with benefits to both the taxpayers and the tax authority. Effective safe harbours could allow the taxpayer and the tax authority to eliminate a material portion of the cost and time in complying with rules that would otherwise govern a controlled transaction. Thus, tax administrations and taxpayers could focus their efforts on more significant and important issues.

The said notification puts forth the first set of Safe Harbour Rules for domestic transfer pricing, though only for electricity companies run by the Government. These rules would assist in saving efforts put in by these Government companies in analyzing and documenting the arm's length price for their inter-company domestic transactions.

The concept of SDT was introduced in India under the Finance Act, 2012, wherein the Government of India increased the scope of transfer pricing to include SDT. Considering that the documentation for SDT shall be assessed and scrutinized by the tax authorities in the coming years, and in view of reducing disputes between multinational firms and tax officials on transfer pricing issues going forward, CBDT should consider issuing Safe Harbour Rules for SDT for private players and other industry sectors as well.

INDIA SIGNS FIRST BILATERAL APA WITH JAPAN

An addition to the transfer pricing legislation occurred through the introduction of the Advance Pricing Agreement ('APA') provisions through the Finance Act, 2012. An APA is an agreement between the Board and any person, which determines, in advance, the ALP or specifies the manner of the determination of ALP (or both), in relation to an international transaction. Hence, once an APA has been entered into with respect to an international transaction, the

ALP with respect to that international transaction, for the period specified in the APA, will be determined only in accordance with the APA.

Financial year 2013-14, being the first year of implementation, the APA regime in India saw a smooth beginning, setting the stage for a robust APA regime in the coming years. The number of APA applications filed in the second year, the last date of which was 31-3-2014, is 232. This is almost 58% higher than 2013, wherein around 146 applications were filed. Of the 232 applications, 206 pertain to unilateral APA, while the rest are for bilateral APAs. A unilateral *APA* is an agreement between the CBDT and the applicant, while in bilateral and multilateral APAs, the agreement is also signed between the competent authority ('CA') of India with the CA of the country of the AE. Further, the CBDT signed the first five APAs with MNCs in a record time of just one year. Currently, multilateral APA's have been seen to materialize primarily in the UK and Germany.

ELP Comments

The APA programme was introduced to bring about certainty and uniformity in the transfer pricing matters of multinational companies and reduce litigation. The APAs act as a vehicle for improving the investment climate in the country. In the context of growing economic ties between Japan and India, especially after Prime Minister Narendra Modi's visit to Japan, this APA is expected to generate positive sentiment among Japanese investors in India.

On 19-12-2014, the CBDT signed India's first bilateral APA with a Japanese company, for a period of five years. The CBDT was elated to announce that the said bilateral APA was finalized in a short time of one and half years, which is shorter than the time normally taken in finalizing APAs internationally. According to news reports, this bilateral APA appears to be in the case of Mitsui, one of the largest general trading companies of Japan operating in diverse businesses including infrastructure and energy. This APA will provide certainty to the company operating in India and avoid conflicts over sharing of taxes between India and Japan, thereby reducing transfer pricing disputes. *[Press Release – Government of India-Ministry of Finance-Department of Revenue – Central Board of Direct Taxes dt. 19-12-2014]*

GLOSSARY OF TERMS

Abbreviation	Meaning	Abbreviation	Meaning
AAR	Authority for Advance Rulings	***FAR***	Functions, Assets and Risks
ALP	Arms Length Price	***FTP***	Foreign Trade Policy
AO	Assessing Officer	***FTS***	Fees for Technical Services
AOP	Association of Persons	***FY***	Financial Year
AY	Assessment Year	***GAAR***	General Anti-Avoidance Rule
AE	Associated Enterprise	***GST***	Goods and Services Tax
BCD	Basic Customs Duty	***HBP***	Handbook of Procedures (Vol. I)
CBDT	Central Board of Direct Taxes	***IEC***	Importer Exporter Code
CBEC/Board	Central Board of Excise and Customs	***Import Rules***	Taxation of Services (Provided from Outside India and Received in India) Rules, 2006
CE Act	Central Excise Act, 1944	***IT Act***	Income Tax Act, 1961
CE Rules	Central Excise Rules, 2002	***IT Rules***	Income Tax Rules, 1962
CESTAT / Tribunal	Customs, Excise and Service Tax Appellate Tribunal	***ITAT / Tribunal***	Income Tax Appellate Tribunal
CETA	Central Excise Tariff Act, 1985	***OECD***	Organisation for Economic Co-Operation and Development
CETH	Central Excise Tariff Heading	***PE***	Permanent Establishment
Credit Rules	CENVAT Credit Rules, 2004	***PY***	Previous Year
CST	Central Sales Tax	***PoT Rules***	Point of Taxation Rules, 2011
CST Act	Central Sales Tax Act, 1956	***RBI***	Reserve Bank of India
CTA	Customs Tariff Act, 1975	***RPM***	Resale Price Method
CTH	Customs Tariff Heading	***SEZ***	Special Economic Zone
Customs Act	Customs Act, 1962	***SEZ Act***	Special Economic Zones Act, 2005
CVD	Additional Duty of Customs	***STPI***	Software Technology Park of India
DGFT	Directorate General of Foreign Trade	***STR***	Service Tax Rules, 1994
DoT	Department of Telecommunications	***the Act***	Finance Act, 1994
dt.	Dt.	***TIEA***	Tax Information Exchange Agreements
DTAA or Tax Treaty	Double Taxation Avoidance Agreement entered into by India	***TNMM***	Transactional Net Margin Method
DTC	Direct Taxes Code Bill, 2010	***TP***	Transfer Pricing
DTC	Direct Taxes Code Bill, 2009	***TPO***	Transfer Pricing Officer
EEZ	Exclusive Economic Zone	***Territorial Waters Act***	The Territorial Waters, Continental Shelf, Exclusive Economic Zone and other Maritime Zones Act, 1976
EOU	Export Oriented Unit	***Valuation Rules***	Service Tax (Determination of Value) Rules, 2006
EPCG Scheme	Export Promotion Capital Goods Scheme	***w.e.f.***	with effect from
Export Rules	Export of Services Rules, 2005		

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