NANUBHAI DESAI & CO.

January 2009
Part-II

the RECKONER

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Contents

INCOME TAX

DOMESTIC TAXATION

General

NEW RULE 40E

The Central Board of Direct Taxes has notified amendment to Income Tax Rule 1962 and inserted rule 40E dealing with certain conditions to be fulfilled in respect of the non-transferable pre-paid electronic meal card for the purposes of sub-clause (iii) of clause (B) of sub-section (2) of section 115WB.

These conditions are as follows:

i. The care shall be granted by the employer to its employees under a scheme framed by the employer specifying therein the circumstances under which the meal card can be used by the employee.
ii. The card under clause (i) shall be issued by the issuing bank.
iii. An employee shall not be issued more than one card.
iv. The card shall bear the name of the employer along with the name, photograph and signature of the employee to whom the card is issued.
v. The card shall be used only by the employee to whom the card is issued.
vi. The card shall be used by the employee only for the purpose of purchasing ready to eat food or nonalcoholic beverage from a member establishment.
vii. The aggregate amount of ready to eat food or nonalcoholic beverage purchased during a day by an employee shall not exceed one hundred rupees.
viii. The details of each transaction of purchases made by the employee against the card shall be maintained by the employer and the member establishment in such manner and for such period as is required under the Act for any other similar transaction.

NEW SUB RULE 4A UNDER RULE 5D AND RULE 5E

The Central Board of Direct Taxes has notified amendment to Income Tax Rule 1962.

Vide this notification, sub rule 4A has been inserted in Rule 5D as well as Rule 5E. The newly inserted sub rule 4A in rule 5D specifies the documents / information to be furnished by the scientific research association to the

Commissioner of Income-tax or Director of Income-tax before due date of furnishing the return of income. While the newly inserted sub rule 4A in rule 5E specifies the documents / information to be furnished by the university, college or other institution.

These documents / information are:

i. a detailed note on the research work undertaken by it during the previous year;
ii. a summary of research articles published in national or international journals during the year;
iii. any patent or other similar rights applied for or registered during the year;
iv. programme of research projects to be undertaken during the forthcoming year and the financial allocation for such programme";

INVESTMENT UNDER SECTION 80 C

Under the provisions of Section 80 C of the Act, the Central Government, vide notification, has notified that investment in the National Housing Bank (Tax Saving) Term Deposit Scheme, 2008 shall be treated as an eligible investment as specified under section 80C.

50 PER CENT DEPRECIATION FOR NEW MOTOR VEHICLES

The CBDT has amended the Table of Depreciation rates appearing in the Income-tax Rules, 1962. As per the amendment, new commercial vehicle which is acquired on or after the 1st day of January, 2009, but before the 1st day of April, 2009 and put to use before the 1st day of April, 2009 for the purposes of business or profession, will be eligible for higher depreciation of 50 per cent of its cost of acquisition.

Case laws

1. BALMUKUND ACHARYA VS. DCIT (BOMBAY HIGH COURT)

The Appellant is an individual and assessed to tax. The appellant filed his Return of Income for the assessment year 1996 – 97 inter alia declaring a total income of Rs 1,04,86,080/- which included an amount of long term capital gains

of Rs.1,07,00,000/- arising on account of sale of godown situated at Mumbai. While computing the amount of capital gains, the appellant considered the cost of acquisition at 'Nil' and computed long term capital gains and taxes accordingly.

The assessing officer served an intimation u/s 143 (1) (a) of the Act and raised additional demand including interest under section 234.

The Appellant preferred an appeal before CIT(A) and challenged the intimation as well as the demand raised by the assessing officer. The Appellant also contended that the amount of capital gains computed by him was erroneous and having regard to the provisions of section 45, the amount of capital gains was not taxable at all. The CIT(A) rejected the appeal and held that the Appellant was not entitled to raise the issue which was not the subject matter of adjustment and that the subject question to be raised in the appeal did not arise from the order passed by the AO.

Being aggrieved by the order of CIT (A) as well as Tribunal, the appellant preferred an appeal before the Bombay High Court.

Decision of Bombay High Court:

The Bombay High Court passed a favorable order reversing the order of the Tribunal and held that:

1. In view of the Explanation to s. 143 (prior to its deletion w.e.f. 1.6.1999) an Intimation is deemed to be an appealable order and appeal by the Appellant was maintainable;

2. The authorities under the Act are under an obligation to act in accordance with law. Tax can be collected only as provided under the Act. If any assessee, under a mistake, misconceptions or on not being properly instructed is over assessed, the authorities under the Act are required to assist him and ensure that only legitimate taxes due are collected. If particular levy is not permitted under the Act, tax cannot be levied applying the doctrine of estoppel.

2. KUBER TOBACCO VS. DCIT (ITAT DELHI - SPECIAL BENCH)

A search action under section 132 of the Act was carried out in the case of the assessee on 21st January, 1999. Consequently, notice under section 158BC was issued and assessment was completed vide orders passed under section 158BC

of the Act. The assessment order was silent about issuance of notice u/s 143(2) and no such objection was taken by the assessee either before the AO or CIT (A) that in the absence of serving a valid notice u/s 143(2), the assessment completed u/s 158BC cannot be held valid. The assessee, for the first time, raised this issue by way of an additional ground before the Tribunal in its appeal by stating that the block assessment proceedings and consequential block assessment order was without jurisdiction in the absence of issuance of mandatory legal notice u/s 143(2) of the Act.

The contention of the Revenue was that in view of insertion of Section 292 BB which is inserted by Finance Act, 2008 w.e.f. 1st April, 2008, the assessee cannot take the plea that assessment should be held invalid merely for the reason that no notice u/s 143(2) was issued. The Revenue contested that the assessee was barred from taking this plea.

The question inter alia scope and effect of insertion of section 292BB was referred to Special Bench for its opinion.

Decision of Special Bench:

The Tribunal held that Section 292BB was applicable to assessment year 2008-09 and subsequent years. It was held that Section 292BB even if it was procedural, it would create a new disability in as much as it would preclude the assessee from taking a plea. An amendment which could affect a right of the assessee cannot be construed to have retrospective effect.

3. COMMISSIONER OF INCOME TAX Vs LARSEN & TOUBRO LTD. (SUPREME COURT)

The asseessee paid Leave Travel Concession (LTC) to its employees based on the declaration furnished by the employees. The assessee had not collected or examined the supporting evidence attached to such declaration. The appeal was filed by the Revenue with Supreme Court to examine if the assessee was required to collect evidence from the employees before granting LTC.

Decision of Supreme Court:

The Supreme Court observed that the beneficiary of exemption under Section 10(5) was an individual employee. No requirement was fastened upon the employer by the circular of Central Board of Direct Taxes (CBDT) under Section 192 to collect and examine the supporting evidence attached to the declaration submitted by an employee. For this reason, the appeal filed by the Revenue was dismissed by Supreme Court.

INTERNATIONAL TAXATION

General

Supreme Court rejects Vodafone's call

As per the press reports, the Supreme Court has dismissed the Special Leave Petition filed by Vodafone and has upheld the order of the Bombay High Court in this regard. Consequently, Vodafone would be now under obligation to file the information/documents as called by the Assessing Officer. The Supreme Court has however observed that Vodafone could challenge the jurisdictional powers of the assessing officer to call & examine for the said information/documents.

Double Taxation Agreement Signed With Serbia And Montengro

In exercise of the powers conferred under section 90 of the Income-tax Act, 1961, the Government of India has signed Double taxation Avoidance Agreement (DTAA) with the Council of Ministers of Serbia and Montengro, vide notification no.5/2009. This agreement was signed on January 7, 2009.

Case laws

Epcos AG, Germany (ITAT, Pune Bench)

Background & Facts

The assessee is a German company engaged in the business of designing, manufacturing and marketing passive electronic components. It has subsidiaries across the world including two subsidiaries in India, namely—Epcos India (P) Ltd. at Nasik and Epcos Ferrites (P) Ltd. at Kolkatta. Epcos Group of companies, which essentially include its subsidiaries companies in India, are manufacturing various components in various countries and selling the same to the consumers in different parts of the world. Whereas sales are handled by the regional sales organizations, the marketing efforts are centralized at the Epcos AG headquartered in Munich. Epcos Group is organized by product divisions

and each division has its central marketing team, which works for all the manufacturing companies within that division. The central marketing team renders valuable services for the benefit of various manufacturing companies in that division all over the world, and a fee is charged by the Epcos AG for those services. These services include (i) market analysis (ii) technology change, growth and price forecast (ii) deciding global marketing strategy on various parameters (iii) co-ordination with sales organizations and factories to implement agreed marketing strategies (iv) follow up with sales organizations (v) handle customer relations centrally (vi) explore new areas of markets, applications and customers (vii) development and printing of product brochures, etc. (viii) advertising (ix) sales staff training (x) planning and organizing of fairs, exhibitions and seminars etc., and (xi) other allied activities. Epcos AG has rendered certain services to its Indian subsidiaries in respect—(a) product marketing and sales support services; and (b) information and technology support services. The terms and conditions on which these services are rendered are set out in separate agreements entered into by the taxpayer company with both its Indian subsidiaries (i.e., EIPL and EFPL). Epcos AG maintains centralised information technology infrastructure at its German office and it provides the services of creating and maintaining the WAN (wide area network) for the whole group. The services of outside parties are engaged for maintaining this WAN. This centralized information technology unit of the taxpayer company also procures and furnishes to its subsidiaries, licences for programmes such as MS Office, Oracle for servers and other softwares, develops and maintains central SAP system which is also used by the Indian subsidiaries, and implements a common e-mail service which is used by Indian subsidiaries. Similarly, so far as product marketing services are concerned, these services are also provided by Epcos AG's centralized marketing unit in Germany. During the previous year relevant to the assessment year under consideration, the assessee earned few streams of income (including interest income from lending foreign currency to the Indian subsidiaries under ECB Scheme), which were held to have been entered between the parties at arms' length price by the Transfer Pricing Officer (TPO). At the time of filing the return of income, in absence of a PE in India, the assessee had offered the said items of income for tax @ 10 per cent of it's gross value. During the course of assessment proceedings, however, the assessing officer completed the assessment by taxing the items of income @ 20 per cent on the premise that the assessee had a PE in India in the form of employees of the Indian subsidiaries. The CIT (A), however, consented to the treatment to the items of income accorded by the assessee at the time of filing the return of income.

Issues:

The Revenue filed an appeal against the order of CIT (A) to challenge the conclusions arrived vide said order. The Revenue sought decision of the Tribunal on the issue of existence of PE of the assessee in India, scheme of taxation formulated under the Act vis-à-vis under the tax treaty & the correct rate of tax as applicable to the assessee.

Contentions of the Assessee

The assessee submitted that since the assessee company does not have a PE in India, these receipts could only be taxed under Article 12 of the Indo-German tax treaty, and in case the Assessing Officer is of the opinion that these receipts are not covered by Article 12, these receipts are not taxable at all. The assessee also submitted that as far as ECB loan interest was concerned, it was indeed not covered under Article 12 of the Indo-German treaty but then that this fact does not make any difference to the tax liability, because, under Article 11 of the treaty, interest income is to be taxed @ 10 per cent anyway. The assessee thus urged that the taxability of all these receipts @ 10 per cent, though under Article 12 and under Article 11 of the Indo-German tax treaty.

Contentions of the Revenue

The Revenue contended that the assessee has accepted a tax liability @ 10 per cent, on the basis of the provisions of Article 12 of the Indo-German tax treaty but none of the receipts, save and except on account of royalty fees, is of such a nature as can be covered by Article 12. It was further contended that 'income from product marketing fees' amounts to a commercial activity as the same cannot be termed as a royalty or fees for technical services. As for the receipts for information and technology support, the Revenue contended that such receipts are not specifically included in Article 12 of the Indo-German tax treaty. Similar was the Revenue's contention so far as the receipts for sales support fees were concerned. As far as interest receipts were concerned, the Revenue contended that the interest income was part of the regular business receipts of the assessee company, and the same cannot be subjected to concessional rate of taxation envisaged for the royalties and fees for technical services. The Revenue pointed out that services of EIPL and EFPL employees have been availed to earn the receipts on account of product marketing, sales support and information technology services as also of the royalty. It was further contended that the assessee has a PE in India, in the form of its subsidiaries i.e. EIPL and EFPL, since the assessee was conducting its business in India through its subsidiaries and more specifically through employees of the subsidiaries. The Revenue invited attention to the article 5 of the tax treaty

providing the definition of the term 'PE' wherein it connotes a fixed place of business through which the business of an enterprise is wholly or partly carried on and that it includes especially 'a place of management, a branch, an office or a factory'. It was noted that in the instant case, the assessee has a place of management by way of subsidiary companies, these companies are making payments for royalties, for fees for technical services etc., and, on the facts of the case, therefore, these subsidiary companies constitute Indian 'PE' of the assessee. In this regard, the Revenue also referred to several judicial precedents.

Decision of the Tribunal

The Tribunal referred to the submissions made by the assessee as well as the Revenue. A detailed analysis of the scheme of the Act vis-à-vis the tax treatment accorded to the items of income under the Tax treaty has been undertaken by the Tribunal. While analysing the same, the Tribunal also referred to the commentaries on interpretation of tax treaties of foreign tax experts. The Tribunal was of the view that a tax treaty was an alternative taxation regime in the sense that it was an allocation of taxing rights between two, or more, competing tax jurisdictions over a tax object. The provisions of treaty override, as envisaged in Section 90 of the Indian Income Tax Act, also support this inherent scheme of the tax treaties as the provisions of the Indian Income Tax Act are applicable only to the extent these provisions are more beneficial to a taxpayer covered by a tax treaty. By implication, in a situation in which India has no right to tax a particular income in the hands of this non-resident covered by a tax treaty, provisions of the Indian Income Tax Act do not come into play at all. The Tribunal therefore chose to follow the approach of first examining whether or not the source country has right to tax a particular crossborder income, and, in case the right is so established, to examine whether or not the domestic tax, laws of the source country provide for taxation of such an income, and if so, to what extent and in what manner. After considering the taxing rules provided under the Tax Treaty for the relevant items of income, the Tribunal concluded that (a) the assessee did not have a PE in India, (b) the relevant items of income would be subject to tax as per the taxing rights provided under Article 12 of the Tax treaty & were correctly offered for tax @ 10 per cent, (c) the provisions of section 44D & 115A of the Act has no applicability to the facts & circumstances of the case & (d) even if it was held that the assessee had a PE in India, it was only after royalties and fees for technical services were so included in the business profits attributable to the PE that the provisions of Sections 44D and 115A can be invoked.

Our comments

This will be one of the landmark decisions in the subject of International taxation in India since the Tribunal has carried out a detailed analysis on the interplay of the scheme of the taxation provided under the Act vis-à-vis under the relevant tax treaty. The decision shall also be very useful to interpret the terms 'fixed place of business' & 'carrying on of the business' for the purposes of determining the existence of a PE of a Foreign company in India. The Tribunal decision is arrived also after giving due consideration to the international jurisprudence on the subject of cross border taxation and taxing rights of a source state.

Bank of America (ITAT Mumbai Bench)

Background & Facts

The assessee is non-resident foreign banking company. The assessee filed its return of income declaring the income of Rs. 61.71 crores. While concluding the assessment proceedings, the assessing officer made certain additions to the amount of returned income on various counts. The assessee preferred an appeal against the said order before CIT(A). Vide his order, CIT(A) confirmed few additions, viz. (1) the claim of losses totalling to Rs. 12,64,816 incurred on security transactions; (2) the claim of expenses amounting to Rs. 2,73,29,000 under section 44C; and (3) the claim of Rs. 4,99,618 in respect of payments made towards subscription to Employees' Provident Fund.

Issues

The assessee preferred this appeal before the Tribunal to challenge the order of the CIT (A) that sustained the additions made by the assessing officer to its returned income.

Contentions of the Assessee

As regard to the loss of Rs 12,64,816, arising on account of number of securities transactions which were claimed to have been carried on by the assessee without violating the provisions of the applicable statute, the assessee contended that the said transactions should not be regarded as 'illegal transactions' and consequently the said loss should be set off against the income earned by the assessee. It was also contended by the assessee that even if the said transactions were regarded as 'illegal transactions', having regard to the judicial precedents in this regard, the amount of illegal loss should also be available for set off against income of the assessee. As regard to the expenses incurred at Head office, the assessee contended that the said expenses did not fall within the ambit of section 44C (prescribing restriction for allowability of head office

expenses) in as much as the same were directly connected to the business operations of the assessee of the Indian branches. Expenses were incurred by those branches abroad to earn income by Indian Branches in India. Since these are expenses incurred exclusively for Indian branches, the assessee contended that the provisions of section 44C and limitations provided therein were inapplicable. The assessee also referred to the various judicial precedents to establish the proposition that where the expenditure was incurred abroad exclusively for the Indian branches, the provisions of section 44C has no application.

Contentions of the Revenue

The Revenue referred to several judicial precedents and contended that the loss arising from the number of securities transactions carried on by the assessee is in the nature of illegal loss and the said loss can not be set off against the income of the assessee. As regard to the expenses incurred outside of India, the Revenue contended that since it was not possible for the Revenue to verify if the relevant expenses were actually not claimed as a deduction by the assessee outside of India, the provisions of section 44C should apply.

Decision of the Tribunal

The Tribunal referred to the relevant securities regulations and also examined the nature of transactions undertaken by the assessee. It also observed the methodology adopted by the assessee to carry out certain transactions in contrast to the methodology prescribed by the statutes. The Tribunal concluded that the assessee indeed violated the provisions of the relevant statute and loss arising from the relevant transactions should be regarded as illegal loss. The Tribunal referred to several decision of various courts (including of Supreme Court) and held that the said loss was eligible for set off as claimed by the assessee. While dealing with the issue of the deductibility of the expenses incurred by the assessee outside of India, the Tribunal examined the provisions of section 44C as well as to the ratio laid down vide various courts on the said subject. The Tribunal concluded that the provision of section 44C was inapplicable to this claim of the assessee.

Stock Engineer & Contractors b v India project office (ITAT Mumbai Bench)

Background & Facts

The Assessee is a foreign company incorporated at Netherlands. In line with the business carried on by the assessee outside of India, the assessee was awarded a contract by an Indian company for engineering, procurement and construction the Sulphur Block for the Haldia Refinery Project on turnkey basis. After securing approval of RBI, the assessee established a project office in Mumbai. To execute this project, the assessee availed technical personnel of a Malaysian company. The assessee made payment of fees to the Malaysian company for providing technical personnel without deduction of any income tax at source. The Assessing Officer disallowed the said payments invoking provisions of section 40(a)(i). The Assessing Officer also disallowed various payments incurred outside of India by the assessee under section 44C. Payments made by the assessee to a UK Company for deployment of their employees for the supervision of Indian Project without deduction of income tax at source were also disallowed by the Assessing Officer. The Assessing Officer also disallowed payments made by the assessee to another company incorporated at Netherlands in connection with the engineering services for the project at Haldia.

Issues

The appeal preferred by the assessee before CIT(A) against the additions/disallowances made by the Assessing Officer was allowed. Aggrieved by the said decision of the CIT(A), the Revenue preferred an appeal before the Tribunal. The Revenue raised certain legal issues before the Tribunal inter alia contending that the additions/disallowances made by the Assessing Officer (and reversed vide the order of CIT(A)) should be upheld.

Contentions of the Assessee

With regard to the payments made to the Malaysian company, it was contended by the assessee that the personnel supplied by the Malaysian company to the assessee were working under the direction, supervision and control of the assessee and, therefore, it could not be said that any services had been rendered by the Malaysian company. The assessee also contended that the Assessing Officer was not justified in coming to the conclusion that Malaysian company had a PE in India. It was further submitted that the Malaysian company did not have any office or any presence in India and therefore, no part of such receipt was chargeable to tax in India and consequently, the assessee was not required to deduct tax at source. The assessee also relied upon several judicial precedents in this regard.

With regard to the payment of Rs.42,09,874/- representing the salary cost attributable to India project but debited in the books of head office, the assessee

contended that the sum represented the payment of salary to the employees working in Head Office for Indian PE. The expenses had been allocated on the basis of total number of hours used by these employees for Indian project & none of the said employees ever visited the Indian office. Since these expense were directly attributable to project in India, the assessee contended that the same could not be considered as Head Office expenses u/s 44C of the Act.

As far as the issue of disallowance made by the Assessing Officer for the payment made by the assessee to UK Company for deployment of their employees for the supervision of Indian Project, the assessee contended that since the total number of days spent by the employees of the UK Company in India was only for 135 days (and less than the threshold of 6 months prescribed under Article 5(2)(j) of the tax treaty), the UK Company did not have a PE in India. The assesssee also contended that the services were not rendered in connection with the prospecting for, or extracting or production of mineral oil in India & therefore the same did not fall under any other clause of para 2 of Article 5. Consequently, the assessee was not liable to deduct tax at source. The assessee also relied upon several judicial precedents in this regard.

As regard to the payment made by the assessee to other Netherlands Company in connection with procuring the engineering services for the project at Haldia, the assessee contended that having regard to the retrospective amendment made to the provisions of Article 12 of the tax treaty, the payments shall not give rise to an item of income falling within the definition of fees for technical services. The assessee was therefore not required to withhold any tax at source.

Contentions of the Revenue

The Revenue invited attention to the Tax Treaty signed by India with Malaysia and it was contended that the Malaysian company (which had provided technical personnel to the assessee in India) had established a PE in India and therefore the payments made by the assessee would be subject to tax in India, having regard to the provisions of the Article 7 of the tax treaty. It was further observed by the Revenue that all the personnel of the Malaysian company stayed in India for more than six months and would therefore fall within the definition of PE provided under Article 5 (especially under para 2 (h)) & consequently the income received by the Malaysian company were chargeable to tax in India. The Revenue therefore concluded that the assessee was required to deduct the tax at source under section 195. Failure to deduct the tax would therefore result into disallowance under section 40(a)(i).

The Revenue referred to the tax treaty signed by India with Netherlands & as per the para 3 of Article 7, no expenses were to be allowed while computing the income of PE except the reimbursement of the actual expenses. In absence of actually verification of the claim made by the assessee, the payments under consideration should not fall outside the purview of section 44C.
The Revenue contended that the activities carried on by the UK Company in India shall fall within the purview of Article 5(2)(k) and having regard to the fact that threshold time limit prescribed therein was 90 days, the assessee was therefore required to withhold tax while making payment to the UK Company.

As regard to the payment made by the assessee to other Netherlands Company in connection with procuring the engineering services for the project at Haldia, the Revenue contended that the amendment carried out to the provisions of Article 12 were not retrospective and consequently, the payments shall fall within the purview of erstwhile provisions of Article 12. The Revenue therefore contended that the assessee had committed a default and the payment made to the Netherlands company without deduction of tax at source should be disallowed.

Decision of the Tribunal

The Tribunal concluded that the payments made to the Malaysian company could be brought to tax only under Article 7 of the tax treaty, since the tax treaty did not contain an article dealing specifically with the income in the nature of fees for technical services. The Tribunal thereafter proceeded towards determining the existence of a PE in India of the Malaysian company. It examined the provisions of Article 5 & having regard to the terms of agreement entered into between the assessee and the Malaysian company for supply of technical personnel by the Malaysian company, the Tribunal held that the Malaysian company had no obligation to supervise the work at Haldia. Drawing reference to the earlier decision, the Tribunal concluded that the Malaysian company did not have PE in India (neither under para 1 nor under para 2 (h) of the Article 5). The Tribunal thereafter concluded that the assessee was not obliged to withhold tax and consequently no disallowance can be made under section 40(a)(i).

The Tribunal reviewed the factual matrix of the payments made towards salary cost incurred at Netherlands. The Tribunal also referred to various judicial precedents as well as the circular on the subject issued by CBDT. The Tribunal upheld the finding of the CIT(A) that the salary paid to the engineers would not fall within the ambit of the expression ‘Head Office expenses' as defined in Explanation (iv) to section 44C & consequently held that the disallowance made by the assessing officer was erroneous.

The Tribunal, at the outset, established that the payments received by the UK Company shall get covered under Article 7 of the tax treaty and not under other article. The Tribunal thereafter proceeded to examine if the UK Company had established a PE in India. After carefully considering the facts of the case and the provisions of the tax treaty, the Tribunal concluded that the UK Company did not establish a PE in India and the assessee was therefore not required to withhold tax at source.

After examining the contents of the notification that carried out amendments to Article 12 of the tax treaty, the Tribunal concluded that the said amendments were retrospective in nature and the payments made to the Netherlands company did not fall within the ambit of amended Article 12 & the assessee was therefore not liable to deduct any tax at source.

Infrasoft Limited (ITAT Delhi Bench)

Background & Facts

The assessee is a marketing and development company incorporated at UK of an international group owned by a holding company incorporated at USA. The assessee established a branch office in India after obtaining necessary approval mainly for import and supply of software. Branch office also provides support services including system related services such as installation of software, interface to peripherals, uninstallation, imparting of training on the application of software, etc.. The assessee was entitled to several receipts on account of sale of software amounting to Rs.2,74,00,630/-, annual maintenance charges amounting to Rs. 9,25,648/- and training fees amounting to Rs 2,50,000/-.

Issues

The assessee treated the relevant receipts as its business income and having regard to the fact that it has established a PE in India, the business profits can be taxed in India, as provided under Article 7 of the tax treaty signed between India & UK. The Assessing Office however was of the view that the said receipts would be regarded as royalty and should be taxed on the gross basis under section 44D read with section 115A. While dealing with this matter, CIT(A) referred to the relevant provisions of Indian Copyright Act, 1957- Income-tax Act, 1961 and the relevant DTAA. He also considered the relevant circulars issued by the CBDT in this context as well as the report of the High Powered Committee set up by the Ministry of Finance, Government of India to examine the projected overall growth in e-commerce business, the flow of technology transfer in and out of India and their position of taxation in the light of existing

laws as well as the relevant DTAA. CIT(A) also carried out an exhaustive analysis of the OECD Model & the commentary on the same & he concluded that the receipts were in the nature of royalty. The assessee filed the appeal before the Tribunal to determine the character of the receipts under consideration.

Contentions of the assessee

The assessee made an exhaustive submission to contend that the receipts under consideration should not be considered as royalty. The assessee relied on several judicial precedents including on the decision of Special Bench of ITAT at Delhi in the case of Motorola Inc. Vs. DCIT. The assessee also pointed out that in the present case it did not grant any license to duplicate the software to the end users. There was thus no transfer of intellectual property right in the transaction and the license in question was a "non-exclusive restricted license" which granted only a limited right to use the software by creating a bar on the software being used in the public domain or for the purpose of commercial exploitation. It was further contended that the transaction thus was one of transfer of copyrighted article and no copyrights got transferred to the end users. The assessee also contended that the copyright of the software in the present case thus had remained with the assessee and even the learned CIT(A) has not been able to prove that intellectual property rights in the software were transferred permanently to the end user.

Contentions of the Revenue

The Revenue distinguished the judicial precedents cited by the assessee. The Revenue contended that the assessee in fact has retained the ownership of the input of the software such as program, instructions, process, etc. and only the device of software has been given to the users by granting user rights to the licensee and the consideration received for grant of such right to use the software is nothing but a royalty for giving license to use the rights in intellectual property which the assessee had developed in the form of software. The Revenue thereafter submitted that Explanation (2) to Section 9(1)(vi) clearly defines royalty and the said inclusive definition has to be understood in its letter and spirit without referring to any other enactment. The Revenue also referred to various judicial precedents to support its contentions.

Decision of the Tribunal

To conclude the character of the receipts under consideration, the Tribunal analysed the relevant provisions of the Act as well as of the tax treaty. The Tribunal also analysed the decision of the special bench in the case of Motorola

to arrive at certain conclusions on the matter of determination of the character of the receipts. The Tribunal also referred to various other judicial precedents and after carefully examining the facts of the case, it held that the amount received by the assessee under the license agreement for allowing use of the software was not 'royalty' either under the Income-tax Act or under DTAA. The Tribunal also held that the other receipts on account of maintenance charges and training fees being incidental to the software receipts assume the same character as that of software receipts and the same were liable to be taxed accordingly.

Our comments

It is commendable to observe that the Tribunal has followed the decisions of the Tribunal rendered in similar cases and has decided the issue in favour of the assessee applying the ratio thereof especially when there are no contrary decision of any higher forum directly on this point. The decision also brings out an exhaustive analysis on the subject of determination of the character of the receipts for the software industry.

REGULATIONS GOVERNING INVESTMENTS

PROMOTERS OF THE COMPANY MUST GIVE DETAILS OF PLEDGED SHARES: SEBI

The Security and Exchange Board of India (SEBI) has started tightening regulatory norms to restore the faith of investors in the securities market which eroded following the Satyam scam. SEBI has decided to make it mandatory on the part of promoters to disclose the details of the shares pledged by them of listed entities promoted by them.

The promoters will have to convey the details of the shares so pledged to the company and the company shall in turn inform of the same to the public through stock exchanges. Necessary steps to amend the relevant regulations and the listing agreement are expected to be taken shortly.

ACCOUNTS & AUDIT

Revised Standard on Auditing (SA) 570 (Revised) "Going Concern"

Recently the Institute of Chartered Accountants of India (ICAI) has come out with revised Standard on Auditing (SA) 570 (Revised) "Going Concern"

This Standard on Auditing (SA) deals with the auditor's responsibility in the audit of financial statements with respect to management's use of the going concern assumption in the preparation and presentation of the financial statements.

Under the going concern assumption, an entity is viewed as continuing in business for the foreseeable future. General purpose financial statements are prepared on a going concern basis, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Special purpose financial statements may or may not be prepared in accordance with a financial reporting framework for which the going concern basis is relevant. When the use of the going concern assumption is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

Effective Date

This SA is effective for audits of financial statements for periods beginning on or after April 1, 2009.

Standard on Internal Audit (SIA) 8 "Terms of Internal Audit Engagement"

Recently the Institute of Chartered Accountants of India (ICAI) has come out with Standard on Internal Audit (SIA) 8, Terms of Internal Audit Engagement.

The purpose of this Standard on Internal Audit is to establish standards and provide guidance in respect of terms of engagement of the internal audit activity whether carried out in house or by an external agency. A clarity on the terms of the internal audit engagement between the internal auditors and the users of their services i. e. "auditee" is essential for inculcating professionalism and avoiding misunderstanding as to any aspect of the engagement.

The internal auditor and the auditee should agree on the terms of the engagement before its commencement. The agreed terms would need to be recorded in an engagement letter. Normally, it is the responsibility of the internal auditor to prepare the engagement letter and it is to be signed both by the internal auditors as well as the auditee.

The terms of engagement of the internal audit inter alia define the scope, authority, responsibilities, confidentiality, limitation and compensation of the internal auditors. The terms of engagement should be approved by the Board of Directors or relevant Committee thereof such as the Audit Committee or such other person(s) as may be authorised by the Board in this regard. The terms should be reviewed by the internal auditor and the audit committee periodically and modified suitably, if required, to meet the changed circumstances.

The following are the key elements of the terms of the internal audit engagement:

Scope

(i) Responsibility

(ii) Authority

(iii) Confidentiality

(iv) Limitations

(v) Reporting

(vi) Compensation and

(vii) Compliance with Standards

ICAI AUDIT NORMS WILL GET LEGAL STATUS

To bring in a more transparent and credible auditing system in the country, the government proposes to give explicit legal status to the audit standards prepared by the Institute of Chartered Accountants of India (ICAI).

The Companies Bill, 2008 aims to make auditing standards statutory. It will make audit firms that do not follow these standards, punishable under the company law.

ICAI has a comprehensive list of auditing standards, but they lack a regulatory teeth. Under the present norms, breaching these standards can only lead to a disciplinary action against the guilty auditor. The Companies Bill 2008 proposes to make bring them at par with accounting standards which are already notified by the government.

The idea behind giving a statutory status to auditing standards is to make chartered accountants, who sign the financial statements of companies, accountable under the law and to provide a strong deterrence against violations. Once the auditing standards are notified by the government, an auditor found guilty of breaching them can be prosecuted under the company law.

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI) WILL REVEAL THE NAME OF AUDIT FIRMS WHO AVOIDS PROPER NORMS

The Institute of Chartered Accountants of India (ICAI) will reveal to the public the names of audit firms that overlook due diligence while auditing companies. This would act as a deterrent to audit firms from compromising on the quality of audit work as the bad publicity would make it lose its clients. This means that audit firms can no longer hide behind their corporate veil, but have to pay for the mistakes committed by their individual auditors.

ICAI will also tell capital market regulator SEBI to disallow auditing by any tainted auditor, which ICAI puts in the public domain, from auditing listed companies.

1,550 PROVIDEND FUNDS MAY LOSE IT'S INCOME TAX BENIFITS

Over 1,550 private provident fund trusts run by Indian companies could lose it's income tax benefits in less than three months time. These private trusts enjoy tax benefits on the basis of it's affiliation to the Employees Provident Fund Organization (EPFO) through temporary relaxations granted by EPFO. The deadline for getting recognized by the Government as an exempted fund under EPFO expires on March 31, 2009.

The finance ministry had mandated in 2006 that private provident trusts should obtain exemption under the EPF Act within a year from the labour ministry if it wanted to continue enjoying tax benefits under the Act. The deadline has been extended twice since then as the process has proved to be tedious.

The EPFO, which is supposed to forward exemption applications filed by the private trusts to the Government for final approval after scrutinizing them, has forwarded 400 applications of the total 1,550 in the last two-and-a-half years. The fate of these 400 funds is also not known as the labour ministry is in double minds about giving its approval. A labour ministry official clarified that several funds are violating investment accounting norms.

There are a total of 2,589 private trusts as per EPFO statistics, with Rs 65,000 crore corpus, which are recognized under the Income-Tax Act. However, only about 1,000 trusts enjoy the exempted status which was given to them way back in the seventies. The remaining trusts are operating as 'deemed exempted funds' as they only have temporary relaxation orders by the EPFO.

AMENDMENT IN COMPANIES (APPOINTMENT AND QUALIFICATION OF SECRETARY) AMENDMENT RULES 1988

Recently the Central Government has amended the Companies (Appointment and Qualification of Secretary) Rules, 1988 which will come into force from the 15th March, 2009.

Accordingly, after 15th March, 2009 every company having a paid up share capital of Rs. 5 crore and above shall be required to have a whole time Company Secretary and a company having a paid up share capital of Rs. 2 crore or more but less than Rs. 5 crore may appoint any individual who possess the qualification of membership of the Institute of Company Secretaries of India.

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