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Embodiment of Virtues

Upholding the Moral & Professional Excellence

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ಮಹಾಶಿವರಾತ್ರಿಯ ಶುಭಾಶಯಗಳು

Vikaas ವಿಕಾಸ್
Expanding Professional Frontiers

27th KSCAA Annual Conference

on Saturday & Sunday

7th & 8th March 2015

Jnana Jyothi Convention Centre

Central College Campus,

Bengaluru

10 Hrs* CPE Unstructured

Congratulations to Torch Bearers of ICAI 2015-16

CA. Manoj Fadnis
President, ICAI

CA. M. Devaraja Reddy
Vice-President, ICAI

From the President

ಸದಾ ನಿನ್ನ ಮನಸ್ಸು ಶಕ್ತಿಪೂರ್ಣವಾಗಿರುವಂತೆ
ನೋಡಿಕೊ. ನಿನ್ನ ಮಾತುಗಳಲ್ಲೂ
ಸದಾ ಶಕ್ತಿಯೇ ಚಿಮ್ಮುತ್ತಿರಲಿ.
'ನಾನು ದುರ್ಬಲ, ನನ್ನ ಕೈಲೇನಾದೀತು'
ಎಂದು ಹೇಳಿಕೊಳ್ಳುತ್ತಲೇ ಇದ್ದರೆ!!!
ಮನುಷ್ಯ ಕೈಲಾಗದವನೇ ಆಗುತ್ತಾನೆ.

– ಸ್ವಾಮಿ ವಿವೇಕಾನಂದ

Dear Professional Colleagues,

India's economy is expected to grow at 7.4 per cent in 2014-15 as per a Government forecast. According to a new formula which uses 2011-12 as the new 'base year', the revised statistics showed inflation-adjusted economic growth rate for October-December 2014 at 7.5 per cent, making India the fastest growing major economy in the world. The higher economic growth brings up new opportunities for the Chartered Accountants and we need to gear up to face new challenges and prospects.

As the budget session 2015 is approaching, the nation is garnering its own expectations. Struggling with the high end compliances and to cope up with the difficult rules to adhere, assessees are in need for some relaxation and simplification. Finance Minister will be presenting the union budget on 28 February, the Economic Survey will be tabled on 27 February and the Railway budget on 26 February. We expect government to pursue policy changes aimed at taking the country to a high-growth trajectory, despite calls from some quarters for more populist measures.

Karnataka State Budget for FY 2015-16 expected to be presented on 9th March 2015. A Pre-budget meeting with Chief Minister is scheduled on 27th February 2015. I call for the members to send their suggestions to our representation for this budget 2015 to info@kscaa.co.in latest by 23rd February. We will collate all the suggestions and submit to the Chief Minister for inclusion in the state budget.

We from KSCAA filed a writ petition in the High Court of Karnataka objecting the inclusion of Non-Chartered Accountants in the definition of 'auditors' under section 63 of the Karnataka Co-operative Societies Act. We request the members to generously contribute towards the legal fund to meet the legal expenses. We thank the members who are already contributed for this purpose, the details of the same are provided elsewhere in the news bulletin.

Bangalore Branch of SIRC of ICAI has received the ICAI best branch award at all India level. We congratulate CA Babu K, Chairman & Team of Bangalore branch for this wonderful achievement. We also congratulate SICASA Bangalore for most commendable performance award and Hubli Branch of SIRC of ICAI on receiving the best branch award in small branch category.

Congratulations to CA. Manoj Fadnis on being elected as President and CA. M. Devaraja Reddy as Vice President of ICAI for the term 2015-16. We thank CA. K. Raghu for the excellent performance as President of ICAI.

We decided to honour KSCAA members who have completed 50 years of service in the profession during this years' annual conference. Please share the information of such members by 25th February, 2015.

The Annual Conference, a mega professional event of the Karnataka State Chartered Accountants Association, is scheduled to be held on 7th & 8th March 2015 at Jnanajyothi Auditorium, Bengaluru. This year's theme for the conference is "Vikaas – Expanding professional Frontiers". The event is designed to allow the participants to meet the very best speakers with varied expertise and to develop a multidisciplinary perspective of the profession. It will also help them to establish the networks for collaboration and exchange of ideas. Details of the program are published elsewhere in the news bulletin. We request the members to register at the earliest to attend the program and make this event a grand success.

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ಮನಸ್ಸು ಶಿವಾಲಯವಾಗಲಿ.....
ತಮಗೆಲ್ಲರಿಗೂ ಮಹಾಶಿವರಾತ್ರಿ ಹಾಗೂ ಹೋಳಿ ಹಬ್ಬದ ಶುಭಾಶಯಗಳು

In service of the Profession,

CA. Raveendra S. Kore
President

KSCAA Stall at ICAI International Conference

CA. Manoj Fadnis, Vice-President, ICAI & CA. G. Ramaswamy, Past President, ICAI

International Tour to Malaysia

International Tour to Malaysia organized by KSCAA & B'lore Br., ICAI

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KSCAA welcomes articles & views from members for publication in the news bulletin / website.

email: info@kscaa.co.in

Website: www.kscaa.co.in

TAX ACCOUNTING STANDARDS LEASES – CBDT OF INDIA

CA. S. Krishnaswamy

In the last two articles I dealt with the subject of lease, in particular, operational lease distinguishing it from a finance lease; in that context the claim for depreciation; in the case of finance lease by the lessee and in the case of operational lease by lessor. Courts go into the contents of a document in deciding whether or not a lease is finance lease or operational lease ignoring the title of the document. The case study in point was,

1. Asea Brown Boveri Ltd. V Industrial Finance Corporation of India [2005]126 Comp Cas 332 (SC).
2. Association of Leasing and Financial Services Companies v Union of India[2010] 35 VST 549(SC)
   Explained and discussed in
3. Indus Bank Ltd V Addl CIT (2012)15 ITR (Trib) 89 (Mumbai) (SB), discussed in the last article (Dec issue).

IFRS Convergence – Ind AS 17, Leases

IFRIC 4 Determing Whether an Arrangement contains a Lease, which is included as Appendix C to Ind AS 17, Leases would not be notified along with the other standards and its application has been deferred.

Reasons:

MCA received feedback regarding the adverse consequences which may ensue to the Indian companies in the event of immediate adoption of the appendix C to Ind AS 17, corresponding to the IFRIC 4. Hence, the MCA decided to defer these.

Present Situation:

In view of the better preparedness of the industry and the profession, this deferment may not be required now.

Pursuant to s. 145 (1) of the Income-tax Act, 1961 which provides that "Profits and gains of business or profession" &"Income from other sources" shall be computed in accordance with Accounting Standards notified by the Central Government, the CBDT had set up a high-powered committee to draft the Accounting Standards. The Committee has prepared the said "**Tax Accounting Standards**" and invited comments from all professionals by 26.11.2012.

The draft Tax Accounting Standards deal with 14 important issues of which Lease is one.

Finance Act, 2015

Shri Arun Jaitley, Minister of Finance, in his budget speech for 2014-15 mentioned that standards for computation of tax would be notified separately. Subsequently, vide the Finance (No. 2) Bill, 2014, suitable amendments have been made to Section 145 of the Income-tax Act including change of team 'Accounting Standards' to 'Income Computation and Disclosure Standards'. These amendments will take effect from 1st April, 2015, i.e., assessment year 2016-17.

The TAS deals with classification and depreciation issues relating to Finance Lease and Operating Lease.

Recommendations

- A finance lease gives rise to depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognized shall be calculated in accordance with Ind AS 16 Property, Plant and Equipment and Ind AS 38

Intangible Assets. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

- The Committee also recommends necessary amendment to address the cases of sale and lease back transactions. This shall ensure uniformity in classification by both lessor and lessee and inconsistent treatment shall be avoided.
- In case of lessor, who is manufacturer or dealer of asset, TAS provides for adjustment in sale price for artificially high rate of interest, as done in case of artificially low rate of interest.

Some Comments**:**

- The Act currently allows depreciation only on those assets that are owned by the assessee. As such, for a finance lease arrangement, it is generally the lessor that is entitled to the depreciation deduction and lease rentals are taxed as income in the hands of the lessor. See the decisions on Finance Lease.
- Using the same approach, an asset given on finance lease by a manufacturer lessor would now be considered to have been sold by the lessor with a corresponding recognition of revenues and profits. Only the finance income component of the lease rental would be recognized as income over the lease term.
- TAS now requires that the lessor and the lessee should have the same lease classification for the lease transaction and that a joint confirmation needs to be executed on the same. Further, in case a joint confirmation is not executed in a timely manner, the lessee would not be entitled to a depreciation deduction on such assets. It is currently unclear on whether the lessor would be eligible for a depreciation deduction in such cases.
- AS 19 requires a lease to be classified as a finance lease, if there is a transfer of substantial risks and rewards relating to the ownership of the leased asset. AS 19 accordingly provides several indicators for finance lease classification that have to be considered in totality along with an understanding of the substance of the arrangement. The TAS considers the existence of any one of the specified indicators as sufficient evidence for finance lease classification as compared to current practice, with a greater number of lease arrangements meeting the finance lease classification criteria.
- Under AS 19, in case of a lessor, the definition of minimum lease payment (which affects the lease classification into operating or finance lease) includes residual value guaranteed by the lessee or any other party. However, in case of the lessee, the definition of minimum lease payment includes only the residual value guaranteed by the lessee. The difference may at times result in different lease classification for lessor and lessee under AS 19. Under the TAS, the definition of minimum lease payment does not include residual value guaranteed by any party other than the lessee. This is to ensure that there is a uniform lease classification.
- AS 19 permits initial direct costs incurred in negotiating and arranging a lease to be recognized upfront or over time. In the absence of specific guidance under the Act, the tax treatment was in line with the requirements of the accounting standards. Under TAS, the upfront recognition of initial direct cost for the lessor is no longer permitted.

Provisions under the AS	Provisions notified under the TAS
• Does not provide for uniform classification of leases into operating and finance leases in the books of the lessor and the lessee • Includes provisions relating to sale and lease-back transactions • Requires cumulative fulfillment of specified indicators, in order to be classified as a finance lease • The lessor should recognise the asset as a receivable equal to net investment in lease. Finance income should be based on pattern reflecting a constant periodic return on net investment in lease	• Requires uniformity in classification of leases, to be demonstrated by a joint confirmation by the lessor and the lessee • Does not cover sale and lease-back transactions since these are specifically covered by the Act • In the case of finance lease, the lessor is entitled to depreciation and only the finance income component is to be treated as taxable income • Fulfillment of any one of certain specified indicators is sufficient to classify a lease as a finance lease. The indicators inter alia include ownership being transferred to a lessee at the end of the lease period, a lease term that is for the major part of the economic life, where the initial present value of lease payments substantially constitutes fair value, the lease is a specialized lease which is designed only for the use of the lessee, etc. • Minimum lease payments include only the residual value guaranteed by the lessee and not the value guaranteed by any third party

Sources:

1. KPMG Report on Tax Accounting Standards, October 31, 2012
2. PwC Report – Sharing Insights, November 19, 2012

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Salient Features of Proposed GST

CA. Madhukar N. Hiregange

GST is a consumption based levy. Destination principle would be applicable in normal course of business to business [B2B] other than for few services and business to consumer.[B2C] GST is proposed to be in place by April 2016- maybe a bit optimitstic.

In an ideal GST, all the credit of taxes paid [VAT+ CVD+ Central Excise] on purchase of inputs, input services and capital goods are seamlessly allowed for set-off against the tax payable on subsequent sale of goods that are either sold as such or sold upon conversion, or in the context of services, are supplied.

Backdrop:

It is required to have a brief view of the existing indirect taxes regime, before proceeding to understanding GST. The excise duty, import duties of customs, VAT/CST and service tax are the main levies at present. The principles of GST would be drawn from the best practices internationally and some time tested principles which have been working well in India.

a. Excise duty: Central Excise Duty is levied by the Central Government under the Central Excise Act, 1944. The levy is on all goods manufactured and produced in India, which are specified in the schedule to the Central Excise Tariff Act subject to certain exemptions. The effective rate may vary from product to product though most goods are subject to excise duty at 12% (without education cess).

The concepts of cenvat credit, dispute resolution, removal and valuation on intrinsic value under this law may find a place in GST. Also the principle of trusting the tax payer while having the checks and balances of audit rather than suspecting all businessmen would hopefully be adopted.

b. Import Duties: Customs duties are levied by the Central Government under the Customs Act, 1962. The levy gets attracted on all specified goods imported into and exported from India, which are specified in the schedule to the Customs Tariff Act. The customs duties are levied on assessable value and the total customs duty ordinarily would amount to an average of 28 % (subject to cenvat credits) on the value of goods imported.

Basic Customs duty would continue but the additional duty of customs (CVD) and special additional duty (SAD) would get subsumed into GST as an IGST. The Classification under customs which is based on the harmonised System of Nomenclature would be adopted under GST.

c. Value Added Tax (VAT): Value Added Tax (VAT) is levied by the State Governments on transfer of property in goods from one person to another, when such transfer is for cash, deferred payment or other valuable consideration. VAT is also payable on certain transactions that are deemed to be sale such as transfer of right to use goods, hire purchase and sale by instalments, works contract and sale of food and drink as a part of rendering of any service.

The supplies of goods and importantly services would now be available to the States as SGST. They would also get apportioned part of the IGST.

d. CST: The rate of CST is 2% against the declaration in Form C and in case the said declaration is not provided by the buyer, they are subject to tax at the rate specified in the local VAT law. Form C is allowed to be issued by the buyer when he purchases the goods for use in manufacture or for resale or for use in telecommunication network or in mining or in generation or distribution of power. Sales without C form would be at the rate as applicable in State of origin.

The principles of inter state sales, sales in the course of export/ import with required changes for supplies would be a part of the GST. The aspects of valuation in some parts would also be adopted.

e. Service Tax: Service tax is levied all activities as defined other than those specified in the negative list and those specifically exempted. Service tax is presently taxed at 12% (without education cess). Ordinarily, service tax is payable by the service provider, except in specified cases where a reverse charge and joint charge has been put in place.

The principles of Place of Provision of Services would be adapted from the place of supply rules. The point of taxation philosophy could also be a viable option. The States are expected to enjoy at least Rs.150,000/- Crores of revenue depending on the intra state consumption of services.

What is meant by GST?

Goods & Service Tax (GST) as the name suggests, is a tax on supply of goods or services. Any person, providing or supplying goods or services would be liable to charge GST. The States would be eligible for the SGST part of services

consumed within the State which would be an additional revenue for the State. The person supplying the goods or services is allowed to take credit for taxes paid on supply of goods or services, consequent to which, GST becomes a tax on the value added at the next stage by the dealer. Further GST would be levied by both the Central Government (CGST) and State Government (SGST) on the same transaction, making GST a dual transaction tax structure. For inter state transactions IGST (total of SGST + CGST) would be charged which would be apportioned to the Union as well as the States. This would apply for the subsumed part of the customs duties.

A 1% origin based tax to offset the CST loss would be collected by the Union retained by the States. This tax would not be vattable.

The definition of services being other than goods raises the concern of whether it would also cover Immovable property transactions.

What would be the Applicability of Levy?

Under GST, every specified transaction would be subject to tax. The rate would be much higher than it is presently and would cause a lot of concern and possible short cuts which may in the long run be disputed.

Supply within State: In case the supply of goods or services is done locally i.e. the place of consumption rules provide that local GST needs to be applied for the transaction, then the supplier would charge dual GST i.e. SGST and CGST at specified rates on the supply. This is explained with the following example:

Basic value charged for supply of goods or services	10,000
Add: CGST @ 10%*	1,000
Add: SGST @ 10%*	1,000
Total price charged for local supply of goods or services	12,000

Note: In the above illustration, the rate of CGST and SGST is assumed to be 10% each

The CGST & SGST charged on the customer for supply of goods or services would be remitted by the seller into the appropriate account of the State/ Central Government.

Supply from One State to Another

In case the supply of goods or services is done interstate i.e. the place of consumption rules provide that interstate GST (or integrated GST) needs to be applied for the transaction, then the supplier would charge IGST at specified rates on the supply. This is illustrated with the help of the following example:

Basic value charged for supply of goods or services	10,000
Add: IGST @ 20%*	2,000
Total price charged for interstate supply of goods or services	12,000

Note: In the above example, the rate of IGST is assumed to be 20%

The IGST charged on the customer for supply of goods or services would be remitted by the seller into the appropriate account of the Central Government. The CG would share the same with the State of destination and itself.

Exports

In case the supply of goods or services are exported out of India i.e. the place of consumption rules provide that regard the transaction as 'exported', then the transaction would be zero rate. In other words, the supplier would be allowed to export the goods or services without charging any tax. This is explained with the help of the following example:

Basic value charged for supply of goods or services	10,000
Add: GST	Nil
Total price charged for export of goods or services	10,000

From the above the following features of the GST emerge. The salient features of GST are given below:

- **Dual GST:** Dual GST signifies that GST would be levied by both, the Central Government and the State, on supply of goods or services. Under the Constitution, presently the taxing powers are presently split between the State and the Centre. In case of certain transactions, the power to tax is vested with the Centre and while in certain others, the power is vested with the State. Under GST, the power to tax on supply of all goods and services would be vested in the hands of both, the State and the Centre. In certain cases, such as the interstate transactions, the power to tax would be vested with the Central Government, while the revenue would in some appropriate manner, get distributed to the States. Considering the dual taxation power to tax transactions under GST, the structure is referred to as Dual GST. Considering the basic framework of the constitution and keeping its structure intact, Dual GST appears to be implementable solution for India scenario.
- **Subsuming many Taxes:** GST should subsume all major indirect taxes levied by the Central Government i.e. central excise, customs and service tax and majority of the taxes levied by the State Government i.e. VAT, luxury tax, entertainment tax, etc. In this regard, tax on sale of

5 specified petroleum products would continue to be under sales tax and central excise till the GST Council suggests its inclusion in the GST. Alcohol is intended to be kept for state excise ONLY. The following taxes would be absorbed/ subsumed into GST:

The following indirect taxes would be subsumed under GST:

Particulars	Levied By
Duty of excise on manufacture	Centre
CVD & SAD (component of customs duties)	Centre
Service tax	Centre
Central Sales Tax - Taxes when sale or purchase takes place in the course of inter-State trade	Centre
CST- Taxes on consignments that take place in the course of inter-State trade	Centre
Taxes on the entry of goods into a local area for consumption, use or sale therein (Including octroi).	State
Taxes on sale/purchase of goods within state	State
Luxury Tax	State
Entertainment Tax	State

- **Rate Structure:** It is expected that GST would be levied on the transaction value i.e. price actually paid or payable for supply of goods and services. The GST for local supplies would be split into SGST and CGST. The Task Force on GST of Thirteenth Finance Commission (TFC) has worked out a Revenue-Neutral Rate (RNR) of 12% (5% CGST and 7% SGST) assuming there is a single GST rate and stamp duty & electricity duty are also subsumed in the GST. However the rate now being discussed is in excess of 20%.

  GST could have a 4 rate structure with standard rate, concessional rate, special rate for bullion & jewellery and exempted/ nil rated. It is presently the view that services and goods would have the same rate.

  The discussion paper mentions and the Constitution Amendment bill 2014 indicates that the empowered committee has decided to adopt the following rate structure for taxing goods and services:

  - Exempted goods: The short list [Out of 91 items] under the State VAT law-0%
  - Special rate: Precious metals- could be 1 %
  - Concessional rate: Necessities and goods of basic importance [the concept of declared goods would not longer be relevant] -could be 10%
  - Standard rate: For all other goods- could be 20% [Maybe more is the indication]

  Note: States maybe able to fix the SGCT based on a band say 9-11%. [1-2 %]

  The recommend uniform State GST threshold of INR 25 Lakhs for both goods and services and composition scheme for those between Rs. 25 Lakhs to 75 Lakhs is being discussed.

  A 1% tax would accrue to the originating States for a period of 2 years unless extended by the GST council.

- **GST Council** would be put in place which would consist of the FM of Union and States. The issue of veto power for the Union still is to be resolved.
- **Credit Scheme:** GST would be levied on supply of goods and services and the supplier would be allowed credit for the GST paid on purchases. The credit would be seamless except that the credit of CGST paid would not be allowed for set-off against SGST payable and vice versa.

  The objective of seamless credit would be met except for those below the threshold limit, those under special composition schemes and the products which are exempted. Presently in the central as well as the state tax laws a number of restrictions exist on eligibility of goods and services used for business. It is hoped that these anomalies would be taken care in the draft law which is expected tobe in place by June 2015.

How would this work?

The assessee dealer would be entitled to avail credit of GST paid on purchases. In this regard, the dealer may purchase the goods or services locally or interstate or as imported. The following taxes paid on purchases when made locally, interstate or imported, would be available as credit in the hands of the dealer:

Type of purchase	Local	Interstate	Imported
GST incidence on purchase (taxes payable)	CGST SGST	IGST	BCD CGST SGST
Credit entitled on (with respect to taxes paid)	CGST SGST	IGST	CGST SGST

The assessee is required to account for CGST, SGST and IGST separately.

Extent of Cross Utilisation:

Nature of tax paid on purchase	Can be utilized for payment of
CGST	CGST IGST
SGST	SGST IGST

IGST	CGST SGST IGST

- **IGST:** Under this model the Centre would levy the IGST which would be CGST plus SGST on all inter-State transactions of taxable goods and services.[This would also include goods and services imports] Inter-State seller would pay the IGST on value addition after adjusting of IGST, CGST and SGST on purchases. The Exporting state would transfer to the Centre the credit of SGST used on payment of IGST.

- **Compensation to States:** In the opinion of the paper writer though some States who are consumer centric like Kerala would immensely benefit by GST most well to do States like Gujrat, Maharastar, Haryana, Tamil Nadu & Karnataka among others would get a share of the services consumed in the State which is a much bigger proposition [59% of GDP]**.** They would also get a share of the Rs125,000/- of Additional Customs Duty as well as the Special Additional Duty] on imports.

  The compensation for the first 3 years would be 100% of the shortfall. Then 75 % and 50% in the 5th year. States which over estimate the impact may find delayed disbursement a possibility.

- **Administrative Mechanism:** Both the Central Government and State Government would have the authority and control over the assessee as follows.

i) The administration of the Central GST would be with the Centre and for State GST with the States.

ii) Each taxpayer could be allotted a PAN linked taxpayer identification number with a total of 13/15 digits. This would bring the GST PAN-linked system in line with the prevailing PAN-based system for Income tax facilitating data exchange and taxpayer compliance. The exact design would be worked out in consultation with the Income-Tax Department.

iii) Keeping in mind the need of tax payer's convenience, functions such as assessment, enforcement, scrutiny and audit would be undertaken by the authority which is collecting the tax, with information sharing between the Centre and the States. Both the State and Centre may also adjudicate jointly to avoid conflicting decisions.

iv) The assessee dealer would be required to pay GST into the specified account of the State/ Centre and file periodic returns separately with the State/ Central Government.

- **Challenges For GST Implementation:** Some expected hurdles to be adequately overcome could be as under:

1. Standardization of systems and procedures all over India
2. Unfair dispute resolution- Equal powers
3. Training/ Equipping Tax administration
4. Adoption of huge capacity IT to improve efficiency and credit states for input credit utilised as taxes collected would be on account of destination state.
5. States not willing to give Veto to Union
6. Compensation disbursal doubts

7. Transitional Provisions

Transitional Provisions

The professional in employment or in practice would have to start preparation for GST much before its actual date of coming into force. Maybe 6-9 months prior. The main issues in transition would be as under:

i. Registration under the new law including all branches in all States.

ii. The carry forward of credits as on date of transition.

iii. The stocks in hand would be duty paid and non duty paid. [At branches, consignment agents, job workers..] Duty paid stocks would be in advantage.

iv. The refund applications especially in VAT as well as in service tax (exports) which are quite substantial. Decision to withdraw the claims if GST can utilise the same would ensure cashing out of the same.

v. Timing differences- goods sold in stock or goods removed but not sold may have some issue.

vi. Rejections, return and warranties may have to be examined for their impact.

vii. New products or services under the GST regime due to withdrawl of exemption or incentive schemes.

viii. Treatment of deemed sale- works contracts, leases and supply of food in the new law.

ix. Care to be taken by CAs while certifying the closing tock + other disclosures as required in transition.

x. ..many others.

The recent events and focus on making India a powerful and respected country also needs tax reforms to be in place for enhanced competitiveness. The view of the paper writer is that in due course of time GST would be useful for the industry immediately and for State / Central Government as well as general public over a period of 2 years.

Acknowledgements to CA Roopa Nayak for base article prepared in 2012.

In case of any queries could post on pdicai.org

TDS on Discounts Allowed by Telecom Companies to Distributors

Vikram A. Huilgol, *B.S.L, LL.B, LL.M from Harvard Law School.*
Practicing Advocate

On August 14, 2014, a Division Bench of the Hon'ble High Court of Karnataka held that telecommunication companies ("telecom companies" or "the assessees") were not liable to deduct tax at source under Section 194-H of the Income Tax Act, 1961 ("the Act") from the value of discounts allowed by them to their distributors on sales of SIM cards and recharge vouchers. SeeBharti Airtel Ltd. v. Deputy Commissioner of Income Tax, (ITA Nos. 637-44/2013). The High Court held that the discounts allowed by the telecom companies to their distributors on sales of SIM cards were not in the nature of a commission and that, therefore, the provisions of Section 194-H would not be attracted. This judgment is the latest and certainly not the last word on the distinction between discounts and commissions vis-à-vis Section 194-H. With High Courts across the country having taken divergent views, the Supreme Court of India will soon have to decide this vexed issue. This article provides a broad overview of the relevant statutory provisions, the Karnataka High Court's judgment, and the judgments of other High Courts on the issue.

Background

The assessees before the High Court of Karnataka were all engaged in the business of providing telecommunication services across the country. Although there are some subtle differences, the business models of the assessees are broadly similar. The assessees appoint channel partners/distributors who purchase, among other things, SIM cards, refill cards, and recharges coupons in bulk from the assessees and, thereafter, sell the cards to sub-dealers or consumers. Pertinently, the price at which the SIM cards are sold to the distributors is less than the MRP at which the cards are eventually sold. For instance, if the MRP of a SIM card is Rs. 100, the assessee would sell the card to the distributor at Rs. 80, and the distributor would sell the card subsequently at the MRP rate of Rs. 100.

Section 194-H of the Act states that "any person […] who is responsible for paying [to another person] any income by way of commission […] or brokerage, shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, deduct income tax thereon" at the rate specified under the provision.

"Commission or brokerage is defined under clause (i) of the Explanation to Section 194-H to include "any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities."

The income tax authorities passed orders against the assessees holding, in essence, that the difference between the MRP value and the discounted value at which the assessees sell the cards to the distributors is nothing but a commission paid by the assessees to their distributors. The authorities, therefore, concluded that the provisions of Section 194-H are attracted and, accordingly, the assessees are liable to deduct tax on the value of commissions paid by them to the distributors.

After appeals filed before the Commissioner and the Tribunal were rejected, the assessees approached the High Court.

Karnataka High Court's Judgment

Before the High Court, the assessees primarily contended that: (1) the transactions between them and the distributors are on a principal to principal basis, and that no relationship of principal agent exists; (2) under the terms of the agreement, the assessees are not required to make any payments to the distributors and, accordingly, no income accrues to the distributors; and (3) what is sold to the distributors is the right to receive services and not the SIM card itself. In essence, the assessees contended that the provisions of Section 194-H are not attracted to the transactions between them and their distributors. The Revenue countered these contentions and argued that the discount allowed to the distributors is the commission paid by the assessees to the distributors, thereby attracting the provisions Section 194-H.

In view of the contentions raised by the parties, the High Court framed the following substantial questions of law for its consideration:

a. "Whether the word `income' which is defined under Section 2(24) of the Income Tax Act, 1961 can be given a wider meaning by the Department so as to include within its scope also a `trade discount' for bulk sales such as discount allowed by the assessee to its distributors (channel partners) on the bulk purchases made by them of Starter-kits (SUKs), Recharge Vouchers (RCVs) and prepaid cards?"

b. "Whether Section 194H of the Income Tax Act is attracted to sale of RCVs, prepaid cards and starter kits and the

trade discount allowed by appellant to its distributors would amount to payment of 'Commission' requiring deduction of tax at source?"

The High Court began its analysis by referring to the judgments of the Supreme Court in Bharat Sanchar Nigam Ltd. v. Union of India, 282 ITR 273 and Idea Mobile Communication v. Commissioner of Central Excise, (2011) 43 VST 1. In the said cases, the Supreme Court held that a SIM card serves no purpose to the customer other than for receiving mobile telephone services from the serviceprovider. The High Court referred to these cases essentially to state the proposition that SIM cards are not goods that are sold or intended to be sold, but are supplied as a part of service.

The High Court thereafter discussed a number of judgments of High Courts across the country wherein the provisions of Section 194-H were analyzed:

1. In Commissioner of Income Tax v. Qatar Airways, (2011) 332 ITR 253 (Bom), the Bombay High Court held that airline companies were not required to deduct tax under Section 194-H on the difference between the minimum fixed commercial price and the price at which the agents thereafter sell the tickets.
2. In Ahmedabad Stamp Vendors Association v. Union of India, (2002) 124 Taxman 628 (Guj), the Gujarat High Court rejected the Revenue's contention that discounts allowed to stamp vendors fall within the ambit of the words "commission or brokerage," and held that the provisions of Section 194-H are, therefore, not attracted in such circumstances. The Gujarat High Court's judgment was subsequently affirmed by the Hon'ble Supreme Court. SeeUnion of India v. Ahmedabad Stamp Vendors Association, (2012) 348 ITR 378.
3. In Commissioner of Income Tax v. Mother Dairy India Ltd., (2013) 358 ITR 218 (Del), the Delhi High Court held that that a dairy, which used to sell milk to its concessionaire at a rate lower than the MRP that was fixed by it, was not liable to deduct tax under Section 194-H on the difference between the MRP rate and the rate at which the dairy sold milk to the concessionaire. In its judgment, the Delhi High Court observed, in pertinent part, that the difference between the MRP and the price which the concessionaire pays to the dairy is the concessionaire's income from business and cannot be categorized ascommission.
4. In Commissioner of Income Tax v. Singapore Airlines Ltd., (2009) 224 CTR 168 (Del), the agreement between the airline and its agent envisaged that from the amounts received from the sale of tickets, the agent would retain a certain amount and pay the balance to the airline. The High Court rejected the contention of the assessee that the monies retained by the agent were in the nature of discounts and not commission. In short, the Delhi High Court held that the airline is liable to deduct tax under Section 194-H from payments to its agents, which it found to be in the nature of commission of brokerage. It is relevant to point out that the facts of this case were rather peculiar as the airline was also paying a standard commission to the agent. The High Court, therefore, held that a relationship of principal and agent existed, and the said relationship does not transform to one of principal to principal when the agent retains a percentage of the monies received from customers.
5. In Commissioner of Income Tax v. Idea Cellular Ltd., (2010) 325 ITR 148 (Del), the Delhi High Court examined the same question raised before the Karnataka High Court: whether telecom companies were required to deduct tax under Section 194-H on discounts/ commission allowed to distributors of SIM cards and recharge vouchers. The Delhi High Court observed that since SIM cards are not goods, there is no question of any title passing from the assessees to the distributors. According to the Delhi High Court, the distributors are only links in the chain for services to be rendered ultimately by the assessees, and that the distributor does not render any services themselves to the consumer. The Court also observed that services are not capable of being sold or purchased, but can only be provided. Accordingly, the Court concluded that distributors are always acting as agents for and on behalf of the company, and that all the features of an agency relationship exist. The question of law was, therefore, answered in favour of the Revenue and it was held that the provisions of Section 194-H are attracted.
6. In Vodafone Essar Cellular Ltd. v. Assistant Commissioner of Income Tax, (2011) 332 ITR 255 (Ker), the Kerala High Court also held that the provisions of Section 194-H are attracted in cases where telecom companies sell SIM cards and recharge coupons to their distributors at discounted prices. The Court observed that the supply of a SIM card is only for the purpose of rendering continued services by the telecom company to the distributor, and that there is no sale of any goods involved. The Court further held that the role of the distributors is that of a middle-man between the telecom company and the consumers and, therefore, the essence of the contract is one of agency. Accordingly, the Court concluded that distributor is an agent of the telecom company and the discount given is nothing but commission within the meaning of Explanation (i) to Section 194-H.

Therefore, two High Courts – Delhi and Kerala – held in identical circumstances that Section 194-H would be applicable and that the telecom companies were liable to deduct tax on the discounts allowed to their distributors on sales of SIM cards and recharge vouchers. The reasoning adopted by both the High Courts was similar – that the

telecom companies were providing services to customers and that there was no sale of goods effected to the distributors. Accordingly, the Delhi and Kerala High Courts concluded that the distributors were only canvassing business for the telecom companies for which the discounts allowed to them were in the nature of commission as defined under Explanation (i) to Section 194-H.

However, the Karnataka High Court, interestingly, took a contrary view. The Karnataka High Court began its analysis by stating as follows:

> *"In order to deduct tax at source, the amount being paid out must necessarily be ascertainable as income chargeable to tax in the hands of the payee. TDS is a vicarious liability and it presupposes existence of primary liability. Therefore, the TDS provisions have to be read in conformity with the charging provisions, i.e., Sections 4, 5 and 9. "*
>
> The Court further observed that:
>
> *"The element of agency is to be there in case of all services or transactions contemplated by Explanation (i) to Section 194H. The mere fact that the word 'agent' or 'agency' is used or the words 'buyer' and 'seller' are used to describe the status of the parties concerned is not sufficient to lead to the irresistible inference that the parties did in fact intend that the said status would be conferred. While interpreting the terms of the agreement, the Court has to look to the substance rather than the form of it. […] For section 194H to be attracted, the income being paid out by the assessee must be in the nature of commission or brokerage."*

After analyzing the terms of the contracts between the assessees and the distributors, the Court observed as follows:

> *"From the [clauses of the contract], it is clear that there is no relationship of principal and agency. On the contrary, it is expressly stated that the relationship is that of principal to principal. Secondly the Distributor/ Channel Partner has to pay consideration for the Product supplied and it is treated as sale consideration. There is a Clause, which specifically states that after such sale of Products, the Distributor/Channel Partner cannot return the goods to the assessee for whatever reason. It is the Channel Partner and the Distributor who have to insure the products and the godowns at their cost. They are even prevented from making any representation to the retailers unless authorized by the assessee. What is given by the assessee to its Distributor/Channel Partner is a trade discount. It is not commission."*

Therefore, after examining the terms of the agreements, the Court categorically held that the relationship between the assessees and their distributors is not one of principal and agent and, accordingly, the Court concluded that the discounts given to the distributors were not in the nature of commissions.

As regards the Delhi and Kerala High Court judgments which had held that Section 194-H would be applicable when SIM cards are sold by telecom companies to their distributors at discounted rates, the Karnataka High Court stated that in both the cases, the Courts proceeded on the basis that a service cannot be sold, but did not examine the question regarding whether the "right to service" can be sold. The Karnataka High Court held that what is sold by the telecom companies to their distributors is the "right to service," which the distributors, in turn, sell to the customers for a profit. Therefore, according to the High Court, the income accrues to the distributors when they sell the right to service, which they acquired from the telecom companies, to the consumers. The Court further observed that at the time of sale of the SIM cards to the distributors, no income has accrued to them and, therefore, there is no primary liability to tax. As there is no primary liability to tax, the Court concluded that there is no liability on the telecom companies to deduct tax at source. In essence, the Court concluded that the difference between the MRP and sale price paid by the distributor to the telecom company is the distributor's income from business and is not "commission."

Thereafter, the High Court explained that, if in their books of accounts the telecom companies account for their sales to the distributors at the gross value and separately show the commission allowed to the distributors, the essence of the contract would be one of service and Section 194-H would be attracted. For instance, if Rs. 100 is the gross value, Rs. 20 is the commission, and Rs. 80 is the net value, and the sale is accounted at the gross value with the commission being accounted separately, according to the High Court, the contract would be one of service and attract the provisions of Section 194-H. However, if the company accounted for only Rs. 80, and on payment of Rs. 80, the prepaid card is handed over to the distributor prescribing the MRP asRs. 100, then according to the High Court, the distributor would not be earning any income and, accordingly, Section 194-H would not be attracted.

In view of these observations, the questions of law were answered in favour of the assessees and against the Revenue. However, the High Court remitted the matters to the assessing authority to examine how the books of accounts are maintained and ascertain how the sale price and sale discount are treated. The Court observed that if only the net sale price is accounted for and the commission is not shown separately, then the provisions of Section 194-H would not be attracted.

Conclusion.

Although the result of the case was in favour of the assessees, the judgment itself raises an interesting question. As stated earlier, the Court clearly and categorically held that what is

being sold by the assessees to the distributors is the right to service, and no services are being rendered by the distributors to the assessees. Explanation (i) to Section 194-H states that only payments received for "services rendered" constitute "commission or brokerage." Therefore, if no services are rendered and only the right to service is transferred, as has been held by the High Court in this case, Section 194-H has no application whatsoever. It is, therefore, surprising why the Court felt the need to remand the case to the assessing authority with a direction to examine how the assessees are accounting their sale price and discount.

Moreover, Section 194-H is only applicable in cases where a principal-agent relationship exists. In other words, the provisions of Section 194-H are applicable only when a person receives payments when acting on behalf of another person. The High Court, after perusing the contracts, held that the relationship between the assessees and the distributors was one of principal to principal. If that were to be the factual finding of the High Court, there was no requirement for the court to remand the matter with a direction to examine the accounting practices of the assessees.

In sum, there appear to be some contradictions in the judgment of the High Court. Nevertheless, the Hon'ble Court has passed an excellent and well-reasoned judgment. The judgment is particularly laudable in view of the fact that two High Courts had taken a contrary view. It remains to be seen whether the Supreme Court will agree with the Karnataka High Court.

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INDIRECT TAXES UPDATE - JANUARY 2015

CA. C.R. Raghavendra, *B.Com, FCA, LLB, Advocate*
and **CA. Bhanu Murthy J.S.,** *B.Com, FCA, LLB*

1) **State of Karnataka Vs. M/s Pro Lab And Ors Etc, 2015-TIOL-08-SC-CT-LB**

Issue: Issue before the Supreme Court was whether Processing and supplying of Photographs, Photo Prints and Photonegatives would be liable to sales tax as works contract.

Held: Larger Bench of Supreme Court held that after insertion of Article 366(29A), the Works Contract, is permitted to be bifurcated into one for "sale of goods" and other for "services" and states could levy sales tax on goods component of the contract. Further, it was observed that while doing this exercise of divisibility, dominant intention behind such a contract, namely, whether it was for sale of goods or for services, is rendered otiose or immaterial by virtue of Art. 366(29A).

2) **Hindalco Industries Limited vs Union Of India, 2015 (315) E.L.T. 10 (Bom.)**

Issue: Whether Dross and skimming of aluminium, zinc or other non-ferrous metal emerging as by-product during manufacture of aluminum/non-ferrous sheets/foils and other products would be liable to duty of excise. Revenue contested that after amendment of Section 2(d) of Central Excise Act, 1944, the said goods would be deemed to be marketable and hence are liable to duty.

Held: Taking into account the decisions of the Supreme Court and High Courts, Bombay High Court held that the merely because the goods satisfying the test of being marketed and saleable, it does not mean that the test of being manufactured in India has been satisfied. It was observed that conditions contemplated under Section 2(d) and Section 2(f) have to be satisfied conjunctively in order to entail imposition of excise duty under Section 3 of the Act. As the goods cannot be termed as manufactured not duty could be imposed.

3) **M/s Lord Chloro Alkali Ltd Vs CCE 2014-TIOL-2420-CESTAT-DEL**

Facts: Appellant is a manufacturer of chemicals and they fabricated and installed 26MW D.G. set in a separate building. It was contended by Revenue that said fabrication and installation of DG set amounts to manufacture hence demanded CE duty on these DG sets.

Held: Tribunal held that the said DG sets which were allegedly manufactured are huge and are installed in a separate building, spread over large area and the same are not portable D.G. sets which can come to market for being bought and sold. Tribunal, placing reliance on the decision of the Supreme Court in the case of Triveni Engg. & Industries Ltd. Vs. Commissioner of Central Excise - 2002-TIOL-14-SC-CX-LB held that such DG sets cannot be held to be marketable and excisable. Further, on the aspect of limitation, the Tribunal observed that the jurisdictional Central Excise authorities were informed about the intended fabrication of the D.G. Sets at the premises in the year 1989 itself and hence no suppression can be attributed to the assessee so as to uphold the longer period of limitation. Therefore, the appeal was allowed on merits as well as on limitation.

4) **M/s Jaypee Sidhi Cement Plant Vs CCE 2014-TIOL-2456-CESTAT-DEL**

Facts: Appellant is engaged in manufacture of cement and clinker and they were providing of first-aid facilities to the workers, in factory as well as in mines as per the requirement of Factories Act, 1948 and the Mines Act, 1952. For deploying the persons qualified to provide first-aid, the appellant have received services from the man power supply agent in respect of which they availed cenvat credit. Revenue demanded reversal of cenvat credit availed on 'manpower supply agency'.

Held: Tribunal held that the availment of services for maintenance of first-aid facilities for the workers has to be treated as the service used in or in relation to the manufacture of final products as the said facility is provided in compliance with statutes governing the factory. Therefore, the credit is allowed.

5) **M/s Hindustan Coca Cola Beverages Pvt Ltd Vs CCE - 2014-TIOL-2460-CESTAT-MUM**

The issue before the Tribunal was eligibility to avail credit on catering services for the period on or after 1.4.2011. In this connection, with reference to the amendment of 'input service' w.e.f., 01.04.2011, the Tribunal held that what is excluded under clause (C) of Rule 2(l) of CCR, 2004 is only the services 'primarily for personal use or consumption of any employee'. Therefore, it was held that the service tax to the extent of cost of Catering Services borne by the company & not recovered from employees is admissible as credit.

6) **COMMISSIONER Vs VODAFONE ESSAR GUJARAT LTD, 2014-TIOL-2190-HC-AHM-ST**

Facts: With regard to extension of stay by the CESTAT, it was contended by the Revenue that in terms of Section.35C(2A) of CEA, 1944 Tribunal could not have extended the stay beyond the period of 365 days from the date it was initially granted; that Tribunal has passed the said order mechanically without assigning any reasons.

Held: High Court held that issue is no longer *res integra* as Gujarat High Court in case of *Commissioner vs. Small*

Industries Development Bank of India ***2014-TIOL-1102-HC-AHM-CX*** has clearly held that the Tribunal, in appropriate cases, may extend the stay even beyond 365 days from the date of initial grant of stay. It can, therefore, be concluded that the Tribunal did not lack the power to extend stay beyond 365 days from the initial date of granting stay. The Court observed that however, if the stand of the revenue is that such extension was granted without recording reasons or without passing speaking order as required by the decision in case of *Commissioner vs. Small Industries Development Bank of India (supra)* it would be open for the Department to move a rectification application before the Tribunal and accordingly the tax appeal disposed of.

7) **J J Foams Pvt Ltd Vs CCE 2014-TIOL-2489-CESTAT-DEL**

Facts: Fire broke out in appellant's factory as also in job workers factory which resulted in destruction of goods in both factories and appellant applied for remission of duty under Rule 21 of CER, 2002 which was denied by the Revenue.

Held: Tribunal held that mere observation of Commissioner that no reasonable steps were taken to avoid the fire cannot be appreciated inasmuch as nobody likes to invite fire resulting in destruction and loss of stock. As regards the destruction of goods in the job workers factory, the receipted goods were work-in-progress which is in semi-finished form and were not the finished goods and such semi-finished goods also entitled to remission of duty.

8) Tamil Nadu Generation and Distribution Corporation Ltd. (TANGEDCO) vs. CC, Tuticorin 2014-TIOL-2503-CESTAT-MAD

Facts: Classification of imported coal under the heading 'Steam coal' Vs 'Bituminous Coal' for the period from 17.03.2012 to 28.02.2013

Held: On this issue, the Bangalore bench of the Tribunal M/s. Coastal Energy Pvt . Ltd. and held that the imported coal is classifiable as Bituminous coal and attracts higher rate of duty. However, on the same issue, the Chennai Bench of the CESTAT took different view based on the following observations and has referred the matter to Larger Bench:

- In terms of the definition of 'bituminous coal' in Sub-heading Note 2 of Chapter 27, the computation of calorific value (CV) limit has to be on moist, mineral matter free basis.
- In the present case, there is no dispute that a calorific value limit on a moist basis as referred in sub-heading Notes 2 of Chapter 27 of CTA would cover the inherent moisture of the coal.
- However, the Department calculated C.V. limit on the basis of Load Port Report, on air dry basis. If sample of coal is tested in Residual Moisture, then, the denominator would be low and C.V. limit would be higher. The case of the applicants is that sample of coal on load port report and discharge report, as relied by the revenue is containing residual moisture and the C.V. limit is much higher.
- After going through the ASTM parameter, prima facie, the Tribunal observed that the view of the Revenue that Load Port Report is based on inherent moisture is not acceptable.
- Further, Tribunal referred to the decision of Chennai Bench of the Tribunal in Tamil Nadu Newsprint & Papers Ltd. Vs Commissioner of Customs, Tuticorin 2010 (253) ELT 153 (Tri.-Chennai) categorically held that if the department had a doubt about the description of the goods and the classification, they should have carried out a chemical test, which was not done in the present appeals.
- Therefore, Tribunal held that in the present case, the adjudicating authority proceeded on the basis of survey report prepared on Air Dried Basis as in the case of TNPL case. Therefore, the decision of Bangalore Bench of the Tribunal in the case of Maheswari Brothers & Others and M/s. Coastal Energy Pvt. Ltd. are contrary to the decision of the Chennai Bench of the Tribunal in the case of TNPL (supra) and hence the matter was referred to Larger Bench.

9) **Precision Fasteners Ltd Vs CCE 2014-TIOL-2211-HC-AHM-CX**

With reference to erstwhile provision of Rule 8(3A) of Central Excise Rules, 2002 which imposes restriction on utilization of cenvat credit for payment of duty, when there is default in payment of duty, High Court held that as Gujarat High Court in the case of Indsur Global held that the condition in erstwhile 8(3A) of CER, 2002 for payment of duty without utilizing CENVAT credit is unconstitutional and, therefore, since the statutory basis for issuance of SCN and raising tax demand is knocked down, the very proceedings have to be struck down. Impugned tax demands and show cause notice set aside and all subsequent actions taken by the department set at naught.

10) Associates Lumbers Pvt. Ltd Vs. CCE, 2015 (315) E.L.T. 117 (Tri. -Mumbai)

Issue: Imported plywood was dipped in boiling hot chemical solution consisting of Sodium Bicarbonate, Boric Acid and Copper Sulphate mixed in water and thereafter dried. Due to this process quality of imported plywood was improved and same sold as marine plywood. Department was of the view that the said process would amount to manufacture and would be liable to duty of excise duty.

Held: Tribunal observed that the initial as well as the final product were both plywood. Further, the process of chemical treatment only improved the quality of plywood, as by coating of chemical it became termite free, etc. and no new product was emerged out of such process. Thus, process undertaken did not amount to manufacture.

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Issuance of Statutory Form 'C' under CST Act 1956

CA. G.B. Srikanth Acharaya and **CA. Annapurna Kabra**

The dealer can affect interstate purchase of goods at a concessional rate by issuing the declaration in Form C at 2% for the following purposes:

- For resale by him; or
- For use by him in the manufacture or processing of goods for sale; or
- For use in the mining; or
- For use in the generation or distribution of electricity or any other form of power; or
- For use in telecommunication network; or
- For containers or packing materials used for packing of goods for sale specified in the certificate of registration or for packing the packing material itself.

As per Rule 12 of CST (R& T) Rules 1957, The declarations and the certificate as referred in sub section (4) of section 8 shall be in Form C provided further that a single declaration may cover all the transactions of sale, which take place in a ***quarter*** of a financial year between the same two dealers.

As per Rule 6(aaaaa) of CST (Karnataka) Rules 1957, notwithstanding anything contained, such class of dealers among the registered dealers as may be notified by the Commissioner of Commercial Taxes shall apply for obtaining the declaration or certificate form prescribed under Rule 12 of the CST (R& T) Rules 1957, through the website notified by the Commissioner of Commercial Taxes in the manner and subject to the conditions specified in the notification issued by him.

In suppression of the Notification No CCW/CR 8/2013-2014 dated 09.09.2014, ***the New Notification is issued on 02/01/2015 with Notification reference of CCW/CR 8/2013-2014*** wherein every dealer registered under the provisions of CST Act 1956 and who has electronically filed the return for any month or quarter commencing from 1st January 2013 shall apply for obtaining the declaration in Form C. The declaration in Form C should be furnished for any purchase of goods in such month or quarter. A Single declaration form covering all transaction of purchases which took place in a month of a financial year between two dealers should be issued in a following manner

The dealer should log on the commercial tax website. The dealer by using the user name and password communicated to him by this office or from the Jurisdictional LVO or VSO should first submit the returns from January 2013. The dealer should declare the gross value of the interstate trade and obtain acknowledgement.

The dealers who require the declaration in Form C against the value of purchases effected in the course of second and subsequent interstate trade or commerce shall be included in the specified box of the return for interstate purchase against C form only.

The dealer should upload the details of purchases in the course of interstate trade or commerce for the tax period of April 2014 and earlier from the main menu. The details of such purchase for the tax periods of May 2014 and onwards shall be uploaded by the dealers using the path purchase statement. When the returns are filed and details of purchases are uploaded for the relevant tax period the dealers shall be allowed to generate declaration in Form C by the system by following the procedure described in the website. The invoice value declared should be gross value which shall be inclusive of taxes and other charges.

The total value of the declaration in C forms should be equal or less than the value declared in the specified box of the return of that tax period. If the value of the goods uploaded for any tax period is more than the value declared in the return then declaration in Form C shall be restricted to the value declared in the return.

If the Invoice belonging to any tax period is accounted for in the books of account in the subsequent tax period subject to six months from the tax period of the invoice even the declaration in Form C form shall be generated for the tax period relating to the invoice date by following the procedure.

The dealer will not be entitled to generate the declarations in Form C for any tax period say month or quarter until all the returns due are filed , tax admitted thereon is paid and details of purchases in the course of interstate trade or commerce are submitted electronically for all the months.

The C form generated can be printed and it is not mandatory to get the seal of the Department of Commercial Taxes affixed by producing it before LVO/VSO. The dealers shall not be allowed to change the value of goods in the course of interstate purchase against C form once the C forms have been generated for that tax period. There is no issuance of C form declaration if it is incomplete, partial or issued in advance.

In case if the declaration is incomplete or incorrect the declaration in Form C should be submitted to LVO or VSO concerned with a written request to cancel the same. And also the dealer should file an undertaking to the effect that the selling dealer of other state has not submitted the said declaration in Form C and has not claimed the concessional rate of tax.

Also the Notification no KSA-CR 248/08-09 dated 10.03.2010 is modified to the extent that a single declaration form covering all transactions of purchases which took place in a ***month*** of a financial year between two dealers.

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Service Tax on Information Technology Software

CA. Madhukar N. Hiregange and **CA. Roopa Nayak**

In this article we look at the service tax implications on declared services entry of ITSS. There have been a lot of disputes with Central Taxes as well as CST/ VAT being levied and collected on software under both laws. This has lead to challenges in Courts of law. Attempt at clarity in this article.

Background

Under negative list based taxation, service tax is levied on all services other than those mentioned in negative list or a subject matter of exemption.The definition of service in the first instance is very wide to cover any activity done by one person to another for consideration. The term service is defined to include declared services.

There are a few activities would overlap with the State levies with a marginal difference, thereby making the levy under service tax possibly constitutionally invalid or questionable leading to litigation. Such activities where the validity of service tax levy was disputed, were considered as service, and declared to be a service. This myopic view did not reduce the confusion- in fact underlined the unfairness of drafting of the laws.

As per declared services list, it has covered specified services relating to information technology software. Also covers temporary transfer of any intellectual property right as a service.

The paperwriter has examined levy of service tax on software in this article.

Validity of Service Tax levy on software

Where the issue is one of regarding taxability of acquiring or providing the right to use software under service tax, one would have to proceed only after considering the decisions given by the Courts on software.

The Apex Court in TCS decision 2004 (178) ELT 0022 (S.C.) (prior to introduction of ITSS in service tax, and in the Infosys decision (2009 (233) ELT 56 (Mad)it was held that software is goods even if customized.

The High Court in ISODA case(2010 (020) STR 0289 Mad)upheld the constitutional validity of service tax on Information technology software service stating that **not in all the case**s of software related transaction there is sale. There may be also service element, what is intended to be taxed on the services involved in the transaction. It further said whether the transaction to be treated as Sale or Service has to be decided on a case to case basis based on terms and conditions between parties.

Declared service of ITSS

As per the declared list entry, to be covered the following are requirements:

i) The activity performed has to be only development, design, programming, customization, adaptation, upgradation, enhancement or implementation.

ii) Such activity has to pertain to information technology software.

iii) The phrase 'information technology software' is specifically defined in Section 65B(28) as under:

(28) "information technology software" means any representation of instructions, data, sound or image, including source code and object code, recorded in a machine readable form, and capable of being manipulated or providing interactivity to a user, by means of a computer or an automatic data processing machine or any other device or equipment;

Levy of VAT vs Service Tax on software

Once software is goods, transfer of right to use the same for consideration should be subject matter of VAT going by Article 366(29A) of Constitution of India.

Where there is a program sold on media **without reservation** [source code etc also transferred] then it is plain and simple sale with no service being involved.

Where the work of development is done on the customers owned software and transfer takes place seamlessly, the activity cannot be a sale and is only a service.

The deemed sale entry covers transfer of right to use goods. In many cases the copyright or the intellectual property right relating to the software sold may still vest with the seller. This would not affect the nature of the transaction from being a sale for the purposes of the VAT Act. Even where the IP continues to vest in seller / developer of software and merely a right to use is transferred; it would be treated as a sale of goods leviable to VAT as per the State.

Though transfer of right to use software is deemed sale.If the software works on a license basis, then it could be covered in declared services entry in Section 66 E which covers "temporary transfer or permitting the use or enjoyment of any intellectual property right" namely software.

The same could also be taxable to service tax, under another declared services entry of transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods if the developer is merely permitting to use the software [which is goods] subject to conditions and restrictions as to its usage/replication imposed in this regards.

Where there is no involvement of transfer of right to use, then there may not be transfer of title in goods nor a deemed sale of goods. There must be a transfer of right to use any goods and when the goods as such is not transferred, the question

of deeming sale of goods does not arise and the transaction would be only a service and not a sale.

There is a finer distinction between the applicability of VATand service tax. In the case of VATthere would be "transfer of Right to Use the Goods''. Whereas under the service Tax, what is levied is "temporary transfer/enjoyment of the goods".

Again taking conservative view most people in software industry, are charging both VAT and Service Tax usually where software given by means of a license.

Applicability of other indirect taxes on software

Any view on software would also very likely affect the position under Customs Act or under the Central Excise Act depending on whether or not the software is imported from outside India or manufactured within India.

a. Levy of excise duty on software

Software on a CD or any other media is covered under the Central Excise Tariff Act, under the chapter heading (hereinafter referred as heading) 8523. For the goods falling under the said heading "recording" of sound or other phenomena shall amount to manufacture. Even reproduction of developed software into number of CDs would also be considered as deemed activity of manufacture. There is exemption from excise duty to customized software.

b. Import duties on software

When software is to be regarded as goods and such goods are imported into India on CDs or other storage media, it could attract duty liability under customs as it would specifically find a mention under heading 85238020 of the First Schedule to the Customs Tariff Act 1975, using the Harmonised System of Nomenclature.

As IT software can be imported free. The BCD is not payable, CVD equal to excise duty on like goods manufactured inIndia. There is exemption from CVD[equal to ED exemption on like software manufactured in India] for customized software.

Issues:

1. **Whether the canned or off the shelf software are liable to service tax?**

   Comments:The taxable service here is in relation to development of the software for other person. In the case of canned software the development is undertaken for oneself and after completion the sale is affected. In such case there is no separate service receiver therefore the levy fails. When software given on CD, the same is covered under the manufacture and governed under central excise/ customs provisions.

2. **Whether customization of the canned software is covered?**

   Comments:The customization of the canned software includes the development of a patch for the existing canned software. Therefore such service could be within the ambit of taxable service. However where the patch is goods liable for VAT/CST then the same would not be covered under service tax. But presently as an industry practice both taxes are being paid though the same is considered to be goods and liable for VAT.

3. **Whether software maintainance is liable to service tax?**

   Comments: If it involves only upgradation service, support and other related aspects, without any additional software patches, only service liable to service tax under Information technology software services.

   As a part of upgradation, any further software patches are provided, then as also involving sale of goods by sales tax authorities. Therefore the same would be subject matter of VAT as well in addition to service tax.

4. **Whether the software licenses are covered?**

   Comments:If the software works on the license basis, then it would be transfer of right to use goods and the same is taxable under declared service entry namely "transfer of goods by way of hiring, leasing, licensing or in any such manner without transfer of right to use such goods". However this issue is debatable and there is no judicial clarity on this as on date.

5. **Whether Support Service is taxable?**

   ***Comments*:** Even though not specifically covered by the entry, it would be taxable since it is an activity done by person to another person for a consideration.

6. **Whether development of software for testing equipment is covered?**

   Comments:The definition of the information technology service is wide to cover the software development not only for computer but also for any device or equipment therefore software testing equipment is also taxable.

Recent decision

In 3I Infotech Ltd Vs CST,Mumbai –II(2014-TIOL-1424-CESTAT-MUM) held Sale of third party software and hardware or sale of standardised software developed in-house cannot come under the category of IPR services. Transaction involved is one of sale of goods; software developed in-house are standard software, which are sold to a particular class of buyers, such as banks, insurance companies, mutual funds and various other financial service providers, under a trade/ brand name and, therefore, they appear to be goods, which can be marketed or sold. Inasmuch as the appellant has discharged the sales tax/VAT liability on such software, there is merit in the contention of the appellant that liability to pay service tax does not arise on a sale transaction.

Conclusion

Till such time that in wisdom of both Governments, a mechanism is put in place whereby the portion of the transaction in software liable to VAT and service tax is determinable on some reasonable basis. Till such time the double taxation would continue for the transfer of right part of the ITSS transactions.

In this article the paperwriter has examined the scope of service tax levy on software. In case of any queries could post on

pdicai.org or roopa@hiregange.com

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on Saturday & Sunday
7th & 8th March 2015

Jnana Jyothi Convention Centre
Central College Campus, Bengaluru

Programme Structure

Saturday 7th March 2015

08.30 AM Registration

INAGUARAL SESSION

09.15 AM Inaugural Address by Chief Guest
Release of Publications
Release of Souvenir

10.45 AM Inauguration of Exhibition & Tea Break

FIRST TECHNICAL SESSION

11.00 AM Companies Act 2013
- New Compliance Requirement
CA. K. Gururaj Acharya

SECOND TECHNICAL SESSION

12.15 PM Assessment of Charitable Trust
CA. Dr. N. Suresh

01.15 PM Lunch Break

02.15 PM Sponsor's Programme

THIRD TECHNICAL SESSION

02.30 PM Consolidated Financials Statements for Unlisted Companies including P. Ltd. Companies 2014-15
CA. M. P. Vijaykumar, *Chennai*

03.30 PM Tea Break

FOURTH TECHNICAL SESSION

03.45 PM GST - The Way Forward
- Cen. Excise & Customs
CA. N. Anand, *Advocate*
- VAT
CA. Venkataramani S
- Service Tax
CA. Madhukar N Hiregange

06.45 PM **ENTERTAINMENT PROGRAMME**

08.30 PM Family Dinner

Sunday 8th March 2015

08.00 AM Breakfast

SPIRITUAL SESSION

09.00 AM Spirituality for Professional Minds
Dr. Aralumallige Parthasarathy, Intl. Celebrity

SPECIAL SESSION

10.00 AM Role of Council Members in ICAI
CA. P.R. Suresh, RCM
CA. Cotha S. Srinivas, RCM
CA. Nithin Mahadevappa, RCM
Moderator : **CA. Nityananda N**, Past CCM

FIFTH TECHNICAL SESSION

10.45 AM FEMA - Liberalised Scheme, Certification & TDS Issues
CA. Vivek Mallya

11.45 AM Tea Break

SIXTH TECHNICAL SESSION

12.00 Noon Controversies in Domestic TDS Issues
CA. Padamchand Khincha

01.15 PM Lunch Break

02.15 PM Sponsor's Programme

SEVENTH TECHNICAL SESSION

02.30 PM Opportunities in Arbitration & Conciliation
Sri K.G. Raghavan, Advocate

03.30 PM Tea Break

EIGHTH TECHNICAL SESSION

03.45 PM Union Budget Proposals - Panel Discussion
Direct Tax : **CA. Vishnumurthy S, CA. Prashanth G.S**
Indirect Tax: **CA.Vishnumoorthi H, CA.Rajeshkumar T.R**
Moderator: **CA. S. Rama Subramanian**

05.45 PM VALEDICTORY SESSION

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