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Upholding the Moral & Professional Excellence

Mangalyaan

India's Successful Mars Orbiter Mission

Kailash Satyarthi
Nobel Peace Prize Winner 2014

Inauguration of One Day Seminar on Tax Implications on Real Estate Sector

Happy Deepawali

ಕನ್ನಡ ರಾಜ್ಯೋತ್ಸವದ
ಶುಭಾಶಯಗಳು

From the President

Dear Professional Colleagues,

ಕನ್ನಡ ರಾಜ್ಯೋತ್ಸವದ ಶುಭಾಶಯಗಳು

ಈ ರಾಜ್ಯೋತ್ಸವದ ಸಂಭ್ರಮದಲ್ಲಿ
ತಾಯಿ ಭುವನೇಶ್ವರಿಯು,

- ಕನ್ನಡಿಗರು ಕನ್ನಡವನ್ನೇ ಮಾತನಾಡುವ ಶಕ್ತಿಯನ್ನೂ,
- ನೆರೆ ಸಂತ್ರಸ್ತರಿಗೆ ನೆಮ್ಮದಿಯನ್ನೂ,
- ಆತ್ಮಹತ್ಯೆ ಮಾಡಿಕೊಳ್ಳುತ್ತಿರುವ ಅನ್ನದಾತನಿಗೆ ಆತ್ಮಸ್ಥೈರ್ಯವನ್ನೂ,
- ನಮ್ಮ ವೃತ್ತಿ ಬಾಂಧವರಿಗೆ ಕೌಶಲ್ಯಯುಕ್ತ ಪರಿಣಿತಿಯನ್ನೂ,

ದಯಪಾಲಿಸಲಿ ಎಂದು ಕೋರುತ್ತ.........

I Am writing this message with a great sense of relief and satisfaction that the one day seminar on 'Tax implications on Real Estate Sector' organised by us on last week was a grand success. The seminar received overwhelming response from members, more than two hundred delegates registered for the event. Technical sessions were addressed by eminent speakers and delegates made the sessions very interactive. Success of this seminar and constructive feedback from delegates boosted our morale. I thank the members for their support to the KSCAA programmes that would encourage us to conduct more such events in the coming days.

ISRO once again made India proud by efficiently completing our most prestigious Mars Orbiter Mission-Mangalyaan. India had on September 24 created space history by successfully placing its low-cost Mars spacecraft in orbit around the Red Planet, catapulting the country into an elite club of three nations. Only the US, Russia and Europe have previously sent missions to Mars, and India has succeeded on its first attempt - an achievement that eluded even the Americans and the Soviets. I congratulate ISRO team for its Mars arrival! ISRO scientists again proved that there is no dearth of talent in India by designing this space shuttle indigenously.

The Norwegian Nobel Committee announced the Nobel Peace Prize for 2014 jointly to Kailash Satyarthi for his struggle against the suppression of children and young people and for the right of all children to education. Children must go to school and not be financially exploited. In the poor countries of the world, 60% of the present population is under 25 years of age. It is a prerequisite for peaceful global development that the rights of children and young people be respected. In conflict-ridden areas in particular, the violation of children leads to the continuation of violence from generation to generation. As rightly mentioned by our Prime minister, Shri Kailash Satyarthi has devoted his life to a cause that is extremely relevant to entire humankind. On behalf of KSCAA, I congratulate Shri Kailash Satyarthi, who brought India again in the Nobel limelight. We salute his determined efforts.

While launching the biggest ever cleanliness drives in India, Swachh Bharat Abhiyan, on "Gandhi Jayanthi" October 2, Prime Minister Narendra Modi had appealed to every citizen of the country to devote at least 100 hours a year for cleanliness work voluntarily. The Government also allocated around Rs 2 lakh crore for the next five years in order to make India clean by 2019. Also, the Government has set up the Swachh Bharat Kosh (SBK) so that big and small corporations provide help to the mission by donating funds in the form of their Corporate Social Responsibility (CSR) and also to attract funds from individual volunteers. Clean India can bring in more tourists, thereby increasing the revenue.

The Ministry of Finance, Government of India, plans to introduce a new annual tax return that will include information from income tax audit report including TDS and Income Tax Returns and Cost Audit Report, as it looks to draw information from multiple sources to clamp down on evasion of central excise and service tax. It is a welcome move initiated by the Government of India, which would be a giant leap towards a unified tax regime, to supplement the roll out of Goods & Service Tax in India and the proposed Direct Tax Code. As torch bearers of tax governance system in the country, we Chartered Accountants have a distinct role in maintaining the country's economy, ensuring transparency, proper disclosure and social security for people at large.

Though the October is a month of festivities and holidays, it demands for even higher professional work like certification of Companies Annual Returns, etc. To avoid last minute rush and system congestion on the MCA21 portal on account of filings under the Company Law Settlement Scheme, 2014 ending on 15.10.2014 and Annual Filings during October/November 2014, Companies are requested to file their Balance Sheet and Annual Return early without postponing it to the last days.

We invite members to participate in the adjourned Annual General Meeting of our Association scheduled on 18th October 2014, 11.00AM at the Bangalore City Institute. The notice and details were circulated in the previous month news bulletin.

We are planning to conduct programs at Moffusil areas and sports meet in the coming months. Details of the same would be informed in due course.

Our Association expresses its concern to people of Jammu & Kashmir and other parts of the Country, who have suffered due to unprecedented floods and series of cyclones. We appreciate efforts of governments and volunteers to reduce the causalities and losses.

We wish prosperity and happiness to members, students and their family on the occasion of Deepawali, Laxmi Pooja and Kannada Rajyotsava.

In service of the Profession,

CA. Raveendra S. Kore
President

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

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Off Balance Sheet Arrangements

CA. S. Krishnaswamy

Summary :

1. Introduction – Implications of Off-Balance Sheet
2. US Law on Off-Balance Sheet arrangements
3. Indian Law
   a. Companies Act, 2013 – Board Report : Audit Committee
   b. Listing Agreement Cl. 49 – Corporate Governance on subsidiaries and Management Disclosure Analysis Report

Introduction

1. Regulators have been grappling the issue of disclosure requirements in respect of Off-Balance Sheet items that could evaluating financial results of entities. One step was consolidation of all subsidiaries with the parent company financial statements. Some areas still remain outside the parent's Balance Sheet.
2. Accounting Standards have been set in some areas. They are -
   1) Ind AS 107 – Financial Instruments: Disclosures
   2) Ind AS 17 – Leases
   3) Ind AS 19 – Employee Benefits
   4) Ind AS 24 – Related Party Disclosures
   5) Ind AS 27 – Consolidated and Separate Financial Statements
   6) Ind AS 28 – Investments in Associates
   7) Ind AS 31 – Interests in Joint Ventures
   8) Ind AS 32 – Financial Instruments: Presentation
   9) Ind AS 37 – Provisions, Contingent Liabilities and Contingent Assets
   10) Ind AS 38 – Intangible Assets
   11) Ind AS 39 – Financial Instruments: Recognition and Measurement
3. Unforeseen corporate failures like Enron highlighted the issue where inclusion of a number of investee companies' financials jumped the consolidation rule and hence deluded analysts to conclude that Enron Balance Sheet was strong. Following Enron failures and others SOX Act was enacted in US to make internal controls over external financial disclosures mandatory and the Act empowered SEC to issue a rule on "Off-Balance Sheet arrangements".
4. Companies have used Off-Balance Sheet entities responsibly and irresponsibly for some time. An area that has come under scrutiny, and one where the company may be at risk, is off-balance sheet arrangements. Generally accepted accounting principles (GAAP) permit certain kinds of transactions to be accounted for off the company's balance sheet, and many companies, as a means of managing risk and/or taking advantage of legitimate tax minimization opportunities, create off-balance sheet arrangements.
5. **SEC Final Rule: (After exposing the draft for comments)**
   Disclosure in Management's Discussion and Analysis About Off-Balance Sheet Arrangements, Contractual Obligations and Contingent Liabilities and Commitments

Securities And Exchange Commission

Background

On July 30, 2002, the Sarbanes-Oxley Act of 2002 was enacted. Section 401(a) of the Sarbanes-Oxley Act added Section 13(j) to the Securities Exchange Act of 1934, to require each annual and quarterly financial report required to be filed with the Commission, to disclose "**all material off-balance sheet transactions,**

arrangements, obligations (including contingent obligations), and other relationships of the issuer with unconsolidated entities or other persons, that may have a material current or future effect on financial condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues or expenses."

Management Discussion and Analysis Report

The Commission has long recognized the need for a narrative explanation of financial statements and accompanying footnotes and has developed MD&A over the years to fulfill this need. The disclosure in MD&A is of paramount importance in increasing the transparency of a company's financial performance and providing investors with the disclosure necessary to evaluate a company and to make informed investment decisions. MD&A also provides a unique opportunity for management to provide investors with an understanding of its view of the financial performance and condition of the company, an appreciation of what the financial statements show and do not show, as well as important trends and risks that have shaped the past or are reasonably likely to shape the future.

The MD&A rules already require disclosure regarding off-balance sheet arrangements and other contingencies. They are designed to cover a wide range of corporate events, including events, variables and uncertainties not otherwise required to be disclosed under U.S. generally accepted accounting principles ("GAAP"). For example, the current MD&A rules require disclosure of:

- "Information necessary to an understanding of the registrant's financial condition, changes in financial condition and results of operations;
- Any known trends, demands, commitments, events or uncertainties that will result in, or that are reasonably likely to result in, the registrant's liquidity increasing or decreasing in any material way;
- The registrant's internal and external sources of liquidity, and any material unused sources of liquid assets;
- The registrant's material commitments for capital expenditures as of the end of the latest fiscal period;
- Any known material trends, favorable or unfavorable, in the registrant's capital resources, including any expected material changes in the mix and relative cost of capital resources, considering changes between debt, equity and any off-balance sheet financing arrangements.
- Any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from continuing operations and, in each case, the extent to which income was so affected.
- Significant components of revenues or expenses that should, in the company's judgment, be described in order to understand the registrant's results of operations;
- Known trends or uncertainties that have had, or that the registrant reasonably expects will have, a material favorable or unfavorable impact on net sales or revenues or income from continuing operations.
- Matters that will have an impact on future operations and have not had an impact in the past; and
- Matters that have had an impact on reported operations and are not expected to have an impact upon future operations."

Subsidiaries do not figure in the SEC rule here as they are now to be consolidated and the consolidated financial statements form an integral part of accounts (Ind AS 27). Only financials of all unconsolidated entities will come under the subject now discussed. The disclosure requirements of Off-Balance Sheet arrangements are to enable investors to assess their impact on the financial position of the company. For example bank guarantees may come up for payment if the guarantee fails to perform. This assumes special importance in the case of banking companies.

6. **Indian Law – Companies Act 2013: Listing Agreement**

Companies Act 2013

- Board Report Sec 134 –

In India, Companies Act prescribes the contents of Board of Directors Report in Sec 134. Sub-section (3)(l) of the said section refers to –

"Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report."

There is no mention of Off-Balance Sheet arrangements.

- Audit Committee Sec 177 –

Sec 177 of the Companies Act, 2013 refers to the terms of reference. This does not include Off-Balance Sheet Arrangements.

- Definition of Subsidiary Company Sec 2(87) –

Companies Act 2013 defines a 'Subsidiary Company' in Sec 2(87); for the first time it adds a proviso –

"Provided that such class or classes of holding companies as may be prescribed **shall not have layers of subsidiaries** beyond such numbers as may be prescribed".

SEBI Act – Listing Agreement – Cl.49

- No Clause on Off-Balance Sheet

SEBI via listing agreement which it is empowered to enforce under the Securities Contracts Regulation Act 1956, has in Cl. 49 prescribed 'Corporate Governance' requirements and disclosures. It has also prescribed the contents of a separate M&D Report (Management Discussion and Analysis Report). This report does not, as in the case of US-SEC or SOX Act, specifically mention of Off-Balance Sheet arrangements. However, it deals extensively in Cl. 49(V) with disclosures regarding the subsidiary companies.

(Contd. on page 8)

Indirect Taxes Update – Sept. 2014

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

<u>FOR THE MONTH OF SEP 2014:</u>

A. Notifications and Circulars

a) Circulars

i) **Clarifications relating to payment of pre-deposit in terms of Section 35F of Central Excise Act, 1944 & Section 129E of the Customs Act, 1962:**

Further to amendment vide Finance Act, 2014 to the provisions relating to pre-deposit to be made for preferring appeal before Commissioner (Appeals) or CESTAT, the CBEC has issued following clarifications:

a) **Pre-deposit in case of appeal against order of Commissioner(Appeals)**: Board has clarified that in the event of appeal before CESTAT against the order of Commissioner(Appeal), 10% is to be paid on the amount of duty demanded or penalty imposed by the Commissioner(Appeal). This need not be the same as the amount of duty demanded or penalty imposed in the Order-in-Original in the said case.

b) Where penalty alone is disputed, then 10% or 7.5% as the case may be shall be paid on cumulative of all penalties imposed.

c) **Procedure and Manner of making the pre-deposits:**

- A self attested copy of the document showing satisfactory proof of payment shall be submitted before the appellate authority as proof of payment made in terms of Section 35F of the Central Excise Act, 1944 or Section 129E of the Customs Act, 1962.
- Column 7 of EA.1, column 6 of CA.1 and column 6 of ST.4 for filing appeal before Commissioner (Appeals), seek details of the duty/penalty deposited. The same may be used for indicating the deposits made under amended Section 35F of the Central Excise Act, 1944 or section 129E of the Customs Act, 1962.
- Column 14(i) of the appeal forms (EA-3/ CA-3/ ST-5) seeks information of payment of duty, fine, penalty, interest along with proof of payment (challan). These columns may, therefore, be used for the purpose of indicating the amount of deposit made, which shall be verified by the appellate authority before registering the appeal.

d) **Amounts paid during investigations**: Amounts paid in connection with the issue in appeal, during the investigation or any time prior to the date of filing appeal would also be considered for the purpose of the pre-deposit.

e) **Recovery of balance dues:** No coercive measures for the recovery of balance amount i.e., the amount in excess of 7.5% or 10% deposited in terms of the above Section.

f) **Refund of pre-deposit**: Pre-deposit for filing appeal is not payment of duty. Hence, refund of pre-deposit need not be subjected to the process of refund of duty under Section 11B of the Central Excise Act, 1944 or Section 27 of the Customs Act, 1962. Therefore, in all cases where the appellate authority has decided the matter in favour of the appellant, refund with interest should be paid to the appellant within 15 days of the receipt of the letter of the appellant seeking refund, irrespective of whether order of the appellate authority is proposed to be challenged by the Department or not.

g) **Procedure for refund:** A simple letter from requesting for return of the said amount, along with a self attested copy of the order in appeal or the CESTAT order consequent to which the deposit becomes returnable and attested copy of the document evidencing payment of such deposit, addressed to Jurisdictional Assistant/Deputy Commissioner of Central Excise and Service Tax or the Assistant/Deputy Commissioner of Customs, as the case may be, would suffice for refund of the amount deposited along with interest at the rate specified.

[Source: Circular No 984/08/2014-CX dt. 16.09.2014]

ii) **Guidelines regarding Structure, Administrative set up and Functions of Audit Commissionerates:**

Consequent to amendments made in the Finance Act, 2014 to the administrative set up in Central Excise and Customs department, Central Government has issued Notifications No. 27-29/2014 Dt.16-09-2014 to implement the said amendments. The said changes to administrative set and the redefined jurisdictions are explained in the circular No. Circular No. 985/09/2014-CX dt. 22.09.2014

iii) Instructions to implement decision of Supreme Court on the aspect of valuation of goods where sales tax incentives are received.

Hon'ble Supreme Court in case of M/s Super Synotex India Ltd. Reported in 2014-TIOL-19-SC-CX, has held that the amount of sales tax collected but retained by manufacture on account of concessional scheme of Government would also be considered as value for the purpose of discharging duty of excise.

In the said case assesse was allowed to retain 75% of the sales tax collected from the buyer and was required to deposit only the remaining 25% with the State Government. Under the circumstances, Hon'ble Court held that after 01.07.2000 i.e. under the transaction value regime, 75% of the sales tax retained by the assesse would form part of the assessable value, on the ground that the definition of "transaction value" mean payment made on actual basis or actually paid by the assesse and what has been collected but not remitted to sales tax authority shall be considered to be consideration.

CBEC has issued instructions to the field officers to take note of the above decision for the purpose of valuation issues.

[Source: CBEC Instruction in F.No. 6/8/2014-CX.1., Dated: September 17, 2014]

[Note: With due respects to Supreme Court, we are of the view that Supreme Court fails to appreciate the nature of incentive scheme. State Government grants incentive in the form of retention of 75% sales tax amount by the assessee, hence what is retained by the assessee is only the amount which they are eligible to get as incentive from State Government and not a consideration which he is charging from customer and retaining. Further, the court while laid more emphasis on the phrase 'actually paid', the scope and purpose of the phrase 'actually payable' has not been considered]

B. Important Decisions

1) M/s BRITISH AIRWAYS vs. CCE., 2014-TIOL-979-CESTAT-DEL

Facts: M/s British Airways (BA, UK) is British Airlines operating from its head office located at London. Under the permission granted by the Reserve Bank of India, they have opened an office in India. The said branch office provided the services of air transportation of passengers and cargo for which they have service tax registration

BA, UK entered into agreement with companies located outside India to obtain 'Computer Reservation System' to book tickets all over world. Consideration for use of such system was paid by BA UK based on number of tickets booked using such system. Such system was used by various ticket booking agents in India who are appointed by Branch of BA in India.

The contention of the department is that the services of said Computer Reservation system is being used and consumed in India by the agents of Indian branch of BA and hence the consideration attributable to tickets booked from India would be liable to service tax under reverse charge on branch of BA under section 66A

Held: Holding that no service tax could be determined from the branch office, the Tribunal observed that in terms of Section 66A, 'BA, U.K.' and its Indian branch office shall be treated as different entities. Therefore, it would be wrong to treat the services received from CRS/GDS companies by 'BA, U.K.', as the services received by their Indian branch-BA, India. Similarly the payments made to CRS/GDS companies by 'BA, U.K.' cannot be treated as payments made to CRS/GDS Companies by BA, India or on behalf of BA, India.

2) GTL Infrastructure Ltd Vs. CCE, 2014-TIOL-1768-CESTAT-MUM

Facts: Assessee is engaged in creating telecom infrastructure (passive telecom infrastructure) providing the same to the telecom operators to use such facility for their telecom services. The appellant availed credit on various goods such as parts of Towers, BTS Cabins etc., which are used for providing the services. The credit was disputed by the department.

Held: Allowing the credit the Tribunal held that rule 2(k)(ii) of Cenvat Credit Rules, 2004 deals with credit availment on inputs for a service provider. The said clause provides that all goods, except light diesel oil, high speed diesel oil, motor spirit, commonly known as petrol and motor vehicles, used for providing any output service would qualify to be input service. Since the said goods are used for provision of services, the same would qualify to be input service. Further, the Tribunal observed that explanation II to the definition of inputs which restricts availment of credit on certain goods used in construction or support structure is only applicable to manufacturers and not to service providers. The Tribunal distinguished the decision of the Tribunal in the case of Bharti Airtel Ltd. Vs. Commissioner of Central Excise, 2012-TIOL-209-CESTAT-MUM, on the ground that the facts in the said case are different, as the service providers were telecom operators in the said case and also the decision of the tribunal in said case is mainly relying on explanation II discussed above.

(*Note*: Tribunal decision in Bharti Airtel has been affirmed by High Court as reported in 2014-TIOL-1452-HC-MUM-ST)

3) Kanade Anand Udyog Pvt Ltd Vs. CCE, 2014-TIOL-1773-CESTAT-MUM

Facts: Assessee imported certain inputs/capital goods and Bills of Entry were in the name of their Head Office. The Bills of entry was endorsed in the name of the factory and the credit was availed on the basis of said endorsed bill of entries. The credit was denied on the ground that the Bills of Entry were not addressed to the factory.

Held: Allowing the credit, the Tribunal held that it is not in dispute that the bills of entry was endorsed and also the lorry receipts clearly establish that the goods have been received at factory. The Tribunal observed that the lower authorities have not understood the provisions of Cenvat credit in true spirit which resulted in the denial of credit which is clearly eligible.

4) **Shapoorji Pallonji & Co Ltd Vs CCE 2014-TIOL-1641-CESTAT-MUM**

*Issue***:** Whether the value of materials supplied free of cost by the customer to the service provider is includible in the value of taxable service?

Held: In the context of commercial or industrial construction service, Hon'ble Tribunal held that the value of goods and materials supplied free of cost by service recipient to the service provider, being neither monetary / non-monetary consideration paid by or flowing from the service recipient nor accruing to the benefit of service provider, it would be outside the taxable value or the gross amount charged, within the meaning of the expression in Section 67 of the Finance Act, 1994. Therefore, Tribunal allowed the appeals of the appellant by holding that the value of free supply by service recipient does not comprise the gross amount charged under Notification No. 15/2004-ST, including the Explanation thereto as introduced by Notification No. 4/2005-ST.

5) Hindalco Industries Ltd Vs CCE 2014-TIOL-1762-CESTAT-MUM-LB

Issue: Whether Aluminium dross and skimmings which arise as a by-product in the process of manufacture of aluminium products are liable to duty?

Held: Larger Bench of the Tribunal held that Aluminium dross and skimmings which arise as a by-product in the process of manufacture of aluminium products are "manufactured" goods. Further, in terms of amendment to Section 2(d) deeming that goods which is capable of being bought and sold for a consideration and such goods shall be deemed to be marketable', the goods become excisable w.e.f. 10/05/2008. Therefore, the said products even though they are scrap of waste products.

6) **Apotex Research Pvt Ltd Vs CC 2014-TIOL-1836-CESTAT-BANG**

Through a Miscellaneous order CESTAT, Bangalore has addressed various issued relating to refund of CENVAT Credit in terms of Rule 5 of CENVAT Credit Rules, 2004 read with the notification and the notifications issued there under. The issues and view of the Tribunal is summarized below:

Issue No.1: Whether CENVAT credit can be refunded under Rule 5 when there was no notification prior to 14.03.2006.

Decision: YES. Wherever the refund has been rejected on the ground of words used in the notification, will have to be remanded to the original adjudicating authority for reconsideration of the eligibility of credit in the light of amendment issued in 2010 with retrospective effect.

Issue No. 2: What is the place of removal in case of export goods for the purpose of Rule 5?

Decision: Port/airport/land customs station from where the goods are exported shall be considered to be place of removal and all the services utilized up to the stage would become eligible for refund under Rule 5.

Issue No. 3: Whether 100% EOUs are also eligible to claim refund under Rule 5? Contention of the department is that the CENVAT credit cannot be taken at all since the finished goods are exempt.

Decision: After 10.09.2004 CENVAT credit cannot be denied on the ground that unit availing the credit is a 100% EOU. Therefore, refund has to be given.

Issue No. 4: Where the services are performed in India, but the recipient is located outside India, whether such services could be termed as export to claim refund ?

Decision: Board itself has issued a clarification vide Circular No. 111/5/2009-ST dated 24.02.2009. In this circular in paragrah-3 Board has accepted that for category (iii) services (As per Export of Services Rules), it is possible that export of service may take place even when all the relevant activities take place in India so long as benefits of these services accrue outside India.

Issue No. 5: Nexus between the input services and the output services.

Decision: nexus between input services and output services shall be established for the purpose of refund.

Issue No.6: Foreign Inward Remittance Certificate

Decision: In certain cases, the lower authorities have taken a view that production of foreign inward remittance certificate by the claimant to claim refund is not sufficient to establish the receipt of consideration in foreign exchange. A certificate from the bank certifying that the amount in the invoice has been received specifically with reference to the invoice has to be made available. What is required to be established by an exporter is that in respect of Invoices raised by him, consideration in foreign currency has been received. it would be unrealistic to require claimants of refund to produce invoice-wise certificate from the bank. In the Circular No. 112/6/2009 as regards FIRC. Board had clarified that where FIRCs are issued on consolidated basis, exporter should submit self-certified statement along with FIRC showing details of exports to which FIRC pertains. Refund should be allowed on such certified statement.

Issue No.7: Can clearance to a 100% EOU be considered as export?

Decision: YES; this issue is no longer res integra and is covered by the decision in the case of NBM Industries & Shilpa Copper Wire Industries .

Issue No.8: Proof of payment of service tax

Decision: In some cases, the authorities sanctioning the refund are insisting that the claimant should produce proof of payment of service tax by the service provider. There is no requirement to produce such proof

Issue No. 9: Registration requirements:

Decision: Rejection of the claim for refund of Cenvat credit on the ground that it is not admissible when the unit was not registered cannot be upheld.

Issue No. 10: Condonation of omissions in documents as per the provisions of Rule 9 of Cenvat Credit Rules, 2004.

Decision: Rule 9(2) of Cenvat Credit Rules provides that if the document does not contain all the particulars but contains details of duty or service tax payable, description of goods, etc, Cenvat credit may be allowed.

Issue No.11: Rejection of refund claim on the ground that output service is not taxable.

Decision: Denial of refund on the ground that services exported are not taxable cannot be sustained.

Issue no. 12: Taxability of output and admissibility of Cenvat credit.

Decision: The requirement under the rule is that the input service should have been used in providing output service ('for providing output service' after amendment) and such credit shall be either utilized or claimed as refund. That being the case, rejection of refund claimed on the ground that output service is not taxable or exempted cannot be sustained..

Issue No. 13: Whether provisions of Section 11B is applicable to refunds under Rule 5.

Decision: provisions of Section 11B for the purpose of limitation would be applicable.

Issue No.14: Method for calculation of relevant date for the purpose of computation of 1 year period.

Decision: the relevant date should be the date on which the consideration has been received where the claimant is service provider and consideration paid where the claimant is service receiver. However, where advance was received towards provision of service, the relevant date would be the date of final invoice issued against provision of service.

[Note: The Hon'ble Tribunal has addressed most of the issues faced by the exporters seeking refund of Cenvat credit.

Department should take the above into consideration while disposing off the refund claims instead of following the same old principles]

7) **Oberoi Mall Ltd Vs CST 2014-TIOL-1757-CESTAT-MUM**

Facts: Appellant availed CENVAT credit of ST paid on various services used for construction of 'mall' and utilizing the credit for payment of service tax on 'renting of immovable property'

Held: while deciding stay application, the Tribunal observed that CENVAT Credit paid on input services used in the construction of immovable property would be available if such immovable property is used for rendering other taxable services. Based on the above observations, Tribunal granted unconditional waiver of pre-deposit of dues and stayed recovery of amounts confirmed by lower authorities.

8) **Travelite(India) Vs. Union of India, 2014(35) STR 653(Del.)**

Facts: Assessee challenged the letter issued by department to produce the records for audit by the audit wing of the department on the ground that the statute does not provide for such audit.

Held: Allowing the writ petition, the High Court held that Section 72A of Finance Act, 1994 provides audit only under certain specified circumstances. Therefore, the audit could be undertaken only under such circumstances and empowering the audit party in terms of Rule 5A(2) of Service Tax Rules, 1994 to undertake audit in general is beyond statutory provisions and ultrvires the rule making power of the Government. The High Court observed that the rules are delegated legislation and mere fact that rule-making power is phrased in terms that indicate general delegation of power, it cannot lead to inference that such power may be exercised to make rule that exceed beyond statute.

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Off Balance Sheet Arrangements

(Contd. from page 4)

These are –

- V. Subsidiary Companies

A. At least one independent director on the Board of Directors of the holding company shall be a director on the Board of Directors of a material non-listed Indian subsidiary company.

B. The Audit Committee of the listed holding company shall also review the financial statements, in particular, the investments made by the unlisted subsidiary company.

C. The minutes of the Board meetings of the unlisted subsidiary company shall be placed at the Board meeting of the listed holding company. The management should periodically bring to the attention of the Board of Directors of the listed holding company, a statement of all significant transactions and arrangements entered into by the unlisted subsidiary company.

D. The company shall formulate a policy for determining 'material' subsidiaries and such policy shall be disclosed to Stock Exchanges and in the Annual Report.

E. For the purpose of this clause, a subsidiary shall be considered as material if the investment of the company in the subsidiary exceeds twenty per cent of its consolidated net worth as per the audited balance sheet of the previous financial year or if the subsidiary has generated twenty per cent of the consolidated income of the company during the previous financial year.

F. No company shall dispose of shares in its material subsidiary which would reduce its shareholding (either on its own or together with other subsidiaries) to less than 50% or cease the exercise of control over the subsidiary without passing a special resolution in its General Meeting.

G. Selling, disposing and leasing of assets amounting to more than twenty percent of the assets of the material subsidiary shall require prior approval of shareholders by way of special resolution

Explanation (i): The term "material non-listed Indian subsidiary" shall mean an unlisted subsidiary, incorporated in India, whose income or net worth (i.e. paid up capital and free reserves) exceeds 20% of the consolidated income or net worth respectively, of the listed holding company and its subsidiaries in the immediately preceding accounting year.

Explanation (ii): The term "significant transaction or arrangement" shall mean any individual transaction or arrangement that exceeds or is likely to exceed 10% of the total revenues or total expenses or total assets or total liabilities, as the case may be, of the material unlisted subsidiary for the immediately preceding accounting year.

Explanation (iii): Where a listed holding company has a listed subsidiary which is itself a holding company, the above provisions shall apply to the listed subsidiary insofar as its subsidiaries are concerned.

- Cl. VIII deals with Disclosures of Related Party Transactions.

A. Related Party Transactions

1. Details of all material transactions with related parties shall be disclosed quarterly along with the compliance report on corporate governance.
2. The company shall disclose the policy on dealing with Related Party Transactions on its website and also in the Annual Report.

B. Disclosure of Accounting Treatment

Where in the preparation of financial statements, a treatment different from that prescribed in an Accounting Standard has been followed, the fact shall be disclosed in the financial statements, together with the management's explanation as to why it believes such alternative treatment is more representative of the true and fair view of the underlying business transaction in the Corporate Governance Report.

It does not deal with entities which are not consolidated under the standard.

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Service Tax Export - Commission Agent

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

Under service tax law, there was ongoing litigation about the applicability of service tax levy on commission agency services by Indian service providers to foreign principals. The argument was that all services were provided by way of marketing/sales promotion to customers in India, consequently taxable in India. The issue was more or less settled over period that services were exports. A reversal in the entire concept has been made whereby Indian commission agents earning valuable foreign exchange would be taxed wef 1.10.14.

Background

Under erstwhile tax regime as applicable till 1.7.12, the export of services has been structured by breaking up the services into three groups/sectors i.e. based on the situation of immovable property, based on the performance of service and on the situation of the recipient of service.

There was confusion as to determination of export of services under the recipient based services group when the services are performed in India and the service recipient was situated outside India and benefit accrued to such service recipient outside India. The objection was that since the services are performed in India, the services are not used outside India; instead it is used within India. This was also argument taken for demanding service tax on commission agent services though booking of orders for goods with Indian customers was done for foreign principal and commission received in convertible foreign exchange

Circular No. 111/5/2009-S.T., dated 24-2-2009, meanwhile clarified that for the services that fall under Category III [Rule 3(1)(iii)], the relevant factor is the location of the service receiver and not the place of performance. …..Thus, for Category III services, which also is covering business auxiliary services of nature of commission agent for goods, a view was prevalent that it is possible that export of service may take place even when all the relevant activities take place in India so long as the benefits of these services accrue to foreign principal outside India.

We examine the service tax applicability on such incomes in light of changes made in rule 9 of Place of Provision of Service Rules by Finance Act (No.2) 2014. First we examine what was the applicable rule and its impact and then the implications of change wef 1.10.14.

Place Of Provision Of Service Rules

The levy of service tax is on services other than negative list of services **provided or agreed to be provided in taxable territory**. Taxable territory means India excluding Jammu and Kashmir. It would also be important to examine whether the services are provided or agreed to be provided in taxable territory.

Services being intangible, it is difficult to ascertain the place where the services are provided or agreed to be provided. For that reason the statute has formulated powers to formulate rules called as Place of Provision of Service Rules(POPS) prescribing methodology to determine the place of provision of service.If by applying these rules sequentially from last from Rule 12 to Rule 3, it is determined that place of provision of service is in India, then service tax is payable on such services.

As per Rule 9 specifies the services where the **<u>place of provision of service is the location of the service provider and covers</u>**:-

i) ………………………………..;

ii) **Intermediary services;…………**

Commission agent service to foreign principal:

Till 1.10.14:

As per Rule 2 (f) of POPS Rules “intermediary” means a broker, an agent or any other person, by whatever name called, who arranges or facilitates a **<u>provision of a service</u>** (hereinafter called the ‘main’ service) between two or more persons, but does not include a person who provides the main service on his account.;

Generally, an “intermediary” is a person who arranges or facilitates a **supply of goods**, or a **provision of service**, or **both**, between two persons, without material alteration or further processing. However as per the definition specifically it is covering only intermediary for provision of service and is not covering an **intermediary in respect of goods** (such as a commission agent i.e. a **buying or selling agent,** or a stockbroker).

As the person who facilitated the supply of goods such as commission agent was not covered in intermediary services. Further the intermediary in respect of goods such as commission agent was not covered in any of the other rules from 4-12. Accordingly covered in default Rule 3.

As per default Rule 3, place of provision of service is location of service receiver. The place of provision of services by commission agent for goods was location of service receiver. If Indian commission agent was providing services to foreign principal, then as per Rule 3 the service recipient was foreign principal outside India. The place of provision of service was location of such recipient outside India and not liable to service tax.

Impact of Change wef 1.10.14

The **definition of intermediary has been amended** to include the intermediary of goods in its scope. Accordingly, with effect from 1.10.2014, an **intermediary of goods**, meaning a broker, an agent or any other person who arranges or facilitates a supply of goods, between two or more persons shall be covered under rule 9. The place of provision of intermediary services is location of service provider.

In other words, when Indian commission agent for goods provides services to a foreign principal, place of provision of services is location of service provider commission agent in India. As place of provision of service is in India, the service provider is liable to service tax on such services provided to foreign principal.

Export Of Services After 01.07.2012:

If the activity is non-taxable as the same is intended to be provided outside taxable territory. However in such cases the service tax rules read with CENVAT Credit Rules, 2004 is so framed that if conditions given below are fulfilled, the said non-taxable services shall not be treated as exempted services but exported services and benefit of CENVAT Credit if eligible can be availed.

In case of commission agent for goods, as seen earlier till 1.10.14 place of provision of service as per Rule 3 of POPS is location of service receiver outside India. Further if all conditions given in Rule 6A below are fulfilled, then can avail eligible credits related to such exported services alternately go for refund.

Rule 6A says that services will be considered as export of service when the following conditions are fulfilled:

I. The provider of service is located in the taxable territory- it is fulfilled-the provider of service is located in the taxable territory of India

II. The recipient of service is located outside India- It is fulfilled - The recipient of service is located outside India

III. The service is not specified under the negative list of services- it is fulfilled - The service is not specified under the negative list of services.

IV. The place of provision of services is outside India-it is fulfilled- For commission agent services: till 30.9.14: As per Rule 3, the place of provision of service is location of service receiver outside India.

V. It is not fulfilled- For commission agent services: post 1.10.2014: The place of provision of service as per Rule 9 is location of service provider in India.

VI. The payment for such service has been received by the provider of service in convertible foreign exchange- it is fulfilled - The payment for such service is said to be received by service provider in convertible foreign exchange and

VII. The provider and the recipient of service are two distinct establishments and not merely establishments of the same person- it is fulfilled –provider of service and service receiver outside India are two different companies. It is not merely establishments of the same person.

As one of the main conditions to treat as export of services in Rule 6A of ST Rules is that the place of provision of service is outside India. Wef 1.10.14, the place of provision of services by commission agent as per Rule 9 of POPS is location of service provider in India. All the conditions to treat as export of services are not satisfied. At same time, as commission agent has to pay service tax on commission post 1.10.14, he can avail eligible credits related to such taxable services.

Impact on services by foreign commission agent for Indian exporters of goods

In parting it would do well to note that the services by foreign commission agent for goods of Indian exporters was also covered in Rule 3 of POPS till 1.10.14. In other words, place of provision of services by foreign commission agent was location of service receiver exporter in India. Consequently liable to service tax under reverse charge in hand of Indian exporter. Alternately the Indian exporter could opt for exemption from paying ST on such foreign commission agent services by following notified procedure prescribed in that regards.

As a positive now as such services by foreign commission agent would be covered in Rule 9 of POPS. As per which place of provision of service is location of service provider foreign commission agent outside India. Consequently the Indian exporter no longer is required to pay service tax on such services received wef 1.10.14.

Some service providers have been examining the splitting the activity into technical, consultancy and business support services which could form of a marketing arrangement. It is suggested that caution is exercised as the higher interest and penalty could lead to enhancing the demands.

Conclusion

This change is an example of legislature making changes as a revenue augmentation measure keeping aside all the basic tenets of taxation one of which is that activities earning CFE for India are to be kept out of tax levy. Higher officers have been saying that this is due to the fact that they are following "best practices" across the world. However in the European Union the intermediary service whether for goods or services has always been based on the place of the customer/ recipient.

As of now the only option for commission agents for goods is to factor the service tax into costing. Alternately examine change over in model to principal to principal buying and selling of principals goods.

In this article the paper writers have sought to examine the changes made. For further queries post at

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The Amazon Crisis: A Legal Analysis

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Amazon Inc. ("Amazon"), the $30 billion American online shopping and e-commerce giant, has recently been attracting a lot of unwanted attention from the Karnataka Commercial Taxes Department. What, at first glance, appeared to be a rather innocuous issue has spiraled into a major headache for Amazon, and the impact of the Commercial Tax Department's actions has been felt even in Delhi.[1] Media reports suggest that Amazon has approached various authorities in the State, and negotiations are on to resolve the issue. The political negotiations that are ongoing, and the ramifications that Amazon's withdrawal from the State may have, are outside the scope of this article. Needless to state, Amazon is here to stay, and the State would benefit tremendously from its presence in Karnataka. This article briefly describes the issue that Amazon currently faces, discusses the legal framework that is applicable to it, and addresses whether the commercial taxes department in Karnataka has legally tenable defenses for its actions.

Background

Amazon, an icon and a global leader in the online shopping and electronic gadget industry entered the Indian market in June, 2013, and the company recently announced that it plans to invest $2 billion in the nascent Indian electronic retailing (often referred to in the media as e-tailing) industry. In India, Amazon operates on two business models: (1) "Sell on Amazon," and (2) "Fulfillment by Amazon."[2]

Under the "sell on Amazon" model, a third-party seller ("retailer" or "dealer") is allowed to list its products on the Amazon website. Consequently, customers across India are allowed to view the product on the popular website and place an order for it. Once the customer places an order for the product, the retailer packs and delivers the product to the customer. Unless specifically requested, Amazon is not involved in the delivery of the product. The retailer raises an invoice directly on the customer, and payment for the product is routed through Amazon. While releasing the payment to the retailer, Amazon withholds a fee for the service of allowing the retailer to list its products on the website.

The sale is, therefore, executed by the retailer directly to the customer, and Amazon's role in the entire transaction is merely to allow the retailer to list its products on the website. In essence, Amazon merely acts as a market place by allowing third-party retailers to host their products on Amazon's website. For rendering the service of allowing the retailer to list its products on its website, Amazon collects a fee. Therefore, Amazon's role in the entire transaction is very limited under the "sell on Amazon" model.

Under the "fulfillment by Amazon" model, Amazon has a larger and more active role to play in the transaction. Under this model, retailers, who would like to sell their goods on the Amazon website, send their products to an "Amazon Fulfillment Center," which is, essentially, a massive warehouse/storage facility owned and operated by Amazon. Amazon stores the retailers' goods in their facility. As a large number of retailers would like to have their goods sold through Amazon, the fulfilment center contains millions of goods belonging to several different retailers. Once the customer places an order for any goods, Amazon, which has a sophisticated and state-of-the-art inventory maintenance software system, picks up the goods from the warehouse, packs it, and delivers it to the customer's location.

Crucially, in this case, too, the seller of the goods remains the retailer, who will raise an invoice directly on the customer. Amazon is never the owner of the goods and, therefore, is not involved in the sale of goods. Here again, once the customer purchases a product, the payment is routed through Amazon, and while disbursing the payment to the retailer, Amazon will withhold a fee for allowing the retailer to store its goods in the warehouse, and for packing and delivering the goods to the customer's location.

It is, therefore, apparent that under both models, Amazon is not buying or selling goods. In both cases, it is the retailer who will directly sell the goods to the customer. Amazon never owns the products and, accordingly, does not sell any goods. Amazon only collects fees for certain services rendered by it, such as allowing the goods to be listed on the website, storing of the goods, and packing and delivering of goods.

The Issue

The issue raised by the department, at least for the moment, relates to Amazon's fulfilment center where goods belonging to several different retailers are stored.[3] Each of the retailers who are storing their goods in Amazon's fulfilment center had registered the center as an "additional place of business" under the Karnataka Value Added Tax Act, 2003 ("KVAT

1 http://articles.economictimes.indiatimes.com/2014-09-18/news/54067928_1_karnataka-cm-siddaramaiah-amazon-digvijay-singh

2 Information regarding Amazon's business models is available online at services.amazon.in

3 There are reports that the department seeks to tax Amazon as an agent selling goods on behalf its principal-retailers. As there is insufficient information in this regard, this article does not discuss the issue regarding whether Amazon can be taxed as an agent under the KVAT and CST Acts. The law in this regard is, however, fairly clear and will, perhaps, be the topic of another article.

Act”). Starting in July and August, 2014, the Karnataka VAT authorities issued notices to numerous retailers who were storing their goods in Amazon’s fulfilment center, proposing to cancel their registration of the Amazon fulfilment center as an additional place of business. In other words, the VAT authorities proposed to cancel the retailers’ designation of Amazon’s fulfilment center as their additional place of business. The proposal to cancel the registrations of the additional place of business was, reportedly, on the ground that a single location cannot be an additional place of business for more than one retailer as it would be detrimental to the enforcement of the KVAT Act.[4] In essence, the department was of the view that allowing hundreds of retailers to register a single place as an additional place of business would make it difficult to identify the goods belonging to different retailers and would, accordingly, hinder the effective implementation of the Act through searches, seizures, and the like. In some cases, the authorities proceeded to cancel the registration of the retailers and, consequently, the dealers whose registrations were canceled were compelled to remove their goods from the Amazon fulfilment center. As a result of the VAT authorities’ actions, a number of retailers were left with no option but to stop selling their goods on the Amazon platform through the fulfilment model.

Provisions under the KVAT Act and Rules relating to Registration of Additional Places of Business

Section 22 of the KVAT Act prescribes the categories of persons who are liable to get registered under the Act. Section 25(1) states that “[t]he form of application to register under Section 22 […], the time and manner of making application, and the fee payable shall be as may be prescribed.” Sub-section (2) of Section 25 states that on receipt of an application for registration, the prescribed authority shall register the dealer and grant him a certificate of registration.

Rule 4 of the KVAT Rules requires that a dealer who wishes to obtain a registration must submit an application for registration in Form VAT 1. Under Rule 5, if a registered dealer has more than one place of business, he shall submit a further application in Form VAT 3. The Form VAT 3 must either be submitted along with the Form VAT 1 (if the additional place of business exists at the time of obtaining registration), or within ten days from the opening of the additional place of business.

Under Rule 7, the registering authority is required to review each application to ensure that it contains all the information required. Under Rule 8, if the registering authority is not satisfied that the particulars contained in the application are correct and complete, the application may be rejected for “reasons to be recorded in writing, after giving the dealer an opportunity of showing cause in writing against such rejection.”

4 http://articles.economictimes.indiatimes.com/2014-09-16/news/53983069_1_service-tax-merchants-tax-troubles

If the registering authority is satisfied that the information is true and correct, he shall, under Rule 9, assign a registration number (TIN) to the dealer and issue a certificate of registration in Form VAT 7. Rule 9 further states that the registering authority shall provide certified copies of the registration certificate for any additional places of business.

Section 27 of the KVAT Act empowers the prescribed authority to cancel the registration of a dealer in the following circumstances:

(a) Any business of a registered dealer has been discontinued;
(b) There is a change in the ownership status of the business;
(c) The taxable turnover of a dealer during any consecutive period of 12 months has not exceeded Rs. 5 lakhs;
(d) A dealer issued tax invoices without effecting taxable sales;
(e) A dealer being an individual, dies; and
(f) For <u>any other good and sufficient reason</u>.

Section 27, therefore, contains an omnibus clause under which the prescribed authority can cancel a dealer’s registration for “good and sufficient reason.” Neither the Act nor any case laws set out any guidelines for what constitutes “good and sufficient reason.” Moreover, the cancelation of the registration can be done by the prescribed authority, either on its own motion or on the application by a dealer, and the section does not provide for an opportunity of showing cause against the cancelation of any registration.

Presumably, in Amazon’s case, the department has relied on Section 27 in initiating cancelation proceedings against retailers storing goods at Amazon’s fulfilment center. As none of the five specific circumstances enumerated under Section 27 apply to the case, the department can only invoke the omnibus “good and sufficient reason” clause to cancel the retailers’ registration of the fulfilment center as an additional place of business. That begs the following question: what is “good and sufficient reason?” In other words, in what circumstances can an authority cancel one’s registration of an additional place of business for good and sufficient reason?” Unfortunately, in the absence of any guidance provided in this regard by both the statute and case law, much is left to conjecture. What is clear is that an authority can, undoubtedly, cancel the registration of an additional place of business for good and sufficient reason. However, what constitutes good and sufficient reason is left to the discretion of the authorities. Needless to state, the authorities cannot exercise their discretion under Section 27 arbitrarily and at their whims and fancies. In my opinion, the decision to cancel a dealer’s registration for good and sufficient reason must be grounded in sound reasoning, which has a nexus to the Act and its objects. In other words, unless the authorities can show that allowing a dealer to function from an additional place of business would hinder and affect the effective administration of the Act, the actions must be held to be illegal and contrary to the object of the Act.

In this case, Amazon's retailers would have a colourable argument in stating that the authorities' actions are contrary to the mandate of Section 27. In short, it is arguable to state that the cancelation of the registrations is not for good and sufficient reason. As stated earlier, the only plausible reason for canceling the registrations is because storing millions of goods belonging to hundreds of retailers would, apparently, difficult for the authorities to identify the goods belonging to different retailers. This argument appears to be entirely frivolous because Amazon would, undoubtedly, have the necessary software and other means to identify the goods. After all, once an order is placed, Amazon is required to remove the goods from the fulfilment center, pack it, deliver it to the customer, collect payment on behalf of the retailer, and then disburse the amount collected after withholding its fee. All of this cannot possibly be done without Amazon having the necessary means to precisely identify which goods belong to which retailer.

Moreover, even if the department were to form the opinion that Amazon is an agent who is selling goods on behalf of the retailers, the same cannot form a basis for canceling the retailers' additional places of business under Section 27. In other words, Amazon's alleged failure to pay tax cannot constitute good and sufficient reason to cancel the retailers' designation of the fulfilment center as an additional place of business.

Therefore, it appears that the department's reason for canceling the registration is frivolous and beyond the scope of Section 27.

Constitutional Validity of Actions

The actions of the authorities can also be challenged as being unconstitutional. In this case, as stated earlier, the authorities have exercised their discretion and canceled the registration of the dealers in so far as it designates Amazon's fulfilment center as an additional place of business. The consequence of such cancelation is that a number of dealers will not be able to store and, thereby, sell their goods through Amazon. More specifically, the dealers would not be able to sell their goods under the Amazon fulfilment model and, therefore, they would either be forced to only avail Amazon's "sell on Amazon" model, or stop trading through Amazon altogether. As stated earlier, under the "sell on Amazon" model, dealers store the goods themselves, and only list their products for sale on Amazon's website. The advantages of the fulfilment model are plain to see. First, small dealers who do not have the capital to invest in godowns or storage facilities have the option of storing their goods at Amazon's fulfilment center for a far more affordable fee. Second, a number of dealers would prefer the fulfilment model because it provides them with the ability to deliver goods to customers located anywhere in the country in a speedy and timely manner. Traditionally, most dealers do not have the retail network to sell their goods all over the country and, therefore, most retailers are localized. Amazon provides these retailers with the option sell their goods all over the country. Therefore, if dealers are forced to pull out of the fulfilment model, they are being deprived of an opportunity to carry on their business in more than just one location.

Article 19(1)(g) of the Constitution guarantees that "[a]ll citizens shall have the right to practice any profession, or to carry on any occupation, trade or business." Article 19(6) states that "[n]othing in sub-clause (g) of the said clause shall […] prevent the State from making any law imposing, in the interests of the general public, reasonable restrictions on the exercise of the right conferred by the said sub-clause[.]"

In order to constitute a reasonable restriction under Article 19(6), both the law as well as any order made thereunder must satisfy the test of reasonableness. <u>See</u> <u>Oudh Sugar Mills v. Union of India</u>, AIR 1970 SC 1970. In other words, an order passed under a "reasonable" law must independently satisfy the test of reasonableness under Article 19(6). Therefore, an order that imposes a restriction on the right of a person to carry on any trade or business must be reasonable, and in the interests of the general public.

The question of paramount importance in Amazon's case is whether an order that cancels the registration of a dealer's additional place of business is a curtailment of his fundamental right under Article 19(1)(g). Essentially, the freedom enshrined under Article 19(1)(g) guarantees the right of every citizen to take up any trade or business. The Supreme Court has held that though the word "business" is ordinarily more comprehensive than the word "trade," in the present clause it is used as synonymous with the other as meaning any substantial and systematic or organized course of purpose. <u>See</u> <u>Ibrahim T.B. v. R.T.A.</u>, AIR 1953 SC 79; <u>Narain Swadeshi Weaving Mills v. Commissioner of Excess Profits Tax</u>, AIR 1955 SC 176. Essentially, the right guaranteed is the natural right to enter into or carry on any trade or business, independent of any legislation by the State. <u>See</u> <u>Saghir Ahmed v. State of Uttar Pradesh</u>, AIR 1954 SC 728. This freedom includes the right to sell one's goods on the public market. <u>See</u> <u>Rashid Ahmed v. Municipal Board, Kairana</u>, AIR 1950 SC 163.

As stated earlier, a number of dealers, mostly small and localized, will not be able to carry on their business of selling goods through Amazon across the country as a consequence of the cancelation of the fulfilment center as their additional place of business. In my opinion, the dealers would have a colourable claim if they were to argue that, by canceling the registration of the retailers' additional place of business, the authorities have restricted their right to carry on a trade or business. In other words, it can be argued that by denying the dealers the option of selling goods on the Amazon website by using the fulfilment model, the dealers are being denied the right to sell their goods on the public market and, therefore, the actions of the department fall foul of the mandate of Article 19(1)(g).

However, as explained earlier, it would not be a violation of the retailers' fundamental right if the department is able to show that the restriction is reasonable and in the interest of the general public. In my opinion, the department would find it difficult to discharge the onus of showing that the restriction placed on the freedom of trade as a result of canceling registrations is reasonable, and in the public interest. It must be noted that in order to satisfy Article 19(6), the restriction placed on the freedom of trade must be reasonable and in the interests of the general public. While it is possible that the restriction may be viewed as reasonable, it is difficult to envision how the restriction can be shown to be in interests of the general public.

Moreover, it can also be argued that by canceling the traders' registrations, the department has violated Article 301 of the Constitution. Article 301 states, in pertinent part, that, "trade, commerce and intercourse throughout the territory of India shall be free." It guarantees freedom from such laws that restrict or affect activities of trade and commerce amongst the States. In other words, Article 301 refers to freedom from laws which go beyond regulations which burden, restrict or prevent trade between the States and also within the State. See Jindal Stainless Ltd. v. State of Haryana, AIR 2006 SC 2550. Article 301, therefore, creates an area of trade that is free from interference by the State. There would be a violation of the freedom where a legislative or executive act operates to restrict trade, commerce or intercourse. The restriction placed must be direct and immediate, as distinct from creating some indirect or inconsequential. See Indian Cement v. State of A.P., AIR 1988 SC 567.

Here again, the freedom is not absolute. In Automobile Transport v. State of Rajasthan, AIR 1962 SC 1406, the Supreme Court held that regulatory measures were outside the purview of Article 301. Therefore, if the impugned law or action is merely regulatory, the same cannot be said to be opposed to Article 301.

In Amazon's case, the cancelation of the dealers' registrations can, arguably, be said to be restrictive of the freedom enshrined under Article 301. It is plausible to state that the cancelation of the registrations operate to place direct and immediate restrictions on the freedom of trade, commerce, and intercourse. The State can, possibly, defend their actions on the ground that the registrations were canceled as a regulatory measure as they were intended to implement the proper collection of taxes and prevent any evasion or escapement. However, the onus to prove that it is a regulatory action is on the State and the burden is not a light one.

Conclusion

First, the department's actions do not appear to have the support of any provisions of the KVAT Act. That apart the actions are also susceptible to be challenged as being violative of both Articles 19(1)(g) and 301 of the Constitution. The above analysis, in all probability, will prove to be merely academic as it appears that the controversy may be settled without any litigation. Nevertheless, it still provides us with the opportunity to study certain interesting, and often neglected, provisions of the KVAT Act, as well as the Constitution.

In summary, from a legal perspective, it is clear that the State would find it difficult to defend its actions. From an economic perspective, much has already been written about how the State is killing the proverbial goose that lays the golden eggs. Media reports suggest that the State has taken up this issue seriously, and on a priority basis. While it is heartening to note that the department is working hard to resolve the issue, its efficiency must not be restricted to cases involving only large dealers such as Amazon. Such promptness and efficiency would be welcome across the trade, particularly by small dealers.

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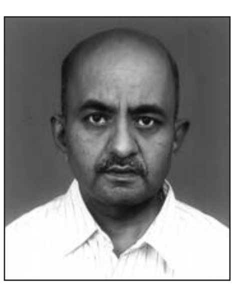
OBITUARY

We deeply regret to inform the sad demise of our Past Treasurer



CA. V.A. Venkatram
Treasurer, KSCAA, 2004-05

May his soul rest in peace.

Transfer Pricing – Basic Concepts

CA. Krishna Upadhya S

Brief background

Business has transcended boundaries. Multinational companies have spread across the globe. Companies are operating from their group entities all across the globe. Generally in economics, income is determined by the price of articles and price is usually determined by market forces. However, tax authorities across the globe have been suspicious about the correctness of the prices that have been shown especially in transactions between group entities where the true economic principles might not be working.

It has also become challenging for national tax laws to keep pace with the global corporations, fluid capital and digital economy; to frame suitable tax laws to handle the complexity that arises from that. Realising that multinationals are undermining the fairness of the tax laws of countries, the Organisation for Economic Co-operation and Development (OECD) announced its Action plan on what is called as 'BEPS' (Base Erosion and Profit Sharing). This Action Plan was fully endorsed by the G20 Finance Ministers and Central Bank Governors at their July 2013 meeting in Moscow as well as the G20 Heads of State at their meeting in Saint-Petersburg in September 2013. The action plan inter alia intends to equip countries across the globe through taxation systems to restore fair practices of profit booking and also to ensure to counter harmful tax practices and strengthen transfer pricing legislations.

The requirement for having strong TP regulations was recognized as early as mid 19th century in the US. US introduced the law to regulate transfer pricing in the later sixties of last century. Further, OECD Model Convention, 1977 as well as the manual on such conventions besides number of studies on Transfer Pricing with the object of having common TP rules have evolved a set of rules.

What is Transfer Pricing?

Transfer pricing refers to the price at arm's length which is required to be adopted in accounting for transfer of goods or services from one center to another, or from one company to another which belong to the same group or which are closely related.

The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration, OECD, 2010 (hereinafter referred as 'OECD TPG' for short) defines "transfer pricing" as the price at which an enterprise transfers physical goods and intangibles or provides services to associated enterprises. The fundamental principle is that the transfer price should be similar to the price that would be charged if the product would be sold to or bought from an unrelated party.

The OECD and U.S. systems provide that prices may be set by the component members of an enterprise in any manner, but may be adjusted to conform to an arm's length standard. Each system provides for several approved methods of testing prices, and allows the government to adjust prices to the midpoint of an arm's length range. Both systems provide for standards for comparing third party transactions or other measures to tested prices, based on comparability and reliability criteria.

Transfer pricing in India

The Indian tax laws had provision for reassessing the transaction price between resident entities in India and other entities if it appears to the tax officer that such transactions were influenced by their close connection in the Income Tax Act, 1922 itself. However such provisions were very limited in scope. Realising that increased participation of multinationals in economic activities of the countries through their group entities could result in lower profits being booked in India, the legislature introduced a comprehensive TP legislation through Finance Act, 2001.

This included section 92 to 92F, which have been amended time to time to suit the requirement of the changing scenarios as perceived by the legislator.

A brief snapshot of the TP regulations under Income Tax Act, 1961 ('the Act') and Income Tax Rules, 1962 ('the Rules')

The Indian TP Regulations comprise Sections 92 to 92F of the Act and Rules 10A to 10TG of the Rules. These consist of the entire code including definitions, modes of determination of Arms length price, price and suggests detailed documentation procedures.

- Section 92 of the Act states that any income arising from an international transaction shall be computed having regard to the arms length price. There are two key terms that emerge out of this which are 'international transaction' and 'arms length price (ALP)'.
- Section 92B defines the term international transaction, which means to include a transaction between two or more associated enterprises (AE) either or both of whom are non-residents. Sub section 2 of section 92B also mentions that a transaction entered into between an enterprise other than an AE shall be deemed to be a transaction entered into between AEs if there exists a prior agreement in relation to the relevant transaction between such other enterprise and the AE or the terms of such agreement are in substance determined between AE and such other enterprise. Further by way of a retroactive amendment w.e.f 1.04.2002 the Finance Act, 2012, also inserted a clarificatory explanation giving a list of various transactions which are within the meaning of

the expression international transaction. This has led to various and long drawn litigation.

The sub section 2 which talks about deemed international transaction had its bit of controversy as to whether the fact that either of both of the persons to be non resident conditions applies for this as well. Let us assume there is F Co a foreign company and I Co, its subsidiary in India. In a instance where I co enters into a purchase agreement with say X co, whereby the terms of agreement have largely been determined by F Co and X Co, would it be a deemed international transaction irrespective whether X Co is a non resident or not; or would it apply only in case where X Co is a non resident was a point of contention. This has been largely settled by an amendment through Finance Act (No.2), 2014 to 92B(2) by inserting a para which states that the other enterprise could be either a non resident or not. Thereby making that in the above illustration transaction between I Co and X Co is an international transaction.

- Section 92A defines the term AE. This is an exhaustive definition covering the following areas of association:
  - **Equity holding** – Holding more than 26% equity holding, by same person in two enterprises, loan in excess of 51% of total assets, guarantee not less than 10% of total borrowings or holding not less than 10% interest in Firm, AOP or BOI.
  - **Management control** – Common management or power to appoint more than 50% of the executive directors by a common person
  - **Activities** – complete dependence on use of intangibles for manufacture/business processing, direct or indirect supply of more than 90% of the raw materials or sale of products are under the influenced price and conditions.
  - **Common control -** One enterprise controlled by an individual and the other by himself or his relative or jointly; or One enterprise controlled by HUF and the other by itself, a member or his relative or jointly
- Section 92C read with rule 10B provides for computation/ determination of arms length price for international transaction between AEs. These provide for various methods of determination of arms length price. While there is a very brief guidelines on each method and its applicability under rule 10B, one can refer to OECD TPG for understanding and contemplate the application of each such method. An attempt to summarise applicability of each method has been made in the ensuing paras:

  i. **Comparable uncontrolled Price (CUP) method -** The CUP Method evaluates the "price" charged in a controlled transaction with reference to the "price" charged in comparable uncontrolled transactions, which could be identified either through internal or external comparables.

  ii. **Resale Price Method (RPM)** – RPM uses resale prices for comparability. The RPM is applicable in a resale situation, where the property or services purchased from an AE are sold to unrelated enterprise. The RPM is applied on either a transactional or a comparable-company basis, and it applies to distributors/marketers.

  iii. **Cost Plus Method (CPM)** – CPM adopts gross profit margins for comparability with uncontrolled transactions. CPM is generally applied in relation to supply of products or provision of services. CPM is most useful where semi-finished goods are sold between related parties, where related parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.

  iv. **Profit Split Method (PSM) -** PSM may be applicable mainly in international transactions involving transfer of unique intangibles or in multiple international transactions, which are so interrelated that they cannot be evaluated separately for the purpose of determining the ALP of any one transaction. The PSM is therefore appropriate for integrated transactions with more than one enterprise. Whereby, the combined net profit of the transaction is determined, relative contribution from each entity is ascertained and the profits is split based on Functions, Assets and Risks (FAR) undertaken by each entity.

  v. **Transactional Net Margin Method (TNMM) -** TNMM is generally appropriate for the provision of services/ sale of goods where CPM or RPM cannot be adequately applied. This method compares the margins of the tested party and the comparable, internal or external to test arms length principle. This is the method that evens out various technical difficulties in choosing comparability and is the most popular method for computation of ALP.

  vi. **Any other method as prescribed** – Such a method was prescribed under rule 10AB w.e.f 1.04.2012 as any method that that takes into account the price that has been charged or paid, or would have been charged or paid, for the same or similar uncontrolled transaction, with or between non-associated enterprises, under similar circumstances considering all the facts, shall be regarded as one of the recognized methods for determining the ALP.

  Rule 10C lists various factors to consider which determining the most appropriate method which inter alia includes nature of transaction, class of AEs, FAR profile of the AEs, availability of comparable information, degree of comparability between the transactions being compared etc.

  Proviso to section 92C(2) provides that in case where more than one method is determined to be most appropriate for a particular transaction which is being tested, arithmetic mean shall be taken as ALP. Moreover, second proviso also prescribes permissible range of variation that is acceptable between the ALP and price at which the transaction took place. Finance Act (No.2), 2014 has done away with this and has inserted a third proviso stating that arithmetic mean of price and acceptable range would not apply w.e.f 01.04.2014 and manner of computation shall be prescribed. This is awaited as of now.

- Section 92D r.w Rule 10D provides that taxpayers who fall under the ambit of transfer pricing have to maintain the relevant information and documents prescribed. Maintaining all the documents as prescribed is not applicable if the aggregate value of international transaction of a tax payer in a particular year does not exceed Rs.1 crore. It is enough to maintain documents that will enable the tax authority to determine the ALP. Further 92E provides that any person having international transaction irrespective of the quantum of the same needs to obtain and furnish a report in Form 3CEB on or before 30th November every year duly certified by a Chartered Accountant.

Administrative provisions connected with TP regulations

While the administrative procedures for international transactions are similar to that of any other transaction in the Income tax law, there are certain specific mechanisms that are worth mentioning:

- When a tax payer's file is selected for scrutiny, the Assessing officer (AO), if he considers necessary and expedient may refer the computation of Arms length price to a Transfer Pricing officer u/s 92CA. Central Board of Direct taxes has fixed a threshold of Rs. 15 crores for compulsory reference of computing of ALP to TPO.
- When reference is made to TPO, tax payer has to furnish details to the TPO for determining the ALP. The TPO's order is binding on the Assessing officer as regards the computation of ALP.
- In cases involving TPO's order, when the AO provides a draft order to the tax payer, he has an option to object to the draft order and chose an alternate dispute resolution by making his objections before the Dispute Resolution Panel (DRP). The DRP will then hear tax payer's plea and shall issue directions to AO to complete the assessment. (section 144C)
- On non satisfaction of such directions, the tax payer is allowed to prefer an appeal directly before the Income Tax Appellate Tribunal (ITAT) by virtue of section 253 of the Act.

Penal provisions for on compliance with TP regulations

Non compliance of transfer pricing provisions would attract penalties, which may be as follows:

- Penalty for concealment of income or furnishing inaccurate particulars thereof would be 100% to 300% of the tax payable (Section 271(1)(C))
- Penalty for failure to keep and maintain information and documents in respect of international transaction or Specified Domestic Transaction will be 2% of each such transaction (Section 271AA)
- Penalty shall be 2% of value of transaction for failure to furnish information and documents under section 92D (section 271G)
- A sum of one lakh rupees shall be penalty for failure to furnish report under section 92E (Section 271BA)

Safe Harbour and Advance Pricing Arrangements (APA)

In order to make the TP regulations less burdensome and more certain, Indian TP regulations in line with the global practice have Safe harbor rules and APA provisions.

- Safe harbor is a circumstance in which the tax authorities shall accept the transfer price declared by tax payer. Rule 10TA to 10TG provides for category of tax payers for whom safe harbor is applicable, procedures to comply with in order to avail benefits of safe harbor and also the safe harbor margins.
- APA is an agreement in advance between the tax payer and the tax authorities fixing the transaction price, such price would be at arm's length price. The agreement entered into is valid for a period, not exceeding 5 previous years, as may be mentioned in the agreement unless there is a change in law or facts applicable for the agreement. Once the agreement is entered into, the ALP of the international transaction, which is subject matter of the APA, would be determined in accordance with such an APA. With an amendment to Sec 92CC under Finance Act (No.2), 2014, a roll back of the application of such an APA for a period of 4 years has been provided.

Conclusion

With constantly increasing cross border transaction, aggressive development of technology and even more aggressive planning by multi nationals, the Governments across the globe are seriously concerned about 'Double non taxation' situations. This has lead to using of Transfer pricing as an effective tool by the Governments to curb such practices. This provides us, professionals an opportunity to help clients to fulfill their obligation to ensure compliance with TP regulations and also help them plan their affairs in a manner permissible under the law keeping the TP regulations in view.

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DAY 1 - SATURDAY 15TH NOVEMBER 2014

Timings	*Topic / Speakers*
08:30am	Registration
09.00am	INAUGURAL SESSION ***Chief Guest*** **Shri. D V Sadananda Gowda** *Hon'ble Central Minister for Indian Railways, Govt of India* ***Guest of Honour*** **CA K Raghu** *President, ICAI* **CA P V Rajarajeshwaran** *Chairman, SIRC of ICAI*
10.00am	TECHNICAL SESSION I Recent Controversies in Assessment of Charitable Trust **Dr. CA N Suresh**, *Bangalore*
11.30am	Tea Break
11.45am	TECHNICAL SESSION II Domestic Transfer Pricing **CA K KChytanya**, *Bangalore*
01.15pm	Lunch Break
02.00pm	TECHNICAL SESSION III Assessment of builders and developers with reference to capital gains **CA Vimal Punmiya**, *Mumbai*
03.30pm	Tea Break
03.45pm	TECHNICAL SESSION IV Joint Development Agreement - Precautions to be taken by CAs **CA A Shankar**, *Bangalore*
	Entertainment Programme & Family Theme Dinner

DAY 2 -SUNDAY 16TH NOVEMBER 2014

Timings	*Topic / Speakers*
09.00am	SPIRITUAL SESSION **Shri VishveshaTirtha Swamiji**, *Udupi Pejavar Mutt*
10.00am	TECHNICAL SESSION V Service Tax - CENVAT Credit Rules, Amendments, Issues & Case Studies **Shri. V S Datey**, *Leading book Author, Pune*
11.30am	Tea Break
11.45am	TECHNICAL SESSION VI Recent Developments in KVAT Act & Precautions to be taken by CAs **CA S Venkataramani**, *Bangalore*
01.15pm	Lunch Break
02.00pm	TECHNICAL SESSION VII Indian Economy - present scenario **Dr. Subramanian Swamy**, *Ex Cabinet Minister of Commerce, Law & Justice, Economist, Harvard Professor & Sr. BJP Leader*
03.30pm	Tea Break
03.45pm	TECHNICAL SESSION VIII Importance of New Companies Act **CA P V Srinivasan**, *Bangalore*

CA Babu K Thevar
Chairman

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Secretary

CA Ravindranath S N
Conference Co-ordinator

Online Registration is available

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Photo Gallery

One Day Seminar on Tax Implications on Real Estate Sector held on 11th October 2014

Invocation song by Kum. Vibha

President welcoming Chief Guest
Shri Vivekananda Babu G.,
Sr. Vice President, Puravankara

Welcome Speech by
President CA. Raveendra S. Kore

Inaugural address by Chief Guest
Shri Vivekananda Babu G.

Vice President CA. Dileep Kumar T.M. presenting
memento to Chief Guest

President greeting
KSCAA Past President CA. N.C.S. Raghavan

Speakers at Technical Sessions

CA. V. Raghuraman

CA. K.K. Chythanya

Shri Arvind Raghavan, Advocate

CA. Annapurna Kabra

CA. Chetan Padaki presenting memento
to Speaker CA. K. K. Chythanya

Vote of thanks by Secretary
CA. Raghavendra Puranik

Seminar Organizers

Sponsor's Stall

Cross section of participants

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