Paper 14 – Indirect & Direct Tax Management

This RTP is divided into two sections: Section A – Case Laws (Indirect Taxation followed by Direct Taxation) and Section – B: Questions & Answers (Direct Taxation followed by Indirect Taxation)

Indirect Taxation

Case Laws:

1. BASIC CONCEPTS

1. Does the process of removal of foreign materials from iron ore for concentration of such ore amount to manufacture?

Commissioner vs. Steel Authority of India Ltd. 2012 (283) E.L.T. A112 (S.C.)

Facts of the Case:

The Steel Authority of India Ltd. (SAIL) was mining iron ore from mines. The Department submitted that Steel Authority of India Ltd. (SAIL) was mining iron ore from mines and subjecting the same to crushing, grinding, screening and washing with an aim to concentrate the ores.

The Department contended that in the case of the Respondents their mining activity was done by fully mechanized system; that they were mining iron ores from mines and then ores were subjected to process of crushing, grinding and screening and washing with a view to remove foreign materials and to concentrate such ores, that at each stage of washing water is added to improve the flowability of material by removing the sticky particles and the processes undertaken by them involved removal of parts of foreign material from the ores and increase the "Fe" content (i.e. iron content), thus goods so obtained by such process would qualify as concentrate.

The SAIL submitted that the washing of iron ore by itself could never convert it into concentrates and that washing by itself did not amount to manufacture. The assessee also contended that the concentrates were manufactured by increasing the concentration of Fe content of the mineral by removing and separating different impurities, that concentrates were manufactured by enriching the material in terms of its Fe content, that under this process, raw iron ore of low Fe content was ground to very fine consistency and passed through various processes for making concentrates, that in the present matters neither they undertook any such process nor there was any variation in the Fe content of iron ore extracted from its mines and the Fe content of seized iron ore.

Point of Dispute:

Department contended that any ore which after being subjected to physical or physico chemical process viz., crushing, screening, etc., has had part or whole of its extraneous, foreign matter removed, would be termed as "concentrate", and thus the

product obtained after the processes carried out by the Respondents was "iron ore concentrate" only and not iron ore.

Decision of the Case:

The Supreme Court held that removal of foreign materials from iron ore, i.e., mining iron ore from mines and then subjecting to process of crushing, grinding, screening and washing with a view to remove foreign materials to concentrate such ores do not result in manufacture of different commercial commodity. No Central excise duty is leviable on iron ore concentrate.

2. **Whether the metal scrap or waste generated during the repair of his worn out machineries/ parts of cement manufacturing plant by a cement manufacturer amounts to manufacture?**

Grasim Industries Ltd. vs. UOI 2011 (273) E.L. T. 10 (S.C.)

Facts of the case:

The assessee was the manufacturer of the white cement. He repaired his worn out machineries/parts of the cement manufacturing plant at its workshop such as damaged roller, shafts and coupling with the help of welding electrodes, mild steel, cutting tools, M.S. Angles, M.S. Channels, M.S. Beams, etc. In this process of repair, M.S. scrap and Iron scrap were generated. The assessee cleared this metal scrap and waste without paying any excise duty. The Department issued a show cause notice demanding duty on the said waste contending that the process of generation of scrap and waste amounted to the manufacture in terms of section 2(f) of the Central Excise Act.

Decision of the case:

The Apex Court observed that manufacture in terms of section 2(f) includes any process incidental or ancillary to the completion of the manufactured product. This 'any process' can be a process in manufacture or process in relation to manufacture of the end product, which involves bringing some kind of change to the raw material at various stages by different operations. The process in relation to manufacture means a process which is so integrally connected to the manufacturing of the end product without which, the manufacture of the end product would be impossible or commercially inexpedient.

However, in the present case, it is clear that the process of repair and maintenance of the machinery of the cement manufacturing plant, in which M.S. scrap and Iron scrap arise, has no contribution or effect on the process of manufacturing of the cement, (the end product). The repairing activity in any possible manner cannot be called as a part of manufacturing activity in relation to production of end product. Therefore, the M.S. scrap and Iron scrap cannot be said to be a by-product of the final product. At the best, it is the by-product of the repairing process.

Hence, it held that the generation of metal scrap or waste during the repair of the worn out machineries/parts of cement manufacturing plant does not amount to manufacture.

3. Are the physician samples excisable goods in view of the fact that they are statutorily prohibited from being sold?

Medley Pharmaceuticals Ltd. vs. CCE & C., Daman 2011 (263) E.L. T. 641 (S.C.)

The question which arose for consideration was whether physician samples of patent and proprietary medicines intended for distribution to medical practitioner as free samples, satisfied the test of marketability. The appellant contended that since the sale of the physician samples was prohibited under the Drugs and Cosmetics Act, 1940 and the rules made thereunder, the same could not be considered to be marketable.

Supreme Court observed that merely because a product was statutorily prohibited from being sold, would not mean that the product was not capable of being sold. Physician sample was capable of being sold in open market.

Moreover, the Drugs and Cosmetics Act, 1940 (Drugs Act) and the Central Excise Act, 1944 operated in different fields. The restrictions imposed under Drugs Act could not lead to non-levy of excise duty under the Central Excise Act thereby causing revenue loss. Prohibition on sale of physician samples under the Drugs Act did not have any bearing or effect on levy of excise duty.

Therefore, the Court inferred that the physician samples were excisable goods and were liable to excise duty.

Note: This case was affirmed in case of Medley Pharmaceuticals Ltd. vs. Commissioner - 2011 (269) E.L.T. A20 (S.C.).

4. Whether assembling of the testing equipments for testing the final product in the factory amounts to manufacture?

Usha Rectifier Corpn. (I) Ltd. vs. CCEx., New Delhi 2011 (263) E.L. T. 655 (S.C.)

Facts of the case:

The appellant was a manufacturer of electronic transformers, semi-conductor devices and other electrical and electronics equipments. During the course of such manufacture, the appellant also manufactured machinery in the nature of testing equipments to test their final products.

The appellant had stated in their balance sheet that the addition to the plant and machinery included testing equipments. The said position was further substantiated in the Director's report wherein it was mentioned that during the year, the company developed a large number of testing equipments on its own.

However, the assessee contended that such items were assembled in the factory for purely research and development purposes, but research being unsuccessful, same were dismantled. Hence, it would not amount to manufacture.

The appellant further submitted that the said project was undertaken only to avoid importing of such equipment from the developed countries with a view to save foreign exchange.

Decision of the case:

The Supreme Court observed that once the appellant had themselves made admission regarding the development of testing equipments in their own Balance Sheet, which was further substantiated in the Director's report, it could not make contrary submissions later on. Moreover, assessee's stand that testing equipments were developed in the factory to avoid importing of such equipments with a view to save foreign exchange, confirmed that such equipments were saleable and marketable. Hence, the Apex Court held that duty was payable on such testing equipments.

5. Does the process of cutting and embossing aluminium foil for packing the cigarettes amount to manufacture?

CCE vs. GTC Industries Ltd. 2011 (266) E.L.T. 160 (Bom.)

Facts of the case:

A roll of aluminium foil was cut horizontally to make separate pieces of the foil and word "PULL" was embossed on it. Thereafter fixed number cigarettes were wrapped in it. Aluminium foil, being a resistant to moisture, was used as a protector for the cigarettes and to keep them dry.

Revenue submitted that the process of cutting and embossing aluminium foil amounted to manufacture. Since the aluminium foil was used as a shell for cigarettes to protect them from moisture, the nature, form and purpose of foil were changed.

Decision of the case:

The High Court pronounced that cutting and embossing did not transform aluminium foil into distinct and identifiable commodity. It did not change the nature and substance of foil. The said process did not render any marketable value, only made it usable for packing. There were no records to suggest that cut to shape/embossed aluminium foils used for packing cigarettes were distinct marketable commodity. Hence, process did not amount to manufacture as per section 2(f) of Central Excise Act, 1944. Only the process which produces distinct and identifiable commodity with marketable value can be called manufacture.

2. CLASSIFICATION OF EXCISABLE GOODS

1. In case of specific classification viz-a-viz classification based on material used/ composition of goods, which one should be adopted?

Commissioner of Central Excise, Bhopal vs. Minwool Rock Fibres Ltd. 2012 (278) E.L. T. 581 (S.C.)

Facts of the Case:

Minwool Rock Fibres Ltd. started manufacturing rockwool and slagwool using more than 25% of blast furnace slag by weight in 1993. They classified them under Central Excise Tarriff heading 6803 00 (i.e. Slagwool, Rockwool and similar mineral wools and had been filing classification declarations mentioning this fact. Such declarations so filed prior to 1997-98 were accepted by the Department. However, another specific sub-heading 6807 10 of Central Excise Tariff was introduced vide Budget 1997 for 'Goods having more than 25% by weight blast furnace slag'. Accordingly, they claimed that the goods manufactured by them, namely, slagwool and rockwool should henceforth be classified under Chapter sub-heading 6807 10 of the Tariff.

The Revenue contended that when there was a specific sub-heading, i.e. 6803 00 wherein the goods, such as Slagwool, Rockwool and similar wools were enumerated, that entry requires to be applied and not Chapter sub-heading 6807.10.

Point of Dispute:

The assessee's contention was that the appropriate classification for their product was under Chapter sub-heading No. 6807 10 of the Act while the Department contended that the appropriate classification was under Chapter sub-heading No. 6803 00 of the Act.

This was the subject matter of the appeal before the Supreme Court.

Decision of the Court:

The Supreme Court held that there was a specific entry which speak of Slagwool and Rockwool under sub-heading 6803 00 chargeable at 18%, but there was yet another entry which was consciously introduced by the Legislature under sub-heading 6807 10 chargeable at 8%, which speaks of goods in which Rockwool, Slag wool and products thereof were manufactured by use of more than 25% by weight of blast furnace slag.

It was not in dispute that the goods in question were those goods in which more than 25% weight of one or more of red mud, press mud or blast furnace slag was used. If that be the case, then, in a classification dispute, an entry which was beneficial to the assessee required to be applied and the same had been done by the adjudicating authority, which had been confirmed by the Tribunal. Further, tariff heading specifying goods according to its composition should be preferred over the specific heading. Sub-heading 6807 10 is specific to the goods in which more than 25% by weight, red mud, press mud or blast furnace slag is used as it is based entirely on material used or composition of goods.

Therefore, the Court opined that the goods in issue were appropriately classifiable under Sub-heading 6807 10 of the Tariff.

2. **In case of a specific entry viz-a-viz a residuary entry, which one should be preferred for classification purpose?**

CCE vs. Wockhardt Life Sciences Ltd. 2012 (277) E.L. T. 299 (S.C.)

Facts of the Case:

Wockhardt Life Sciences Ltd. was the manufacturer of Povidone Iodine Cleansing Solution USP and Wokadine Surgical Scrub. The only difference between these two products was that Wokadine was a branded product whereas Povidone Iodine Cleansing Solution was a generic name.

The Revenue contended that the said products were not medicament in terms of Chapter Note 2(i) of the Tariff Act as it neither had "Prophylactic" nor "Therapeutic" usage. The Revenue said that in order to qualify as a medicament, the goods must be capable of curing or preventing some disease or aliment. Therefore, the said products cannot be classified under Chapter Heading 3003 of Tariff Act. They submitted that the product in dispute, namely Povidone Iodine Solution or its patent and proprietary equivalent Wokadine surgical scrub, was essentially used as a medicated detergent.

The assessee stated that the Revenue, in their show cause notices, had admitted that the products in issue were antiseptic and used by surgeons for cleaning or de-germing their hands and scrubbing surface of skin of patient before operation. They further submitted that the products were medicament in which some carriers were added and therefore, it would fall under chapter sub-heading 3003 and not under chapter 34.

Point of Dispute:

The assessee's claim before the authorities and also before the Tribunal was that the aforesaid products were medicaments and, therefore, required to be classified under Chapter sub-heading 3003 of the Tariff, whereas the Revenue's stand was that the products in question are detergents and, therefore, to be classified under chapter subheading 3402.90.

Decision of the Case:

The Supreme Court observed that it is the specific case of the assessee that the products in question are primarily used for external treatment of the human-beings for the purpose of the prevention of the disease. This is not disputed by the Revenue. Revenue's stand is that since the products in question are primarily used as detergents/cleansing preparation, they cannot be brought under the definition of medicaments. Medicaments are products which can be used either for therapeutic or prophylactic usage. The Court said that since the product in question is basically and primarily used for the prophylactic uses, the Tribunal was justified in coming to a conclusion that the product was a medicament. The miniscule quantity of the prophylactic ingredient is not a relevant factor.

The Court said that the combined factor that requires to be taken note of for the purpose the classification of the goods are the composition, the product literature, the label, the character of the product and the use to which the product is put. In the instant case, it is not is dispute that this is used by the surgeons for the purpose of cleaning or de-germing their hands and scrubbing the surface of the skin of the patient that portion is operated upon. The purpose is to prevent the infection or disease. Therefore, the product in question can be safely classified as

"medicament" which would fall under chapter sub-heading 3003 which is a specific entry and not under chapter sub-heading 3402.90 which is a residuary entry.

Thus, on the basis of the above observation by the Court the Revenue's appeal was rejected.

3. When entries in Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, can reliance be placed upon HSN for the purpose of classification of goods?

Camlin Ltd. vs. CCEx., Mumbai 2008 (230) E.L.T. 193 (SC)

The Supreme Court ruled that when the entries in the Harmonised System of Nomenclature (HSN) and the Excise Tariff are not aligned, reliance cannot be placed upon HSN for the purpose of classification of goods under the said Tariff. It further added that in the instant case, the Tribunal erred in relying upon the HSN for the purpose of classification of the impugned product. The Tribunal failed to appreciate that since the entries under the HSN and the entries under the said Tariff were completely different, the Tribunal could not base its decision on the entries in the HSN.

4. Whether the rules of interpretation applicable to the cases of classification under the Excise Tariff are also applicable to interpretation of exemption notification?

CCEx., Jaipur vs. Mewar Bartan Nirman Udyog 2008 (231) ELT 27 (SC)

The Apex Court clarified that it is well settled position in law that exemption notification has to be read strictly. A notification of exemption has to be interpreted in terms of its language. Where the language is plain and clear, effect must be given to it.

While interpreting the exemption notification, one cannot go by rules of interpretation applicable to cases of classification under the Excise Tariff. Tariff items in certain cases are required to be interpreted in cases of classification disputes in terms of HSN, which is the basis of the Tariff. The rules of interpretation applicable to the cases of classification under the Tariff cannot be applied to interpretation of exemption notification.

5. How to determine whether a product is covered by 'cosmetics' or 'medicaments?

CCEx., Nagpur vs. Shree Baidyanath Ayurved Bhawan Ltd. 2009 (237) E.L.T. 225 (S. C.)

The question that arose for consideration before the Apex Court was in relation to classification of "Dant Manjan Lal" (DML) manufactured by M/s. Baidyanath Ayurved Bhawan Limited. While Baidyanath contended that the product DML was a medicament under Chapter sub-heading 3003 31 of the Central Excise Tariff Act, 1985, the stand of the Department was that the said product was a cosmetic/toiletry preparation/tooth powder classifiable under Chapter heading 3306.

The Apex Court observed that in order to determine whether a product is covered by 'cosmetics' or 'medicaments' or in other words whether a product falls under Chapter 30 or Chapter 33, common parlance test continues to be relevant. One should resort to the popular meaning and understanding attached to such products by those using the product and not to the scientific and technical meaning of the terms and expressions used. Hence, it is important to note how the consumer looks at a product and what is his perception in respect of such product.

The Supreme Court further ruled that merely because there is some change in the tariff entries, the product will not change its character. Something more is required for changing the classification especially when the product remains the same. Therefore, since there was no change in the nature, character and uses of DML, it had to be classified as a tooth powder as held earlier in case of the assessee itself in *Shree Baidyanath Ayurved Bhavan Ltd. vs. Collector 1996 (83) E.L. T. 492 (S.C.)*. The Apex Court clarified that although, this case related to old Tariff period i.e. prior to enactment of new Tariff Act but since the product in its composition, character and uses continued to be the same, even after insertion of new sub-heading 3301 30, change in classification was not justified as common parlance test continued to be relevant for classification.

6. Is the product "Scrabble" classifiable under sub-heading 9503 00 or sub-heading 9504 90 of the First Schedule to the Central Excise and Tariff Act, 1985?

Pleasantime Products vs. CCE 2009 (243) E.L.T. 641 (S.C.)

Facts of the case:

According to the assessee, "Scrabble" was a puzzle or in the alternative it was an educational toy falling under sub-heading 9503 00. However, Revenue alleged that "Scrabble" was not a puzzle, it was not a toy but a game. Moreover, since "Scrabble" has board(s) and pieces it was classifiable under sub-heading 9504 90.

Decision of the case:

The Court opined that "Scrabble" was not a puzzle/crossword. The difference between a "game" and a "puzzle" is brought out by three distinct features, viz., outcome, clue-chance and skill. In a puzzle, the outcome is fixed or pre-determined which is not there in "Scrabble". In a "Scrabble" there are no clues whereas in crossword puzzle, as stated above, words are written according to clues. Hence, the essential characteristic of crossword to lay down clues and having a solution is absent from "Scrabble". Thus, "Scrabble" would not fall in the category or class mentioned in sub-heading 9503 00, namely, "puzzles of all kinds".

As per the dictionary meaning, "Scrabble" is a board game in which players use lettered tiles to create words in a crossword fashion. Applying the dictionary meaning, the Apex Court held that "Scrabble" was a board game. It was not a puzzle. In the circumstances, it would fall under heading 9504 and not under sub-heading 9503 00 of the Central Excise Tariff.

Note - The headings cited in the case law mentioned above may not co-relate with the headings of the present Excise Tariff as it relates to an earlier point of time.

3. VALUATION OF EXCISABLE GOODS

1. Whether the price used for selling of a product below the cost price for penetration of market can be considered as transaction value?

CCEx., Mumbai vs. Fiat India Pvt. Ltd. 2012 (283) E.L. T. 161 (S.C.)

Facts of the Case:

The Fiat India Pvt. Ltd. (Fiat) was the manufacturer of motor cars. They were selling Fiat UNO model cars below cost and were making losses in wholesale trade. The purpose was penetrate the market and competing with other manufacturers of similar goods. The prices were not based on manufacturing cost and profit. This was happening over the period of five years. The Assistant Commissioner directed for the provisional assessment of the cars at a price which would include cost of production, selling expenses including transportation and landing charges, wherever necessary and profit margin, on the ground that the cars were not ordinarily sold in the course of wholesale trade as the cost of production is much more than their wholesale price, but were sold at loss for a consideration.

Point of Dispute: -

The Department disputed that as the extra commercial consideration was involved in this case an additional consideration should be added to the price for the purpose of duty. Thus, the Department invoked Best Judgment Assessment.

Decision of the Case:

The Supreme Court held that the duty has to be paid on the "transaction value". Section 4(1)(a) of the Central Excise Act, 1944 defines transaction value as under "in a case where the goods are sold by the assessee, for delivery at the time and place of the removal, the assessee and the buyer of the goods are not related and the price is the sole consideration for the sale, be the transaction value.

If any of the ingredients in the above definition is missing then the price shall not be considered as the sole consideration as transaction value.

Supreme Court opined that this is a case of extra commercial consideration in fixing of price and artificially depressing it. Full commercial cost of manufacturing and selling was not reflected in the price as it was deliberately kept below the cost of production. Thus, price could not be considered as the sole consideration for sale. No prudent business person would continuously suffer huge loss only to penetrate market; they are expected to act with discretion to seek reasonable income, preserve capital and, in general, avoid speculative investments. It is immaterial that the cars were not sold to related persons.

In view of the above resorting to best judgment assessment was proper.

2. **Whether the charges towards pre-delivery inspection and after-sale-service recovered by dealers from buyers of the cars would be included in the assessable value of cars?**

Maruti Suzuki India Ltd. vs. CCE 2010 (257) E.L. T. 226 (Tri. – LB)

Facts of the case:

The appellants were manufacturers of various types of motor vehicles chargeable to duty on ad valorem basis. Department observed that while selling the vehicles to the customers, the dealers added their own margin known as the dealer's margin to the price at which the vehicles were made available to them by the appellants

This dealer's margin contained provision for rendering pre-delivery inspection and three after sale services. Hence, the Department contended that the cost of post delivery inspection and after sale services were to form part of the assessable value of the automobile while discharging the duty liability.

Decision of the case:

The Larger Bench of the Tribunal drew the following propositions:-

(i) Transaction value includes the amount paid by reason of/in connection with sales of goods

The Court noted that the transaction value does not merely include the amount paid to the assessee towards price, but also includes any amount a buyer is liable to pay by reason of or in connection with the sale of the goods, including any amount paid on behalf of assessee to the dealer or the person selling the vehicles. The reason of sale and inter connection thereto are essential elements to contribute for assessable value.

Measure of levying is expanded and its composition is broad based to bring all that a buyer is liable to pay or incur by reason of sale or in connection on therewith. The transaction value, therefore, is not confined to the amount actually paid and is not restricted to flow back of consideration or part thereof to the assessee directly but even for discharge of sales obligations both in present and future. Thus, all deferred and future considerations are added to assessable value.

(ii) Definition of transaction value is extensive, at the same time restrictive and exhaustive in relation to the items excluded therefrom

Extensive

The use of expressions like "includes in addition to" and "including but not limited to" in the definition clause establishes that it is of very wide and extensive in nature.

Restrictive and exhaustive

At the same time, it precisely pinpoints the items which are excluded therefrom, with the prefix as "but does not include''. Exclusions being defined no presumption for further exclusions is permissible. Hence, the definition is restrictive and exhaustive in relation to the items excluded therefrom.

(iii) PDI and after sales service charges is a payment on behalf of the assessee to the dealer by the buyer

Both, direct benefit as well as indirect benefit (wholly or partly), flowing from buyer to assessee, resulting from the payment made by the buyer to the dealer in connection with or by reason of the sale transaction will have to be included in the assessable

value. Being so, any amount collected by the dealer towards pre-delivery inspection or after sale services from the buyer of the goods under the understanding between the manufacturer and the dealer or forming part of the activity of sales promotion of the goods would be a payment on behalf of the assessee to the dealer by the buyer, and hence, it would form part of the assessable value of such goods.

Hence, it was held that the charges towards pre-delivery inspection and after-sale-service recovered by dealers from buyers of the cars would be included in the assessable value of cars.

Notes:

1. As per section 4(3)(d) of the Central Excise act, 1944, transaction value is defined as follows:-

   Transaction value:-

   - **means** the price actually paid or payable for the goods, when sold, and
   - **includes in addition to** the amount charged as price, any amount that the buyer is liable to pay to, or on behalf of , the assessee, by reason of, or in connection with the sale, whether payable at the time of the sale or at any other time,
   - **including, but not limited to,** any amount charged for, or to make provision for, advertising or publicity, marketing and selling organization expenses, storage, outward handling, servicing, warranty, commission or any other matter;
   - **but does not include** the amount of duty of excise, sales tax and other taxes, if any, actually paid or actually payable on such goods.
2. It may be noted that CBEC, in view of the aforesaid judgment has clarified vide Circular No. 936/26/2010-CX. dated 27-10-2010 that pre-delivery Inspection charges and after-sale service charges collected by the dealers are to be included in the assessable value under section 4 of the Central Excise Act, 1944.

3. CENVAT CREDIT

1. In case the testing is critical to ensure marketability of manufactured product i.e. the manufacture is not complete without testing; is CENVAT credit of the testing material allowed?

Flex Engineering Ltd. vs. Commissioner of Central Excise, U.P. 2012 (276) E.L.T. 153 (S. C.)

Facts of the Case:

The Flex Engineering Ltd. ('Flex' in short), a manufacturer was engaged in the manufacturing of various types of packaging machines, marketed Automatic Form Fill and Seal Machines ('F&S machines' in short) ,. The machines were 'made to order', in as much as all the dimensions of the packaging/sealing pouches, for which the F&S

machine is required, are provided by the customer. The purchase order contained the following inspection clause:

"Inspection/ trial will be carried out at your works in the presence of our engineer before dispatch of equipment for the performance of the machine.''

As the machine ordered was customer specific, if after inspection by the customer it was found deficient in respect of its operations for being used for a particular specified packaging, it could not be delivered to the customer, till it was re-adjusted and tuned to make it match with the required size of the pouches as per the customer's requirement. On completion of the above process and when the customer was satisfied, an entry was made in the RG-1 register declaring the machine as manufactured, ready for clearance.

As per the above clause, testing material to be used was Flexible Laminated Plastic Film in roll form & Poly Paper which are duty paid.

Point of Dispute:

The Department denied CENVAT credit on the material used for testing of the packaging machines. Two questions were raised to the High Court in this regard:-

(i) Whether duties paid on testing material would be eligible as credit under rule 57A of the erstwhile Central Excise Rules, 1944 [now rule 2(k) of the CENVAT Credit Rules, 2004]?

(ii) Whether such use of material in testing in view of the purposes mentioned above, could be said to be used in the manufacture of or use in relation to the manufacture of the final products viz., machines as assembled?

The High Court answered both the above questions in the negative. According to the High Court, anything required to make the goods marketable must form a part of the manufacture and any raw material or any materials used for the same would be a component part of the end product. It thus observed that materials used for testing after manufacture of the final product, viz. the F&S machine, is only to detect the deficiency in the final product and therefore, could not be considered as the goods used in or in relation to the manufacture of the final product. The Flex made an appeal to the Supreme Court against the above order.

Decision of the Case:

The Supreme Court held that the process of manufacture would not be complete if a product is not saleable as it would not be marketable. Thus, the duty of excise would not be leviable on it.

The Supreme Court was of the opinion that the process of testing the customized F&S machines was inextricably connected with the manufacturing process, in as much as, until this process is carried out in terms of the afore-extracted covenant in the purchase order, the manufacturing process is not complete, the machines are not fit for sale and hence, not marketable at the factory gate. The Court was, therefore, of

the opinion that the manufacturing process in the present case gets completed on testing of the said machine. Hence, the afore-stated goods viz. the flexible plastic films used for testing the F&S machines are inputs used in relation to the manufacture of the final product and would be eligible for CENVAT credit under rule 57A of the erstwhile Central Excise Rules, 1944 [now rule 2(k) the CENVAT Credit Rules, 2004].

2. **The assessee claimed the CENVAT credit on the duty paid on capital goods which were later destroyed by fire. The Insurance Company reimbursed the amount inclusive of excise duty. Is the CENVAT credit availed by the assessee required to be reversed?**

CCE vs. Tata Advanced Materials Ltd. 2011 (271) E.L.T. 62 (Kar.)

Facts of the case:
The assessee purchased some capital goods and paid the excise duty on it. Since, said capital goods were used in the manufacture of excisable goods, he claimed the CENVAT credit of the excise duty paid on it. However, after three years the said capital goods (which were insured) were destroyed by fire. The Insurance Company reimbursed the amount to the assessee, which included the excise duty, which the assessee had paid on the capital goods. Excise Department demanded the reversal of the CENVAT credit by the assessee on the ground that the assessee had availed a double benefit.

Decision of the case:

The High Court noted that the as per CENVAT Credit Rules, 2004, CENVAT credit taken irregularly stands cancelled and CENVAT credit utilized irregularly has to be paid for.

In the instant case, the Insurance Company, in terms of the policy, had compensated the assessee. The High Court observed that merely because the Insurance Company had paid the assessee the value of goods including the excise duty paid, it would not render the availment of the CENVAT credit wrong or irregular. It was not a case of double benefit as contended by the Department.

The High Court therefore answered the substantial question of law in favour of the assessee.

3. **In case of combo-pack of bought out tooth brush sold alongwith tooth paste manufactured by assessee, is tooth brush eligible as input under the CENVAT Credit Rules, 2004?**

CCus. vs. Prime Health Care Products 2011 (272) E. L. T. 54 (Guj.)

Facts of the case:
The assessee was engaged in the manufacture of tooth paste. It was sold as a combo pack of tooth paste and a bought out tooth brush. The assessee availed CENVAT credit of central excise duty paid on the tooth brush. Revenue contended that the tooth brush was not an input for the manufacture of the tooth paste and the cost of tooth brush was not added in the M.R.P. of the combo pack and hence the assessee had availed CENVAT credit of duty paid on tooth brush in contravention of the provisions of the CENVAT Credit Rules, 2004.

Decision of the case:

The High Court noted that the process of packing and re-packing the input, that was, toothbrush and tooth paste in a unit container would fall within the ambit of "manufacture" [as per section 2(f)(iii) of the Central Excise Act, 1944].

Further, the word "input" was defined in rule 2(k) of the CENVAT Credit Rules, 2004 which also included accessories of the final products cleared along with final product. There was no dispute about the fact that on toothbrush, excise duty had been paid. The toothbrush was put in the packet along with the tooth paste and no extra amount was recovered from the consumer on the toothbrush.

Considering the definition given in the rules of "input" and the provisions contained in rule 3, the High Court upheld the Tribunal's decision that the credit was admissible in the case of the assessee.

4. **Whether CENVAT credit can be denied on the ground that the weight of the inputs recorded on receipt in the premises of the manufacturer of the final products shows a shortage as compared to the weight recorded in the relevant invoice?**

CCE vs. Bhuwalka Steel Industries Ltd. 2010 (249) ELT 218 (Tri-LB)

Relevant Rule: 3(1) of the CENVAT credit Rules, 2004

The Larger Bench of the Tribunal held that each case had to be decided according to merit and no hard and fast rule can be laid down for dealing with different kinds of shortages. Decision to allow or not to allow credit under rule 3(1), in any particular case, will depend on various factors such as the following:-

(i) Whether the inputs/capital goods have been diverted en-route or the entire quantity with the packing intact has been received and put to the intended use at the recipient factory.

(ii) Whether the impugned goods are hygroscopic in nature or are amenable to transit loss by way of evaporation etc.

(iii) Whether the impugned goods comprise countable number of pieces or packages and whether all such packages and pieces have been received and accounted for at the receiving end.

(iv) Whether the difference in weight in any particular case is on account of weighment on different scales at the despatch and receiving ends and whether the same is within the tolerance limits with reference to the Standards of Weights and Measures Act, 1976.

(v) Whether the recipient assessee has claimed compensation for the shortage of goods either from the supplier or from the transporter or the insurer of the cargo.

Tolerances in respect of hygroscopic, volatile and such other cargo has to be allowed as per industry norms excluding, however, unreasonable and exorbitant claims. Similarly, minor variations arising due to weighment by different machines will also have to be ignored if such variations are within tolerance limits.

5. **Head office distributed the CENVAT credit of the service tax paid on the services received to its various units. Can the CENVAT credit be denied to a particular unit on the ground that input services were obtained by another unit belonging to the same manufacturer?**

CCE vs. Ecof Industries Pvt. Ltd. 2011 (271) E.L. T. 58 (Kar.)

Facts of the case:

The assessee was engaged in manufacturer of excisable goods in Malur. Its head office, located in Chennai, was registered as 'Input Service Distributor'. The head office had paid service tax for services received by the head office and its units from various service providers. Thereafter, it had distributed the credit of service tax to its various units including the unit at Malur. The assessee availed and utilized the said credit for payment of central excise duty on their final products.

Revenue contended that since the service tax was paid in respect of services obtained by Cuttack unit, the credit of the said service tax paid could not be utilized by Malur unit.

Decision of the case:

Considering rules 2(k), 2(l), 2(m), 3(1) and 7 of the CENVAT Credit Rules, 2004, the High Court elucidated that availment of credit of the service tax paid on the input service at a particular unit by another unit is not prohibited under law. However, the head office is expected to register itself as an input service distributor and thereafter, is entitled to distribute the credit of such input services in the manner prescribed under law. The High Court therefore held that Malur unit had rightly availed the CENVAT credit of the service tax paid by its head office.

6. **Can the CENVAT credit of duty paid on inputs and capital goods used in mines be availed?**

Madras Cements Ltd. vs. CCE 2010 (257) E.L.T. 321 (S.C.)

Decision of the case:

The Apex Court decided the issue with regard to the eligibility of Modvat/ Cenvat credit on inputs and capital goods used in mines as follows:-

(i) CENVAT credit on inputs used in mines

The Supreme Court held that the issue as to availability of Modvat/ Cenvat credit on inputs (explosives, lubricating oils etc.) was squarely covered by the case of Vikram Cement vs. CCE 2006 (194) E.L.T. 3 (S.C.). Therefore, the credit on inputs is allowed.

(ii) CENVAT credit on capital goods used in mines

(a) If the mines are captive mines

If the mines are captive mines so that they constitute one integrated unit together with the concerned cement factory, Modvat/ Cenvat credit on capital goods will be available to the assessee.

(b) If the mines are not captive mines

If the mines are not captive mines but they supply goods to various other cement companies of different assessees, and it is found that the said goods were being used in the lime stone mines outside the factory of the assessee, Modvat/ Cenvat credit on capital goods used in such mines will not be available to the concerned assessee.

REFUND

1. **Whether the interest on delayed refund under section 11BB would be payable from the date of deposit of tax or from the date of receipt of application for refund?**

Kanyaka Parameshwari arameshwari Engineering Ltd. . vs. Comm of Cus & Cx 2012 (26) STR 380 (A.P)

Facts of the Case:

Kanyaka Parameshwari Engineering Ltd. was engaged in business of manufacture and sale of LPG cylinders. The appellant had paid excise duty under protest for the financial year 1999-2000 as the price was not finalized by the oil companies so the appellant undertook to pay the differential duty, if any, on fixation of exact price.

Pursuant to the reduction in the prices of LPG cylinders, the appellant filed applications for finalization of assessments and for refund of excess duty so paid by them. The Department refunded the excess duty paid by the appellant with interest from three months after the application for refund filed till the date of payment.

The appellant further filed an appeal demanding interest on the excess duty so paid by them as per section 11BB of Central Excise Act from the date of payment as duty was paid under protest.

Point of Dispute:

Whether under section 11BB, the interest on refund is payable from the date of deposit of tax or from the date three months after the submission of the application the refund?

Decision of the Case:

Under section 11BB of the Central Excise Act, 1944, if any duty is no refunded within three months from the date of receipt of application under sub-section (1), the interest shall be paid on such duty from the date immediately after expiry of three month from the date of receipt of such application till the date of refund of such duty.

The High Court upheld the order of the CESTAT and granted interest on delayed refund from the expiry of three months from the date of application till the date of refund.

2. **What is the date of commencement of the period for the purpose of computing interest on delayed refunds under section 11BB- the date of receipt of application for refund or date on which the order of refund is made?**

Ranbaxy Laboratories Ltd. vs. UOI 2011 (273) E.L. T. 3 (SC)

Decision of the case:

The Apex Court observed that interest under section 11BB becomes payable, if on an expiry of a period of three months from the date of receipt the application for refund, the amount claimed is still not refunded. Thus, the only interpretation of section 11BB that can be arrived at is that interest under the said section becomes payable on the expiry of a period of three months from the date of receipt of the application under section 11B (1).

The Apex Court further noted that Explanation appearing below the proviso to section 11BB introduces a deeming fiction that where the order for refund of duty is not made by the Assistant Commissioner/ Deputy Commissioner of Central Excise but by an Appellate Authority or the Court, then for the purpose of this section the order made by such higher Appellate Authority or by the Court shall be deemed to be an order made under section 11B(2). It is apparent that the explanation does not bearing or connection with the date from which interest under section 11BB becomes payable and does not postpone the said date.

In the light of the aforesaid discussion, the Supreme Court elucidated that section 11BB of the Central Excise Act, 1944 comes into play only after an order for refund has been made under section 11B. However, the liability of the revenue to pay interest under section 11BB commences from the date of expiry of three months from the date of receipt of application for refund under section 11B(1) and not on the expiry of the said period from the date on which order of refund is made.

3. **Can the excess duty paid by the seller be refunded on the basis of the debit note issued by the buyer?**

CCE vs. Techno Rubber Industries Pvt Ltd. 2011 (272) E. L. T. 191 (Kar.)

Facts of the case:

The assessee cleared the goods paying higher rate of excise duty in the month of March, although the rate of duty on the said goods had been reduced in the budget of the same financial year. However, the buyer refused to pay the higher duty which the assessee had paid by mistake. The customer raised a debit note in his name in the month of June of the same year. The assessee applied for the refund of excess excise duty paid. Revenue rejected his claim on the ground that incidence of the duty had been passed by him to the buyer.

While claiming refund, the assessee relied on the debit note raised by the buyer in his name in the month of June to demonstrate that his customer had not paid the excess duty to him. The adjudicating authority argued that since the debit note was issued in the month of June and not March, it could not be the basis for refund.

Decision of the case:

The High Court elucidated that once it is admitted that the Department has received excess duty, they are bound to refund it to the person who has paid the excess duty. If the buyer of the goods has paid that excess duty, he would have been entitled to the said refund.

In the instant case, when the buyer had refused to pay excess duty claimed and had raised a debit note, the only inference to be drawn was that the assessee had not received that excess duty which he had paid to the Department. Consequently, Department was bound to refund to the assessee the excess duty calculated. Hence, the substantial question of law raised was answered in favour of the assessee and against the revenue.

APPEALS

1. **Whether doctrine of merger is applicable when appeal dismissed on the grounds of limitation and not on merits?**

Raja Mechanical Co. (P) Ltd. vs. Commissioner of C. Ex., Delhi-I, 2012 (279) E.L.T.481(S. C.)

Point of Dispute:

The issue under consideration is that in case the first appellate authority had rejected the appeal filed by the assessee on the ground of limitation, whether the orders passed by the original authority would merge with the orders passed by the first appellate authority.

The learned counsel for the assessee contended that in given case, the orders passed by the original authority would merge with the orders passed by the first appellate authority and therefore, the Tribunal should consider the appeal filed by the assessee.

It further submitted that the Tribunal ought to have considered the assessee's appeal not only on the ground of limitation but also on merits of the case. Since that has not been done, according to the learned counsel, the Tribunal has committed a serious error. The learned counsel further submitted that the "doctrine of merger" theory would apply in the sense that though the first appellate authority had rejected the appeal filed by the assessee on the ground of limitation, the orders passed by the original authority would merge with the order passed by the first appellate authority and, therefore, the Tribunal ought to have considered the appeal

On the other hand, the learned counsel for the respondent submitted that the doctrine of merger would not apply to a case where an appeal was dismissed only on the ground of the limitation.

Decision of the Case:

The Court observed that if for any reason an appeal is dismissed on the ground of limitation and not on merits that order would not merge with the orders passed by the first appellate authority. Apex Court opined that the High Court was justified in rejecting the request made by the assessee for directing the Revenue to state the case and also the question of law for its consideration and decision. In view of the above discussion, Supreme Court rejected the appeal.

2. Whether the construction of pre-fabricated components at one site to be used at different inter-connected metro construction sites in Delhi would get covered under exemption Notification No. 1/2011 -C.E.(N.T.) dated 17-2-2011 exempting the "goods manufactured at the site of construction for use in construction work at such site" ?

Commissioner of Central Excise vs. Rajendra Narayan 2012 (281) E.L. T. 38 (Del.)

Facts of the Case:

The respondent-assessees were carrying on construction of the Delhi Metro. They had manufactured pre-fabricated components, which have been used in the construction of the Delhi Metro. The assessee claimed the exemption under Notification No. 1/2011-C.E. (N.T.) dated 17-2-2011 which exempts the goods covered under specified chapter headings for a specified period, manufactured at the site of construction for use in construction work at such site. The Department contended that the respondent-assessees were not entitled to claim the exemption stating that the goods were not manufactured at the site of the construction for use in the construction work at the site.

Decision of the Court:

The Court noted that Delhi Metro Rail Corporation Ltd. had contracted and called upon the respondent- assessee to construct pre-fabricated components of different segments to be used in elevated viaducts etc.. For the purpose of pre-fabricating the components a specific casting yard, premises was allotted by Delhi Metro Rail Corporation Ltd.. The said casting yard constituted the construction site. From the said construction site, components had been moved to different locations where elevated viaducts of the tunnel were being constructed. The Court held that keeping in view the facts of the present case and that the construction was done virtually all over Delhi and construction sites were interconnected, practically pre-fabrication was done on construction site only.

Therefore, it allowed the appeal in the favour of the respondent- assessee.

Hence, the Court opined that CESTAT exceeded its powers under section 35C(2) of the Act. In pursuance of a rectification application, it cannot re-appreciate the evidence and reconsider its legal view taken earlier.

3. Is the CESTAT order disposing appeal on a totally new ground sustainable?

CCE vs. Gujchem Distillers 2011 (270) E.L. T.338 (Bom.)

The High Court elucidated that in the instant case, the CESTAT had disposed of the appeal on a ground which was not urged by the respondents before the adjudicating authority. Thereby the CESTAT had disposed of the appeal on a totally new ground which was not laid before the adjudicating authority and which would entail a finding of facts.

The High Court explained that had the CESTAT not been satisfied with the approach of the adjudicating authority, it should have remanded the matter back to the

adjudicating authority. However, it could not have assumed to itself the jurisdiction to decide the appeal on a ground which had not been urged before the lower authorities.

4. Can re-appreciation of evidence by CESTAT be considered to be rectification of mistake apparent on record under section 35C(2) of the Central Excise Act, 1944?

CCE vs. RDC Concrete (India) Pvt. Ltd. 2011 (270) E.L. T. 625 (S.C.)

Decision of the case:

In the instant case, the arguments not accepted at an earlier point of time were accepted by the CESTAT while hearing the application for rectification of mistake and it arrived at a conclusion different from earlier one.

The Apex Court elucidated that re-appreciation of evidence on a debatable point cannot be said to be rectification of mistake apparent on record. It is a well settled law that a mistake apparent on record must be an obvious and patent mistake and the mistake should not be such which can be established by a long drawn process of reasoning.

The Supreme Court observed that arguments not accepted earlier during disposal of appeal cannot be accepted while hearing rectification of mistake application.

Submissions made before Tribunal while arguing rectification of mistake application had also been advanced before Tribunal when appeal heard at earlier stage. The Apex Court held that CESTAT had reconsidered its legal view as it concluded differently by accepting the arguments which it had rejected earlier.

Hence, the Court opined that CESTAT exceeded its powers under section 35C(2) of the Act. In pursuance of a rectification application, it cannot re-appreciate the evidence and reconsider its legal view taken earlier.

Note: Section 35C(2) reads as under:-

The Appellate Tribunal may, at any time within six months from the date of the order, with a view to rectifying any mistake apparent from the record, amend any order passed by it under sub-section (1) and shall make such amendments if the mistake is brought to its notice by the Commissioner of Central Excise or the other party to the appeal.

7. EXEMPTION BASED ON VALUE OF CLEARANCES (SSI)

1. Whether an assessee can claim the benefit of SSI exemption on the brand name of another firm if its proprietor is also a partner in such other firm?

Commissioner vs. Elex Knitting Machinery Co. 2012 (283) E.L T. A 18 (S. C.)

Facts of the Case:

The Elex Knitting Machinery Co. was engaged in the manufacture of flat knitting machines. They had been availing the SSI exemption. They were found using the brand name "ELEX" on those machines which belonged to M/s. Elex Engineering Works

and according to the Central Excise Authorities they were not entitled to avail the benefit of said notification.

Point of Dispute:

The Department denied the benefit of the SSI exemption notification solely on the ground that they had manufactured and cleared the goods (flat knitting machines) under the brand name "ELEX" which belonged to M/s. ELEX Engineering Works but on record there was no oral or documentary proof to substantiate this ground.

Decision of the Court:

The Supreme Court was of the view that the benefit of exemption could be availed only when the company is manufacturing the goods under its own brand name or the brand name being used belonged to a sister concern of that company.

The Supreme Court held that the appellant was eligible to claim benefit of the SSI exemption as the proprietor of Elex Knitting Machinery Co. was one of the partners in Elex Engineerin Works. And hence being the co-owner of the brand name of Elex, he could not be said to have used the brand name of another person, in the manufacture and clearance of the goods in his individual capacity.

2. **Whether the exempted goods on which duty has been paid by mistake by the assessee and refund thereof has also not been claimed would be excluded while computing turnover for preceding year for claiming SSI exemption?**

Bonanzo Engg. & Chemical P. Ltd. vs. CCEx. 2012 (277) E.L.T. 145 (S.C.)

Facts of the case:

The appellant was a manufacturer of goods falling under Chapter headings 32 and 84 of the first schedule to the Central Excise Tariff Act, 1985. The goods falling under Chapter heading 84 were wholly exempt from duty vide an exemption notification, but the appellant by mistake paid the excise duty on it and did not even claim refund of the same. For goods falling under Chapter heading 32, the appellant wanted to claim SSI exemption. It satisfied all the conditions for claiming the said exemption.

For the purposes of computing the eligible turnover for SSI exemption, the assessee excluded the goods which were exempted although duty was paid mistakenly on them. However, the Revenue contended that clearances of such goods should be included while computing the eligible turnover.

Decision of the Case:

The Supreme Court opined that SSI exemption would be allowable to the assessee, as they meet all the conditions thereof. The amount of clearances in the SSI exemption notification needs to be computed after excluding the value of exempted goods. Merely because the assessee by mistake paid duty on the goods which were exempted from the duty payment under some other notification, did not mean that the goods would become goods liable for duty under the Act. Secondly, merely because the assessee had not claimed any refund on the duty paid by him would not come in the way of claiming benefit of the SSI exemption.

Accordingly the appeal was allowed in the favor of the appellant-assessee. The Court directed the adjudicating authority to apply the SSI exemption notification in the assessee's case without taking into consideration the excess duty paid by the assessee under the other exemption notification.

3. **Whether the clearances of two firms having common brand name, goods being manufactured in the same factory premises, having common management and accounts etc. can be clubbed for the purposes of SSI exemption?**

CCE vs. Deora Engineering Works rks 2010 (255) ELT 184 (P & H)

Facts of the case:

The respondent-assessee was using the brand name of "Dominant" while clearing the goods manufactured by it. One more manufacturing unit was also engaged in the manufacture and clearance of the same goods under the same brand name of "Dominant" in the same premises. Both the firms had common partners, the brand name was also common and the machines were cleared from both the units under common serial number having common accounts. Department clubbed the clearance of the goods from the both the units for the purposes of SSI exemption because both the units belong to same persons and they had common machinery, staff and office premises etc.

Decision of the case:

The High Court held that indisputably, in the instant case, that the partners of both the firms were common and belonged to same family. They were manufacturing and clearing the goods by the common brand name, manufactured in the same factory premises, having common management and accounts etc. Therefore, High Court was of the considered view that the clearance of the common goods under the same brand name manufactured by both the firms had been rightly clubbed.

CUSTOMS

1. BASIC CONCEPTS

1. **In case no statutory definition is provided under law, can the opinion of expert in trade who deals in those goods be considered?**

Commissioner of Customs (Import), Mumbai vs. Konkan Synthetic Fibres2012 (278) E.L. T. 37 (S.C.)

Facts of the Case: Konkan Synthetic Fibres was an importer. It had imported one unit of the equipment which was declared as "Kari Mayer High Speed Draw Warping Machine

with 1536 ends along with essential spares"· The importer claimed that these goods are covered under an exemption notification.

Under said notification, exemption was available in respect of the High Speed Warping Machine with yarn tensioning, pneumatic suction devices and accessories. Undisputedly, the assessee had imported High Speed Warping Machine, but it had drawing unit and not the pneumatic suction device. The textile commissioner, who was well conversant with these machines, had stated that the goods imported by the assessee were covered under the exemption notification. He further stated that drawing unit was just an essential accessory to the machines imported by assessee and, therefore, was covered under said notification. The opinion so furnished is taken note of by the Tribunal while granting relief to the assessee.

The Customs authorities refused to accept the request of the assessee and accordingly, had directed the assessee to pay the duty under the provisions of the Customs Act, 1962.

Point of Dispute: Revenue contended that the machine imported by the assessee was not in consonance with the exemption notification and, therefore, the benefit of exemption should not be available under the notification to the assessee.

Decision of the Case: The Supreme Court stated that it was a settled proposition in a fiscal or taxation law that while ascertaining the scope or expressions used in a particular entry, the opinion of the expert in the field of trade, who deals in those goods, should not be ignore rather it should be given due importance. The Supreme Court on referring to the case of Collector of Customs vs. Swastic Woollens (P) Ltd. 1988 (37) E.L. T. 474 (S. C.), held that when no statutory definition was provided in respect of an item in the Customs Act or the Central Excise Act, the trade understanding, i.e. the understanding in the opinion of those who deal with the goods in question was the safest guide.

Thus, the Supreme Court concluded that the imported goods were covered under the exemption notification.

2. Are the clearance of goods from DTA to Special Economic Zone chargeable to export duty under the SEZ Act, 2005 or the Customs Act, 1962?

Tirupati Udyog Ltd. vs. UOI 2011 (272) E.L.T. 209 (A.P.)

Decision of the case: The High Court, while deciding the aforesaid question of law, made the following observations:-

- A charging section has to be construed strictly. If a person has not been brought within the ambit of the charging section by clear words he cannot be taxed at all.
- SEZ Act does not contain any provision for levy and collection of export duty for goods supplied by a DTA unit to a Unit in a Special Economic Zone for its authorised operations. In the absence of a charging provision in the SEZ Act providing for the levy of customs duty on such goods, export duty cannot be levied on the DTA supplier by implication.

- With regard to the Customs Act, 1962, a conjoint reading of section 12(1) with sections 2(18), 2(23) and 2(27) of the Customs Act, 1962 makes it clear that customs duty can be levied only on goods imported into or exported beyond the territorial waters of India. Since both the SEZ unit and the DTA unit are located within the territorial waters of India, Section 12(1) of the Customs Act 1962 (which is the charging section for levy of customs duty) is not attracted for supplies made by a DTA unit to a unit located within the Special Economic Zone.

  The High Court thus inferred that the clearance of goods from DTA to Special Economic Zone is not liable to export duty either under the SEZ Act, 2005 or under the Customs Act, 1962.

  Notes:

  Karnataka High Court in case of CCE vs. Biocon Ltd. 2011 (267) E.L.T. 28 has also taken a similar view as elucidated in the aforesaid judgment.

3. Is the Port Trust liable to pay duty on goods pilfered while in their possession?

Board of Trustees of the Port of Bombay vs. UOI 2009 (241) E.L. T. 513 (Bom.)

In the instant case, goods were pilfered before clearance while in possession of the Port Trust as custodian. The Department raised the demand of custom duty on the Port Trust because goods were pilfered whilst in their custody.

The High Court viewed that considering the language of section 45(3) of the Customs Act, the liability to pay duty is of the person, in whose custody the goods remain, as an approved person under section 45 of the Customs Act. Considering that the possession of the goods by the Port Trust is by virtue of powers conferred on the Port Trust under the Port Trust Act, the Court found it impossible to hold that the Port Trust is an approved person or can be notified as an approved person. It implies that section 45(3) of the Customs Act refers to the persons who have approved warehouses in terms of sections 9 and 10 of the Customs Act.

The High Court further opined that under section 45 of the Customs Act, the person referred to in sub-section (1) thereof can only be the person approved by the Commissioner of Customs. It excludes a body of persons, who by virtue of a law for the time being in force, is entrusted with the custody of goods by incorporation of law under another enactment,(for example, the Port Trust Act in the given case).

The Court interpreted that the intention of the law might have been to check the pilferage taken place from a private warehouse or a customs warehouse run by a private party. The negligence on such private parties should not cause loss to the exchequer.

Thus, the Court held that under section 45(1) of the Customs Act, the recovery of duty in respect of pilfered goods could only from the approved person and the Port Trust is not liable to pay duty on goods pilfered while in their possession.

2. Whether remission of duty is permissible under section 23 of the Customs Act, 1962 when the remission application is filed after the expiry of the warehousing period (including extended warehousing period)?

CCE vs. Decorative Laminates (I) Pvt. Ltd. 2010 (257) E.L. T. 61(Kar.)

Facts of the case:

The respondent imported resin impregnated paper and plywood for the purpose of manufacture of furniture. The said goods were warehoused from the date of its import. The respondent sought an extension of the warehousing period which was granted by the authorities. However, even after the expiry of the said date, it did not remove the goods from the warehouse. Subsequently, the assessee applied for remission of duty under section 23 of the Customs Act, 1962 on the ground that the said goods had become unfit for use on account of non-availability of orders for clearance.

Decision of the case:

The High Court, while interpreting section 23, stipulated that section 23 states that only when the imported goods have been lost or destroyed at any time before clearance for home consumption, the application for remission of duty can be considered. Further, even before an order for clearance of goods for home consumption is made, relinquishing of title to the goods can be made; in such event also, an importer would not be liable to pay duty.

Therefore, the expression "at any time before clearance for home consumption" would mean the time period as per the initial order during which the goods are warehoused or before the expiry of the extended date for clearance and not any period after the lapse of the aforesaid periods. The said expression cannot extend to a period after the lapse of the extended period merely because the licence holder has not cleared the goods within the stipulated time.

Moreover, since in the given case, the goods continued to be in the warehouse, even after the expiry of the warehousing period, it would be a case of goods improperly removed from the warehouse as per section 72(1)(b) read with section 71.

The High Court, overruling the decision of the Tribunal, held that the circumstances made out under section 23 were not applicable to the present case since the destruction of the goods or loss of the goods had not occurred before the clearance for home consumption within the meaning of that section. When the goods are not cleared within the period or extended period as given by the authorities, their continuance in the warehouse will not attract section 23 of the Act.

3. CLASSIFICATION OF GOODS

1. Where a classification (under a Customs Tariff head) is recognized by the Government in a notification any point of time, can the same be made applicable in a previous classification in the absence of any conscious modification in the Tariff?

Keihin Penalfa Ltd. vs. Commissioner of Customs 2012 (278) E.L. T. 578 (S.C.)

Facts of the Case:

Department contended that 'Electronic Automatic Regulators' were classifiable under Chapter sub-heading 8543.89 whereas Keihin Penalfa Ltd. was of the view that the aforesaid goods were classifiable under Chapter sub-heading 9032.89. An exemption

notification dated 1-3-2002 exempted the disputed goods classifying them under chapter sub-heading 9032.89. The period of dispute, however, was prior to 1-3-2002.

Point of Dispute:

The dispute was on classification of Electronic Automatic Regulators.

Decision of the Court:

The Apex Court observed that the Central Government has issued a exemption notification dated 1-3-2002 and in the said notification it has classified the Electronic Automatic Regulators under Chapter sub-heading 9032.89. Since the Revenue itself has classified the goods in dispute under Chapter sub-heading 9032.89 from 1-3-2002, the said classification need to be accepted.

2. **Whether classification of the imported product changes if it undergoes a change after importation and before being actually used?**

Atherton Engineering Co. Pvt. Ltd. vs. UOI 2010 (256) E.L.T. 358 (Cal.)

Decision of the case:

The Court noted that it was the use of the product that had to be considered in the instant case. If a product undergoes some change after importation till the time it is actually used, it is immaterial, provided it remains the same product and it is used for the purpose specified in the classification. Therefore, in the instant case, it examined whether the nature and character of the product remained the same.

The Court opined that if the embryo within the egg was incubated in controlled temperature and under hydration, a larva was born. This larva did not assume the character of any different product. Its nature and characteristics were same as the product or organism which was within the egg.

Hence, the Court held that the said product should be classified as feeding materials for prawns under the heading 2309. These embryos might not be proper prawn feed at the time of importation but could become so, after incubation.

Note - The Headings cited in this case law may not co-relate with the Headings of the present Customs Tariff as this case relates to an earlier point of time.

3. **Will the description of the goods as per the documents submitted along with the Shipping Bill be a relevant criterion for the purpose of classification, if not otherwise disputed on the basis of any technical opinion or test? Whether a separate notice is required to be issued for payment of interest which is mandatory and automatically applies for recovery of excess drawback?**

MIS CPS Textiles P Ltd. vs. Joint Secretary 2010 (255) ELT 228 (Mad.)

Decision of the case:

The High Court held that the description of the goods as per the documents submitted along with the Shipping Bill would be a relevant criteria for the purpose of classification, if not otherwise disputed on the basis of any technical opinion or test. The petitioner could not plead that the exported goods should be classified under different headings contrary to the description given in the invoice and the Shipping Bill which had been assessed and cleared for export.

Further, the Court, while interpreting section 75A(2) of the Customs Act, 1962, noted that when the claimant is liable to pay the excess amount of drawback, he is liable to pay interest as well. The section provides for payment of interest automatically along with excess drawback. No notice need to be issued separately as the payment of interest become automatic, once it is held that excess drawback has to be repaid.

4. Where the importer clears the imported goods on the basis of classification which was upheld by Commissioner of Customs (A), is the seizure of such goods and collecting any amount in excess of what is assessed by the custom authorities justified?

Vodafone Essar South Ltd. vs UOI 2009 (237) E.L. T. 35 (Bom.)

The Commissioner of Customs (Appeals) in petitioner's own case, on 25-3-2008, had held that Optic Fibre Cables (OFC) imported by petitioners were classifiable under Heading 85.44 of the Central Excise Tariff, 1985. The Revenue filed an appeal before CESTAT against the said order claiming the classification of the goods under Heading 90.01. However, on 18-12-2008, the customs authorities (DRI officers) threatened the petitioner to arrest the directors of the petitioner-company and other staff unless differential duty between Headings 85.44 and 90.01 was paid.

The Bombay High Court held that the action of the Director of Revenue Intelligence (D.R.I. officers) in the Customs Department in seizing the goods and collecting money from the petitioners was wholly unjustified and uncalled for, because of following five reasons:-

(i) When the Commissioner of Customs (Appeals) in petitioner's own case on 25-3-2008 had held that OFC imported by petitioners were classifiable under Heading 85.44 of the Central Excise Tariff, the petitioners were not wrong in classifying the goods imported after 25-3-2008 under Heading 85.44 ibid.

(ii) Decision of Commissioner (Appeals) was neither stayed by CESTAT nor by any other competent authority. Hence, mere fact that appeal filed by Revenue against the decision of Commissioner (Appeals) was pending could not be a ground to hold the petitioner guilty of misclassification of goods.

(iii) D.R.I. officers were bound by the decision given by Commissioner of Customs (Appeals).

(iv) The Bills of Entry filed by the petitioners by classifying the goods under Heading 85.44 had been assessed under Heading 85.44 and the goods had been cleared only on payment of duty as assessed. Therefore, till the assessment was set aside, the customs authorities could not have seized the goods assessed and cleared under Heading 85.44, on the ground that the goods were liable to be assessed under Heading 90.01.

(v) In the absence of any re-assessment order passed determining the duty liability, there would be no question of recovering differential duty.

VALUATION UNDER THE CUSTOMS ACT, 1962

1. **Whether subsequent increase in the market price of the imported goods due to inflation would lead to increase in customs duty although the contract price between the parties has not increased accordingly?**

   Commissioner of Cus., Vishakhapatnam vs. Aggarwal Industries Ltd. . 2011 E.L. T. 641 (S.C.)

   Facts of the Case:

   On 26th June 2001, Aggarwal Industries Ltd. entered into a contract with foreign suppliers viz M/s. Wilmar Trading Pvt. Ltd., Singapore, for import of 500 metric tons of crude sunflower seed oil at the rate of US $ 435 CIF/metric ton. Under the contract, the consignment was to be shipped in the month of July 2001. However, the mutually agreed time for shipment was extended to 'mid August 2001'. Thus, the goods were actually shipped on 5th August 2001 at the price prevailing at the contract date.

   Point of Dispute:

   The Revenue contended that when actual shipment took place, after the expiry of the original shipment period, the international market price of crude sunflower seed oil had increased drastically, and, therefore, the contract price could not be accepted as the 'transaction value' in terms of rule 4 of the erstwhile Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 [now rule 3 of Customs Valuation (Determination of Value of Imported Goods) Rules, 2007]. Therefore the duty should be imposed on the increased prices.

   Decision of the Case:

   The Supreme Court held that in the instant case, the contract for supply of crude sunflower seed oil @ US $ 435 CIF/ metric ton was entered into on 26th June 2001. It could not be performed on time because of which extension of time for shipment was agreed between the contracting parties. It is true that the commodity involved had volatile fluctuations in its price in the international market, but having delayed the shipment, the supplier did not increase the price of the commodity even after the increase in its price in the international market. There was no allegation of the supplier and importer being in collusion. Thus, the appeal was allowed in the favour of the respondent- assessee.

3. **Service charges paid to the Canalising Agent (MMTC) includible in the assessable value of imports - "Service Commission" paid to Canalising Agent (MMTC) not to be equated with "buying commission" under Rule 9(1)(a)(i) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988 - Canalising Agency (MMTC) not to be treated as an Agent of the buyer as it does not represent its buyer abroad - Purchases by Canalising Agency (MMTC) from foreign sellers and subsequent sale by it to Indian buyers are independent of each other.**

   Hyderabad Industries Ltd. vs. UOI 2000 (115) ELT 593 (SC)

Relevant Section: 14 of the Customs Act, 1962.

Fact of the Case:

Under the provisions of the Import and Export Policy of the Government of India the MMTC is designated as a canalising agent for import of raw asbestos from foreign Countries. The MMTC imports the raw asbestos in bulk purchasing the same from the foreign sellers. It then enters into sale agreement on what is known as high seas sales basis with the various users of raw asbestos. Consideration paid by the purchasers of the raw asbestos from the MMTC (which includes the appellant) includes apart from the purchase value incurred by the MMTC an additional sum equivalent to 3.5 per cent of the C & F value of the imports as service charges. As per the Appellant these service charges are in the nature of `buying commission' and accordingly are not includible in the assessable value in view of the exclusion provided in Rule 9(1)(a)(i) of the Customs Valuation (Determination of Price of Imported Goods) Rules, 1988, whereas as per Revenue department there is no relationship of Principal and Agent between Indian buyers and the MMTC. Service charges paid to the MMTC cannot be equated with "buying commission" nor the Canalising Agency (MMTC) is an Agent of the Indian buyers as there is no relationship of Principal and Agent between them and nor the Canalising Agency (MMTC) represented the Indian buyer abroad to purchase the material. On the contrary the Canalising Agency (MMTC) purchased the material of its own and then sold the goods to Indian buyers on high seas sales basis. The purchases of Canalising Agency (MMTC) from foreign sellers and subsequent sale of it to Indian buyers are independent of each other. Thus the Service Charges paid to the Canalising Agency (MMTC) are includible in the assessable value of the imported goods and form part of the sale consideration. [para 7]

Decision of the case:

Customs duty - Heavy and unreasonable burden - Inclusion of 'Service Charges' paid to Canalising Agency (MMTC) in the assessable vlaue - Even if it causes heavy burden, it cannot be avoided on that ground - Even otherwise Appellant were permitted to import goods independently - Procurement from Canalising Agency (MMTC) also benefitted the Indian buyers from avoiding sales tax - Plea of unreasonableness of the levy hence not acceptable - Sections 12 and 14 of the Customs Act, 1962 - Article 226 of the Constitution of India.

(3) Design and engineering charges are includible in the assessable value of the imported goods only if the goods imported are specifically manufactured on the basis of the design and engineering specifications provided by the importer.

TISCO Ltd. vs. CCEx. & Cus. 2000 (116) ELT 422 (SC)

Relevant Section: 14 of the Custom Act, 1962

The Supreme Court in this case has held that design and engineering charges paid for use during construction, erection, assembly etc. of imported goods, being relatable to post import activity, are not includible in the value. Thus, the design and engineering charges which relate to pre-importation activity are only includible in the value. Since, in this case the design and engineering charges are paid for manufacturing the imported product, i.e., they relate to pre-importation activity, the same are includible in the value. Thus, the statement is correct.

(4) Inspection charges are not includible in the assessable value of the imported goods if contract does not specify for certification by an independent agency.

Bombay Dyeing & Mfg. vs. CC 1997 (90) ELT 276 (SC)]

Where there is no requirement in the contract for independent inspection and the inspection is carried out by foreign supplier on his own and is not required for the purpose of fulfilling the condition of the contract, then such charges incurred on inspection are not includible in assessable value

WAREHOUSING

1. Whether the issue of the imported goods warehoused in the premises of 100% EOU for manufacture/production/processing in 100% EOU would amount to clearance for home consumption?

Paras Fab International vs. CCE 2010 (256) E.L.T. 556 (Tri. - LB)

Issue:

Following questions arose before the Larger Bench of the Tribunal for consideration:-

(a) Whether the entire premises of 100% EOU should be treated as a warehouse?

(b) Whether the imported goods warehoused in the premises of 100% EOU are to be held to have been removed from the warehouse if the same is issued for manufacture/production/processing by the 100% EOU?

(c) Whether issue for use by 100% EOU would amount to clearance for home consumption?

(d) Whether non-filing of ex-bond bill of entry before using the goods by the 100% EOU makes the goods as not cleared for home consumption?

Facts of the case:

The appellants were 100% EOU in Alwar. They imported the impugned goods namely HSD oil through Kandla Port and filed 'into Bond Bill of Entry' for warehousing the imported goods. The impugned goods were warehoused in their 100% EOU in Alwar and subsequently used in the factory within the premises of the 100% EOU for manufacture of the finished goods. The Department demanded customs duty on the impugned goods.

The contention of the appellants was that since (i) the entire premises of the 100% EOU had been licensed as a warehouse under the Customs Act; (ii) the impugned goods had been warehoused therein and subsequently utilized for manufacture of finished goods in bond; and (iii) the impugned goods had not been removed from the warehouse, there could not be any question of demanding duty on the same.

Department contended that the entire premises of the 100% EOU could not be treated as a warehouse. The Appellants had executed a common bond B-17 for fulfilling the requirements under the Customs Act, 1962 and the Central Excise Act, 1944. Under the Central Excise Law, the removal of goods for captive consumption

would be treated as removal of goods and the assessee were required to pay duty on such removal.

Decision of the case:

The Tribunal observed that as per Customs manual, the premises of EOU are approved as a Customs bonded warehouse under the Warehousing provisions of the Customs Act. It is also stated therein that the manufacturing and other operations are to be carried out under customs bond. The goods are required to be imported into the EOU premises directly and prior to undertaking import, the unit is required to get the premises customs bonded. The imported goods, except capital goods and spares are required to be utilized within a period of one year or within such period as may be extended by the Customs authorities and the importer is required to maintain a proper record and proper account of the import, consumption and utilization of all imported materials and exports made and file periodical returns. The EOUs are licensed to manufacture goods within the bonded premises for the purpose of export.

The Tribunal held that neither the scheme of the Act nor the provisions contained in the Manual require filing of ex-bond bills of entry or payment of duty before taking the imported goods for manufacturing in bond nor there is any provision to treat such goods as deemed to have been removed for the purpose of the Customs Act, 1962.

The Tribunal answered the issues raised as follows:-

(a) The entire premises of a 100% EOU has to be treated as a warehouse if the licence granted under section 58 to the unit is in respect of the entire premises.

(b), (c) and (d) Imported goods warehoused in the premises of a 100% EOU (which is licensed as a Customs bonded warehouse) and used for the purpose of manufacturing in bond as authorized under section 65 of the Customs Act, 1962, cannot be treated to have been removed for home consumption.

2. Under what circumstances can the penalty be imposed in terms of section 112(a)(ii) of the Customs Act, 1962?

O. T. Enasu vs. UOI 2011 (272) E.L. T. 51 (Ker.)

The High Court noted that under sub-clause (ii) of clause (a) of section 112, the liability to penalty is determined on the basis of duty sought to be evaded. Therefore, the jurisdictional fact to impose a penalty in terms of section 112(a)(ii) includes the essential ingredient that "duty was sought to be evaded". Being a penal provision, it requires to be strictly construed. 'Evade' means, to escape, slip away, to escape or avoid artfully, to shirk, to baffle, elude. The concept of evading involves a conscious exercise by the person who evades. Therefore, the process of "seeking to evade" essentially involves a mental element and the concept of the status "sought to be evaded" is arrived at only by a conscious attempt to evade.

In view of the above discussion, the High Court inferred that unless it is established that a person has, by his omissions or commissions, led to a situation where duty is

sought to be evaded, there cannot be an imposition of penalty in terms of section 112(a)(ii) of the Act.

3. Can separate penalty under section 112 of the Customs Act be imposed on the partners when the same has already been imposed on partnership firm?

Textoplast Industries vs. Additional Commissioner of Customs 2011 (272) E.L.T. 513 (Bom.)

Decision of the case:

The High Court noted that Explanation to section 140 of the Customs Act, 1962 brings within purview of "Company", a firm or an association of individuals, and 'Director' in relation to firm, includes its partner. The High Court observed that in case of Apex Court judgment of Standard Chartered Bank vs. Directorate of Enforcement, there emerged the principle that the deeming fiction is not confined to a criminal prosecution but will also extend to an adjudication proceeding as well. Hence, the High Court, in the instant case, held that the deeming fiction in section 140(2) making Director, Manager, Secretary or other officer of company liable to penalty, would not be confined to criminal prosecution but extends to adjudication proceeding as well.

The High Court explained that had it been otherwise, it would have led to strange situation where, for criminal prosecution, partner as well as person in charge responsible for conduct of business of partnership firm would be liable whereas for adjudication purposes, a narrower construction had to be adopted. There was no reason to exclude penalty on partnership firm, particularly when it was consistent with overall scheme an object of the Act.

In view of the above discussion, the High Court held that for the purpose of imposing penalty, the adjudicating authority under Customs Act, 1962 might, in an appropriate case, impose a penalty both upon a partnership firm as well as on its partners.

Note: The Gujarat High Court, in case of CCE & C, Surat-II vs. Mohammed Farookh Mohammed Ghani 2010 (259) E.L.T. 179, has held that separate penalty under section 112 could not be imposed on the partners in addition to the penalty on the partnership firm. However, the Gujarat High Court, while deciding the said case, has not considered the principle enunciated by the Supreme Court in the Standard Chartered Bank case. In the circumstances, it appears that separate penalty under section 112 can be imposed on the partners in addition to the penalty on the partnership firm.

4. Is the want of evidence from foreign supplier enough to cancel the confiscation order of goods undervalued?

CCus. vs. Jaya Singh Vijaya Jhaveri 2010 (251) E.L.T. 38 (Ker.)

Decision of the case:

In the instant case, the High Court held that in a case of confiscation of goods because of their under valuation, Tribunal could not cancel the confiscation order for the want of evidence from the foreign supplier. The Court considered it be illogical that a person who was a party to under-valuation would give evidence

to the Department to prove the case that the invoice raised by him on the respondent was a bogus one and that they had received underhand payment of the differential price. Resultantly, the Court upheld the confiscation order.

5. Whether the benefit of exemption meant for imported goods can also be given to the smuggled goods?

CCus. (Prev.), Mumbai vs. M. Ambalal & Co. 2010 (260) E. L. T. 487 (SC)

Decision of the case:

The question which arose before the Apex Court for consideration was whether goods that were smuggled into the country could be considered as 'imported goods' for the purpose of granting the benefit of the exemption notification.

The Apex Court held that the smuggled goods could not be considered as 'Imported goods' for the purpose of benefit of the exemption notification. It opined that if the smuggled goods and imported goods were to be treated as the same, then there would have been no need for two different definitions under the Customs Act, 1962.

The Court observed that one of the principal functions of the Customs Act was to curb the ills of smuggling on the economy. Hence, it held that it would be contrary to the purpose of exemption notifications to give the benefit meant for imported goods to smuggled goods.

Date of determination of rate of tax, value of taxable service and value of exchange [Section 67A]

New section 67A has been inserted by the Finance Act, 2012 to provide for:

(a) date of determination of rate of tax,

(b) value of taxable service, and

(c) rate of exchange (as referred in section 14 of Customs Act, 1962) **This will be effective from 1-7-2012.**

The provisions of section 67A reads as follows -

The rate of service lax, value of a taxable service and rate of exchange, if any, shall be the rate of service tax or value of a taxable service or rate of exchange, as the case may be, in force or as applicable at the time when the taxable service has been provided or agreed to be provided".

It provides that value of taxable services (particularly in case of import, and export of taxable services) and the rate of tax shall be determined in terms of Point of Taxation Rules, 2011. Accordingly, date, value and rate of exchange, as the case may be, shall be as in force or as applicable at the time when taxable service has been provided or agreed to be provided.

As per explanation to section 14 of the Customs Act, 1962, `rate of exchange' means the rate of exchange-

(i) determined by the Central Government, or

(ii) ascertained in such manner as the Central Government may direct, for the conversion of Indian currency into foreign currency or foreign currency into Indian currency. Both Indian currency and foreign currency are defined in Foreign Exchange Regulation Act, 1973.

Gross Value - Some Points to be Noted

(i) Service tax is chargeable on gross value of taxable services rendered as determined in terms of Service Tax (Determination of Value) Rules, 2006.
(ii) Where gross amount charged is inclusive of service tax, value of taxable service shall be an amount which with addition of service tax would be equal to gross amount charged.
(iii) Services provide free (without any consideration) shall not attract any service tax as value will be nil.
(iv) Gross amount charged includes amounts received before, during and after the provision of taxable service.
(v) Gross amount would include payment by cheque, credit card, deduction from account, credit notes, debit notes, book adjustments and amounts debited or credited to any account including suspense account in case of transactions with associated enterprises.
(vi) Gross consideration would include reimbursement of expenses unless incurred by a pure agent on behalf of the client.
(vii) Value of taxable service is total amount of consideration whether split into various components or not.
(viii) Value of goods and material supplied will not be included in the gross amount charged except in case of works contract/outdoor catering/restaurant services (Refer Notification No. 2412012-ST, dated 6-6-2012).
(ix) Gross value of taxable services and service tax should be indicated in invoices.
(x) Abatements, if any allowed, are to be calculated on the gross amount charged.
(xi) TDS is to be deducted on gross amount charged.
(xii) Value of taxable services will exclude Sales tax, VAT etc.
(xiii) Service tax returns should indicate gross amount charged for all taxable services.
(xiv) Only gross value of taxable service determines the liability of service tax.
(xv) CENVAT credit should be taken before depositing service tax on value of taxable service.

In Quadrant Communication Ltd. v. CCE, Pone III (2012) 26 STR 33 (Cestal, Mumbai), it was held that appellant was liable to pay service tax on the gross amount charged from the clients in respect of advertising services rendered. The value added tax practiced in India is on "invoice basis". The service tax liability has to be discharged on the gross amount charged to the client and the service provider can avail Service Tax/excise duty paid on the inputs or input services used in or in relation to the provision of output. Rule 5 of the Service Tax (Determination of Value) Rules, 2006 makes it abundantly clear that where any expenditure or costs are incurred by the service provider in the course of providing taxable service, all such expenditure or costs shall he treated as consideration for the taxable service provided and shall be included in the value for the purpose of charging service tax on the said service.

Valuation w.e.f. 1.7.2012

With the introduction of system of taxation of services based on the negative list there has been no fundamental change in the manner of valuation of service for the purpose of payment of service tax. The broad scheme remains the same barring some marginal changes carried out to align the scheme of valuation of taxable services and the Service Tax (Determination of Value) Rules, 2006 with the new system of taxation, Broadly these changes in the Valuation Rules are as follows:-

(i) As compared to the existing two schemes for valuation of works contract services - one under the rule 2A of the Valuation Rules and second under the Works Contract (Composition Scheme for Payment of Service Tax) Rules 2007 has been replaced with a unified scheme under the new rule 2A of Service Tax (Determination of Value) Rules, 2006.
(ii) A new Rule 2C has been inserted for determining the value of service involved in supply of food or any other article of human consumption or any drinks in a restaurant or as outdoor catering. The existing scheme of determination of value of such services through prescribed abatements in various exemption notifications has been done away with.
(iii) There are certain changes in rule 6 of the Service Tax (Determination of Value) Rules, 2006.
(iv) All notifications that prescribed the abatements for working out the taxable value from the gross amount charged have been merged into one single exemption notification i.e., Notification No. 26/2012- ST dated 2016112.

The manner of value of service is provided in Section 67. As per sub-section (1) of Section 67 wherever Service Tax is chargeable on any taxable service with regard to its value then its value shall -

(i) in a case where the provision of service is for a consideration in money, be the gross amount charged by the service provider for such service provided or to he provided by him;

(ii) in a case where the provision of service is for a consideration not wholly or partly consisting of money, be such amount in money as, with the addition of service tax charged, is equivalent to the consideration;

(iii) in a case where the provision of service is for a consideration which is not ascertainable, be the amount as may be determined in the prescribed manner.

There may be several situations wherein it may be difficult to determine the consideration received by service provider for provision of a service. Such situations can arise on account of several factors such as consideration of service being embedded in the total amount received as consideration for a composite activity involving elements of provisions of service and element of sale of goods or consideration for service being included in the gross amount charged for a particular transaction or consideration of service being wholly or partly in the nature of non-monetary consideration.

The manner has been prescribed under Service Tax (Determination of Value) Rules 2006. These rules in/or-olio provide provisions in respect of the following situations:

(i) Determination of value of service portion involved in execution of works contract.

(ii) Determination of value of service in relation to money changing.

(iii) Determination of value of service portion involved in supply of food and any other article of human consumption or any drinks in a restaurant or as outdoor catering.

(iv) Determination of value where such value is not ascertainable.

(v) The said rules also specify certain expenditures or costs that are incurred by the service provider which have to be included or excluded

(vi) The said rules also specify certain commissions or costs that are received by the service provider that have to be included or excluded while arriving at the taxable value.

In addition to the Service Tax (Determination of Value) Rules 2006, certain sub-rules in rule 6 of the Service Tax Rules, 1994 also provide simplified compounded mechanism for determination of value of taxable services in specified situations.

Salient Features of Service Tax (Determination of Value) Rules, 2006 (Notification No. 12/2006-ST dated 19.4.2006 as amended)

Following valuation rules have been prescribed vide Service Tax (Determination of Value) Rules, 2006.

These rules contain seven rules dealing with -

(1) Title and commencement

(2) Definition of value, section and other words

(2A) Determination of value of services involved in execution of Works Contract

(substituted by Notification No. 11/2012-ST, dated 17-3-2012)

(2B) Determination of value of service in relation to money changing

(2C) Determination of value of taxable service involved in supply of food and drinks in a restaurant or as outdoor catering (inserted by Notification No. 11/2012-ST, dated 17-3-2012 and superceded by Notification No. 24/2012-ST, dated 6-6-2012 w.e.f. 1-7-2012)

(3) Manner of determination of value

(4) Rejection of value

(5) Inclusion in or exclusion from taxable value of certain expenditure or costs

(6) Cases in which commission, costs etc. will be included or excluded

(7) Actual consideration to be the value of taxable service provided from outside India. (Omitted by Notification No. 11/2012-ST, dated 17-3-2012 and superceded by Notification No. 24/2012-ST, dated 6-6-2012 w.e.f. 1-7-2012)

In Jaihind Projects Ltd. v. CST, Ahmedabad (2010) 25 STT 196 (Costal, Ahmedabad), it was observed that section 67 clearly provides that for calculating value of a service, consideration in monetary as well as non monetary terms are required to be taken into account and where consideration is not ascertainable, it has to be determined in the prescribed manner. Service Tax (Determination of Valuation Rules), 2006 provides for determination of value of services. Rule clearly provides that where the value cannot be determined, equivalent money value of consideration which cannot be less than the cost of the provisions of taxable service, is required to be taken into account and value of taxable service is the total value of taxable service is the total amount of consideration consisting of all components of taxable service. Rule 5 provides that all expenditure/cost incurred by service provider are to be treated as consideration. Rule 5 also provides examples of different types of expenses. It was held that assessee was required to pay service tax on full value of contracts including cost of pipes provided by service receiver, and if value of pipes, which were used for laying pipelines, was not included, assessee would not be eligible for abatement.

Valuation rules known as Service Tax (Determination of Value) Rules, 2006 provide for arms length pricing mechanism for valuing a taxable service for levy of service tax. These rules, in all contain seven rules providing for manner of determination of taxable value, rejection of value, inclusion in or exclusion from taxable value of certain expenditure or costs, cases in which commission, cost etc. will be included or excluded and actual consideration to be the value of taxable service provided from outside India.

Value

Rule 2 defines value as referred to in Section 67 of the Finance Act, 2006 i.e., gross amount charged by the service provider for taxable services provided or to be provided. When it is in money terms the consideration in money would include any amount that is payable for the taxable services provided or to be provided. The terms-consideration, money and gross amount charged have been defined by way of explanation to Section 67.

(A) Determination of Value of Services in Execution of Works Contract (Rule 2A)

Service Tax (Determination of Value) Rules, 2007 have been amended by Notification No. 29/2007-ST dated 22.5.2007 w.e.f. 1.6.2007 to insert new rule 2A which provides for determination of value of taxable service involved in the execution of works contracts. It prescribes the manner in which valuation of service component of works contracts shall be done.

Accordingly,

(i) Value of works contract service determined shall be equivalent to the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.

(ii) Where Value Added Tax or sales tax, as the case may be, has been paid on the actual value of transfer of property in goods involved in the execution of the works contract, then such value adopted for the purposes of payment of Value Added Tax or sales tax, as the case may be, shall be taken as the value of

transfer of property in goods involved in the execution of the said works contract for determining the value of works contract service.

The gross amount shall include and exclude as follows -

(a) gross amount charged for the works contract shall not include Value Added Tax (VAT) or sales tax, as the case may be, paid, if any, on transfer of property in goods involved in the execution of the said works contract;

(b) value of works contract service shall include,-

(i) labour charges for execution of the works;

(ii) amount paid to a sub-contractor for labour and services;

(iii) charges for planning, designing and architect's fees;

(iv) charges for obtaining on hire or otherwise, machinery and tools used for the execution of the works contract;

(v) cost of consumables such as water, electricity, fuel, used in the execution of the works contract;

(vi) cost of establishment of the contractor relatable to supply of labour and services;

(vii) other similar expenses relatable to supply of labour and services; and

(viii) profit earned by the service provider relatable to supply of labour and services;

In case of works contracts, CBEC has vide Circular No. 150/2012-ST, dated 08.02.2012 clarified that the meaning of the expression `gross amount' appearing in Rule 3(1) of the Works Contract (Composition Scheme for Payment of Service Tax) Rules, 2007, is qualified by the Explanation inserted in the said Rule with effect from 07/07/2009. Since the Explanation inserted in Rule 3(1) with effect from 07/07/2009 is clarificatory and prospective in nature, inclusion of value of free-of-cost supplies of goods and services in or in relation to the execution of Works Contract [mentioned in the Explanation to Rule 3(1)(a)(i) and (ii)] in the 'gross amount' for the purpose of payment of service tax on works contract under the composition scheme, is a legal requirement, only with effect from 07/07/2009 when the Explanation became a part of Rule 3(1).

The explanation appended to Rule 3(1) with effect from 07/07/2009, categorically says in the proviso that "...nothing contained in this Explanation shall apply to a works contract where the execution under the said contract has commenced or where any payment, except by way of credit or debit to any account, has been made in relation to the said contract on or before the 7th day of July, 2009." Where execution of works contract has commenced prior to 07/07/2009 or where any payment(except payment through credit or debit) has been made towards a works contract prior to 07/07/2009, then in those cases `gross amount' for the purpose of payment of service tax does not include the value of free of cost supplies.

Notification No 11/2012-ST dated 17.3.2012 as superceded by Notification No. 24/2012-ST, dated 16-6-2012 has completely substituted Rule 2A w.e.f. 1-7-2012. Accordingly, the value of service portion in the execution of works contract shall be redefined as follows -

(i) As at present, first determination will be the value of service being the total amount charged for the contract reduced by the value of property transferred in goods for State VAT purpose;

(ii) If value of goods is not intimated to State VAT, the assessees can still calculate the actual value of goods and the same will be relevant to deduce the value of the service involved in the works contract;

(iii) If the value is not so deduced, and not merely as an option, the value shall be specified percentage of the total value as follows:

  (a) for original works: 40% of the total amount;

  (b) for maintenance/repair/reconditioning/restoration servicing : 70% of the total amount

  (c) other contracts: 60% of the total amount;

  (d) for contracts involving construction of complex or building for sale where any part of the consideration is received before the completion of the building: 25% of the total amount (deleted by Notification No. 24/2012-ST)

Original works will include all new constructions; all addition/alterations to abandoned or damaged structures on land that are required to make them workable; and all types of additions and alterations to abandoned or damaged structures to make them workable,

The total amount will be gross amount plus the fair market value of any material or services supplied under the same contract or any other contract after deducting amend charged for such goods or services if any and amount of VAT levied thereon.

The input tax credit on goods forming part of the property on which VAT is payable shall not be available as they are not used in the provision of service, which is totally independent of the deemed sale. However taxes paid on capital goods and input services will be available including in respect of (iii.c) above.

The manner for determining the value of service portion of a works contract from the total works contract is given in Rule 2A of the Service Tax (Determination of Value) Rules, 2006. As per sub-rule (i) of the said Rule 2A the value of the service portion in the execution of a works contract is the gross amount charged for the works contract less the value of transfer of property in goods involved in the execution of the said works contract.

(B) Determination of Value of Service in relation to Money Changing (Rule 2B)

A Rule 2B was inserted vide Notification No. 2/2011-ST to prescribe the value of services rendered in relation to money changers w.e.f. 1.4.2011. The value shall be as follows:

(i) The difference between the buying rate or the selling rate, as the case may be, and the RBI reference rate for that currency for that day multiplied by units of currency exchanged;

(ii) If RBI reference rate is not available the value shall be 1% of the value of money exchanged in Indian rupees;

(iii) When both the currencies are not Indian rupees, 1% of the lesser of the amounts receivable if the two currencies are converted at RBI reference rate.

Composite rate

The rate of composition under rule 6(7B) of Service Tax Rules, 1994 has been lowered from 0.25% to the following rates of the gross amount of money exchanged. However, the proviso relating to paying tax on billed charges has been deleted. Thus now the assesse will have the option to pay tax @ the following rates of gross amount exchanged or else at standard rate on the value of service in terms of rule 2B, as mentioned above:

(a) 0.1 per cent (0,12 per cent w.e.f. 1-4-2012) of the gross amount of currency exchanged for an amount upto rupees 100,000, subject to the minimum amount of rupees 25 (₹ 30 w.e,f, 1-4-2012); and

(b) rupees 100 (₹ 120 w.e.f. 1-4-2012) and 0,05 per cent (0.06 per cent w.e.f. 1-4-2012) of the gross amount of currency exchanged for an amount of rupees exceeding rupees 100,000 and upto rupees 10,00,000; and

(c) rupees 550 (₹ 660 w.e,f. 1-4-2012) and 0.01 per cent (0.012 per cent w,e.f. 1-4-2012) of the gross amount of currency exchanged for an amount of rupees exceeding 10,00,000, subject to maximum amount of rupees 5000 (₹ 6000 w.e,f. 1-4-2012):

Provided that the person providing the service shall exercise such option for a financial year and such option shall not be withdrawn during the remaining part of that financial year."

Manner of Determination of Taxable Value (Rule 3)

As per Rule 3, the value of taxable service shall be determined in accordance with Service Tax (Determination of Value) Rules, 2006 except as provided otherwise in the Act. Thus, subject to as provided in the Section 67 of Finance Act, 1994, value of taxable service shall be determined by the rules as under-

(a) Taxable Value where Consideration is not wholly or partly in Money Under Rule 3, value of taxable service is determined in cases where consideration is not wholly or partly in money terms, i.e., part of it is in cash and part of it is otherwise than for cash. In such cases, value of taxable service shall be equivalent to the gross amount charged by service provider in ordinary course of trade and gross amount charged will be the sole consideration. Notification No. 24/2012-ST, dated 6-6-2012 has substituted the words, 'where such value is not ascertainable' for the words, `where the consideration received is not wholly or partly consisting of money' w.e.f. 1-7-2012.

While the money consideration would be on actuals and can be determined without any problem, there may be some subjectivity in ascertaining the value where consideration is not in money but in kind of some money equivalent value.

Central Excise Officer shall have powers and right to satisfy himself about the accuracy of information or documents presented for this purpose to him (Rule 4).

(b) Taxable Value where Consideration is not ascertainable

Under Rule 3, it has been provided that where the taxable services provided are for a consideration in money term but such consideration or value is not ascertainable, the value of such services shall be determined by service provider as equivalent money

value of such consideration which shall in no case be less than the cost of providing such taxable service.

Notification No. 11/2012-ST, dated 17-3-2012 as superceded by Notification No 24/2012-ST, dated 6-6-2012 has amended Rule 3 to provide that it will be applicable only in the cases where valuation is not ascertainable.

Rejection of Value (Rule 4)

Rule (4) provides powers to Central Excise Officer to reject the valuation done under Rule (3) above. Rule (3) shall and does not restrict the powers of Central Excise Officer to question about the accuracy of information furnished on documents presented for valuation. Central Excise Officer shall be empowered to issue a notice to service provider to show cause why the value of taxable service be notified, as specified in notice, where he is satisfied that value so determined by the service receiver under Rule 3 is not in accordance with provisions of Act. He cannot change the valuation unless notice is served on the service provider and show cause opportunity given. After the reasonable opportunity has been given, he can determine the value of taxable service under question for levy of service tax thereon,

The value determined by the service provider under rule 3 for the purpose of payment of service tax should not be less than the cost of provision of such services. However, where there are adequate reasons warranting verification of the value adopted by the service provider for payment of service tax, rule 4(2) specifically enables verification of records in such cases.

The service tax department can, therefore, reject or modify the value determined by the service provider. It may be noted that ----

(i) The Central Excise Officer is empowered to verify the accuracy of any information furnished or document presented for valuation.

(ii) If the value adopted by the Service Tax assessee is not acceptable in accordance with the statute, the officer shall issue a show cause notice (SCN) proposing to determine the value as per the law.

(iii) The SCN would be decided after providing reasonable opportunity of being heard to the assessee.

(D) Inclusion or Exclusion of Certain Expenses/Costs from Value of Taxable Service (Mule 5)

Rule 5 deals with circumstances where certain costs or expenses could be excluded from or added to value of taxable services. It has been provided that all expenses and costs incurred by the service provider for providing the taxable services during the course of such service shall be included as part of value of taxable services. In such cases, there will be no exemption or abatement from service lax in respect of such costs or expenses. For example, cost of consumables, office expenses, telephone expenses, rentals etc. However, where the service provider incurs expenses and cost as a agent of service receiver, i.e., for or on behalf of the service receiver (as a pure agent of the client), such costs or expenses shall be excluded from the value of taxable services. For claiming such costs or expenses to be out of scope of value of service, the service receiver should act as a pure agent or agent of the service receiver.

Pure Agent

A pure agent or agent shall be a person who satisfies the following conditions -

(a) enters into a contractual agreement with his client (recipient of service) to act as an agent of the client to incur expenditure or costs in the course of providing a taxable service;

(b) neither intends not holds any title to the goods or services so provided as an agent of the client;

(c) never uses such goods or services provided; and

(d) receives the actual amount incurred to procure such goods or services.

Following conditions must be satisfied in respect of certain expenses or costs for exclusion from the value of taxable service -

(i) the service provider acts as an agent of the recipient of service when he makes payment to the third party for the goods or services procured;

(ii) the recipient of service receives and uses the goods or services so procured by the service provider as an agent of the recipient of service;

(iii) the recipient of service is liable for making payment to the third party;

(iv) the recipient of service authorises the service provider to make the payment on his behalf;

(v) the recipient of service knows that the goods and services for which payment has been made by the service provider shall be provided by a third party;

(vi) the service provider's payment on the service recipient's behalf is indicated separately when he invoices the recipient of service;

(vii) the service provider recovers from recipient of service only the actual amount he has paid to the third party; and

(viii) the goods or services procured by service provider from third party as a pure agent of recipient of service are in addition to the services he provides on his own account.

The rules explain the aforesaid exclusion/inclusion test by way of following illustrations-

Illustration 1 - X contracts with Y, a real estate agent to sell his house and thereupon Y gives an advertisement in newspaper. Y billed X including charges for newspaper advertisement and paid service tax on the total consideration billed. In such a case, consideration for the service provided is what X pays to Y. X cannot contend that Y acted as agents on his behalf when obtaining newspaper advertisement even if the cost of newspaper advertisement is mentioned separately in the bill. Such services are in the nature of input services for the estate agent in order to enable or facilitate him to perform his services as an estate agent.

Illustration 2 -- To provide a taxable service, a service provider incurs costs such as travelling expenses, postage, telephone, etc., in the course of providing a taxable service and may indicate these items separately on the invoice to the recipient of service. In such a case, the service provider is not acting as an agent of the recipient of service but procure the inputs or input service on his own account for providing the

taxable service. Merely because such expenses are shown separately in an invoice do not mean that they are reimbursable expenditure.

Illustration 3 -- A contracts with B, an architect for building a house. During the course of providing the taxable service B incurs expenses such as telephone charges, air travel tickets, hotel accommodation, etc., Co enable him effectively to perform the provision of services to A. In such a case, in whatever form B recovers such expenditure from A, whether as a separately itemised expense or as part of an inclusive overall fee, service tax is payable on the total amount charged by B. It is quite immaterial how the service provider computes the charges or how they break their invoice or bill down. Consideration for the service is what A pays B which is the taxable value for the purposes of levy of service tax.

Illustration 4 - To provide a taxable service of rent-a-cab, company X provides chauffeurs for overseas visitors. The chauffeur is given a lump sum amount during the tour to cover his food and overnight accommodation and any other incidental expenses such as parking fees. At the end of the tour, he returned the balance of the amount with a statement of his expenses and the relevant bills. Company X charged these amounts from the recipients of service. In such a case, the cost incurred by the chauffeur and billed to the recipient of service constituted part of the consideration for the provision of services by the company.

An explanation has been added after rule 5(1) of the Service Tax (Determination of Value) Rules, 2006 clarifying that for the purpose of telecommunication service [Section 65(105)(zzzx)] the value shall be the gross amount paid by the person to whom the service is provided by the telegraph authority. Thus, in case of service provided by way of recharge coupons or prepaid cards or the like, the value shall be the gross amount charged from the subscriber or the ultimate user of the service and not the amount paid by the distributor or any such intermediary to the telegraph authority. This amendment shall come into force on 1.3.2011. Vide Notification No. 24!2012-ST, dated 6-6-2012, it has been provided that w.e.f. 1-7-2012, value of telecommunication services shall be the gross amount paid by the person to whom telecommunication service is actually provided.

On reimbursable expenditure, it has been clarified by CBEC vide Letter No. B1/4/2006 dated 19.4.2006 (Refer Annexure 13.1) as under -

Value for the purpose of charging service tax is the gross amount received as consideration for provision of service. All expenditures or costs incurred by the service provider in the course of providing a taxable service forms integral part of the taxable value and are includable in the value. It is not relevant that various expenditure or costs are separately indicated in the invoice or bill issued by the service provider to his client.

The service provider in the course of providing any taxable service may incur certain expenditure or cost as a pure agent of the client. The service provider seeks to exclude such expenditure or cost incurred by him as a pure agent of his client (generally known as reimbursable expenditure) from the value of the taxable services.

There could be situations where the client of the service provider specifically engages the service provider, as his agent, to contract with the third party for supply of any goods or services on his behalf. In those cases such goods or services so procured are

treated as supplied to the client rather than to the contracting agent. The service provider in such cases incurs the expenditure purely on behalf of his client in his capacity as agent of the client. Amounts paid to the third party by the service provider as a pure agent of his client can be treated as reimbursable expenditure and not includible in the taxable value. However, if the service provider acts as an undisclosed agent i.e. acting in his own name without disclosing that he is actually acting as an agent of his client, he cannot claim the expenditure incurred by him as reimbursable expenditure. Whether the expenditure or cost incurred by the service provider in his capacity as a pure agent of the client or incurred on his own account is a question of fact and law and is to be determined carefully.

Indication of different elements of the transaction in the invoice or bill could often be misleading. One has to carefully examine the exact legal nature of the transactions and other material facts before taking a view as to whether or not the expenditure sought to be excluded from the value is reimbursable expenditure. Not only the form, but also the substance of the transaction should be duly taken into account.

5 pertains to reimbursable expenditure incurred by the service provider as a pure agent of his client. Explanation (1) to rule 5(2) clearly specifies the criteria to decide whether the service provider acts as a pure agent or not in a given situation. In the case of agency function, the agent neither intends to hold nor holds any title to the goods or services and also never uses such goods or services so procured. It is also important to note that the service provider only receives the actual amount incurred to procure such goods or services.

The service provider who seeks to claim exclusion of certain value from the taxable value should also fulfill all the conditions specified in rule 5(2).

In Rolex Logistics Ptit. Ltd vs. CST Bangalore (2009) 13 STR 1471; (2009) 20 STT 431 (Cestat, Bangalore), it was held that reimbursement of expresses are not for services rendered but expenditure incurred on behalf of client by service provider. Gross amount for service rendered means only for services rendered. It also interpreted `reimbursement' as payments made on behalf of service recipient by service provider in the course of rendering services. The gross receipt for the services rendered means only for the services rendered.

It held as follows;

is a reimbursement? When a service provider provides service to a service receiver or a client, on behalf of his client he incurs various expenditure and these expenditure are all for different purposes. The Service Tax liability in terms of Section 67 is only on the gross amount received towards the services rendered. If the service provider in the course of rendering service has to make certain payments on behalf of the service receiver, they are known as reimbursements. The reimbursements are actually not towards the service rendered but they are only towards other expenditure incurred on behalf of the client by the service provider. Normally, the service provider incurs these expenditures in the interest of quicker service. Suppose the service provider has to first receive the money and then render the service, it would cause lot of delay. Therefore, while providing service to the client, the service provider has to incur various expenditure in order to save time and avoid delay, hence, the expenditure is incurred by the service provider and later these are reimbursed by the client. In fact, the client is

supposed to pay all these amounts. For example, take the case of a Custom House Agent in the course of clearance of the goods, the importer may have to incur different expenditures towards the port, stevedoring clearances, stationery, all that. These expenditures are actually to be paid by the importer but the CHA initially incurs all these expenditure and then later collects from the client. These are reimbursements. So what is to be borne in mind is that these reimbursements are not for the services rendered. The gross receipt for the services rendered means only for the services rendered. The amount of money received only for the services rendered not for all the other expenditure which is to be incurred normally by the client."

The above judgment clearly specifies the reimbursements that can be excluded from the taxable value by citing of the example of CHA who incurs expenses such as port charges, customs duties on importation, demurrage charges payable to the wharf etc., actually payable by the client but incurred on behalf of the latter, which were reimbursed on actual basis, and qualify for abatement from the taxable value of CHA which includes his charges for clearing the goods from the customs and the above analogy also holds good for `pure agent' of the Valuation Rules, as these expenses are not related to the service rendered at all.

The Apex Court in the case of Al] India Federation of Tax Practitioners v. Union of India [2007] 10 STT 166 held that service tax is destination based consumption tax and that may be either performance based or property based. Economic services are provided for valuable consideration without being rendered charitable. No service which is uneconomical or commercially unviable is provided in the commercial world. Various elements of cost contribute to the provision of economic services. Expenses which are indispensable and inevitably incurred to make the economic service performable that contribute to the gross value of service. The provider of economic service recovers his entire cost involved in providing such service in the best possible manner that may be viable to him and the service recipient.

In Intercontinental Conslt. & Tech. Pvt. Ltd. v Union of India (2008) 12 S.TR. 689 (Delhi), it was held by high court that the demand on reimbursement of expenses like air travel, hotel stay, room rent, boarding and lodging charges etc. after including such amounts in taxable value in case of consulting engineer's services can not be coerced. The petitioner contended that reimbursable expenses were not forming part of services and such amounts were also indicated separately in bills. It was held that while proceedings pursuant to SCN may continue, coercive steps need not to be taken till passing of adjudication order.

In Scott Wilson Kirkpatrick (I) Ltd. vs. Commissioner of Service Tax, (2007) 5 STR 118 (Cestat, Bangalore), it was held that reimbursable expenses were not subject to service tax at the relevant time.

In Sri Bhugovathy Traders v CCE (2011) 24 S.T.R. 290 (CESTAT - LB, Bangalore), it was held that reimbursement arises only when person actually paying under no obligation to pay and pays amount on behalf of buyer while recovering same from buyers. Only when service recipient is halting obligation, legal or contractual to pay certain amount to any third party and said amount is paid by service provider on behalf of service recipient, question of reimbursing expenses arises.

Reimbursement of expenses has been a contentious issue and actual reimbursements of expenses is not subject to levy of Service Tax; more so when these reimbursements can be substantiated by evidence. Reference can be made to following judicial pronouncements -

(i) Alalhor Agencies vs, CCE & C (2007) 8 STT 204 (CESTAT, Bangalore)

(ii) Nandini Warehousing Corporation vs. CCE (2008) 12 STT 120 (CESTAT, Bangalore)

(iii) Hassan Hajee & Co vs. CCE (2007) 5 STR 397 (CESTAT, Bangalore)

(iv) M.P.R. Mercantile Syndicate vs. CCE, Cochin (2011) 22 STR 443 (CESTAT, Bangalore).

(v) Sri Sastha Agencies Pvt. Ltd. vs. Asst. Commr. of C.Ex & Gus. Palakkad [2007 (6) SIR 185 (CESTAT, Bangalore)]

(vi) Bhagyanagar Services vs. CCE, Hyderabad [2006 (4) STR 22 (CESTAT, Bangalore.)]

(vii) CCE, C & ST, BBSR-I vs. M/s. Nilaiohita Enterprises [2007 (6) STR 318 (CESTAT, Kolkata)]

(viii) Sangamitra Services Agency vs. CCE, Chennai [2007 (8) STR 233 (CESTAT, Chennai)]

(ix) Apco Agencies vs. CCE, (2008) 10 STR 169 (CESTAT, Bangalore).

(x) S & K Enterprises vs. CCE (2008) 10 STR 171(CESTAT, Bangalore).

(xi) E.V. Mathui & Co. vs. CCE (2006) 3 STR 116 (CESTAT, Bangalore).

(xii) Keralam Enterprises vs. CCE (2008) 9 STR 503 (CESTAT, Bangalore).

(xiii) M/s U.M. Thariuth & Company, M/s S.J.C. Pharma vs. CCE. Cochin [2007 (8) STR 161 (CESTAT, Bangalore)]

(xiv) Al -Baith Steel Pvt. Ltd. vs. CCE (2008) 10 STR 554 (CESTAT, Bangalore).

(xv) Javalaxmi Enterprises vs. CCE Mungalore [2008 (9) STR 19 (CESTAT, Bangalore)]

(xvi) M/s. B.S. Refrigeration Ltd. vs. CST, Bangalore [2006 (4) S.T.R. 103 (CESTAT, Bangalore)]

(xvii) Rolex Logistics Pvt. Ltd. vs. CST (2009) 13 STR 147 (CESTAT, Bangalore).

(xviii) K.D. Sales Corporation vs. CCE, Belgaum [2007 (6) STR 418 (CESTAT, Bangalore)]

Inclusion/Exclusion of Commission, Costs etc. in Value (Rule 6)

Rule 6 as amended by Notification No. 24/2012-ST, dated 20-6-2012, deals with cases in which the commission, costs etc. shall be excluded from or included in the value of taxable services. The Rule 6 would operate subject to provisions of Section 67.

The value of taxable services shall include the following -

(i) the aggregate of commission or brokerage charged by a broker on the sale or purchase of securities including the commission or brokerage paid by the stock-broker to any sub-broker;

(ii) the adjustments made by the telegraph authority from any deposits made by the subscriber at the time of application for telephone connection or pager or facsimile or telegraph or telex or for leased circuit;

(iii) the amount of premium charged by the insurer from the policy holder,

(iv) the commission received by the air travel agent from the airline;

(v) the commission, fee or any other sum received by an actuary, or intermediary or insurance intermediary or insurance agent from the insurer;

(vi) the reimbursement received by the authorised service station, from manufacturer for carrying out any service of any motor car, light motor vehicle or two wheeled motor vehicle manufactured by such manufacturer;

(vii) the commission or any amount received by the rail travel agent from the Railways or the customer;

(viii) the remuneration or commission, by whatever name called, paid to such agent by the client engaging such agent for the services provided by a clearing and forwarding agent to a client rendering services of clearing and forwarding operations in any manner;

(ix) the commission, fee or any other sum, by whatever name called, paid to such agent by the insurer appointing such agent in relation to insurance auxiliary services provided by an insurance agent, and

(x) The amount realised as demurrage or by any other name whatever called for the provision of service beyond the period originally contracted or in any other manner relatable to the provision of service.

The value of taxable services shall exclude the following --

(i) initial deposit made by the subscriber at the time of application for telephone connection or pager or facsimile (FAX) or telegraph or telex or for leased circuit;

(ii) the airfare collected by air travel agent in respect of service provided by him;

(iii) the rail fare collected by rail travel agent in respect of service provided by him;

(iv) interest on loans. [Interest on delayed payment of any consideration for the provision of services or sale of property whether movable or immovable as amended by Notification No. 11/2012-ST, dated 17-3-2012 and superceded by Notification No. 24/2012-ST dated 6-6-2012 w.e.f, 1-7-2012.]

(v) the taxes levied by any government on any passenger travelling by air, if shown separately on the ticket, or invoice for such ticket issued to the passenger, and]inserted

w.e.f. 27.2.2010 by Notification No. 15/2010- ST dated 27,2.2010].

(vi) accidental demages due to unforeseen action not relatable to the provisions of service [inserted w.e.f. notified date by Notification No 11/2012-ST dated 17.3.20121.

(vii) subsidies and grants disbursed by the Government, not directly affecting the value of service (amended by Notification No. 24/2012-ST dated 6-6-2012 w.e.f. 1-7-2012].

The exclusion entry related to accidental damages due to unforeseen actions not relatable to the provisions of service has been inserted vide the Serviced Tax (Determination of Value)

Second Amendment Rules, 2012. In terms of this exclusion accidental damages are not to be included in the value of service provided the following two conditions are specified:

- The damages are due to unforeseen actions.
- The damages are not related to provisions of service.

Examples-

- Insurance Companies provide insurance services to the clients for which the premium is charged. The premium charged is a consideration for the insurance service provided. However, in case due to an unforeseen action, like an accident etc., a compensation is paid by the insurance company to the client then the money would not be included as part of value of taxable service as it is not relatable to the provisions of service but is only in the nature of consequence of provisions of insurance service.
- In case a landlord who has rented out his office building to a tenant receives compensation from the tenant for the damage caused to the building by an unforeseen action then such compensation would not form part of the value of taxable service related to tenant of his building as an unforeseen damage caused by the tenant is not relatable to provision of service of renting of the office building.

The exclusion entry relating to subsidies and grants disbursed by the Government, not in the nature of directly influencing the value of service has also been inserted by the Service Tax (Determination of Value) Second Amendment Rules, 2012. A subsidy influences the price directly when the price goes down proportionately to the amount of subsidy. In terms of this exclusion any subsidy or grant disbursed by the Government cannot form part of the value of taxable service unless such subsidy or grant directly influences the value of such service.

In Keeping Newcastle Warm Ltd. (2012) 36 STT 702 (ECJ), where assessee received energy advice grants for providing energy advice, it was held by the European Court of Justice that energy advice grants paid by the public authority constituted a subsidy.

Since taxable amount comprises of everything which makes up consideration for service, every advice grants were received by assessee in consideration for service provided by the assessee and hence taxable.

In Office Des Products Walloons ASBL v. Belgian State (2012) 36 STT 683 STT (ECJ), it was held that operating subsidies covering a part of running costs always affect the cost price of the goods and services supplied by the subsidised body. However, the mere fact that a subsidy may affect the price of the goods or services supplied by the subsidised body is not enough

to make that subsidy taxable. For the subsidy to be directly linked to the price of such supplies, it is also necessary that it be paid specifically to the subsidised body to enable it to provide particular goods or services. Only in that case, the subsidy can be regarded as consideration for the supply of goods or services, and therefore be taxable.

Subsidy is identifiable only if there is significant relation between price and subsidy. In order to determine whether the consideration represented by the subsidy is identifiable, the Court may either compare the price at which the goods are sold in relation to their normal cost price, or examine whether the amount of the subsidy has been reduced once those goods are no longer produced. If the factors examined are significant, it must be concluded that the part of the subsidy allocated to the production and sale of the goods in question constitutes a subsidy directly linked to the price, In that regard, it is not necessary for the subsidy to correspond exactly to the diminution in the price of the goods supplied, it being sufficient if the relationship between the diminution in price and the subsidy, which may be at a flat rate, is significant.

Value of Taxable Service to be the Actual Consideration where Services provided from outside India (Rule 7)

According to Rule 7, in cases where the taxable services are provided by person from outside India in India (Section 66A cases), the value of taxable services received shall be taken at such amount as is equal to the actual consideration charged for the services so provided or to be provided. This could, therefore, be taken as actual remittance made to service provider abroad.

In case of services partly performed in India, the value of taxable services shall be the total consideration paid by the recipient for such services including the value of service partly performed outside India.

Rule 7 stands omitted by Notification No. 11/2012-ST, dated 17-3-2012 and as superceded by Notification No. 2412012-ST, dated 6-6-2012 w.e.f. 1-7-2012.

Adjudication

No forms have been prescribed for seeking determination of value of taxable services and it is expected that in case of difference of amount between the value of taxable service as determined by the service provider and that as per the opinion of Central Excise Officer, the matter could be decided by way of adjudication by giving a show cause notice and an opportunity of being heard.

If the assessee does not agree with the valuation, he may also prefer an appeal.

Withdrawal of Circulars on Valuation

Consequent upon notification of Service Tax (Determination of Value) Rules, 2006, all circulars on valuation of taxable services or portions thereof, which are inconsistent with the new valuation rules have been withdrawn B1'4/2006 dated 19-4-2006. These same has been retriated vide Circular No. 93/04/2007, dated 10-5-2007.

DIRECT TAXATION

1. **Whether the Tribunal was justified in upholding the order of Commissioner of Income-tax (Appeals) deleting the addition of ₹ 10 lakhs as deemed dividend under section 2(22)(e) of the Income-tax Act ?**

CIT vs. Hotel Hilltop (2009) 313 ITR 116 (Raj.)

Relevant Section: 2(22)(e)

The assessee-firm constituted of two partners ran a hotel business. It entered into an agreement with a private limited company formed by the two partners with their close relations under which the management of the firm's hotel was to be handed over to the company. The assessee-firm received a sum of Rs.10 lakhs as advance against security. The Assessing Officer made an addition to the income of the assessee treating the amount as deemed dividend under section 2(22)(e) of the Act. The Commissioner (Appeals) deleted the addition on the ground that the firm was not a shareholder of the company. The Tribunal confirmed the deletion.

The High Court held that in order to attract the provisions of section 2(22)(e) of the Income-tax Act, 1961, the following four conditions are the sine qua-non : (i) the assessee should be a shareholder of the company ; (ii) the company should be a closely held company in which the public are not substantially interested ; (iii) there must be payment by way of advance or loan to a shareholder or any payment by the company on behalf of or for the individual benefit of the shareholder ; and (iv) there must be sufficient accumulated profits in the hands of the company up to the date of such payment.

It was further held that the assessee was not shown to be the shareholder of the company and the two individuals who were partners of the firm were the majority shareholders of the company. Therefore, the security advanced by the company to the assessee could not be deemed to be dividend as the assessee was not a shareholder in the company. The amount was paid by the company to the assessee on behalf of the individuals. Therefore, the liability of tax as deemed dividend could be attracted in the hands of the individuals, being the shareholders in the company. The Tribunal was justified in upholding the order of the Commissioner (Appeals) deleting the addition of Rs.10 lakhs made as deemed dividend under section 2(22)(e) of the Act.

2. **Whether the Tribunal was justified in deleting the addition which has been received on account of gift when no relation has been established from whom gifts have been received?**

CIT vs. Padam Singh Chouhan (2009) 315 ITR 433 (Raj.)

Relevant Section: 68

The Assessing Officer found that the assessee and his family had received huge gifts from a person residing abroad and concluded that the gifts were not genuine. The Commissioner (Appeals) held that the gifts were made out of love and affection towards the assessee and having gone through the bank accounts of the donors he found there was sufficient cash balance on the date of the gift to the assessee and deleted the addition. The Tribunal affirmed the finding of the Commissioner (Appeals).

The High Court held that there was no legal basis to assume that to recognise a gift to be genuine, there should be any blood relationship, or any close relationship between the donor and the donee. The assessee had produced the copies of gift deeds and the affidavits of the donors. In the absence of anything to show that the act of the assessee in claiming gift was an act by way of money laundering, simply because he happened to receive gifts, it could not be said that amount had to be added in his income.

3. Whether Tribunal was right in law to hold that the addition to the capital of the partner is not cash credit in the books of account of the firm but is cash credit in the case of the partner? CI vs. Kulwant Industries (2009) 311 ITR 377 (P&H)

Relevant Section: 68

The assessee, a firm which had four partners filed its return. One of the partners J who enjoyed a 15 per cent share in the firm was asked to explain the credits which appeared in his capital account amounting to ₹ 25,000 which he claimed as gift by a non-resident Indian. The Assessing Officer made an addition of ₹ 25,000 by treating it as unexplained income credited in the capital account of J. The Commissioner (Appeals) deleted the addition of ₹ 25,000. The Tribunal held that the basic ingredients of cash credit were source of money and income and genuineness of the transaction and if the source was clearly and categorically explained and the amount was paid through genuine process then it was not advisable to refer to circumstantial and preponderance of the evidence. Therefore, it held that there was no logic in treating the gifts as income of the firm.

The High Court held that it had been categorically found by the Tribunal that the gift was genuine for the reason that the donor was the real maternal uncle of the donee. The gift had been made from the NRE account maintained by the donor and remittance in such an account could only be made from foreign exchange. The account had been found to be genuine as per the findings recorded by the Assessing Officer and duly accepted by the Tribunal. The identity of the donor stood established and the gift had been made through cheque by banking channel. Once the broad features and basic ingredients constituting gift were satisfied then it could not be replaced by circumstantial evidence.

4. Would the interest earned on surplus funds of a club deposited with institutional members satisfy the principle of mutuality to escape taxability?

Madras Gymkhana Club vs. DCIT (2010) 328 ITR 348 (Mad.)

The assessee, club providing facilities like gym, library, etc., to its members and also earns interest from fixed deposits which it had made by investment of its surplus funds with its corporate members.

The High Court held that interest earned from investment of surplus funds in the form of fixed deposits with institutional members does not satisfy the principle of mutuality and hence cannot be claimed as exempt on this ground. The interest earned is, therefore, taxable.

5. Can winnings of prize money on unsold lottery tickets held by the distributor of lottery tickets be assessed as business income and be subject to normal rates of tax instead of the rates prescribed under section 115BB?

CIT vs. Manjoo and Co. (2011) 335 ITR 527 (Kerala)

On the above issue, the Kerala High Court observed that winnings from lottery is included in the definition of income by virtue of section 2(24)(ix). Further, in practice, all prizes from unsold tickets of the lotteries shall be the property of the organising agent. Similarly, all unclaimed prizes shall also be the property of the organising agent and shall be refunded to the organising agent.

The High Court contended that the receipt of winnings from lottery by the distributor was not on account of any physical or intellectual effort made by him and therefore cannot be said to be "income earned" by him in business. The said view was taken on the basis that the unsold lottery tickets cease to be stock-in-trade of the distributor because, after the draw, those tickets are unsaleable and have no value except waste paper value and the distributor will get nothing on sale of the same except any prize winning ticket if held by him, which, if produced will entitle him for the prize money. Hence, the receipt of the prize money is not in his capacity as a lottery distributor but as a holder of the lottery ticket which won the prize. The Lottery Department also does not treat it as business income received by the distributor but instead treats it as prize money paid on which tax is deducted at source.

Further, winnings from lotteries are assessable under the special provisions of section 115BB, irrespective of the head under which such income falls. Therefore, even if the argument of the assessee is accepted and the winnings from lottery is taken to be received by him in the course of his business and as such assessable as business income, the specific provision contained in section 115BB, namely, the special rate of tax i.e. 30% would apply.

Therefore, the High Court held that the rate of 30% prescribed under section 115BB is applicable in respect of winnings from lottery received by the distributor.

B. INCOME WHICH DO NOT FORM PART OF TOTAL INCOME

1. **Whether section 14A is applicable in respect of deductions, which are permissible and allowed under Chapter VI-A?**

CIT vs. Kribhco (2012) 209 Taxman 252 (Delhi)

In the given case, the assessee is a co-operative society and is engaged in marketing of fertilizers and purchase and processing of seeds. The assessee had claim deduction under section 80P(2)(d) on dividend income received from NAFED and co-operative bank and also on interest on deposits made with co-operative banks.

The Assessing Officer, relying upon section 14A, contended that the aforesaid incomes were not included in the total income of the assessee and therefore, expenditure with respect to such income should be disallowed.

The High Court observed that section 14A is not applicable for deductions, which are permissible and allowed under Chapter VIA. Section 14A is applicable only if an income is not included in the total income as per the provisions of Chapter III of the Income-tax Act, 1961. Deductions under Chapter VIA are different from the exclusions/ exemptions provided under Chapter III.

The words "do not form part of the total income under this Act" used in section 14A are significant and important. Income which qualifies for deductions under section 80C to 80U has to be first included in the total income of the assessee and then allowed as a deduction. However, income referred to in Chapter III do not form part of the total income and therefore, as per section 14A, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to such income which does not form part of the total income.

Therefore, the Delhi High Court held that no disallowance can be made under section 14A in respect of income included in total income in respect of which deduction is allowable under section 80C to 80U.

2. Can Explanation to section 11(2) be applied in respect of the accumulation up to 15% referred to in section 11(1)(a), to treat the donation made to another charitable trust from the permissible accumulation upto 15% as income of the trust?
DIT (Exemption) vs. Bagri Foundation (2012) 344 ITR 193 (Delhi)

The assessee is a charitable trust registered under section 12AA and recognized under section 80G. The assessee filed the return of income for the previous year declaring nil income. On perusal of the application of income made during the year, it was found that donation to the corpus of another trust was made which was much higher than the gross total income declared in the return of income. The source of the excess donation was the accumulation of income of the past made under section 11(1)(a) (i.e., out of permissible accumulation upto 15%) and encashment made out of these accumulations/funds.

The Assessing Officer added the donation made out of the accumulations or the set apart income, applying the Explanation to section 11(2) and accordingly, computed taxable income of the assessee.

Considering the above mentioned issue, the Delhi High Court held that, as per the provisions of section 11(1)(a), the accumulations upto 15% is permitted and no additional conditions are attached with such accumulation. It is an absolute exemption.

However, as per section 11(2) accumulations in excess of 15% is also allowed but subject to certain conditions mentioned therein and also subject to provisions of Explanation to section 11(2), which mentions that the amount accumulated in excess of 15% under section 11(2) cannot be donated to another trust. Such an explanation is not mentioned under section 11(1). Therefore, the Explanation to section 11(2) cannot be said to be applicable to the accumulations under section 11(1)(a) i.e. accumulations upto 15%, unless there is an express mention in the Act for the same.

Therefore, it follows that even if the donations by the assessee to another charitable trust were out of past accumulations under section 11(1)(a) i.e. upto 15%., the same would not be liable to be included in the total income as assessed by the Assessing Officer.

3. Can exemption under section 10(10C) be availed by a retiring employee of Reserve Bank of India opting for the Optional Early Retirement Scheme?
Chandra Ranganathan vs. CIT (2010) 326 ITR 49 (SC)

Relevant section : 10(10C)

On this issue, the Supreme Court held that the amounts received by employees retiring from the Reserve Bank of India opting for the Optional Early Retirement Scheme are eligible for exemption under section 10(10C).

4. Whether the assessee can claim exemption under section 10B in respect of interest earned from advance amount received from its sister concern for purchasing goods?

CIT vs. Hycon India Ltd. (2009) 308 ITR 251 (Raj.)

Relevant Section: 10(B)

The assessee purchased goods from its sister concern and for such purchases it paid in advance to the seller and the advance amount yielded interest income to the assessee. The Assessing Officer allowed exemption to the interest income under section 10B holding that the interest income was attributable to the business of the undertaking. The Commissioner found that there was nothing on record to show that the sister concern had desired deposit of any specific amount of advance prior to its agreement to supply raw material to its own sister concern nor was there anything to indicate that the Assessing Officer examined the case from this angle, before allowing the exemption under section 10B. Likewise, the Commissioner considered that even if there was a business practice where the suppliers of certain goods required an advance for future purchase, the transactions of the assessee with its own sister concern were to be considered on a different footing. On these findings, the Commissioner revised the order of the Assessing Officer under section 263 on the ground that it was prejudicial to the interests of the Revenue. The Tribunal did not agree with the view of the Commissioner and held that interest income received by the assessee from its sister concern was income from business.

The High court held that "Profits and gains of business or profession" and "Income from other sources" are different species of income. Section 2(24) of the Income-tax Act, 1961, does not categorise separately, profits and gains of business or profession. The expression "profits and gains" as used in section 2(24) is wider and is not confined to "Profits and gains of business or profession". Section 10B provides for exemption with respect to any "profits and gains" derived by the assessee, and is not confined to "profits and gains of business or profession".

Hence, the interest income received by the assessee from its sister concern did fall within the expression "profits and gains" and was eligible for exemption as business income under section 10B.

C. INCOME FROM SALARIES

1. Is the limit of ₹ 1,000 per month per child to be mandatorily deducted, while computing the perquisite value of the free or concessional education facility provided to the employee by the employer?

CIT (TDS) vs. Director, Delhi Public School (2011) 202 Taxman 318 (Punj.& Har.)

As per the provisions of Rule 3(5) of the Income-tax Rules, 1962, in case an educational institution is maintained and owned by the employer and free or concessional education

facility is provided to the employees', expenses in such institution, then, the cost of education in a similar institution in or near the locality shall be taken to be the value of perquisite in the hands of the employee. In case the cost of such education or the value of benefit does not exceeds ₹ 1,000 per month per child, the perquisite value shall be taken to be nil.

In the present case, the cost of education was more than ₹ 1,000 per month per child, therefore, while determining the perquisite value on the above basis, the assessee claimed a deduction of ₹ 1,000 per month per child.

The Punjab and Haryana High Court, in the above case, held that on a plain reading of Rule 3(5), it flows that, in case the value of perquisite for free/concessional educational facility arising to an employee exceeds ₹ 1,000 per month per child, the whole perquisite shall be taxable in the hands of the employee and no standard deduction of 1,000 per month per child can be provided from the same. It is only in case the perquisite value is less than ₹ 1,000 per month per child, the perquisite value shall be nil. Therefore, ₹ 1,000 per month per child is not a standard deduction to be provided while calculating such a perquisite.

2. Whether the amount received by the employee on cessation of employment with his employer will be exempted from tax under section 17(3)(i) of the Income-tax Act?

CIT vs. Shyam Sundar Chhaparia (2008) 305 ITR 181 (MP)

Relevant Section: 17(3)

The assessee after his retirement was granted an amount of ₹ 27,50,000 as a special compensation in lieu of an agreement for refraining from taking up any employment activities or consultation which would be prejudicial to the business/interest of his employer. The assessee claimed that it was a non-taxable receipt being the compensation for not taking up any competitive employment under a restrictive covenant. The Assessing Officer did not accept the claim of the assessee on the grounds that (i) the decision of the Supreme Court relied on by the assessee was that of an agency whereas the case of the assessee was that of one who was in service, and (ii) section 17(3)(i) was squarely applicable to the case of the assessee. The Commissioner (Appeals) held that as there was restriction for the assessee not to work in business of any type and anywhere, the compensation was received in lieu of loss of future work and was a capital receipt. The Tribunal held in favour of the assessee.

The High Court held that the assessee retired from service on attaining the age of superannuation and hence there was severance of the master-servant relationship and there was no material to suggest that there existed a service contract providing therein a restrictive covenant preventing thereby the assessee from taking up any employment or activities on consultation which would be prejudicial to the business/interest of his employer. Therefore, it could not be termed as profit in lieu of salary because it was not compensation due to or received by the assessee from his employer or partner-employer at or in connection with the termination of his employment. Thus, the Commissioner (Appeals) and the Tribunal rightly held that the amount could not be added for the purpose of income-tax.

3. Can reimbursement of expenditure on medical treatment taken by the assessee, who was a member of the Legislative Assembly, be taxed as perquisite under section 17(2)(iv)?

CIT vs. Shiv Charan Mathur (2008) 306 ITR 126 (Raj)

Relevant Section: 15 & 17(2)

Notice under section 148 was issued to the assessee, at the relevant time a sitting MLA and former Chief Minister of the State, for the reason that he received a sum from the State Government as reimbursement of medical expenses which amount was liable to be taxed under section 17 but had not been offered for taxation. The contention of the assessee was that the amount received by MPs and MLAs was not taxable under the head "Salary" but under the head "Income from other sources".

The High Court held that MLAs and MPs are not employed by anybody rather they are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be "salary" within the meaning of section 15 of the Income-tax Act, 1961. The fundamental requirement for attracting section 15 is that there should be a relationship of employer and employee whether in existence or in the past. This basic ingredient is missing in the cases of MLAs and MPs. When the provisions of section 15 were not attracted to the remuneration received by the assessee, section 17 could not be attracted as section 17 only extends the definition of "Salary" by providing certain items mentioned therein to be included in salary. Thus, the reimbursement of medical treatment taken by the assessee, who was a member of the Legislative Assembly for open heart surgery conducted abroad was not taxable as perquisite under section 17(2)(iv).

D. INCOME FROM HOUSE PROPERTY

1. Can the rental income from the unsold flats of a builder be treated as its business income merely because the assessee has, in its wealth tax return, claimed that the unsold flats were stock-in-trade of its business?

Azimganj Estate (P.) Ltd. vs. CIT (2012) 206 Taxman 308 (Cal.)

The assessee, a property developer and builder, in the course of its business activities constructed a building for sale, in which some flats were unsold. During the year, the assessee received rental income from letting out of unsold flats which is disclosed under the head "Income from house property" and claimed the permissible statutory deduction of 30% therefrom. The Assessing Officer contended that since the assessee had taken the plea that the unsold flats were stock-in-trade of its business and not assets for the purpose of Wealth-tax Act, 1961, therefore, the rental income from the said flats have to be treated as business income of the assessee. Consequently, he rejected the assessee's claim for statutory deduction of 30% of Net Annual Value.

On this issue, the Calcutta High Court held that the rental income from the unsold flats of a builder shall be taxable as "income from house property'' as provided under section 22 and since it specifically falls under this head, it cannot be taxed under

the head "Profit and gains from business or profession". Therefore, the assessee would be entitled to claim statutory deduction of 30% from such rental income as per section 24. The fact that the said flats have been claimed as not chargeable to wealth-tax, treating the same as stock-in-trade, will not affect the computation of income under the Income-tax Act, 1961.

2. **Can benefit of self-occupation of house property under section 23(2) be denied to a HUF on the ground that it cannot occupy a house property, being a fictional entity?**

CIT vs. Hariprasad Bhojnagarwala (2012)342 ITR 69 (Guj.) (Full Bench)

The assessee, being a Hindu Undivided Family (HUF), claimed the benefit of self occupation of a house property under section 23(2). However, the Assessing Officer did not accept the said claim and denied the benefit of self occupation of house propertyt0 the HUF arguing that such benefit is available only to the owner who can reside in his own residence i.e., only an individual assessee, who is a natural person, and not to a imaginary assessable entity being HUF or a firm, etc.

On the above mentioned issue, the Gujarat High Court observed that a firm, which is a fictional entity, cannot physically reside in a house property and therefore a firm cannot claim the benefit of this provision, which is available to an assessable entity who can actually occupy the house. However, the HUF is a group of individuals related to each other i.e., a family comprising of a group of natural persons. The said family can reside in the house, which belongs to the HUF. Since a HUF cannot consist of artificial persons, it cannot be said to be a fictional entity. Also, it was observed that since singular includes plural, the word "owner" would include "owners" and the words "his own" used in section 23(2) would include "their own".

Therefore, the Court held that the HUF is entitled to claim benefit of self-occupation of house property under section 23(2).

3. **Can an assessee engaged in letting out of rooms in a lodging house also treat the income from renting of a building to bank on long term lease as business income?**

Joseph George and Co.vs. ITO (2010) 328 ITR 161 (Kerala)

On the above issue, it was decided that while lodging is a business, however, letting out of building to the bank on long-term lease could not be treated as business. Therefore, the rental income from bank has to be assessed as income from house property.

PROFITS AND GAINS OF BUSINESS OR PROFESSION

1. **Can business contracts, business information, etc., acquired by the assessee as part of the slump sale be described as 'goodwill', be classified as an intangible asset to be entitled for depreciation under section 32(1)(ii)?**

Areva T and D India Ltd. vs. DCIT (2012) 345 ITR 421 (Delhi)

In the present case, a transferor under a transfer by way of slump sale, transferred its ongoing business unit to the assessee company. On perusal of the sale consideration, it was found that some part of it was attributable to the tangible assets and the balance payment was made by the assessee company for acquisition of various business and commercial rights categorized under the separate head, namely, "goodwill" in the books of account of the assessee. These business and commercial rights comprised the following: business claims, business information, business records, contracts, skilled employees, know-how. The assessee company claimed depreciation under section 32 on the excess amount paid which was classified as "goodwill" under the category of intangible assets.

The Assessing Officer accepted the allocation of the slump sale between tangible and intangible assets (described as Goodwill). However, he claimed that depreciation in terms of section 32(1)(ii) is not allowable on goodwill. He further contended that the assessee has failed to prove that such payment can be categorized under "other business or commercial right of similar nature" as mentioned in section 32(1)(ii) to qualify for depreciation.

The assessee argued that any right which is obtained for carrying on the business effectively, is likely to come within the sweep of the meaning of intangible asset. Therefore, the present case shall qualify for claiming depreciation since business claims, business information, etc, are in the nature of "any other business or commercial rights" However, the Revenue argued that, the business or commercial rights acquired by the assessee would not fall within the definition of intangible assets under section 32.

The Delhi High Court observed that the principle of ejusdem generis provides that where there are general words following particular and specific words, the meaning of the latter words shall be confined to things of the same kind. The Court applied this principle for interpreting the expression "business or commercial rights of similar nature" specified in section 32(1)(ii). It is seen that such rights need not be the same as the description of "know-how, patents, trademarks, licenses or franchises" but must be of similar nature as the specified assets. The use of these general words after the specified intangible assets in section 32(1)(ii) clearly demonstrates that the Legislature did not intend to provide for depreciation only in respect of specified intangible assets but also to other categories of intangible assets, which were neither feasible nor possible to exhaustively enumerate.

Further, it was observed that the above mentioned intangible assets are invaluable assets, which are required for carrying on the business acquired by the assessee without any interruption. In the absence of the aforesaid intangible assets, the assessee would have had to commence business from scratch and go through the gestation period whereas by acquiring the aforesaid business rights along with the tangible assets, the assessee has got

a running business. The aforesaid intangible assets are, therefore comparable to a license to carry on the existing business of the transferor.

Therefore, the High Court held that the specified intangible assets acquired under the slump sale agreement by the assessee are in the nature of intangible asset under the category "other business or commercial rights of similar nature" specified in section 32(1)(ii) and are accordingly eligible for depreciation under section 32(1)(ii).

2. What would be the nature of expenditure incurred by the assessee by way of severance cost paid to the employees in respect of suspension of one of the activities, in a case where he continues to carry on other business activities - Capital or Revenue?

CIT vs. KJS India P. Ltd. (2012) 340 ITR 380 (Delhi)

In the present case, the assessee was carrying more than one business activity, namely manufacturing powdered soft drink and trading in soft drinks. However, the manufacturing activity was not profitable and hence, was stopped. The employees who were directly connected with this manufacturing activity were laid off and severance cost was paid to those employees. The same was claimed by the assessee as revenue expenditure. The Assessing Officer disallowed the same treating it as a capital expenditure, on the argument that it was incurred as a result of closure of business of the assessee.

The Delhi High Court, on the above mentioned issue, held that though one of the business activities was suspended, it cannot be construed that the assessee has closedown its entire business. The assessee still continues to trade in soft drinks. Therefore the said expenditure will be allowed as revenue expenditure though it was related to manufacturing activity which was suspended.

3. Can an assessee, engaged in money lending business, claim interest paid on money borrowed as business expenditure?

Rajendra Kumar Dabriwala vs. CIT (2012) 347 ITR 353 (Cal.)

In the present case, the assessee was engaged in the business of dealing in shares and money lending. He borrowed funds for lending purposes, paid interest on the funds borrowed and claimed the same as deduction while computing business income. The interest received was shown as income. The Assessing Officer did not allow the claim of interest paid as business expenditure on the contention that, substantial amount of loan was obtained by the assessee from various parties and substantial amount of loans were given to different parties. The Assessing Officer claimed that the loans were not given for the sake of business transactions but simply the loans taken from one party were transferred to the other parties by way of loan.

The Calcutta High Court held that the Assessing Officer is not right in his contention, since the assessee is in the money lending business. He is entitled to receive interest from the loan advanced and is also entitled to take loan for running the money lending business. Therefore, the assessee is lawfully entitled to deduct interest paid on the funds borrowed as business expenditure, subject however to the provisions contained in section 14A. In other words, if any loan has been taken by the assessee in relation to the income which does not form part of his total income under the Act, the assessee will not get deduction of interest paid on that amount.

4. Can subsidy received by the assessee from the Government of West Bengal under the scheme of industrial promotion for expansion of its capacities, modernization and improving its marketing capabilities be treated as a capital receipt?

CIT vs. Rasoi Ltd. (2011) 335 ITR 438 (Cal.)

In the present case, the assessee received the subsidy by way of financial assistance in the period of crisis for promotion of the industries mentioned in the schemes which had manufacturing units in West Bengal and which were in need of financial assistance for expansion of their capacities, modernization and improving their marketing capabilities. The subsidy was a onetime receipt and was equivalent to 90% of the amount of sales tax paid.

The Assessing Officer, relying on the decision of the Supreme Court in the case of "Sahney Steel & Press Works Ltd. vs. CIT (1997) 228 ITR 253", came to the conclusion that since the subsidy received from the Government was 90% of the sales tax paid, the same was in the form of refund of sales tax paid and hence, should be considered as a revenue receipt.

The Calcutta High Court, applying the rationale of Supreme Court in CIT vs. Ponni Sugars & Chemicals Ltd. (2008) 306 ITR 392, observed that if the object of the subsidy is to enable the assessee to run the business more profitably, the receipt is a revenue receipt. On the other hand, if the object of the assistance is to enable the assessee to set up a new unit or to expand an existing unit, the receipt would be a capital receipt. Therefore, the object for which subsidy is given determines the nature of the subsidy and not the form of the mechanism through which the subsidy is given. Further, it was observed that in "Sahney Steel and Press Work Ltd. ", the subsidy was given by way of assistance in carrying the trade or business more profitably and hence, the receipt was a revenue receipt. However, in the instant case, the object of the subsidy was for expansion of their capacities, modernization and improvement of their marketing capabilities. It was further observed that merely because the subsidy was equivalent to 90% of the sales tax paid, it cannot be construed that the same was in the form of refund of sales tax paid.

Therefore, the High Court held that, in the present case, the subsidy received has to be treated as a capital receipt and not as a revenue receipt.

5. Can a company engaged in the business of owning, running and managing hotels claim interest on borrowed funds, used by it for investing in the equity share capital of a wholly owned subsidiary company, as deduction where the subsidiary company was formed for exercising effective control of new hotels acquired by the parent company under its management?

CIT vs. Tulip Star Hotels Ltd. (2011) 338 ITR482 (Del.)

The assessee-company was engaged in the business of owning, running and managing hotels. The assessee had borrowed certain funds which it had utilized to subscribe to the equity capital of the subsidiary company. The investment in the wholly owned subsidiary was for effective control of the hotels acquired by the assessee-company under its management and the subsidiary company also used the funds for the said purpose.

The assessee paid interest on the borrowed money. This interest liability incurred by the assessee was claimed by it as deduction under section 36(1)(iii) on the ground that it was business expenditure. The Assessing Officer refused to allow the expenditure. However, the Commissioner (Appeals) reversed the decision of the Assessing Officer and this opinion was confirmed by the Tribunal.

The High Court held that the assessee was in the business of owning, running and managing hotels. For the effective control of new hotels acquired by the assessee under its management it had invested in a wholly owned subsidiary company. The expenditure incurred was for business purposes and was thus allowable under section 36(1)(iii).

Note - Under section 36(1)(iii), the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession is allowable as deduction. In this case, it has been held that interest paid on capital borrowed for investment in a subsidiary company is allowable as deduction since the subsidiary company was formed to carry on the business of the parent company in a more effective manner.

6. Can "moneys payable" in respect of a building sold by the assessee (which has to be reduced from the opening written down value of the block of assets for calculating depreciation) be construed as the fair market value of the asset instead of the actual sale price?

CIT vs. Cable Corporation of India Ltd. (2011) 336 ITR 56 (Bom.)

On this issue, the Bombay High Court observed that the "moneys payable" to be reduced from the written down value of the block of assets as per section 43(6) is to be construed as per the meaning assigned to the same according to the Explanation below section 41(4) which states that the moneys payable"" in relation to the sale of a building, machinery, plant or furniture would be the price for which it is sold.

Therefore, the written down value of the asset falling within that block of assets at the beginning of the previous year has to be adjusted by the amount for which the asset is actually sold and not by its fair market value.

It may, however, be noted that, in case of scrap, the amount of scrap value (i.e. the fair market value) has to be reduced as per the provisions of section 43(6), to arrive at the written down value at the end of the year.

7. Can the expenditure incurred on the assessee-lawyer's heart surgery be allowed as business expenditure under section 31 by treating it as current repairs considering heart as plant and machinery or under section 37 by treating it as expenditure incurred wholly and exclusively for purposes of business or profession?

Shanti Bhushan vs.CIT (2011) 336 ITR 26 (Delhi)

In the present case, the assessee is a lawyer by profession. The assessee argued that the repair of vital organ (i.e. the heart) had directly impacted his professional competence. He contended that the heart should be treated as plant as it is used for the purpose of his professional work. He substantiated his contention by stating that after his heart surgery, his gross receipts from profession increased manifold. Hence, the expenditure on the heart surgery should be allowed as business expenditure either under section 31 as current repairs

to plant and machinery or section 37 as an expense incurred wholly and exclusively for the purpose of profession. The department argued that the said expenditure was personal in nature and was not incurred wholly and exclusively for the purpose of business or profession, and therefore, the same should not be allowed as business expenditure.

On this issue, the Delhi High Court observed that a healthy and functional human heart is necessary for a human being irrespective of the vocation or profession he is attached with. Expenses incurred to repair an impaired heart would thus add to the longevity and efficiency of a human being which would be reflected in every activity he does, including professional activity. It cannot be said that the heart is used as an exclusive tool for the purpose of professional activity by the assessee. Further, the High Court held that:-

(i) To allow the heart surgery expenditure as repair expenses to plant, the heart should have been first included in the assessee's balance sheet as an asset in the previous year and in the earlier years. Also, a value needs to be assigned for the same. The assessee would face difficulty in arriving at the cost of acquisition of such an asset for showing in his books of account. Though the definition of plant as per the provisions of section 43(3) is inclusive in nature but the plant must have been used as a business tool which is not true in case of heart. Therefore, the heart cannot be said to be plant for the business or profession of the assessee. Therefore, the expenditure on heart surgery is not allowable as repairs to plant under section 31.

(ii) According to the provisions of section 37, inter alia, the said expenditure must be incurred wholly and exclusively for the purposes of the assessee's profession. As mentioned above, a healthy heart will increase the efficiency of human being in every field including its professional work. Therefore, there is no direct nexus between the expenses incurred by the assessee on the heart surgery and his efficiency in the professional field. Therefore, the claim for allowing the said expenditure under section 37 is also not tenable.

Hence, the heart surgery expenses shall not be allowed as a business expenditure of the assessee under the Income-tax Act, 1961.

CAPITAL GAINS

1. Can non-cumulative preference shares carrying a fixed rate of dividend with a fixed holding period be said to be equated with bonds or debentures so as to deny the indexation benefit while computing capital gain on its transfer, applying the third proviso to section 48?

CIT vs. Enam Securities P. Ltd. (2012) 345 ITR 64 (Bom.)

As per the third proviso to section 48, benefit of indexation is not available on transfer of a long-term capital asset, being bond or debenture other than capital indexed bonds issued by the government.

In the present case, the assessee had subscribed to non-cumulative preference shares of a private limited company carrying dividend@4% p.a. and redeemable after the expiry of 10 years from the date of allotment. On the redemption of a part of the aforesaid preference shares at par, the assessee computed the capital loss on the same after claiming the benefit of indexation. However, the Assessing Officer claimed that the above mentioned 4% non-cumulative redeemable preference shares have a fixed holding period and a fixed rate of return which are the principal characteristics of

a bond and on this basis denied the benefit of cost indexation to the assessee, applying the third proviso to section 48.

On this issue, the Bombay High Court, following the judgement of the Supreme Court in Anarkali Sarabhai vs. CIT (1997) 224 ITR 422, observed that the redemption of preference shares by a company falls within the ambit of section 2(47) and amounts to transfer so as to attract capital gain tax.

The Court held that, since shares, debentures and bonds are not defined in the Income-tax Act, 1961, the terms have to be understood from the meaning given in the Companies Act, 1956. As per the Companies Act, 1956, the share capital of a company limited by shares can be of two kinds only, namely, equity share capital and preference share capital. Further, as per section 2(12) of the Companies Act, 1956, debenture is defined to include debenture stock, bonds and any other securities of a company, whether or not they constitute a charge on the assets of the company. A debenture is a certificate of a loan or a bond evidencing the fact that the company is liable to pay an amount specified with interest. Though the amount which is raised by a company through debentures becomes a part of its capital structure, it does not become part of share capital. Hence, the 4% non-cumulative preference shares cannot be said to be in the nature of bonds or debentures.

Therefore, the indexation benefit on the transfer of long-term capital asset, being 4% non-cumulative preference shares cannot be denied applying the provisions of the third proviso to section 48.

2. **In case of a house property registered in joint names, whether the exemption under section 54F can be allowed fully to the co-owner who has paid whole of the purchase consideration of the house property or will it be restricted to his share in the house property?**

CIT vs. Ravinder Kumar Arora (2012) 342 ITR 38 (Delhi)

In the present case, the assessee filed the return of income showing long-term capital gain on sale of plot of land. The assessee claimed exemption under section 54F from such long-term capital gain on account of purchase of new residential house property within the stipulated time period as mentioned in the aforesaid section. He claimed exemption under section 54F taking into consideration the whole of purchase price of the residential house property. However, after going through the purchase deed of the house property, the Assessing Officer found that the said house property was purchased in joint names of assessee and his wife. Therefore, the Assessing Officer allowed 50% of the exemption claimed under section 54F, being the share of the assessee in the property purchased in joint names.

The assessee submitted that the inclusion of his wife's name in the sale deed was just to avoid any litigation after his death. He further explained that all the funds invested in the said house were provided by him, including the stamp duty and corporation tax paid at the time of the registration of the sale deed of the said house. This fact was also clearly evident from the bank statement of the assessee. The assessee claimed that the exemption under section 54F is to be allowed with reference to the full amount of purchase consideration paid by him for the aforesaid residential house and is not to be restricted to 50%. The Assessing Officer did not deny the fact that the whole amount of purchases of the

house was contributed by the assessee and nothing was contributed by his wife. However, the Assessing Officer opined that exemption under section 54F shall be allowed only to the extent of assessee's right in the new residential house property purchased jointly with his wife, i.e. 50%.

Considering the above mentioned facts, the Delhi High Court held that the assessee was the real owner of the residential house in question and mere inclusion of his wife's name in the sale deed would not make any difference. The High Court also observed that section 54F mandates that the house should be purchased by the assessee but it does not stipulate that the house should be purchased only in the name of the assessee. In this case, the house was purchased by the assessee in his name and his wife's name was also included additionally. Therefore, the conditions stipulated in section 54F stand fulfilled and the entire exemption claimed in respect of the purchase price of the house property shall be allowed to the assessee.

Note: A similar view was taken by the Karnataka High Court in the case of DIT (IT) vs. Mrs. Jennifer Bhide (2011)15 Taxmann.com 82,in the context of deductions under section 54 and 54EC, wherein the assessee had sold a residential house property. The assessee, in order to claim exemption of the long-term capital gain, made the investment in the residential house property and bonds jointly in her name and in the name of her husband. The Karnataka High Court, in this case, observed that it was clear from the facts of this case that the entire investment was done by the assessee and no contribution was made by her husband. Therefore, in the present case, it was, held that section 54 and 54EC only stipulate that the capital gain arising on a sale of property is to be invested in a residential house property or in the long-term specified asset i.e., bonds. It is not mandatory in those sections that the investment is to be made in the name of the assessee only. The name of the assessee's husband is shown in the sale deed as well as in the bonds, as a joint owner. However, since the consideration for acquisition flows entirely from the assessee's funds, the assessee is entitled to claim deduction under section 54 and 54EC in respect of the full amount invested. Therefore, in the present case, the exemption under section 54 and 54EC shall not be restricted to 50%, being the share of the assessee in the ownership of the house property and the bonds. The assessee is entitled to 100% exemption of the long-term capital gain so invested in the residential house property and in the bonds.

3. Can the scheme of arrangement approved under section 391 to 394 of Companies Act, 1956 be treated as slump sale to attract capital gains provisions?

SREI Infrastructure Finance Ltd. vs. Income-tax Settlement Commission (2012) 207 Taxman 74 (Delhi)

In this case, assessee had received certain amount from its subsidiary (under a scheme of arrangement) which was sanctioned by the High Court under sections 391 to 394 of the Companies Act, 1956. The Settlement Commission brought to tax such amount by applying the provisions of section 50B treating such arrangement as slump sale. However, the assessee contended that the transfer of assets between the assessee and its subsidiary was under the "scheme of arrangement", and the same cannot be treated as slump sale as contemplated under section 2(42C).

Considering the above, the Delhi High Court held that it would be wrong to infer that section 50B is applicable only in case actual "sale" of assets takes place. It shall apply in case of all types of "transfer" mentioned in section 2(47). When a scheme under sections 391 to 394 of the Companies Act, 1956 is sanctioned by the Court, it is treated as a binding statutory scheme because the scheme has to be implemented and enforced. However, this cannot be a ground for the assessee to escape tax on 'transfer' of a capital asset under the provisions of the Income-tax Act, 1961. The taxability of the said transaction is to be decided as per the provisions of the Income-tax Act, 1961.

Therefore, the scheme approved by the court under sections 391 to 394 of the Companies Act, 1956 shall be treated as slump sale and capital gains provisions would be attracted. The cost of acquisition of the arrangement shall, therefore be determined as per the provisions of section 50B.

4. Will an agricultural land be treated as capital asset, in case it is located within 8 kilometers from the local limits ofa City Municipal Corporation, even though the same is not notified by the Central Government under section 2(14)(iii)(b)?

CIT vs. Madhukumar N. (HUF) (2012) 208 Taxman 394 (Kar.)

On this issue, the Karnataka High Court observed that, as per section 2(14), an agricultural land is not a capital asset except in the following cases -

(a) when it is located within the jurisdiction of a municipality, etc, which has a population not less than 10,000 or

(b) when it is located within 8 kilometers from the local limit of a municipality, etc., mentioned in (a) above, which is notified by the Central Government in this regard.

For an agricultural land to become a capital asset by virtue of (b) above, two conditions have to be satisfied namely, the population of the municipality etc, should not be less than 10,000 and the same should be notified by the Central Government.

Therefore, in case an agricultural land is situated within 8 kilometers from the local limit of a municipality, etc. whose population is more than 10,000 but the same is not notified by the Central Government, the said land would not be a capital asset and no capital gain tax would be attracted on its sale.

5. What are the factors determining the nature of income arising on sale of shares i.e. whether the income is taxable as capital gains or business income?

PVS Raju vs. ACIT (2012) 340 ITR 75 (AP.)

On the said issue, the Andhra Pradesh High Court held that the question whether the shares were held as an investment to give rise to capital gain on its sale or as a trading asset to give rise to business income is not a pure question of law but essentially one of fact. The character of a transaction cannot be determined solely on the application of any abstract rule, principle or test but must depend upon all the facts and circumstances of the case. The facts that may be considered while determining the same are the magnitude and frequency of buying and selling of shares by the assessee; the period of holding of shares, ratio of sales to purchases and the total holdings, etc. Mere classification of shares in the books of accounts of the assessee is not relevant for determining the nature of income for income-tax purposes.

6. Can an assessee be deprived of claiming exemption under section 54EC, if bonds of assessee's choice are not available or are available only for a broken period within the period of six months after the date of transfer of capital asset and the bonds are purchased shortly after it became available next time after the expiry of the said six months?

CIT vs. Cello Plast (2012) 209 Taxman 617 (Bom.)

In the present case, the assessee sold its building on 22.03.2006. To avail exemption under section 54EC, the assessee was required to invest the sale proceeds either in the bonds of Rural Electrification Corporation Ltd. (REC bonds) or in the bonds of National Highway Authority (NHA bonds) within six months from the date of sale of building i.e. on or before 21.09.2006. However, during this period of six months, REC bonds were available only between 1.07.2006 to 3.08.2006. Thereafter, it became available only on 22.01.2007 to 31.01.2007. The assessee purchased the REC bonds on 31.01.2007 and claimed the exemption under section 54EC.

However, the Assessing Officer disallowed the benefit of section 54EC to the assessee and taxed the entire capital gain on the contention that bonds were purchased beyond the period of six months from the date of transfer of capital asset. The Assessing Officer contended that since the REC bonds were available during the period from 1.07.2006 to 3.08.2006, the same could have been purchased before 3.08.2006. The Assessing Officer further argued that the assessee could have purchased NHA bonds, if REC bonds were not available throughout the period of said six months.

On the above mentioned issue, the Bombay High Court observed that though REC bonds were available for limited period between 1.07.2006 to 3.08.2006, but assessee had time till 21.09.2006 to invest in these bonds to avail the benefit under section 54EC. The availability of the bonds only for a limited time during the period of six months from the date of sale of the asset as provided in section 54EC, cannot restrict the assessee's right to exercise the same upto last date. The contention of the Revenue that since the REC bonds were available upto 3.08.2006, the assessee should have purchased the bonds before this date, is not sustainable as the time given by the statute is till 21.09.2006.

Hence, reasonable extension ought to be granted after the bonds are made available, at least to the extent of the number of days between 4.08.2006 (being the last date the bonds were available) and 21.09.2006 (being the expiry of 6 months from the date of transfer)

Therefore, the High Court held that since the assessee invested in the bonds on 31.01.2007 i.e within 9 days of their being available once again from 22.01.200 he cannot be deprived of exemption under section 54EC.

The High Court further held that since section 54EC gives the choice to the assessee either to invest in REC bonds or in NHA bonds, in case the bonds of the assessee's choice are not available, the time to invest in the bonds get automatically extended till the bonds are available in the market.

7. Would sale of a plot of land held as stock-in-trade by an assessee engaged in the business of real estate and construction of plots, be treated as sale of capital assets, to attract the provisions of section 50C?

CIT vs. Kan Construction and Colonizers (P) Ltd (2012) 208 Taxman 478 (All.)

On this issue, the High Court observed that for applicability of section 50C, the essential requirement is that the building and land transferred should be a capital asset. Further, as per section 2(14), capital asset does not include stock-in-trade held for the purpose of an assessee's business or profession.

The Assessing Officer treated the sale of plot of land held by the assessee as sale of capital asset and accordingly, applied the provisions of section 50C.

The High Court held that since the assessee is a builder and construction of buildings is its business, investment in purchase and sale of plots by it is ancillary and incidental to its business activity. Therefore, it was held that the assessee has held the land as stock in-trade and not as a capital asset. Hence, section 50C will not apply in this case and the profit on sale of land will be treated a business income.

8. Can exemption under section 54F be denied to an assessee in respect of investment made in construction of a residential house, on the ground that the construction was not completed within three years after the date on which transfer took place, on account of pendency of certain finishing work like flooring, electrical fittings, fittings of door shutter, etc?

CIT vs. Sambandam Udaykumar (2012) 345 ITR 389 (Kar.)

In this case, the assessee has claimed benefit of exemption under section 54F in respect of capital gain arising on sale of shares of a company by investing the amount in construction of a house property. However, the Assessing Officer contended that no exemption under section 54F would be available in this case, as the construction of a residential house was not completed on account of pendency of certain work like flooring, electrical fittings, fittings of door shutter, etc., even after lapse of three years from the date of transfer of the shares.

The Karnataka High Court held that the condition precedent for claiming the benefit under section 54F is that capital gains realized from sale of capital asset should have been invested either in purchasing a residential house or in constructing a residential house. If he has invested the money in the construction of a residential house, merely because the construction was not completed in all respects and possession could not be taken within the stipulated period, would not disentitle the assessee from claiming exemption under section 54F. In fact, in this case, the assessee has taken the possession of the residential building and is living in the said premises despite the pendency of flooring work, electricity work, fitting of door and window shutters. The condition precedent for claiming exemption under section 54F is that the capital gain realized from sale of capital asset should have been parted by the assessee and invested either in purchasing a residential house or in constructing a residential house within the stipulated period.

Therefore, the Court held that in this case the assessee would be entitled to exemption under section 54F in respect of the amount invested in construction within the prescribed period.

SECTION B – QUESTIONS & ANSWERS

DIRECT TAXATION

Q. 1. a) A was employed with Z Ltd. He retired w.e.f. 1.2.2013 after completing a service of 24 years and 5 months. He submits the following information:
Basic Salary : ₹5,000 per month (at the time of retirement)
Dearness Allowance : 100% of Basic Pay (60% of which forms part of salary for retirement benefits). Last increment : ₹ 500 w.e.f. 1st July, 2012. His pension was determined at ₹ 3,000 per month. He got 50% of the pension commuted w.e.f. 1.3.2013 and received a sum of ₹ 1,20,000 as commuted pension. In addition to this, he received a gratuity of ₹1,50,000 and leave encashment amounting to ₹ 56,000 on account of accumulated leave of 240 days. He was entitled to 40 days leave for every year of service.
Compute his Gross Salary for Assessment Year 2013-14 assuming that he is not covered under Payment of Gratuity Act.

b) A Ltd. incurred ₹ 5.00 lakhs towards replacement of worn out parts of machinery, which it debited to the account "Repairs to Plant and Machinery". Comment

Answer.

a) Assessee: Mr.Aniket **Assessment Year: 2013-14**

Computation of Income from Salary

Particulars	**Amount (₹)**	**Amount (₹)**
Basic Pay		
April 2012 to June 2012 @ ₹ 4,500 p.m.	13,500	
July 2012 to January 2013 @ ₹5,000 p.m.	35,000	48,500
Add: Dearness Allowance @ 100 % of Basic Pay		48,500
Add: Uncommuted value of pension		
February 2013 @ ₹3,000 p.m	3,000	
March 2013 ₹1,500 p.m. (since 50% already commuted)	1,500	4,500
Add: Commuted Value of Pension Amount Received Less: Exemption u/s/ 10(10A) 1/3rd of full value of commuted pension [1/3rd of ₹2,40,000] Full Value of commuted pension = Amount received / % commuted = ₹ 1,20,000 / 50% = ₹2,40,000	 1,20,000 80,000	 40,000

Add: Taxable Value of Gratuity Amount received as Gratuity Less: Exemption u/s 10(10) Least of the followings: Actual amount received = 1,50,000 Maximum limit = 10,00,000 ½ months average salary for each years of completed service = [½ x 7,760 x 24] = 93,120 Salary for Gratuity (not covered by Payment of Gratuity Act) = Basic Pay + D.A. (forming part of salary for retirement benefits) Average Salary = Total salary of 10 months preceding the month of retirement / 10 = (48,500 + 60% of 48,500)/10 = ₹ 7,760	 1,50,000 93,120	 56,880
Add: Taxable Value of Leave Encashment Amount Received Less : Exemption u/s 10(10AA) Least of the followings: Actual amount received = 56,000 10 months average salary = 77,600 Maximum limit = 3,00,000 Leave credit (- refer Note 1) = NIL Notes: Calculation of leave credit Total leave entitlement (24 years x 40 days p.a.) = 960 days Less: Leave availed during service = Total leave entitlement – leave encashment = (960 days – 240 days) = 720 days 240 days Less: Leave in excess of 30 days p.a. granted by employer [24 years (40 days p.a. granted by employer - 30 days p.a. as per rules)] = 24 x 10 = 240 days NIL	 56,000 NIL	 56,000
Gross Income from Salary		**2,54,380**

b) Where a repair amounts to restoration or replacement of subsidiary parts or defective parts of existing or old machinery, then no new asset comes into existence and so treated as current repairs. However, where a repair has resulted in restoration or replacement of whole or substantially the entire machinery, then the same shall be treated as capital expenditure as it enhances the life of the asset. [Darbhanga Sugar Co. Ltd. 29 ITR 21 (Pat)].

U/s 31, amount paid on account of current repairs of machinery shall be allowed as deduction. However such expenses shall not include any expenditure of capital nature.
In the given case if the expenditure incurred towards current repairs is of capital nature, then the same shall not be allowed as a deduction. Otherwise, it can be claimed as deduction u/s 31.

Q. 2. a) Mr. Ashis discloses the following particulars of the property owned by him during the PY 2012-2013.

Particulars	House self-occupied	Flat allotted by HB Society let out ₹	Shops & godowns let out ₹
Municipal Value	5,00,000	2,00,000	4,00,000
Fair Rent	4,00,000	2,50,000	5,00,000
Municipal taxes payable	60,000	80,000	80,000
(a) Paid by Ashis	60,000	30,000	-
(b) Paid by tenant	-	50,000	80,000
Annual Rent	-	3,60,000	7,00,000
Expenses incurred by Ashis : Maintenance charges			
Repairs	-	12,000	-
Collection charges	-	-	2,60,000
Electricity bills paid	-	-	6,000
Insurance premium	-	-	Nil
Ground rent	20,000	-	6,000
Depreciation	5,000	2,000	600
	1,000	2,000	20,000

Other information :

(i) **He has taken the loan on 1st July 2010 to purchase the house in self-occupancy. However, he could purchase the house on 1st May 2011. He repaid ₹ 6,30,000 on 1st July 2012. This includes a charge of ₹ 1,20,000 on account of interest from the date of borrowing.**

(ii) **The flat has been purchased under EMI scheme of the Gujarat Apartment Cooperative House Building Society Ltd. He has to pay 120 EMI of ₹ 10,000 each, which includes 50% charge on account of interest. He has defaulted in payment of the last 20 EMI. To repay the outstanding EMI and penal interest of ₹ 20,000, he borrowed ₹ 2,20,000 on 1st October 2012 @ 15% p.a.**

The flat remained vacant for 1.5 months and rent of 3/4th month could not be realized. Conditions of Rule 4 have been satisfied.

(iii) **Shops and godowns are held as stock-in-trade. However, till a suitable buyer is found, these are let out. P claims that income from letting should be computed under the head "Profits and Gains of Business of Profession".**

He has borrowed money to construct/repair the godowns/ shops. He paid ₹ 20,000 on account of brokerage for arranging the loan.

Interest is payable outside India, in two equal installments of ₹ 50,000 each. The first installment was paid net of tax at ₹ 40,000. However, the second instilment was paid without deducting tax at sources as the recipient had given an undertaking in the prescribed form to pay the tax. Compute Income from House Property for the Assessment Year 2013-2014.

Answer .

Assessee : Mr. Ashis Computation of Income from House Property A. Y : 2013-14

Particulars	**House self-occupied ₹**	**Flat let-out ₹**	**Shops and godowns let out ₹**
Gross Annual Value	Nil	2,92,500	7,00,000
Less: Municipal taxes paid by the assessee	—	30,000	—
Net Annual Value	Nil	2,62,500	7,00,000
Less: Deductions u/s 24			

Statutory deduction u/s 24(a) @ 30% of NAV	—	78,750	2,10,000
Interest on Loan u/s 24(b)	24,000	37,500	50,000
Income from House Property	(24,000)	1,46,250	4,40,000

Workings:

1. Gross Annual Value:

(a) ALV	2,50,000
(b) Annual Rent (3,60,000 – 22,500)	3,37,500
Higher of the above (a) & (b)	3,37,500
Less: Vacancy Allowance	(45,000)
	2,92,500

2. Interest on loan taken for self occupied:

(i) Amount of interest = ₹ 1,20,000

(ii) Period of interest = 01.07.2010 to 01.07.2012 = 2 years

(iii) Pre-acquisition period = 01.07.2010 to 31.3.2011 = 9 months

(iv) Interest for pre-acquisition period =1,20,000× 9/24 = ₹ 45,000

(v) Interest for 2011-2012 = ₹ 1,20,000/2 = ₹ 60,000

(vi) Interest for 2012-2013 for 3 months = 1,20,000 × 3/24 = 15,000

(vii) Interest deductible during PY 2012-2013 = (45,000/5) + (15,000) = 24,000

3. Interest for the flat:

(i) Interest included in EMI from 01.04.2012 to 30.09.2012: ₹ (10,000 × 6/2) = ₹ 30,000

(ii) Interest on money borrowed to repay original loan interest
₹ (10,000 × 20/2) = (1,00,000 × 15% × 1/2) = 7,500

(iii) Total interest = ₹ (30,000 + 7,500) = ₹ 37,500

(iv) No deduction is allowed for penal interest.

4. Letting out of shops and godowns, held as stock-in-trade:

Section 22 excludes from its charge only such building as is occupied by the assessee for his business or profession, profits of which are chargeable to tax. In the instant case, as letting out is not the business of the assessee, so, it cannot be said that he has occupied shop and godown for his business. Accordingly, income from letting out shop and building, held as stock-in- trade is assessable under the head "Income from House Property". Where an assessee is not holding shops and godowns as stock-in-trade but engaged in the business of letting them on hire, the income is again chargeable under the head "House Property" as it is a specific head of income dealing with letting out of buildings only.

5. Deduction in respect of other expenses: Section 24 does not allow any deduction in respect of (i) maintenance charges, (ii) repairs, (iii) collection charges, (iv)electricity, (v) fire insurance premium, (vi) ground rent, and (vii) depreciation.

Q. 3. a) Free Call Ltd. obtained a telecom licence on 15.6.09 for a period of 8 years ending on 31.3.2017 against a fee of ₹ 30 crores to be paid in four instalments of ₹12 crores, ₹7 crores, ₹6 crores, ₹5 crores by June 2008, June 2010, June 2011 and June 2012 respectively. Explain how the payment for licence fee shall be dealt under the Income Tax Act, 1961.

b) Mr. Goutam, out of his own funds, had taken a FDR for ₹ 1,00,000 bearing interest @ 10% p.a. payable half-yearly in the name of his wife Latika. The interest earned for the year 2012-2013 of ₹ 10,000, was invested by Mrs. Latika in the business of packed spices which resulted in a net profit of ₹ 55,000 for the year ended 31st March, 2013. How shall the interest on FDR and income from business be taxed for the Assessment Year 2013-2014?

Answer.

Assessee : Free Call Ltd. **Previous Year 2012-13** **Assessment Year : 2013-14**

(i) U/s 35ABB, expenditure incurred for the purpose of acquiring any right to operate telecommunication services is allowed equally as deduction throughout the unexpired life of the licence. Deduction shall be allowed only for the actual payment made.

(ii) If only part payment is made, amortization is based on the amount paid and not on the basis of total consideration. For any further payments, deduction/amortization is allowed equally for the remaining unexpired useful life.

(iii) Computation of amount of eligible deduction u/s 35 ABB:

Previous Year	Amount paid (₹ Crores)	Unexpired Period of Licence on the date of actual payment	Amount of Deduction (₹ Crores)
2009-10	12.00	8 years	1.50
2010-11	7.00	7 years	[1.50 + (7.00/7)] = 2.50
2011-12	6.00	6 years	[2.50 + (6.00/6)] = 3.50
2012-13	5.00	5 years	[3.50 + (5.00/5)] = 4.50

b) Where an individual transfers an asset (excluding house property), directly or indirectly to his/her spouse, otherwise than for adequate consideration, or in connection with an agreement to live apart, income from such asset is included in the total income of such individual [Sec. 64(1)(iv)].

Accordingly, interest on FDR, accruing to wife, is included in the total income of her husband. However, business profits cannot be clubbed with total income of husband. Clubbing applies only to the income from assets transferred without adequate consideration. It does not apply to the income from accretion of the transferred assets. Hence, business profit is taxable as the income of wife.

Q. 4. Mr. Sahani was the owner of a residential house property which was purchased by him on 1.8.1981 for ₹ 50,000. The Government acquired the house as per notification on 1.4.2009 against the compensation of ₹ 10,00,000 out of which ₹ 6,00,000 was received by Mr. Sahani on 31st December, 2012 and ₹ 4,00,000 was received on 30th April, 2013. On his appeal, the court enhanced its compensation from ₹ 10,00,000 to ₹ 12,00,000. Mr. Sahani received the additional compensation on 21st January, 2016. Ascertain the amount of investment and time of investment for availing the maximum exemption u/s 54.

Answer 4.

Assessee : Mr. Sahani **Previous Year : 2012-13** **Assessment Year : 2013-14**

Computation of Capital Gain

Particulars	₹
Consideration received	10,00,000
Less: Index cost of acquisition [50,000 × 852/100]	4,26,000
Long Term Capital Gain	5,74,000

In order to avail the exemption u/s 54, Mr. Sahani has to purchase a house property of ₹ 5,74,000 or more within one year before the date of receipt of initial compensation or upto the due date of filing the Income Tax Return u/s 139 for the A.Y. – 2013-14. Otherwise he can also deposit the amount in the deposit account with a nationalized bank within the due date of filing return. However in this case he has to purchase the house property within 2 years or constructed it within 3 years from the date of receipt of the part of the initial compensation, which can be shown as follows:

Date of part received	31/12/2012	30/04/2013
Amount of part received	6,00,000	4,00,000
Minimum investment to get full exemption u/s 54	1,74,000	4,00,000
Date by which a house should be purchased by withdrawing from deposit account	31/12/2014	29/04/2015
Date by which a house should be constructed by withdrawing from deposit account	30/12/2015	29/04/2016

Additional compensation received on 21st January, 2016 :

Assessee : Mr. Sahani **Previous Year : 2015-16** **Assessment Year : 2016-17**

Computation of Capital Gain

Particulars	₹
Consideration received	2,00,000
Less: Cost of acquisition	NIL
Long Term Capital Gain	2,00,000

Ravi should purchase a new house property of ₹ 2,00,000 or more within one year before the additional compensation received or upto the due date of filing the Income Tax Return u/s 139 for the A.Y. 2016-17. Otherwise, he can also deposit the amount in the deposit account with a nationalized bank within the due date of filing return but in this case he has to purchase the house within 20th January, 2018 or constructed it within 20th January, 2019.

Q. 5. a) Mr. Samir submits the following information for the A.Y. 2013-14.

Particulars	₹
Taxable Income from Salary	**1,64,000**
Income from House property :	
House 1 Income	**37,000**
House 2 loss	**(53,000)**
Textile Business (discontinued on 10.10.2012)	**(20,000)**
Brought forward loss of textile business - A.Y. 2009-10	**(80,000)**
Chemical Business (discontinued on 15.3.2012)	
– b/f loss of Previous Year 2009-10	**(25,000)**
– unabsorbed depreciation of Previous Year 2009-10	**(15,000)**
– Bad debts earlier deducted recovered in July '2012	**40,000**
Leather Business	**62,000**
Interest on securities held as stock in trade	**10,000**

Determine the Gross Total Income for the Assessment Year 2013-14 and also compute the amount of loss that can be carried forward to the subsequent years.

b) An assessee filed a return of income on 31.8.2013 in respect of Assessment Year 2013-14 disclosing an income of ₹5 lakhs from business. It was not accompanied by proof of payment of tax due on self-assessment. Discuss the validity of such a return.

Answer 5.

a) Computation of Gross Total Income A.Y. 2013-14

Particulars		₹	₹
I. Income from Salary			1,64,000
II. Income from House property :			
House 1 Income		37,000	
House 2 Loss		(53,000)	(16,000)
III. Profits and Gains of Business or Profession :			
(i) Textile business loss		(20,000)	
(iii) Chemical business – Bad debts recovered taxable u/s 41(4)	40,000		
Less : (i) Set off of brought forward loss of P.Y. 2009-10 u/s. 72	(25,000)	15,000	
		(5,000)	
(iii) Leather Business Income	62,000		
(iv) Interest on securities held as stock-in-trade	10,000	72,000	
		67,000	Nil
Less: B/f business loss ₹ 80,000 restricted to		67,000	
Gross Total Income			**1,48,000**

Note :

1. The unabsorbed loss of ₹ 13,000 (80,000-67,000) of Textile business can be carried forward to A.Y. 2014-15 for setoff u/s. 72, even though the business is discontinued.
2. The unabsorbed depreciation of ₹ 15,000 is eligible for set off against any income other than salary income. Since, Gross Total Income contains the balance of Income from Salary only, unabsorbed depreciation cannot be adjusted, and hence, carried forward for adjustment in the subsequent years.

b) As per Explanation to sub-section (9) of section 139 a return is regarded as defective unless it is accompanied by proof of tax deducted at source, advance tax and tax on self-assessment, if any, claimed to have been paid. Therefore, the return is prima facie defective. It is not invalid at that stage. On receipt of the return, the Assessing Officer has to intimate the defect to the assessee and give him an opportunity to rectify the defect within a period of 15 days from the date of such intimation or within such further period which, on application by the assessee, he may, in his discretion, allow. If the defect is not rectified within the said period, the return will be treated as an invalid return and the provisions of the Income-tax Act shall apply, as if the assessee has failed to furnish the return.

Also, it may be noted that section 140A(3) says that if an assessee fails to pay tax or interest on self assessment he shall be deemed to be an assessee in default in respect of the tax or interest or both remaining unpaid and all the provisions of the Act shall apply accordingly.

Q. 6. M, an individual, retired from the services of a Company on 31.10.2012. He joined another employer on 1.11.2012 and was in service till end of March 2013, when he furnishes the following details and information —

1. Salary and Allowances for the period

From First Employer	**₹ Per month**
Basic Salary	**30,000**
Dearness Allowance	**16,000**
Conveyance Allowance	**6,000**
From Second Employer	**₹ Per month**
Basic Salary	**35,000**
Fixed Conveyance Allowance	**8,000**

2. While he was with the first employer, M contributed 10% of his basic salary to a Provident Fund Account with the Regional Provident Fund Commissioner. He did not become a member of the Provident Fund maintained by the second employer.

3. M was permitted by the second employer to encash 15 days leave he had accumulated during his service and received ₹ 12,500 from his employer.

4. M had constructed a residential house in Chennai in February 2008 for ₹ 30 Lakhs. Part of the costs of construction was met by borrowals of ₹ 20 lakhs from the Housing Development Corporation, at interest of 12.5% p.a. The loan was taken on June 2007. The loan outstanding at the beginning of the current year was ₹ 12,00,000. The rate of interest applicable for the current year was reduced to 9% p.a. due to reduction in rates. [He had also borrowed from some relatives ₹ 4,00,000 on which interest at 15% p.a. was due.] The property had been let-out soon after completion.

5. In the Assessment Year 2008-09, M was allowed a deduction of ₹ 50,000 for irrecoverable rents. The annual value decided by the Corporation of Channai for the property is ₹ 80,000. The property was let-out in the current year to a Company on a rent of ₹ 20,000 p.m. The half-yearly municipal taxes on the property were fixed by the Corporation of Channai only in August 2012 at ₹ 15,000 for every half year from 1.4.2009. M paid the taxes due in September 2012 upto the year ending 31.3.2012.

6. M also received from the previous tenant ₹ 40,000 (out of the dues of ₹ 50,000).

7. After retirement from the first employer, M received ₹ 4,50,000 from the Regional Provident Fund Commissioner, money was fully invested by him in the 15% Non-Redeemable Debentures issued by the Indian Oil Corporation interest on these had not come in by the end of March 2013.

8. M received interest of ₹ 60,000 on long-term fixed deposits with Banks, ₹ 2,500 as interest on Post Office Savings Bank Accounts and ₹ 20,000 as income from units.

9. M owns a car which is used for office purposes also and it is found that the entire conveyance allowance from his employer had been fully spent on travel for official purposes.

10. One of the policies of insurance taken by M had matured for payment and ₹ 8,00,000 received by him in June 2012 from the LIC was invested by him, in the name of his 16-year old son, in fixed deposits with companies. Interest received uplo 31.3.2013 on these deposits was ₹ 90,000. On one of the continuing policies of insurance, M paid a premium of ₹ 60,000 in the year.

Compute M's Total Income for the Assessment Year 2013-14.

Answer.

Assessee : Mr. M **Previous Year : 2012-13** **Assessment Year : 2013-14**

Computation of Total Income

Particulars	**₹**	**₹**	**₹**
Income under the head Salaries			
From First Employer			
Basic Pay (₹ 30,000 × 7)		2,10,000	
Dearness Allowance (₹ 16,000 × 7)		1,12,000	
Conveyance Allowance (₹ 6000 × 7)	42,000		
Less: Exempt u/s 10(14)	(42,000)	Nil	3,22,000
Amount received from Regional Provident Fund Commissioner	4,50,000		
Less: Exempt u/s 10(12)	(4,50,000)	Nil	

From Second Employer			
Basic Salary (₹ 35,000 × 5)		1,75,000	
Conveyance Allowance (₹ 8,000 × 5)	40,000		
Less: Exempt u/s 10(14) (incurred for official performance of duties)	(40,000)	Nil	
Leave Encashment - Fully taxable while in service		12,500	1,87,500
Gross Income from Salary			**5,09,500**
Income from House Property :			
Gross Annual Value u/s. 23(1) — Higher of Municipal Value of ₹ 80,000 or Actual Rent of ₹ 2,40,000		2,40,000	
Less: Municipal Taxes paid during the year @ ₹ 15,000 for every half year from 1.4.2009 upto 31.3.2012		(90,000)	
(Current Year - Not Paid)		1,50,000	
Net Annual Value (NAV)			
Less: Deduction		(45,000)	
@ 30% of NAV u/s 24(a)			
Interest on Borrowed Capital u/s 24(b)			
Loan from Housing Development Corporation:			
Current Period Interest: ₹ 12,00,000 × 9%	1,08,000		
Prior Period Interest (Interest upto 31.3.2008)			
[(₹ 20,00,000 × 12.5%) +(4,00,000 × 15%)] × 10/12 × 1/5	51,667	(2,19,667)	
Loan from Relative - Current Period Interest		40,000	
(₹ 4,00,000 x 15%)	60,000		
Add: Unrealised Rent recovered (taxable in the year of recovery u/s 25AA]			**(74,667)**
Income from Other Sources			
Interest on Long-term Fixed Deposits with Bank		60,000	
Interest on Post Office Savings Bank A/c	2,500		
Less: Exempt u/s 10(15)	(2,500)	Nil	
Income from Units of UTI	20,000		
Less: Exempt u/s. 10(35)	(20,000)	Nil	
LIC Policy matured	8,00,000		
Less: Exempt u/s. 10(1D)	(8,00,000)	Nil	
Interest from Fixed Deposits with Companies in the name of minor son		88,500	
Less: Exemption u/s. 10(32)	90,000		**1,48,500**
Gross Total Income	(1,500)		**5,83,333**
Less: Deduction under Chapter VIA:		(60,000)	
u/s 80C – LIC Premium		(21,000)	
– RPF – 10% of ₹ 2,10,000			81,000
Total Income			**5,02,333**
Total Income (Rounded Off u/s 288A)			**5,02,330**

Assumptions :

1. It is presumed that Mr. M accounts for his interest income on receipt basis.
2. Assumed that there has been no repayment of Housing Loan Principal during the year ending 31.3.2007 for the purpose of calculation of prior period interest.
3. Recognised Provident Fund received on retirement shall not be taxable u/s 10 (assuming conditions are satisfied).
4. **Unrealised Rent recovered :** Since the assessee has been allowed a deduction of ₹ 50,000 from his house property income in earlier years in respect of Unrealised Rent, entire ₹ 40,000 recovered during current year becomes taxable.
5. **Deduction of Interest** u/s 24 shall be allowed even if the amount is borrowed from any person other than the Banks/Financial Institutions in respect of Let Out property.

Q. 7. D Ltd., a closely-held Indian company, is engaged in the business of manufacture of chemical goods (value of plant and machinery owned by the company is ₹ 55 lakh). The following information for the financial year 2012-13 are given :
D Ltd. is engaged in the business of manufacture of garments.

Particulars	₹
Sale proceeds of goods (domestic sale)	25,00,000
Sale proceeds of goods (export sale)	7,00,000
Amount withdrawn from general reserve (reserve was created in 1997-98 by debiting P&L A/c)	
Amount withdrawn from revaluation reserve	2,00,000
Total	1,50,000
Less : Expenses	**35,50,000**
Depreciation (normal)	
Depreciation (extra depreciation because of revaluation)	6,16,000
Salary and wages	2,70,000
Wealth tax	2,10,000
Income-tax	10,000
Outstanding customs duty (not paid as yet)	3,50,000
Proposed dividend	17,500
Consultation fees paid to tax expert	60,000
Other expenses	21,000
Net Profit	1,39,000
	18,56,500

For tax purposes the company wants to claim the following :
—Deduction under section 80-IB (30 per cent of ₹ 14,56,500).
—Depreciation under section 32 (₹ 5,36,000)
The company wants to set off the following losses/allowances :

Particulars	**For tax purposes ₹**	**For accounting purposes ₹**
Brought forward loss of 2005-06	14,80,000	4,00,000
Unabsorbed depreciation	—	70,000

Compute the net income and tax liability of D Ltd. for the Assessment Year 2013-14 assuming that D Ltd. has a (deemed) Long-term Capital Gain of ₹ 60,000 under proviso (i) to section 54D(2) which is not credited in Profit and Loss Account.

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Answer.

Computation of Book Profit & Minimum Alternate Tax for the Assessment Year 2013-14

Particulars	Amount (₹)
Net Profit as per P&L A/c	18,56,500
Add :	
Excess depreciation [i.e., ₹ 6,16,000 + ₹ 2,70,000 — ₹ 5,36,000]	3,50,000
Wealth tax	10,000
Income tax	3,50,000
Customs duty which is not paid	17,500
Proposed dividend	60,000
Total	26,44,000
Less : Amount withdrawn from reserve (i.e., ₹ 2,00,000+₹ 1,50,000)	3,50,000
Business income	22,94,000
Less : Unabsorbed loss	14,80,000
Business Income	8,14,000
Long-term Capital Gain	60,000
Gross Total Income	**8,74,000**
Less : Deductions under section 80-IB [30% of ₹ 4,14,000] =[₹ (8,14,000 – 4,00,000)]	1,24,200
Net Income (rounded off)	**7,49,800**
Tax liability (under normal provisions) [20% of ₹ 60,000 + 30% of ₹ 6,89,800, plus 3% of tax as Cess]	2,25,508
Book Profit	
Net Profit	18,56,500
Add :	
Depreciation (i.e. ₹ 6,16,000 + ₹ 2,70,000)	8,86,000
Wealth tax	Nil
Income-tax	3,50,000
Proposed dividend	60,000
Less : Amount withdrawn from general reserve	(–) 2,00,000
Unabsorbed depreciation	(–) 70,000
Depreciation (normal)	(–) 6,16,000
Amount withdrawn from revaluation reserve to the extent it does not exceed extra depreciation because of revaluation	(–) 1,50,000
Book Profit	**21,16,500**
Tax liability (19.055% of 21,16,500)	4,03,299

D Ltd. will pay ₹ 4,03,299 as tax for the Assessment Year 2013-14 as per section 115JB. Tax credit is however, available in respect excess tax (i.e., ₹ 1,77,791) under section 115JB.

Q. 8. The following details have been supplied by the Karta, of an HUF aged 62 years. You are required to compute its total income and tax liability for the Assessment Year 2013-2014.

Particulars	₹
(i) Profits from business (after charging ₹ 1,00,000 salary to Karta for managing the business)	**15,00,000**
(ii) Salary received by the member of a family	**60,000**
(iii) Director's fee received by Karta from B Ltd where HUF holds 20% shares but he became director because of his qualifications,	**40,000**
(iv) Rental income from house property (after deduction of municipal taxes ₹ 12,000)	**78,000**
(v) Dividends (gross) from Indian companies	**15,000**
(vi) Long-term Capital Gain	**80,000**
(vii) Short-term Capital Gain	**30,000**
(viii) Donation to a school, which is an approved institution	**1,00,000**
(ix) Deposits in Public Provident Fund	**20,000**
(x) NSC-VIII issues purchased	**40,000**

Answer .

Computation of Total Income for the A.Y. 2013-14

Particulars	₹	₹
(i) Income from House Property:		
Gross annual value (₹ 78,000 + ₹ 12,000)	90,000	
Less: Municipal Taxes paid	12,000	
Annual value	78,000	
Less: Statutory deduction: 30% ×78,000	23,400	54,600
(ii) Profits and gains from business		15,00,000
(iii) Capital Gains (a) long-term + (b) short-term		1,10,000
(iv) Income from other sources—gross dividends from Indian companies: Exempt [Sec. 10(34)]		Nil
Gross Total Income		**16,64,600**
Less:		
1. Contribution to approved savings (Sec. 80C)		
(i) Deposits in Public Provident Fund	20,000	
(ii) NSC-VIII Issue	40,000	
	60,000	
2. Donation to recognised school:		
(a) Actual donation: ₹ 1,00,000 or		
(b) 10% of adjusted total income = (Gross Total Income – Long Term Capital Gains – All deductions under Chapter VIA excluding Sec. 80G) of ₹ 15,24,600 (16,64,600 - 80,000 - 60000)		
whichever is less, is qualifying amount.		
Amount of deduction: : 50% of ₹ 1,00,000	50,000	1,10,000
Total Income		**15,54,600**

Computation of Tax Liability:

Particulars of total income	Rate of income tax		₹
	₹	₹	
(a) Long-term Capital Gain	80,000	20%	16,000
(b) Balance of total income: ₹ 14,74,600			
(i) First	2,00,000	Nil	—
(ii) Between 2,00,000 – 5,00,000	3,00,000	10%	30,000
(iii) Between 5,00,000 – 10,00,000	5,00,000	20%	1,00,000
(iv) Between 10,00,000 – 14,74,600	4,74,600	30%	1,42,380
Gross Income Tax			**2,88,380**
Add: Education cess @ 2% on income tax			5,768
SHEC @ 1% on income tax			2,884
Tax Payable			**2,97,032**
Rounded off u/s 288B			**2,97,030**

Note: Assumed applicability conditions of AMT are not satisfied and hence, AMT provisions are not applicable.

Q. 9. A, B and C are three partners (3: 3: 4) of ABC & Co., a LLP engaged in manufacturing leather goods and it has agencies of different companies. The Profit and Loss Account of the LLP for financial year ending March 31, 2013 is as follows:

Particulars	₹	Particulars	₹
Cost of goods sold	7,90,000	Sales	21,22,000
Salary to staff	7,80,000	Long-term Capital Gains	3,00,000
Depreciation	2,50,000		
Remuneration to Partners :			
A	1,92,000	Short-term Capital Gain under section	
B	96,000	111A	55,000
C	1,80,000	Other Short-term Capital Gain	65,000
Interest on capital to partners		Fixed deposit interest	50,000
A	17,000	Other business receipts	2,000
B	30,000	Interest on drawings recovered from A	
C	40,000		16,000
Other expenses	1,65,000		
Net Profit:			
A	21,000		
B	21,000		
C	28,000		
	26,10,000		26,10,000

Other information:

1. **The LLP satisfies conditions of sections 184 and 40(b).**
2. **The LLP is not eligible for deduction under section 80-IA/80-IB.**
3. **The LLP has given donation of ₹ 70,000 to a notified public charitable trust which is not debited to the Profit and Loss Account.**
4. **Up to March 31, 2012, there is no provision in the partnership deed to pay remuneration to partners. The deed is amended on April 1, 2012 to pay remuneration/interest to partners as under:**

Particulars	Remuneration (₹)	Interest on capital (₹)
A	16,000 per month	17 per cent simple interest
B	8,000 per month	15 per cent simple interest
C	15,000 per month	20 per cent simple interest

5. **Depreciation as per section 32 comes to ₹ 95,000**
6. **Other expenses to the tune of ₹ 65,000 is not deductible under sections 30 to 43D.**
7. **For the Assessment Years 2011-12 and 2012-13, the firm has assessed business loss of ₹ 30,000 and Long-term Capital Loss of ₹ 15,000 (which has not been set off so far).**

Answer.

Particulars	₹
Computation of remuneration deductible under section 40(b)	
Net Profit as per P&L A/c (₹ 21,000+₹21,000+₹28,000)	70,000
Add:	
Depreciation debited to P&L A/c	2,50,000
Remuneration to partners (i.e., ₹ 1,92,000+₹96,000+₹1,80,000)	4,68,000
Interest to partners (to the extent not deductible) (i.e., 5/17 of ₹ 17,000 + 3/15 of ₹ 30,000 + 8/20 of ₹ 40,000)	27,000
Other expenses (to the extent not deductible)	65,000
	8,80,000
Less:	
Capital Gain (₹ 3,00,000+₹55,000+₹65,000)	4,20,000
Interest on Bank Fixed Deposit	50,000
Depreciation as per Section 32	95,000
Book Profit	3,15,000
Remuneration deductible (90% of ₹ 3,00,000 + 60% of ₹15000)	2,79,000

Computation of income of the firm	₹	₹
Business Income		
Book Profit	3,15,000	
Less : Remuneration deductible	2,79,000	
Balance	36,000	
Less : Brought forward business loss	30,000	6,000
Long-term Capital Gain (minus brought forward Long-term Capital Loss of ₹15,000)	2,85,000	
Short-term Capital Gain under section 111A	55,000	
Other short-term Capital Gain	65,000	4,05,000
Interest on Fixed Deposit		50,000
Gross total income		4,61,000
Less: Deduction under section 80G [i.e., 50% of 10% of ₹ (4,61,000-2,85,000-55,000)]		6,050
Net Income (rounded off)		4,54,950
Computation of tax of firm		
Long-term Capital Gain (20% of 2,85,000)		57,000
Short-term Capital Gain under section 111A (15% of ₹ 55,000)		8,250
Other Income (30% of ₹ 1,14,950)		34,485
Total		99,735
Add: Surcharge		Nil
Total		99,735
Add: Education cess		1,995
Add: Secondary and higher education cess		997
Tax liability of the firm (rounded off)		1,02,730

Note:

1. Interest recovered from partners is fully taxable.
2. Provisions of Alternate Minimum Tax are not applicable in the above cases.

Q. 10. a) What is the difference between dispersal and diversion of income?

b) In the case of Ms Laxmi, you are required to compute the interest u/s 234A, 234B & 234C from the following details—
Tax on total income ₹ 2,00,000; Due date for filing the return 30.09.2013; Actual date of filing the return 1.10.2014 and tax paid on 30.09.2013 ₹ 2,00,000.

Answer .

a) Dispersal ensures that income accrues separately in different hands. Diversion is said to take place when money is siphoned off to other hands after accrual in one hand. The decision of the *Supreme Court in CIT* v *Sitaldas Thirakhdas* is as to what constitutes diversion as distinct from dispersal. In this case, an amount of annuity decreed by the court to be paid by son to his mother in view of his obligation was held to be dispersal, i.e., diversion by overriding title, so that he was entitled to re-duce such payment from his taxable income. While diversion by overriding title will amount to dispersal, any other diversion without title at source is a mere application of income. The decision of Supreme Court in *CIT* v *Thakar Das Bhargava* illus-trates the principle of application of income, which does not help, where a lawyer who had assigned his right to fees to a charitable institution and had not received the same was still held liable to pay tax on such fees.

b) Computation of interest u/s 234A

Particulars	As per assessed income	
Tax		₹ 2,00,000
Less : Advance tax paid	Nil	Nil
TDS	Nil	
Amount on which interest is payable		₹ 2,00,000
Period of default (October being part of a month shall be considered)		1 month
Interest u/s 234A (1% × ₹ 2,00,000 × 1 month)		**₹ 2,000**

Computation of interest u/s 234B

Since assessee did not pay any amount by way of advance tax, hence she is liable to pay interest u/s 234B.

Particulars	Assessed income
Shortfall	₹ 2,00,000
Period of default (From April to September)	6 months
Interest (1% × ₹ 2,00,000 × 6 months)	**₹ 12,000**

Computation of interest u/s 234A

Due date	Advance Tax Payment ₹	Advance Tax paid ₹	Cumulative Advance Tax paid before due date ₹	Shortfall in Payment ₹	Surplus ₹	Months	Interest @ 1% p.m. ₹
15.9.2012	30% of ₹ 2,00,000 = 60,000	Nil	Nil	60,000	—	3	1,800
15.12.2012	60% of ₹ 2,00,000 = 1,20,000	Nil	Nil	1,20,000	—	3	3,600
15.3.2013	100% of ₹ 2,00,000 = 2,00,000	Nil	Nil	2,00,000	—	1	2,000
							7,400

Total interest payable

Particulars	Amount
U/s 234A	2,000
U/s 234B	12,000
U/s 234C	7,400
Total	**21,400**

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Q. 11. Compute the Advance Tax payable by R from the following estimated income submitted for the Previous Year 2012-13.

Particulars	₹
(1) Income from Salary	**3,64,000**
(2) Rent from house property (per annum)	**1,80,000**
(3) Interest on Government securities	**5,000**
(4) Interest on bank deposits	**3,000**
(5) Receipt from horse race (net)	**14,000**
(6) Agricultural Income	**90,000**
(7) Contribution towards PPF	**10,000**

Tax deducted at source by the employer on salary is ₹ 9,680.

Answer

Computation of Estimated Total Income for the Previous Year 2012-13

Particulars	₹	₹
Income from Salary: Gross salary	3,64,000	
Less : Deduction	Nil	3,64,000
Income from House Property: Rent received	1,80,000	
Less : (Statutory deduction u/s 24(a) @ 30%)	54,000	1,26,000
Income from Other Sources: Interest on Government securities	5,000	
Interest on Bank Deposit	3,000	
Horse Races (Gross)	20,000	28,000
Estimated Gross Total Income		5,1 8,000
Less : Deduction under section 80C		10,000
		5,08,000
Estimated Tax: Step-1 : Aggregate of Agricultural income + Non-Agricultural income (90,000 + 5,08,000) = 5,98,000		
Tax on: Income from Horse Race of ₹ 20,000 @ 30%	6,000	
Balance income of ₹ 5,78,000	45,600	
		51,600
Step-2 : Aggregate of Basic exemption limit of agricultural income (2,00,000 + 90,000) = 2,90,000		
Tax on ₹ 2,90,000		9,000

Step-3 : Tax on non-agricultural income		
Tax under step-1 - Tax under step-2 (51,600 – 9,000) = 42,600		
Estimated tax payable		42,600
Add: Education cess @2%		852
Add: SHEC @1%		426
Less : Estimated TDS		43,878
on salary	9,680	
on horse races	6,000	15,680
Advance tax payable (rounded off)		28,198
First installment payable by 15.9.2012 (30%)		8,459
Second installment payable by 15.12.2012 (30%)		8,459
Third installment payable by 15.3.2013 (balance 40%)		11,280
Working notes:		
1. Computation of gross winnings from horse races:		₹
Net Amount		14,000
Grossing up 14,000 X100/70		20,000
Tax deducted at source (Gross amount ₹ 20,000 – Amount received ₹ 14,000)		6,000

2. Interest on Bank deposit assumed not to be from savings deposit.

Q. 12. From the following dated furnished by Mr.Soumitra, determine the value of house property built on leasehold land as at the valuation date 31.3.2012 :

Particulars	₹
Annual Value as per Municipal valuation	1,40,000
Rent received from tenant (Property vacant for 3 months during the year)	1,08,000
Municipal tax paid by tenant	10,000
Repairs on property borne by tenant	8,000
Refundable deposit collected from tenant as security deposit which does not carry any interest	50,000
The difference between unbuilt area and specified area over aggregate area is 10.5%.	

Answer.

Assessee: Mr. Soumitra Valuation Date: 31.3.2012 Assessment Year: 2013-14

Computation of Value of House Property

Step I: Computation of Gross Maintainable Rent(GMR)

Particulars	₹	₹
Actual Annual Rent- ₹ 1,08,000 x 12 Months/9 Months		1,44,000
Add: Municipal tax paid by the Tenant	10,000	
I/9th of Actual Rent Receivable as repair expenses are borne by the tenant - ₹ 1,44,000/9	16,000	
Interest on Refundable Security Deposit- ₹ 50,000 x 15% x 9/12	5,625	31,625
GROSS MAINTAINABLE RENT (GMR)		17,05,625

Step II: Computation of Net Maintainable Rent (NMR)

Particulars	₹	₹
Gross Maintainable Rent (GMR) Less: Municipal Taxes levied by the local authority 15% of Gross Maintainable Rent - ₹ 1,75,625 x 15%	 10,000 26,399	1,76,000 (36,399)
NET MAINTAINABLE RENT (NMR)		1,39,281

Step III: Capitalisation of the Net Maintainable Rent (CNMR) (Assumed that unexpired lease period is more than 50 Years)
NMR × Multiple Factor for an Unexpired Lease Period - ₹ 1,39,281 × 10 = ₹ 13,92,810

Step IV: Addition of Premium to SNMR in case of excess inbuilt area:

Particulars	₹
Add: Capitalisation of the Net Maintainable Asset Premium for excess of 10.5% unbuilt area over specified area-30% of CNMR	13,92,810 4,17,843
Value of House Property as per Wealth Tax Act	18,10,653

Q. 13. a) Net wealth of firm consisting of three partners Bidyut, Kingshuk and Deepak in 2:2:1 and a capital contribution of ₹17 Lakhs, ₹13 Lakhs, and ₹12 Lakhs respectively is as under -

(a) Value of assets located outside India	**₹ 30,00,000**
(b) Value of assets located in India	**₹ 80,00,000**
(c) Debts incurred in relation to assets in India	**₹ 40,00,000**

Determine the value of interest of the partners in the firm under the Wealth Tax Act, 1957.

b) 'X' received a vacant site under his father's will. The value of the site on 31.3.2013 is ₹15 Lakhs. As per terms of the 'Will' in the event 'X' wants to sell the site he should offer it to his brother for sale at ₹10 Lakhs. 'X', therefore, claims that the value of the site should be taken at ₹10 Lakhs as at 31.3.2013. Is the claim correct?

Answer.

a) Assesses : Bidyut, Kingshuk & Deepak Valuation Date : 31.3.2013 Assessment Year: 2013-14

Computation of net wealth of the Firm

Particulars	₹	₹
Value of Assets located in India **Less**: Liability in relation to assets in India Value of Assets located outside India	80,00,000 40,00,000 	 40,00,000 30,00,000
Net Wealth of the Firm		70,00,000

b) As per Rule 21 of Schedule III to the Act, the **price or other consideration for which** any property may be **acquired by or transferred to any person under the terms of a deed of trust** or through or under any restrictive agreement in any instrument of transfer **shall be ignored** for the purpose of determining the value under the provisions of the Schedule.
In view of the above, the value of the site should be taken as ₹ 15 Lakhs and not as ₹ 10 Lakhs.
Therefore, **claim of X is incorrect.**

Q. 14. a) Raja, an individual was carrying on a business as sole proprietor. On his death, his legal heirs decided to continue the same business by forming a firm. At the time of death, Raja had a determined business loss of ₹ 3 lakhs, under the provisions of the Income-tax Act, to be carried forward. Does the firm, consisting of all the legal heirs of Raja, get a right to have this loss adjusted against its current income ? Discuss.

b) Bharat Ltd. Purchased a flat for a sum of ₹ 6.5 lakhs in 1979, which was allowed to be used by Mr. Pratap, Director, as residence free of rent. On retirement of Pratap from the Company in 2012, Bharat Ltd. Sold the flat to Pratap for a sum of ₹ 6.5 lakhs on the plea that it was a tenated property and hence could not be sold for a higher price. Discuss the impact of these transactions in the hands of Bharat Ltd and Mr. Pratap.

Answer

a) Under section 78, on death of an individual, if the legal heirs carry on the business of the individual by forming a Partnership, then the firm is entitled to carry forward the loss of individual. [Madhukant Mehta 247 ITR 805 (SC)]. In the instant case, the carry forward business loss in the hands of late Mr. Raja can be set off against the income of the firm subject to the following conditions :

(i) The legal heirs are the only partners and no other outsiders are involved

(ii) The business carried on belongs to the deceased assessee.

In view of the Supre me Court decision given above, they are entitled to carry forward and set off Mr. Raja's business loss of ₹ 3 lakhs.

b) In the hands of Bharat Ltd. : Under Section 50C, where any land or building is transferred and if the value is below the value determined by Stamp Duty Valuation Authority, then Capital Gains shall be computed on the value determined by Stamp Duty Valuation Authority.

Capital Gain = value determined by Stamp Duty Valuation Authority or Actual Consideration (whichever is higher)

Less : Indexed cost of acquisition

In the hands of Mr. Paratap : The difference between ther Fair Market Value of the house and the consideration paid shall be treated as perquisite u/s/ 17(2) and chargeable under the head "Salaries".

Q. 15. a) An interest free loan of ₹ 60 lakhs was given by Raja Ltd. to its sister concern Rani Ltd. (which sells its entire production to Raja Ltd.) for procurement of raw material available at a discount on cash payment. Assessing Officer proposes to disallow the interest paid on loans by Raja Ltd. To the extent of interest foregone by advancing loan to Rani Ltd.. Is the action of A.O. correct ?

b) A company had an inventory of closing stock on 31.03.2013, the cost of manufacture of which was ₹ 12 lakhs. Since the goods were liable to excise duty, a provision of ₹ 12 lakhs, towards the duty was also made in the accounts. Since the excise duty was eligible for deduction only on actual payment, the Company valued the closing stock at cost viz. ₹ 12 lakhs. Discuss the position from the taxation point of view.

Answer

a) There should be nexus between the interest expenditure and the purpose of the business which need not necessarily be the business of the Assessee himself. [S.A. Builders Ltd. Vs. CIT 206 CTR 631 (SC)]

Interest paid on the borrowed capital for the purpose of business is deductible irrespective of the fact that substantial amount was outstanding and due from its sister concern [Caldern Pharmaceuticals Ltd. 136 Taxman 531 (Cal.)]

On the basis of the above, the AO's action to disallow interest paid by Raja Ltd. To the extent of interest foregone by advancing loan to Rani Ltd. Is incorrect.

b) Under section 145A, any tax, cess, duty or fee actually paid or incurred by the assessee to bring the goods to the place of the location and condition as on the valuation date should be added to the cost of manufacture for determining the value of the goods.

Therefore, the company should add the excise duty payable on the goods to the cost of ₹ 12 lakhs.

Section 43B is applicable only for the allowability of excise duty paid, and has no bearing on valuing closing stock on the Balance Sheet date. Therefore, the company's contention is not correct.

Q. 16. a) Suvam & Co. started two separate industrial undertaking, which prima facie are eligible for deduction u/s 80-IB. For the year ending 31.03.2013, the profit of one unit was ₹ 5 lakhs while the other unit suffered a loss of ₹ 1 lakh.
The Assessing Officer has allowed the deduction u/s 80-IB on the net profit of ₹ 4 lakhs. Discuss the validity of the order of the AO?

b) Mr. Asrani won the first prize in a quiz show and the prize was a Maruti Car worth ₹ 3.60 lakhs. According to Sec 194B, tax has to be deducted at source from the winning of the show at the time of payment of the prize money. What is the procedure to be adopted handling over the Maruti Car to Mr. Asrani ?

Answer
Under section 80 IB deduction is available in respect of the profits or gains derived from the eligible industrial undertaking of the assessee. [Canara Workshops Pvt. Ltd. 161 ITR 320 (SC)].
Even section 80 IB expressly provides that the deduction under this section shall be calculated on the gains derived from such undertaking.
In view of the above, Suvam & Co. is entitled for deduction u/s 80 IB at 25% of income derived from first undertaking, not on the net income from the two undertakings.
Hence, the eligible deduction for the AY 2013-2014 is ₹ 1,25,000 (₹ 5,00,000 x 25%)
Total income shall be net income from both the undertakings less deduction u/s 80 IB i.e. ₹ 4,00,000 less ₹ 1,25,000 = ₹ 2,75,000. Therefore, the action of the AO is not valid in law.

a) Under proviso to section 194B, where ainnings are wholly in kind or partly in cash and partly in kind, but the part in cash is not sufficient to meet the liability of deduction of tax in respect of the whole of the winnings, the person responsible for making the payment shall, before releasing the winnings, ensure that tax has been paid in respect of the winnings.
Hence, where the prize is not in cash but in kind, then the winner of the prize shall deposit the amount of tax on the value of the prize won in kind and then claim the prize.
The person conducting the show should collect tax equivalent to ₹ 1,08,000 i.e. 30% x value of the car from Mr. Asrani before handing over the Maruti car to him. [Note : Where the winnings exceed ₹ 10,000 the entire winnings are liable for TDS.]

Q. 17. a) What is a protective assessment under Income-tax law? What is the procedure followed for the recovery of tax in such cases?

b) What do you mean by annexure less return? What is the manner of filling the return of income?

Answer.

a) A protective assessment is made in a case where there are doubts relating to the true ownership of the income. If there is an uncertainty about the taxing of an income in the hands of Mr. A or Mr. B, then at the discretion of the Assessing Officer, the same may be added in the hands of one of them on protective basis. This is to ensure that on finality, the addition may not be denied on the ground of limitation of time. Once finality regarding the identity of the tax payer to be taxed is established, the extra assessment is cancelled. But the Department cannot recover the tax from both the assessees in respect of the same income. Penalty cannot be imposed on the strength of a protective assessment.

b) The return of income required to be furnished in Form No.ITR-1,ITR-2,ITR-3,ITR-4,ITR-5 or ITR-6 shall not be accompanied by a statement showing the computation of the tax payable on the basis of the return, or proof of the tax, if any, claimed to have been deducted or collected at source or the advance tax or tax on self-assessment, if any, claimed to have been paid or any document or copy of any account or Form or report of audit required to be attached with the return of income under any of the provisions of the Act.
Manner of filling the return: The return of income referred to in sub-rule (1) may be furnished in any of the following manners, namely:-
(i) Furnishing the return in a paper form;
(ii) Furnishing the return electronically under digital signature;
(iii) Transmitting the data in the return electronically and thereafter submitting the verification of the return in Form ITR-V;
(iv) Furnishing a bar-coded return in paper form.

Q. 18. a) An assessee has filed a belated return showing a business loss. What is the remedy available to him for carry forward and set off of the said loss?

AG Ltd. filed its return of loss for the Assessment Year 2013 – 2014 on 10.01.2014 beyond the time prescribed u/s 139(3) declaring a total loss of ₹ 12,00,000. It approaches you for your advice regarding the course of action to be taken to secure the benefit of carry forward of the business loss for set off against future profits. Advise the company suitably.

b) Sawant is a fashion designer having lucrative business. His wife is a model. Sawant pays her a monthly salary of ₹ 20,000. The Assessing Officer, while admitting that the salary is an admissible deduction, in computing the total income of Sawant, had applied the provisions of Sec. 64(1) and had clubbed the income (salary) of his wife in Sawant's hands.
Discuss the correctness of the action of the Assessing Officer.

Answer. a)

A. CBDT's Powers: CBDT has the powers to condone the delay in filing return in cases having claim of carry forward of losses. **[Associated Electro Ceramics vs. CBDT 201 ITR 501 (Kar.)]**

B. Monetary limits prescribed for the condonation of delay are as under – **[Cir. No. 8/2001 dt. 16.5.2001]**

Refund claimed	Authority empowered to condone
Upto ₹ 10,000	Assessing Officer with the prior approval of the CIT
₹ 10,001 - ₹ 1,00,000	Assessing Officer with the prior approval of the CCIT / DGIT
₹ 1,00,001 and above	Central Board of Direct Taxes

C. Analysis and conclusion: Here, since the loss of AG Ltd. is ₹ 12,00,000, the authority empowered to condone the delay is CBDT. Hence, AG Ltd. has to file a condonation petition to the CBDT to carry forward the business loss.

b) Where an individual has got substantial interest in a concern and his spouse derives any income from such concern by way of salary, commission, fees or by any other mode, such income is clubbed with the total income of such individual [Sec. 64(1)(ii)].
However, clubbing provision does not apply if the earning spouse holds technical or professional qualification and the income is solely attributable to the application of such knowledge and experience.
Salary earned by wife as model from the concern where her husband holds substantial interest is assessable as her income.

Q. 19. a) A Company, incorporated for the manufacture of steel, had not commenced production. The plant and machinery was in the stage of erection. During the Previous Year ending 31.3.2013, it paid interest on borrowings, amounting to ₹ 20 Lakhs. It also received interest of ₹ 1.50 Lakhs on investment in short-term deposits of moneys not immediately required for business. The Assessing Officer assessed the interest income under other sources. Discuss the correctness of the assessment.

b) Discuss the admissibility or otherwise of the following claims in connection with assessment to income-tax. They do not necessarily relate to the same assessee:

(i) An expenditure of ₹ 1,00,000 was incurred on the occasion of the silver jubilee of the company for presentation of silver mementos to shareholders and directors, the value of each memento being ₹ 1,000 only.

(ii) An assessee carries on business in respect of which it holds tenancy rights. It carries out improvements to the said building at a cost of ₹ 2,00,000 and claims depreciation @ 10% thereon. The assessing officer rejects the claim on the ground that the assessee is not the owner of the building.

(iii) Excise duty amounting to ₹ 2,00,000 for the period 2012-13 was paid by the company by 30-9-2012 before furnishing the return of income for the Assessment Year 2013-14.

(iv) A criminal case was filed against a company under the Essential Commodities Act, 1955. The company incurred litigation expenses amounting to ₹ 50,000 to defend the directors. The directors were ultimately acquitted.

(v) A company was generating electricity privately for its factory. Later, at its expense, electric lines were laid from the trunk road to the factory. It paid ₹ 5,00,000 to the State Electricity Board as its contribution for this purpose. The ownership of the power-line was to vest with the State Electricity Board.

(vi) X and Y are two shareholders of Pooja Ltd., a closely held company. X holds 55% share capital on 30-1-2012, X transfers his shares to A. Pooja Ltd. wants to set of brought forward loss of ₹ 4,00,000 (business loss ₹ 1,00,000; unadjusted depreciation ₹ 3,00,000) of the Previous Year 2011-12 against the income of the previous year 2012-13 (i.e., ₹ 9,00,000). Can it do so?

Answer.

(a) Interest on surplus funds: Interest income earned on deposits made out of surplus funds before commencement of business is taxable as "Income from Other Sources".
In view of the above judgment, the sum received as interest on deposits shall be charged to tax under the head 'Income from Other Sources'.
No part of the interest paid on the loan borrowed shall be allowed as deduction u/s 57 as the same was not borrowed wholly and exclusively for the purpose of earning such interest. Whole of such interest shall be capitalised.
Therefore, the action of the Assessing Officer is correct.

b)

(i) As per the decision of the Apex Court in the case of *Aluminum Corporation of India Ltd.* v *CIT* (1972) 86 ITR 11 (SC) and various other decisions, where an expenditure is incurred for commercial expediency, the same shall be allowed as deduction under section 37(1). If at the time the expenditure is incurred, commercial expediency justifies it, it will be taken to be for the purpose of the business even though not supported by any prevailing practice.

Presentation of silver mementos to the directors and shareholders on the occasion of silver jubilee is to motivate both the directors and the shareholders. The expenditure has been incurred on account of commercial expediency and should qualify for deduction under section 37(1).

(ii) According to Explanation to section 32(1) where the business or profession of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purposes of the business or profession on the construction of any structure or doing of any work, in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of section 32 shall apply as if the said structure or work is a building owned by the assessee. Hence, depreciation in this case will be allowable.

(iii) As the excise duty has been paid on or before the due date of furnishing return under section 139(1) in respect of the previous year in which the liability to pay such sum was incurred, the same shall be allowed as deduction on due basis as per section 43B.

(iv) Section 37(1) does not make any distinction between expenditure incurred in civil litigation and that incurred in criminal litigation. All that the court has to see is whether the legal expenses were incurred by the assessee in his character as a trader, in other words, whether the transaction in respect of which proceedings are taken arose out of and was incidental to assessee's business. Further, it is to be seen whether the expenditure was *bona fide* incurred wholly and exclusively for the purpose of the business. [*CIT* vs. *Birla Cotton Spg. & Wvg. Mills Ltd.* (1971) 82 ITR 166 (SC)]. In view of this, the litigation expenses of ₹ 50,000 incurred in defending directors is deductible under section 37(1).

(v) The new electric power lines were laid to run the factory efficiently but since the ownership of the power lines was to vest with the State Electricity Board, the contribution of ₹ 5,00,000 paid to the State Electricity Board shall be allowable as revenue expenditure under section 37(1).

(vi) According to section 79 the losses of a closely held company can be carried forward and set off in the subsequent assessment year only when at least 51% of the shares of the company carrying voting rights are held by the same persons as on the last day of the Previous Year in which the loss was incurred and the last day of the previous year in which the losses are set off. In this case business loss will not be allowed to be set off but unabsorbed depreciation is not a loss and shall be allowed to be set off.

Q. 20. a) The Assessing Officer has served a notice proposing to levy penalty under section 271(1)© of the Income Tax Act 1961, as the variation of income assessed to income returned and also the tax effect was more than 30%. The addition arose consequent to the disallowance of claim of assessee. The assessee wants to reply to the effect that there was no mens rea or conscious act of concealment on his part and that the claim made was bonafide, the levy of penalty under section 271(1)© is not valid. You are requested to help the assessee in this regard in drafting a suitable reply.

b) Mr. Pradip, a foreign technician is employed with an Indian company. His contract of service was approved by the Government. He was in receipt of bonus from the said Company where he is working. The Assessing Officer subjected the amount to tax on the ground that bonus receipt falls outside the purview of the contract of service. Is the Assessing Officer justified?

Answer

a) Merely because the assessee had claimed the expenditure, which claim was not accepted or was not acceptable to the revenue, that by itself would not, attract the penalty under section 271(1)© as it does not amount to furnishing of inaccurate particulars. [Reliance Petroproducts Pvt. Ltd. (2010) 322 ITR 158, CIT vs. Vijay Kumar Jain 325 ITR 378 (Chhattisgarh)].

Since in the given case the penalty is rejected due to disallowance of the claim made by the assessee on an honest belief, the assessee can put forth the above supreme court decision in his reply to the notice issued by AO.

b) U/s 9(1)(ii) salary earned in India is deemed to accrue or arise in India and is taxable in India. The salary and bonus paid to a foreign technician for services rendered in India is taxable in India and the same is not entitled for any exemption from the Assessment Year 2008-09 onwards.

Q. 21. a) An assessee made an application u/s 32E of the Central Excise Act, 1944 to the settlement commission. The settlement commission was not satisfied saying that the applicant had not made a true and full disclosure of his duty liability and the manner in which same was arrived at was also not correct and rejected the application. The assessee contended that obligation to make truthful disclosure of duty liability would arise only after the application was admitted and not before that. Is plea taken by the assessee acceptable in law? Explain in brief, with the help if a decided case law, if any.

b) Sun Academy Pvt. Ltd., is providing commercial training services since, 2009. During the year 2011-12 service tax liability arises to pay was ₹ 12,00,000. However, service tax paid was paid ₹ 8 lacs after adjustment of CENVAT CREDIT of ₹ 4 lacs. In the month of April 2012, 60 students were joined for pursing Point of Taxation Rules (from 1st April'12 to 1 0th April'12). Fee per student is ₹ 3,000 (inclusive of Service tax) paid by all students the month of June 2012. Service Tax @12.36% paid on 5th July 2012. Calculate the following:
(i) Point of Taxation
(ii) Due Date
(iii) Service Tax liability
(iv) Interest if any
(v) Penalty under Sec. 76 of the Finance Act, 1994, if any.

Answer.

a) The applicant is not correct.

The matter of the case is similar to the case of Customs & Central Excise Settlement Commission v. Mars Therapeutics & Chemicals Ltd. 2008 (223) ELT 363 (HC). The High Court held that the application made u/s 32E of the Central Excise Act, 1944 could be admitted and proceeded with only when Settlement Commission is satisfied that the application has made true and full disclosure of the duty liability and the manner in which the same was arrived at.

The High Court clarified that the onus is on the applicant to make full and true disclosure of the duty liability and the manner in which the same was arrived at and the Settlement Commission will admit the application only when it is satisfied on the true and full disclosure of the duty liability and the manner it was arrived at. Further, the object behind the enactment of the provisions of Settlement Commission is the creation of a forum of self surrender and true confession and to have matter settled once for all. It is not a forum to challenge the legality of the order passed under the provisions of the Act.

b) (i) Point of taxation = April 2012

(ii) Due date = 6th May 2012

(iii) Service tax = ₹ 19,800 (i.e. 3,000 x 60 x 12.36/112.36)

(iv) Interest = ₹ 586 (i.e. 19,800 x 18/100 x 60/365)

(v) Penalty = ₹ 6,000

i.e. ₹ 100 x 60 days = ₹ 6000 or ₹ 391 (19,800 x 12/1 00x 60/365) whichever is higher

Q. 22. State briefly with reasons whether credit under the CENVAT Credit Rules, 2004 would be available in the following cases :

(a) Inputs are pilfered from the store-room

(b) Final product is cleared in durable and returnable packing material

(c) Assessee was purchasing chlorine gas in cylinders, but, after use, a small part of it was left in cylinders (unavoidable) and returned to supplier. Duty was paid on full quantity of chlorine gas purchased. Does quantity left and returned in cylinders qualify as 'input'?

(d) Inputs used in trial runs

(e) Cenvat credit of ₹ 20,000 was taken on certain inputs. Due to long-storage, they have become unfit and were sold as scrap for ₹ 5,000 and excise duty is 12.36%

Answer .

a) NO. Goods must be used within factory of production and must have some relation with manufacture so as to qualify as 'input' under rule 2(k). Since input "pilfered" (theft) are never "used", hence, they are not input and credit is not admissible.

b) YES. Goods must be used within factory of production and must have some relation with manufacture so as to qualify as 'input' under Rule 2(k). Cost of durable and returnable packing a part of cost of production, which forms part of value liable to duty. Further, packing is a part of process of manufacture. Hence, it is 'input' and credit is admissible.

c) YES. Goods must be used within factory of production and must have some relation with manufacture so as to qualify as 'input' under Rule 2(k) . Since it was impossible to use total quantity of chlorine gas and some quantity left out was unavoidable, hence, quantity left out was "used" within factory. Hence, credit was admissible on left out portion also – CCEx v. Andhra Paper Mill Ltd. 2011 269 ELT 79 (AP).

d) YES. As inputs used in trial runs are necessary for manufacture, hence, they are eligible as 'input'.

e) Since input were never used for production, question of their qualifying as input doesn't arise. Hence, credit taken earlier must be reversed.

Q. 23. a) Determine the taxable turnover, input tax credit and net VAT payable by a works contractor from the details given below on the assumption that the contractor maintains sufficient records to quantify the labour charges. Assume output VAT at 12.5%:

	₹ lakhs
(*i*) Total contract price (excluding VAT)	**100**
(*ii*) Labour charges paid for execution of the contract	**35**
(*iii*) Cost of consumables used not involving transfer of property in goods	**5**
(*iv*) Material purchased and used for the contract taxable at 12.5% VAT (VAT included)	**45**

The contractor also purchased a plant for use in the contract for ₹ 10.4 lakhs. In the VAT invoice relating to the same VAT was charged at 4% separately and the said amount of ₹ 10.4 lakhs is inclusive of VAT.

Assume 100% input credit on capital goods. Make suitable assumption wherever required and show the working notes.

b) When VAT Registration can be cancelled ?

Answer .

a)

	₹ lakhs
Total contract price (excluding VAT)	100.00
Less: Labour charges paid for execution of the contract	(35.00)
Less: Cost of consumables used not involving transfer of property in goods	(5.00)
Taxable Turnover	60.00
VAT @12.50% on ₹ 60 lakhs	7.50
Less: ITC ₹ 45 lakhs x 12.50/112.50	(5.00)
Less: ITC ₹ 10.40 lakhs x 4/104	(0.40)
Net VAT payable	2.10

b) Registration can be cancelled in the following cases

i. Dealer ceases to exist for which he got registered under respective state VAT Act.
ii. Dealer got insolvent
iii. Change of business constitution.
iv. Amalgamation or liquidation of company
v. Sale of entire business.

Q. 24. a) Briefly explain whether the following units are eligible for the benefits under Not. Nt. 8/2003-CE dated 1.3.2003 during the financial year 2012-13 as Small Scale Industry.

(i) ABC Ltd. Had registered a turnover for the purposes of the above Notification of ₹ 4.2 crores in the financial year 2011-12. Due to recession in the industry, they anticipate a fall in turnover of 20% in 2012-13, when compared to the year 2011-12.

(ii) MNP Ltd. Has started its manufacturing operations in the year 2012-2013 with an investment of ₹ 3.5 crores in plant and machinery and hope to achieve a sales turnover of ₹ 2 crores in 2012-13.
b) A Ltd. provided services valuing ₹ 8 lakhs during the financial year 2011-12. During 2012-2013, it has provided taxable services valuing ₹ 10 lakhs and has received payments towards payable services ₹ 8.5 lakhs. It has also received services in the nature of transport of goods by road on 1-4-2012, valuing ₹ 50,000 (exclusive of service tax), in respect of which it is the person liable to pay service tax. Freight has been paid on 10-6-2012. Compute the service tax, if any, payable by A Ltd. for the financial year 2012-2013. It is given that goods transport service is exempt to the extent of 75% of value thereof.

Answer.

a) (i) No, ABC Ltd. Will not be eligible for SSI exemption in F.Y. 2012-13, as turnover of preceding year 2011-12 exceeded ₹ 400 lakhs

(ii) Yes, MNP Ltd. Is eligible for SSI exemption during 2012-13 (being first year of its operation) because turnover during preceding year 2011-12 cannot be said to exceed ₹ 400 lakhs.

b) Value of transport services received = ₹ 50,000
Less: abatement 75% on ₹ 50,000 = ₹ 37,500
Taxable services ₹ 12,500
Service tax liability in the hands of A Ltd (2012-13) = ₹ 1,545 (i.e. ₹ 12,500 x 12.36/100)
Note:
i) The company is eligible for small service provider exemption during the financial year 2012-13, as the value of taxable services provided during financial year 2011-12 does not exceed ₹ 10 lakhs.
ii) For the value of taxable services provided during the financial year 2012-13, no tax liability would arise, as the payments received or services provided do not exceed ₹ 10 lakhs. However, for goods transport agency services received, in respect of which M/s. A Ltd. is the person liable to pay service tax, the company cannot claim for small service provider exemption.

Q. 25. a) A show cause notice demanding customs duty was issued case of clearances made by 100% Export Oriented Undertaking (EOU) to Domestic Tariff Area (DTA). Is the show-cause notice defective in law ?

b) Compute the VAT liability of Mr. X for the month of January 2013, using 'invoice method' of computation of VAT, from the following particulars:-
Purchase price of the inputs purchased from the local market (inclusive of VAT) ₹ 52,000
VAT rate on purchases 4%
Storage cost incurred ₹ 2,000
Transportation cost ₹ 8,000
Goods sold at a profit margin of 5% on cost of such goods
VAT rate on sales 12.5%

Answer .

a) In case where goods manufactured or produced by 100% EOU are cleared to DTA, proviso to section 3 of the Central Excise Act, 1944 provides for the levy of central excise duty equal to customs duty. The duty levied is excise duty, but only quantum thereof is equal to customs duty.
Hence, the show-cause notice demanding "customs duty" is defective law.

b) Cost of Purchases = ₹ 52,000 x 100/104 =	₹ 50,000
Add: Storage cost and transportation cost =	₹ 10,000
Total cost =	₹ 60,000
Addl profit 5% on Cost (₹ 60,000 x 5%) =	₹ 3,000
Taxable Turnover =	₹ 63,000
Add; VAT on Taxable Turnover (₹ 63,000 x 12.50%) =	₹ 7,875
Net VAT Tax liability	
VAT payable on Sales =	₹ 7,875
Less: ITC (₹ 52,000 – ₹ 50,000) =	₹ 2,000
Net VAT liability payable by Mr. X for the month of Jan 2013 =	₹ 5,875

Q. 26. a) State with reasons in brief whether the following statement is true or false with reference to the provisions of Service Tax.
Mr Rahim, an interior designer has received an advance amount of ₹ 5,16,300, after deduction of Income Tax of ₹ 53,100. The Service Tax is payable on ₹ 5,16,300.

b) Determine PoP in the given case - An architect based in Kolkata provides his service to an Indian Hotel Chain (which has business establishment in Mumbai) for its newly acquired property in Muscat.

Answer .

a) Service Tax is to be paid on the value of Taxable Service, which is charged by a Service Tax Assessee. Income Tax deducted at source is included in the charged amount. Service Tax is, therefore payable on the total amount inclusive of the Income Tax deducted at source.
Hence, the given statement is false. Service tax is payable on 5,16,300 + 53,100 = ₹ 5,69,400.

b) If Rule 5 (Property Rule) were to be applied, the place of provision would be the location of the property i.e., Muscat (outside the taxable territory). With this result, the service would not be taxable in India.
Whereas, by application of Rule 8, since both the provider and the receiver are located in taxable territory, the place of provision would be the location of the service receiver i.e. Mumbai. Place of provision being in the taxable territory, the service would be taxable in India.
By application of Rule 14, the later of the Rules i.e. Rule 8 would be applied to determine the place of provision. The service would be taxable in India.

Q. 27 a) A manufacturer of cameras sells leather cases/soft cases and instruction manuals along with the cameras. The cost of such cases and manuals were being charged separately apart from the cost of the camera. The excise department has claimed that the cost of such cases and manuals should be included in the assessable value of the camera. According to the excise department as per Rule 5 of the Interpretative Rule for Central Excise Tariff brought into force from 28.2.2005, cases for camera, musical instruments, drawing instruments, necklaces etc. specially shaped for that article, suitable for long-term use will be classified along with that article, if such articles are normally sold along with such

cases. Examine briefly with the help of decided case law, if any, whether stand taken by department is correct.

b) Write short notes on duty deferment under the Customs Act, 1962.

Answer

a) Concept of valuation is different from that of classification. Goods are valued in the condition in which they are removed from the place of removal.

The facts of this case are identical to that in CCEx v. PHIL Corporation 2005 180 ELT 311 (SC) wherein it was held that –

- Classification under same heading : As per Rule 5 of Interpretative Rules of the Tariff, camera cases were classified in the same heading as the camera.
- Camera case was accessory and was to be valued separately : Leather cases/ soft cases and instruction manuals supplied with cameras which were charged separately by the assessee were not components but were merely accessories. Hence, they were to be valued separately.

Stand taken by Department as regards classification was correct, but as regards valuation was incorrect.

b) Section 143A authorizes AC/DC of Customs to permit clearance of certain materials without payment of duty.

The materials are imported under an Import Licence belonging to the category of the Advance Licence granted under the Imports and Exports (Control) Act, 1947, subject to the condition that the goods are exported within the specified time mentioned in the said licence.

On export of the goods, the duty payable on the imported goods are to be adjusted against the duty drawback admissible to the exported goods.

If however, the duty (import duty) cannot be adjusted due to failure of meeting the export obligation, the importer has to pay such duty along with simple interest @ 12% p.a., from the date of grant of permission u/s 143A till the date of actual payment.

While permitting clearance, the AC/DC of Customs may require the importer to execute a bond with suitable surety or security.

Q. 28 a) 'Smartphone' is in the business of providing mobile telephone service. The assessee sells 'SIMCARDS" to its mobile telephone subscribers for a price. 'Smartphone' pay service tax on the activation and other charges. On the 'SIMCARDS' sold to the customers, VAT under the applicable State Law is paid. The department's view is that the 'SIMCARD' is used for provision of mobile services and is a part of the service and therefore the value of the 'SSIMCARD' has to be included in the category of 'telecommunication services' for purpose of service tax.

Explain with a brief note and reference to decided case law whether the view taken by the department is correct in law.

b) M/s. ABCL, providing management consultancy to its client, do not maintain any separate accounts and have paid ₹ 1,50,000 as service tax and excise duty towards input services and input material/ capital goods used by them. They have used the inputs for partially exempted and partially taxable services. They are now providing the output services for which current tax liability is ₹ 2,00,000. How much credit out of ₹ 1,50,000 can be available by them for paying output service tax liability, if they do not maintain any separate accounts ?

Answer.

a) Yes, the view taken by the Department is correct is law. The facts of the above case are similar to the case of CCEx v. Idea Mobile communications Ltd. 2010 19 STR 18 (Ker.). The High Court, while examining the functioning of a SIM Card, admitted that SIM Card is a computer chip having its own SIM number on which telephone number can be activated. SIM card is a device through which customer gets connection from the mobile tower. Unless the SIM card is activated, service provider cannot give service connection to the customer because signals are transmitted and conveyed through towers and through SIM Card communication signals reach the customer's mobile instrument. Hence, it can be inferred that it is an integral part required to provide mobile service to the customer.

Further, SIM Card has no intrinsic value or purpose other than use in mobile phone for receiving mobile telephone service from the service provider. Thus, the Court accepted the view that SIM cards, were not goods sold or intended to be sold to the customer, but supplied as part of service. Consequently, it held that the value of SIM card supplied by the assessee would form part of the value of taxable service on which service tax was payable by the assessee.

b) With effect from 1.4.2011, Rule 6(3) of the Cenvat Credit Rules, 2004 inter alia provides that where common input/ input services are used for providing taxable as well as exempted services and separate accounts are not maintained, the output service provider has the following options at his disposal :

(i) Pay an amount equal to 6% of the value of exempted services; or

(ii) Pay an amount as determined under Rule 6(3A) of CCR, 2004 i.e., Reverse the Cenvat Credit attributable to the inputs and input services used for providing exempted services.

(iii) Maintain separate accounts for inputs as provided for in Rule 6(2)(a) of CCR, 2004 and take credit of only those inputs which are used for provision of output services excluding exempted services. In addition, a service provider has to pay an amount determined in accordance with Rule 6(3A) in respect of input services.

In absence of any details to that effect, the relevant calculations cannot be made.
There is no other restriction as to utilization of Cenvat credit availed.

Q. 29 a) A manufacturer having a factory at Mumbai has uniform price of ₹ 2,000 per unit (exclusive of taxes and duties) for sale anywhere in India. During the financial year 2012-13, he made the following sales:

Particulars	**Quantity sold in units**	**Cost of transportation (₹)**
Goods sold at factory in Mumbai	**1,000**	**Nil**
Goods sold from New Delhi	**500**	**12,000**
Goods sold from Chennai	**600**	**48,000**
Goods sold from Kolkata	**900**	**30,000**

Find assessable value per unit and total excise duty payable by the manufacturer. Excise duty @12% plus
2% education cess and 1% Secondary and Higher Education cess.

b) M/s. A Ltd. Used to label its products with a foreign brand and claimed exemption under a notification. The classification list was approved by the department after carrying out verifications and all returns were regularly filed. The invoice containing description of goods were also regularly approved by the department. The department denied the benefit of exemption to the assessee by invoking extended period of limitation under section 11A on the ground that it failed to declare the particulars regarding affixing of labels. Is the department justified ?

Answer

a) (Rule 5 of valuation rule)

Selling price per unit = ₹ 2,000
Less: cost of equalized freight = ₹30
Assessable value per unit = ₹ 1,970
Total excise duty payable = ₹ 7,30,476 (3,000 units x ₹ 1 ,970 per unit x 12.36%)

Working note:

(1)

Particulars	**Quantity sold in units**	**Cost of transportation (₹)**
Goods sold at factory in Mumbai	1,000	Nil
Goods sold from New Delhi	500	12,000
Goods sold from Chennai	600	48,000
Goods sold from Kolkata	900	30,000
Total	3,000	90,000

(2) Cost of equalized freight = ₹ 30 (₹ 90,000/3,000 units)
(3) The aforesaid equalized freight has to be certified by the Cost Accountant/Chartered Accountant/ Company Secretary in practice.

b) The Supreme Court in Pahwa Chemicals Private Ltd v. CCEx 2005 189 ELT 257 (SC) has held that mere failure to declare the particulars does not amount to mis-declaration or willful suppression. Some positive act on the part of the assessee to establish either willful mis-declaration or willful suppression is must.

In the instant case, there was no willful mis-declaration or willful suppression as all the facts were within the knowledge of the department and the assesses did not make the declaration on the belief that

affixing of a label made no difference. Thus, since all the facts were within the knowledge of department, hence extended period of limitation was not invokable.

Q. 30. a) M/s. Sun Industries imported finishing agents, dye-carriers, printing paste etc. to be used for manufacture of textile articles. The importer claimed exemption for Additional duty of customs (CVD) leviable u/s 3 of the Customs Tariff Act, 1975, on the ground that there was an exemption for excise duty in respect of said goods used in the 'same factory' for manufacture of textile articles. The Department contended that CVD is payable on the ground that the goods which were to be used must also be manufactured in the 'same factory'. You are requested to comment upon the contention of Department, with reference to a decided case law, if any.

b) Mrs. Indu, a resident of India and carrying out her profession in USA, returned back to India after 2 years of stay and brought –
(i) Used personal effects (including jewellery ₹ 40,000) - ₹ 80,000
(ii) Professional equipments - ₹ 1,50,000 (including personal computer - ₹ 50,000)
(iii) Used household articles - ₹ 25,000
(iv) Other articles not falling under Annexure I - ₹ 35,000
Determine duty payable by Mrs. Indu

Answer .

a) Additional duty of customs leviable u/s 3(1) of the Customs Tariff Act, 1975 is equal to excise duty leviable in India. If goods are exempt from excise duty in India, such goods cannot be charged to additional duty of customs. The expression "used in the same factory for manufacture of textile articles" means –

- Imported articles must be used in the factory in which textile articles were manufactured; and
- It didn't mean that imported article must have been manufactured in same factory in which textile articles were manufactured, which was impossible, as the imported article was manufactured outside India.

Since, in this case, Sun Industries imported finishing agent, dye-carriers, printing paste etc. to be used for manufacture if textile articles, hence, in view of exemption, they are not liable to additional duty of customs. The Department contention, is, therefore, incorrect in law.

b) Computation of customs duty – Mrs. Indu is eligible for allowance under Rules 3,5 (professional equipments) and 6 (jewellery)

Particulars	Rule 3	Rule 5	Rule 6
Used personal effects (jewellery covered by Rule 6, not Rule 3)	Exempt	-	40,000
Professional equipments (personal computer is not professional equipment, but is covered by GFA under Rule 3; other professional equipments are covered by Rule 5)	50,000	1,00,000	-
Used household articles – covered by allowance under rule 5	-	25,000	-
Other articles not falling under Annexure I (covered by Rule 3)	35,000	-	-
Total	85,000	1,25,000	40,000
Less : Duty free allowance [under Rule 5 : ₹ 12,000 for household articles and ₹ 40,000 for professional equipments, as stay is more than 6 months. Further, allowance under Rule 6 is available as stay abroad is more than 1 year]	35,000	52,000	20,000
Dutiable Value	50,000	73,000	20,000
Total dutiable value			1,43,000
Duty @ 36.05%			51,552

Q. 31 a) state with reasons in brief, whether Service Tax is payable in the following cases –
(i) Services provided to SEZ and SEZ Developer, except where services are wholly consumed within SEZ
(ii) Services provided by SEZ to DTA (Domestic Tariff Area)
(i) Services provided by Indian Agents undertaking marketing in India of goods of a Foreign Seller.

b) An importer has imported certain goods, which are not eligible for import as per Import Policy. The offending goods have been confiscated. The importer wishes to re-export the goods. Can permission be given for re-export? State briefly what are the other consequences of such Import.

Answer a)

Question	Solution
Services provided to SEZ unit and SEZ Developer, except where services are wholly consumed within SEZ	ST shall be charged, collected & paid by Service Provider. However, refund of service tax paid is given to service receiver, where the services are not wholly consumed within SEZ
Services provided by SEZ to DTA	Provision of services by units in SEZ to units in DTA shall be liable to service tax [C. No. 105/8/2008 dated. 16.09.2008] The same is considered as Import of Services and the receiver of service shall be liable on reverse charge basis
Services provided by Indian Agents undertaking marketing in India of goods of a foreign seller	Booking of orders for foreign supplier, for supply of goods in India, cannot be treated as Export of services, because service was not provided outside India and not used outside India. Hence, the same is liable for service tax. [Cani Merchandising P Ltd (2008) 11 STR 10 (Tri-Del.)]

b) The goods are not eligible for import as per import policy. But the re-export of such goods is permitted under the Foreign Trade Policy with the following consequences –
Section 112 (a) – Penalty for improper importation of goods etc. – Penalty not exceeding – (i) value of goods, or (ii) ₹ 5,000 whichever is higher
Section 125 – Redemption fine in lieu of confiscation – Maximum fine : Market Price – Import duty thereon.

Q. 32 a) How to identify the Rule to be applied for a given Service under POPS Rules ?

b) A Fashion Designer firm undertakes fashion designing contracts for various events. The Firm provided services to Sundaram Ltd., who is a manufacturer of Cosmetics. The Firm received a Cosmetics Packs as gift.
Find the Taxable Value of service if : (i) For similar services the Firm charges ₹ 5,00,000 or (ii) Consideration nor known.

Answer.

a) The rules to be applied as per the following :
- Rules of Interpretation as given in Section 66F shall be applicable
- As the rules are specifically identifiable with a particular service, the relevant rule has to be applied directly
- If a service is capable of differential treatment for any purpose based on its description, then the rule which gives the most specific description shall be preferred over the rule giving a general description. [Sec 66F(1)]
- However, if the service is still determinable in terms of more than one rule, then it shall be determined in accordance with the rule that occurs later among the rules that merit equal consideration [Rule 14]

b) Computation of taxable value
Case (i) - For similar services the Firm charges ₹ 5,00,000 – The taxable value of service = Gross amount charged by the service provider to provide similar service to any other person in the ordinary course of trade - ₹ 5,00,000 [deemed to be inclusive of service tax].

Case (ii) – Consideration not known – Value shall be determined by the service provider, i.e., the Firm. However, the value shall not be less than the cost for rendering such service.
Such value will have to be worked out on the basis of usual costing principles of normal costs and allocation of normal overheads, including reasonable profit thereon.

Q. 33. a) M/s. ABC manufacture footwear bearing the brand name "Rose" which is owned by M/s Rose Industries Ltd., for manufacture of detergent powder. When the department disallowed the benefit of small scale exemption under Notification No. 8/2003-CE on the ground that their goods bearing brand name of another person. M/s. ABC contended that M/s. Rose Industries Ltd. Owns brand bane 'Rose' only for detergent powder and not for footwear. Decide the case with reasons and mention case law, if any.

b) Mr. Sad, a service provider, has provided services of ₹ 2,00,00,000. Out of this, ₹ 1,40,00,000 are taxable output services and ₹ 60,00,000 are exempt output services. Mr. Sad has opted not to maintain separate inventory and accounts and pay prescribed amount on value of exempt output services.
Service tax paid on his input services excluding education cess and secondary and higher education cess is ₹ 12,00,000. Rate of service tax, excluding EC and SAHEC, is 12%
Calculate the total amount payable including Service tax, EC and SAHEC by Mr. SAD by GAR-7 challan.

Answer .

a) Notification No. 8/2003-CE, dated 01.03.2003 provides that the benefit of small scale industry exemption shall not apply to the goods bearing a brand bane or trade name, whether registered or not, of another person. As per the notification, brand name or trade means a brand name or trade name, whether registered or not, that is to say a name or a mark, such as symbol, monogram, label, signature or invented word or writing which is used in relation to such specified goods for the purpose of indicating, or so as to indicate a connection in the course of trade between such specified goods and some person using such name or mark or without any indication of the identity of that person.
Supreme Court has held in the case of CCEx v. Bhalla Enterprises [2004] 173 ELT 225 (SC) that :

(i) Exemption notification debars those persons from the benefit of the SSI exemption who use someone else's name in connection with their goods, either with the intention of indicating, or in a manner so as to indicate a connection between their goods and such other person;
(ii) There is no requirement for the owner of the trade mark using the name or mark with reference to any particular goods;
(iii) The object of the Notification is clearly to grant benefits only to those industries which otherwise do not have the advantage of a brand name.

In other words, if brand name of another person is used even in respect of goods of other class or kind (different from the nature of the goods of the owner of brand name), benefit of SSI exemption shall not be available.
In view of the aforementioned provisions, M/s. ABC will not be entitled to the SSI exemption as their goods bear the brand name "ROSE" owned by M/s. Rose Industries Ltd. The fact that M/s. ABC uses the brand name on footwear while the same is being used by M/r. Rose Industries Ltd. On detergent powder will have no relevance.

b) Since Mr. SAD has taken option to pay prescribed amount on value of exempted services viz., 6% on value of services under Rule 6(3)(i), hence, he can avail full credit.
The payment required to be made by him is as follows :

Particulars	CENVAT	EC	SHEC
Credit of service tax paid on input service	12,00,000	24,000	12,000
Less : 6% of value of exempted services ₹ 60 lakhs i.e., reversal (no EC/SHEC)	3,60,000		
Balance credit available	8,40,000	24,000	12,000
Service tax on taxable output services @ 12% on ₹ 140 lakhs	16,80,000	33,600	16,800
Total amount payable by Mr. SAD by GAR-7 challan	8,40,000	9,600	4,800

Q. 34. a) A Port Trust used cement concrete armour units in the harbor foe keeping water calm. Each unit weighted about 50 toms and is like a tripod and keeps water calm and tranquil. These units are essentially in prismoid form and were made to order. They are harbor or location specific. The Central Excise Department contended that the armour units are excisable goods and chargeable to duty. Examine the validity of the Department's contention in the light of decided case law.

b) In a particular case of import of goods, the seller in USA and the Indian buyer were found to be together controlling a third company in India. What are the conditions subject to which then transaction value of such goods would be accepted for customs purpose?

Answer .

a) Any product is liable to duty only if it is marketable in the condition in which Department wants to levy excise duty and the same is a manufactured product.

The fact of the given case are identical to that in Board of Trustees v. CCEx 2007 (216) E.L.T. 513 (S.C.) wherein it was held that –

- The cement concrete armour units were manufactured product. No issue as to whether there was manufacture or not was raised by the parties.
- The concrete armour blocks or units are made to order. They are of certain specifications. They are harbor or location specific. It would depend on the water level required to be maintained in the harbor. There is no evidence to show that these blocks could be used in any other harbor. There is no evidence that they are bought and sold in the market as a commodity.
- Since the goods are location specific and not bought and sold in the market, therefore, they are not marketable and not liable to duty.

The armour blocks/units are not marketable. The department's contention is invalid.

b) (A) Rule 2(2) of Customs Valuation Rules, 1989 specifies the situations in which persons shall be related. One of the specified situations is that the persons together directly or indirectly control a third person. It has been further clarified in the explanation to this sub-rule that the term' person' also includes legal persons. In view of the above, the seller and buyer are deemed to be related in the given case.

(B) As per Rule 3(3) of Customs Valuation Rules transaction value where buyer and seller are related are acceptable under the following cases –

(i) Price not influenced by relationship

(ii) Price shown to be closely approximate to transaction value/ deductive value/ computed value of identical or similar goods- Whenever the importer demonstrated that the declared value of the goods being valued, closely approximates to one of the following values ascertained at or about the same time :

- The transaction value of identical goods, or of similar goods, in sales to unrelated buyers in India
- The deductive value for identical goods or similar goods
- The computed value of identical goods or similar goods

However, in applying the values used for comparison, due account shall be taken of –

- Demonstrated difference in commercial levels, quantity levels
- Adjustments in accordance with the provisions of rule 10 and
- Cost incurred by the seller in sales in which he and the buyer are not related

(iii) substitute values shall not be established under the provisions of (ii) given above.

Q. 35 a) Compute taxable value and service tax from following sums received by M/s. High Power Ltd. (a state transmission utility)(exclusive of service tax) (Ignore small service provider's exemption)
Collections from transmission and distribution of electricity - ₹ 100 lakh
Rent from hiring of electricity meters - ₹ 25 lakhs

b) A particular Central Excise Notification grants full exemption to all products of printing industry including newspaper and printed periodicals. A Manufacturer, who is manufacturing Cardboard Cartons and subsequently doing varied printing on them, claims the benefit of the said exemption notification on the ground that every materials on which, printing work is done becomes a product of the Printing Industry. Is the claim of the manufacturer justified ? Give reasons.

Answer .

a) Computation of service tax liability

Collections from transmission and distribution of electricity - ₹ 100 lakhs – Covered within negative list u/s 66D(k) – not taxable

Rent from hiring of electricity meters - ₹ 25 lakhs- Has a close and direct nexus with transmission or distribution of electricity – Covered within negative list u/s 66D(k)- not taxable

Taxable value – NIL and service tax thereon – NIL.

b) The exemption notification is in respect of a product of printing industry. The cardboard carton is a product of packaging industry, and in common parlance the cardboard carton remains a carton only whether any printing is done on it or not. Where a packaging manufacturer also prints on the cardboard/ packaging manufactured by him, he will not be entitled for the benefit of exemption notification because, any amount of printing on cardboard will not make it a product of printing industry [Rollatainers Ltd. 72 ELT 793 (SC)].

Therefore, the claim of the manufacturer does not hold good.

Q. 36. a) Discuss briefly with reference to the decided case law whether the landing charges imposed after the landing of the goods, but prior to their clearance for custom purposes are to be included for determining the value under section 14 of the Customs Act, 1962 and arriving on the custom duty payable.

b) Vivitha & Co., is a dealer in an electronic product, chargeable to CST at 2%. For the year ended 31.3.2012, the dealer has shown total turnover (including CST) at ₹ 38,76,000. In the above, the dealer has treated the following amounts thus:

(i) Dharmada collected from buyers, shown separately in invoice ₹ 28,000.

(ii) Weighment Charges incidental to sale ₹ 14,000.

(iii) Central excise duty collected (including cess) ₹ 2,06,000.

The dealer has recorded the following amount in separate folios in the ledger:

(i) Packing charges (These have been collected from buyers through Debit notes) ₹ 45,000

(ii) Cash discount allowed to buyer ₹ 18,000

(iii) Indemnity/guarantee charges collected from buyer to cover loss during transit ₹ 12,000

(iv) Marine insurance premium for transporting goods to the premises of buyers, collected from buyers ₹ 32,000.

Determine the total and taxable turnover under CST Act 1956 for the financial year 2011-12. You are required to show the treatment of each and every item distinctly.

Answer.

a) In Garden Silk Mills Ltd. V. UOI [1999] 113 ELT 358 (SC) the Supreme Court held **that** in determining the deemed price **in international** trade the element of port charges, which are borne by the importer, have **to** be **added** in the assessable value.

As per the Customs Valuation Rules, 1988, handling charges are added in the CIF value @ 1% of CIF value irrespective of the actual **amount of** landing charges.

b) Determination of turnover for CST purposes

	(₹)
Turnover including CST as per books	38,76,000
Less: CST included in above 38,76,000 x 2/102	76,000
Turnover as per books excluding CST	**38,00,000**
Add: Packing Charges	45,000
Marine insurance	32,000
Taxable turnover	**38,77,000**
Add: CST @2% on 38,77,000	77,540
Total Turnover	**39,54,540**

Note:

The following items addable in the selling price, which has been added already in the sale price:

(i) Dharmada collected from buyers, shown separately in invoice ₹ 28,000.

(ii) Weighment Charges incidental to sale ₹ 14,000.

(iii) Central excise duty collected (including cess) ₹ 2,06,000.

The dealer has recorded the following amount in separate folios in the ledger:
(i) Packing charges (These have been collected from buyers through Debit notes) is ₹ 45,000. It is addable into the assessable value even though the same has been charged separately. The Honorable Supreme Court of India in *Rai Bhart Das and Brothers* v *CST* (1988) 71 STC 277 held that the packing charges realized by the dealer was an integral part of the sale price. (Service charges are different from charges for packing materials).
(ii) Cash discount allowed to buyer is ₹ 18,000, it is assumed to be already deducted from the sale price.
(iii) Indemnity/guarantee charges collected from buyer to cover loss during transit is ₹ 12,000 charged separately. Hence, not included in the sale price.
(iv) Marine insurance premium for transporting goods to the premises of buyers, collected from buyers is ₹ 32,000 is included in the selling price, because Freight and insurance charges incurred by the assessee prior to the delivery of the goods at their places of business to their customers, form part of turnover.

Q. 37. a) What are the difference between Rule 3(5) and Rule 4(5) of CENVAT for Removal of Inputs from a factory?

b) AB Ltd., imported Super Kerosene Oil (SKO) and stored in a warehouse. An ex-bond bill of entry for home consumption was filed and duty was paid as per rate prevalent as on the date of presentation of such bill of entry, and the order for clearance for home consumption was passed. On account of highly combustible nature of SKO, the importer made an application to permit the storage of such kerosene oil in the same warehouse until actual clearance for sale/use and the application was allowed. When the goods were actually removed from the warehouse, the rate of duty got increased. The department demanded the differential duty. The company challenged the demand. Whether it will succeed ? Discuss briefly taking support of decided case law, if any.

Answer .

a) Difference between Rule 3(5) and Rule 4(5) of Cenvat for Removal of Inputs from a factory

Particulars	Removal under 3(5)	Removal under 4(5)
Nature of removal	Inputs or capital goods are removed as such or after being used from the factory, or premises of the output service provider	Inputs or capital goods are sent to the job worker for further processing, testing, repair etc.
Purpose of removal	Goods are removed for any purpose other than job work, e.g. sale	Goods are to be removed specifically for job work
Cenvat credit	An amount equal to the cenvat credit availed on the inputs has to be paid at the time of removal	No duty is payable at the time of removal of goods but if these goods are not returned within 180 days, the credit availed on such goods has to be paid.

b) Yes, the company will succeed. The facts of the given situation are similar to the case of CC v Biecco Lawrie Ltd. 2008 223 ELT 3 (SC) wherein the Supreme Court has held that where duty on the warehoused goods is paid and out of charge order for home consumption is made by the proper officer in compliance of the provisions of section 68, the goods removed in smaller lots have to be treated as cleared for home consumption and importer would not be required to pay anything more. Further, section 49 of the Customs Act, 1962 inter alia also provides that imported goods entered for home consumption if stored in a public warehouse, or in a private warehouse on the application of the importer that the same cannot be cleared within a reasonable time shall not be deemed to be warehoused goods for the purposes of this Act, and accordingly the provisions of Chapter IX shall not apply to such goods.

Q. 38. a) Sun Industries Ltd. sent certain goods by a ship from Kolkata to Colombo in Sri Lanka under claim for drawback on the said goods u/s 75 of the Customs Act, against shipping bill. The ship had passed beyond the territorial waters of India and the engine developed trouble while the ship was in the high seas falling within the ambit of expression 'taking out to a place outside India'. The ship returned back and ran aground in Indian territorial waters at the port of Paradeep. The fittings, stores and cargo were salvaged. Discuss the admissibility of claim for drawback by the company.

b) Can department file appeal in respect of same assessee, if in respect of same years, no appeal was filed involving identical dispute ?

Answer

a) Since goods had crossed territorial waters of India; it could be said that the "export" was complete inasmuch as the goods had reached a place outside India. Merely because the ship returned back and ran a ground in the territorial waters doesn't affect the fact of "export", which was complete – Sun Industries v CC 1988 (35) ELT 241 (SC).

b) It was held in C K Gangadharan v. CIT 2008 228 ELT 497 (SC) that if the Revenue has not filed an appeal against any order/ judgment in one case, it would not be allowed to file an appeal in another case when the same issue is involved due to the reasons that it cannot pick and choose and certainty in law should be ensured.

However, the Revenue can file an appeal in another case involving same/similar issue –

(i) Where there is just cause in doing so (e.g. where appeal was not preferred earlier in view of small amount involved or where earlier case was revenue-neutral); or
(ii) Where it is in public interest to do so; or
(iii) For a pronouncement by higher court when divergent views are expressed by Tribunals/High Courts

Section 35R of the Central Excise Act also provides that the Board may issue orders or instructions or directions fixing monetary limits for the purposes of regulating the filing of appeal, etc. by the Department. If Department has not filed an appeal, etc. as per circular fixing monetary limits, the Department may file any appeal, application or revision in any other case involving the same or similar issues or questions of law and the assessee cannot contend that the Department has accepted the decision on the disputed issue by not filing the appeal.

Q. 39 a) Compute taxable value in following case in respect of transport of goods by vessel (assume option to pay at abated value has been taken) (all sums exclusive of taxes)-
Transport of goods from Dubai to Indian Customs clearance Station - ₹ 100 lakh
Transport by Inland waterways - ₹ 30 lakh
Transport of food stuff within India - ₹ 400 lakh
Transport of export goods from India to Dubai - ₹ 400 lakh
Transport of goods in other cases - ₹ 300 lakh

b) M/s. PIL Ltd. Claimed duty drawback in respect of its export products. Over 97% of the inputs by weight of the product were procured indigenously and were not excisable. All industry rates under the customs and Central Excise duties Drawback Rules, 1995 were fixed taking into account the incidence of customs duty on imported product inputs. Explain briefly with reference to Rule 3(1)(ii) of the said rules whether the claim of M/s. PIL will merit consideration by the authorities.

Answer .

a) Computation of taxable value

Transport of goods from Dubai to Indian Customs clearance Station - ₹ 100 lakh – covered within negative list u/s 66D(p)
Transport by Inland waterways - ₹ 30 lakh - covered within negative list u/s 66D(p)
Transport of food stuff within India - ₹ 400 lakh – exempt
Transport of export goods from India to Dubai - ₹ 400 lakh – Place of provision is place of destination of goods viz. Dubai as per Rule 10 of PoP Rules, 2012. Since PoP is outside India, hence, it is not liable to service tax in India
Transport of goods in other cases - ₹ 300 lakh – Taxable
Taxable sum = ₹ 300 lakh; Taxable value (net of abatement) = 50% of 300 = ₹ 150 lakhs.

b) Drawback is allowed under rule 3 based on average quantity or value of the imported materials or excisable materials used for production or manufacture in India of a particular class of goods. Hence, such drawback at average rate viz. All Industry Rate is allowed even if some non-dutiable or non-duty-paid inputs are used in manufacture of export goods.

But, if no duties have been paid on imported/excisable material, then, Rule 3 itself disallows any drawback. In this case, 97% of inputs were non-excisable i.e., not liable to excise duty. Merely because duty is paid on 3% of the inputs, it cannot be said that duty-paid materials have been used so as to allow drawback at average rates under Rule 3. Hence, drawback under Rule 3 will not be allowed to M/s. PIL.

Q. 40 a) M/s. ABC Ltd. Imported certain goods at US $ 20 per unit from an exporter who was holding 30% equity in the share capital of the importer company. Subsequently, the assessee entered into an agreement with the same exporter to import the said goods in bulk at US $ 14 per unit. When imports at

the reduced price were effected pursuant to this agreement, the Department rejected the transaction value stating that the price was influenced by the relationship and completed the assessment on the basis of transaction value of the earlier imports i.e., at US $ 20 per unit under rule 4 of the Customs Valuation (Determination of Value of Imported Goods) Rules 2007, viz transaction value of identical goods. State briefly, whether the Department's action is sustainable in law, with reference to decided cases, if any.

b) M/s. High Tech Co. imported laptops with Hard Disc Drivers (HDD) preloaded with operating software like Windows XP, XP home etc. The department has claimed that the said laptop along with the operating software was classifiable and assessable as a single unit. It is the claim of the assessee that the software loaded HDD should be classified and assessed separately as an exemption is available as per notification issued u/s 25(1) of the Customs Act, 1962. Decide whether the action proposed by the department is correct in law.

Answer .

a) No, the Department's action is not sustainable in law. Rule 2(2) of Customs Valuation (Determination of Value of Imported Goods) Rules 2007 inter alia provides that persons shall be deemed to be "related" if one of them directly or indirectly controls the other. The word "control" has no where been defined under the said rules. As per the common parlance, the control is established when one enterprise holds at least 51% of the equity shareholding of the other company. However, in the instant case, the exporter company held only 30% of shareholding of the assessee. Thus, exporter company does not exercise a control over the assessee. So, the two parties cannot be said to be related. The fact that assessee had made bulk imports could be a reason for reduction of import price. The burden to prove under valuation lies on the Revenue and in absence of any evidence from the Department to prove under-valuation, the price declared by the assessee is acceptable. The same has been judicially decided by Supreme Court in CC v. Initiating Explosives Systems (I) Ltd. 2008 224 ELT 343 (SC). In the light of foregoing discussion, it could be inferred that Department's action is not sustainable in law.

b) The action proposed by the Department is correct in law. The facts of the case are similar to CC v Hewlett Packard India Sales (P) Ltd. 2007 215 ELT 484 (SC). In this case, the Supreme Court observed that the pre-loaded operating system recorded in HDD in the laptop (item of import) forms an integral part of the laptop as the laptop cannot work without the operating system. A laptop without an operating system is like an empty building. Hence, laptop should be treated as one single unit and assessed accordingly. However, if the operating system had been imported as packaged software like an accessory, then the benefit of exemption notification would have been available on it.

Q. 41a) Mr. Dev manufactures product X out of raw material A. the cost of raw material A is ₹ 2.5 lakhs. The labour and other manufacturing expenses are ₹ 4.5 lakhs. The manufacturing process requires a machinery of ₹ 30 lakhs (subject to VAT @ 12.5%). The useful life of the plant is 5 years with no salvage. The expected output of product X is 10,000 units. Mr. Dev fixes a profit margin of ₹ 250 per unit.
Compute the selling price of product X and its cost to consumer if –

(i) No credit is allowed on the capital goods;
(ii) Credit is allowed on the capital goods. The VAT rate on final product is 12.5%. There is no VAT on raw material.

b) Explain the special rule for determining Point of Taxation for Intellectual Property Rights.

Answer.

a) Computation of selling prices under two cases (amount in ₹)

Particulars	No credit allowed	Credit is allowed
Cost of raw material A	2,50,000	2,50,000
Labour and other manufacturing expenses	4,50,000	4,50,000
Depreciation on machinery [WN]	6,75,000	6,00,000
Total cost	13,75,000	13,00,000
Number of units	10,000	10,000
Cost per unit	137.50	130.00
Profit margin per unit	250.00	250.00
Selling price per unit	387.50	380.00
Add : VAT @ 12.5%	48.00	47.50
Cost to customer	435.50	427.50

Thus, non-availment of credit of VAT paid on capital goods will increase the final price of the product

Working note : Calculation of depreciation

(ii) When no credit is allowed on capital goods = (₹ 30 lakhs + 12.5% VAT) ÷ 5 = ₹ 6,75,000
(iii) When credit is allowed on capital goods = ₹ 30 lakhs ÷ 5 = ₹ 6,00,000

b) In respect of royalties and payments pertaining to Copyrights, trademarks, designs or patents, where –

- The whole consideration is not ascertainable at the time of performance of service, or
- The consideration is determined based on subsequent usage or the benefit of these services by the Service Receiver

Point of taxation – Date of receipt of consideration or date of invoice, whichever is earlier.

Q. 42 a) Bose Fibres had filed an appeal to the High Court on August 11, 2012 u/s 35G of CEA, 1944 aggrieved by an order passed by the Appellate Tribunal. The order appealed against was received by the Assessee on January 2012.
M/s. Bose Fibres urged before the High Court that the delay in presenting the appeal ought to be condoned. State briefly whether High Court could condone the delay.

b) M/s. Nirmal Marketing supplies 14 bottles of mineral water in a single package to High Fly Airways (airline company), Maximum retail price was printed on the package. However, individual bottle of 200 ml. each did not carry such maximum retail price (MRP) as these were to be distributed to the passengers by the airline company and not intended for resale. M/s. Nirmal Marketing pays duty of excise assessing the goods under section 4 of the Central Excise Act, 1944.
The Department has taken a view that the package of 14 bottles is not a wholesale package. The airline company itself is the ultimate consumer. Hence, the package of 14 bottles itself is a 'retail package' and duty is payable on the basis of MRP u/s 4A of the Central Excise Act, 1944.
Examine briefly, whether the stand taken by the Department is correct in law.

Answer

a) Under section 35G, the appeal should be filed to High Court against the order of CESTAT within 180 days from the date of receipt of the order of the CESTAT.
Under section 35G(2A) of the Central Excise Act, 1944, the High Court can condone the delay in filing the appeal after the expiry of 180 days, if it is satisfied that there was sufficient cause for not filing the same within that period.
So in the given case, the High Court can condone the delay in filing the appeal.

b) No, the stand taken by the Department is not valid in law. Section 4A(2) of the Central Excise Act, 1944 stipulates that value of the goods notified by the Central Government u/s 4A(1) of the Act shall be the retail sale price declared on such goods less such amount of abatement, if any, from such retail sale price as the Central Government may allow. For the purpose of valuation u/s 4Aof the Central Excise Act, 1944, there should be requirement under the provisions of the Legal Metrology Act, 2009 or the rules made there under or any other law to declare the retail price of such goods on the package.
As per Legal Metrology (Packaged Commodities) Rules, 2011, MRP is not required to be printed in case of sale to institutional consumers. Institutional consumers have been defined as those consumers who buy packaged commodities directly from the manufacturers/packers for service industry like airways, railways etc. Thus, High Fly Airways, being an institutional consumer, package of mineral water bottles meant for them is not required to bear any MRP. Hence, in the present case, the goods are to be valued u/s 4 and not u/s 4A of the Central Excise Act, 1944.