

RNM ALERT

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U.N. Marwah

Dear Readers,

We hope that all the readers whom are required to file their Return of Income by July 31 are well on course to finalising their financial statements expeditiously. As you are well aware, all individuals, HUF, body of individuals, association of persons and partnerships whom are not required to get their accounts audited u/s 44AB of the Income Tax Act, 1961 are required to file by the end of this month. We urge all our esteemed clients to ensure from their accounts staff that their Returns are under finalisation so that the due date can be met well in advance.

We as a member firm, are pleased to announce that Geneva Group International has been **ranked 7th** in **Accountancy Magazine's 2008 survey** of international networks and associations, up from last year's 8th place. GGI, which was established 13 years ago, was ranked 8th in the world in both 2006 and 2007 before climbing up a notch this year.

As the **biggest global multidisciplinary network**, GGI's cumulated fee income has reached **USD 3.146 billion**. GGI currently has **351 offices** in **66 countries**, **1,470 partners** and a total **professional staff of 12,023** to take care of the accounting, legal, taxation and consulting matters of their growing international clientele.

U.N. Marwah
Senior Partner

On behalf of the Editorial Team

[Service Tax]
**“Estate Builders” who
Construct Buildings/Premises
for themselves are not liable for
Service Tax**

The High Court of Guwahati in the matter of *Magus Construction (P.) Ltd. v Union of India* held that under the Finance Act, 1994, “service tax” is levied on “taxable service” only and not on “service provider”. A “service provider” is only a means for deposit of the “service tax” to the credit of the Central Government. Although the term “service receiver” has not been defined in the Finance Act, 1994, the “service receiver” is a person, who receives or avails the services provided by a “service provider”.

From the provisions of the law extracted hereinabove, it becomes abundantly clear that the burden of registration and payment of “service tax” is on the person, who provides “taxable service” to any person. According to the petitioner-company, it does not provide any “taxable service” to any person so as to warrant its registration under the Finance Act, 1994, and/or to pay any “service tax” thereunder. Any part of constructional activity for construction of building, which is carried out by the petitioner-company, is not a “service” rendered to any one, but an activity, which is carried out by the petitioner-company, for its own self. Since the very concept of rendering of “service” implies two entities, one, who renders the “service”, and the other, who is recipient thereof, it becomes transparent that an activity

carried on by a person for himself or for his own benefit, cannot be termed as “service” rendered.

Prior to the amendment of the Finance Act, 1994, in the year 2005, the Central Board of Excise and Customs, vide Circular No. 80/10/2004, dated September 17, 2004, clarified that “estate builders”, who construct buildings/premises for themselves (for their own use, renting it out or for sale thereof subsequently) are not covered within ambit of the “construction services”.

The clarification offered under the abovementioned circular, shall be applicable even after amendment of the Finance Act, 2005, whereby “construction service” includes construction of “residential complex”. Thus, construction of “residential complex” has also been brought within the purview of “service tax” and what kind of activities for “residential complex” would attract “service tax” would have to be understood in the light of the clarification, which the circular aforementioned offers.

When a builder, promoter or developer undertakes construction activity for its own self, then, in such cases, in the absence of relationship of “service provider” and “service recipient”, the question of providing “taxable service” to any person by any other person does not arise at all. In the present case too, the materials placed by the writ petitioners clearly show that the construction activities, which the petitioners have been undertaking, are in respect of the petitioners' own work and it is only the completed construction work, which is

sold by the petitioner-company to the buyers, who may have made agreements for sale before the construction had actually started or during the progress of the construction activity or at the end or completion of the construction activity. Any advance, made by a prospective buyer, or deposit received by the petitioner-company, is against consideration of sale of the flat/building to such prospective buyer and not for the purpose of obtaining “service” from the petitioner-company.

Trucker-operators exempted from service tax on supply to GTAs

The Central Government by Notification No. 29 dated 26.06.2008 has exempted the taxable service of supply of a goods carriage, without transferring right of possession and effective control of such goods carriage, referred to in sub-clause (zzzzj) of clause (105) of section 65 of the Finance Act, provided by any person to a goods transport agency for use by the said goods transport agency to provide any service, referred to in sub-clause (zzp) of clause (105) of section 65 of the Finance Act, to a customer in relation to transport of goods by road in the said goods carriage, from the whole of the service tax leviable thereon under section 66 of the Finance Act.

Leading Service Tax Case Laws

Service tax was not leviable on hire-purchase finance

Service Tax Case Laws

Service tax was not leviable on hire-purchase finance

In this case the Supreme Court of India upheld the decision of the Mumbai Tribunal that Hire-purchase Agreement and Hire-Purchase Finance are two different thing and service tax was not leviable on Hire-Purchase Finance.

(Commissioner Of Central Excise V. Bajaj Auto Finance Ltd. 2008 (10) STR 433 (SC))

When no tax is collected separately, the gross amount has to be adopted to quantify the tax liability

When the amount is collected for the provision of services, the total compensation received should be treated as inclusive of service tax due to be paid by the ultimate customer of the service unless service tax is also paid by the customer separately. So considered, when no tax is collected separately, the gross amount has to be adopted to quantify the tax liability treating it as value of taxable plus service tax payable. We find that this principle has been legislated with effect from 18-4-2006 in section 67(2) of the Finance Act, 1994. This principle has all along been relevant and had to be applied.

(Commissioner of Central Excise V. Advantage Media Consultant, 2008(10)STR 449(Tri-Kolkata))

Amounts shown in the income tax returns or balance sheet are not liable for service tax

In this matter Revenue proceeded to recover differential Service Tax on the basis of the balance sheet and the declaration made in ST-3 Returns for the year 2000-2001 which show certain amount due from the parties.

The Tribunal held that there are a number of previously decided cases which have settled the issue that amounts shown in the Income Tax returns or Balance Sheet are not liable for Service Tax. Those cases are as follow:

Tempest Advertising (p) Ltd. v. CCE-2007(5) STR 312 (Tri-Bang.); *Alpa Management Consultants P. Ltd. v. CST -2007 (6)STR 181 (Tri-Bang)*; *Free Look Outdoor Advertising v. CCE-2007(6)STR153 (Tri-Bang)*; *Kirloskar Oil Engines Ltd v. CCE-2004 (178)ELT, 998 (Tribunal)* and *Hindalco Industries v. CCE-2003 (161) ELT 346 (T)*

(Synergy Audio Visual Workshop P. Ltd. V. Commissioner Of S.T., Bangalore 2008 (10) STR 449 (Tri-Bang.))

[Income Tax]

India – Syria DTAA Revised

India and Syria on June 18, 2008 signed a revised Double Taxation Avoidance Agreement (DTAA) to facilitate mutual economic cooperation and stimulate flow of investment, technology and services between the two countries. The latest agreement has revised an earlier DTAA notified on June 25, 1985. Besides including anti-abuse provisions, the revised DTAA provides for source-based taxation of capital gains from sale of shares. Simply put, capital gains from sale of shares may be taxed in the country of source. The revised DTAA provides for exchange of

information between tax authorities of the two countries.

India- Luxembourg DTAA entered

In June 2008 the government of India, thru Shri R.S. Mathoda, Chairman of the Central Board of Direct Taxes has signed a Double Taxation Avoidance Agreement (DTAA) with the Luxembourg government, covering the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital.

The DTAA provides that capital gains from alienation of shares of a company shall be taxable in the country where the company is a resident. The incidence of double taxation shall be avoided by one country giving credit for taxes paid by its residents in the other country." There is a provision for exchange of information in cases, which are under investigation in either of the two countries. Both the countries shall assist each other in collection of revenue claims. There is also a provision for limitation of benefits under the DTAA to prevent misuse of the provisions of the DTAA.

ITAT rules on determining rental income for tax liability

The Income Tax Appellate Tribunal has ruled that the standard rent of property value, used in determining the taxability of house properties,

could be determined by applying a rate of 10% to the aggregate value of the actual cost of construction and the market price of the land at the time of commencement of the construction. The judgement follows an appeal by the revenue department against an order of the Commissioner of Income Tax (appeals) on the tax liability in respect of the property of a Delhi-based company. The CIT had turned down a revised assessment of the tax liability of the company's property by the assessment officer.

Monitoring Services Income to be Taxed as Business Profit

Income earned by the foreign technical consultants for providing monitoring services to Indian entities will be taxed at higher rate as business profits as opposed to royalties which are taxed at 15 percent as per the DTAA, the authority for Advance Ruling has said. The ruling was given after Australia based Worley Parsons Services filed an application asking whether the monitoring services provided by its Indian arm to dehej – vijaipur gas pipeline project of GAIL would be treated as royalty under the Double Tax Avoidance Agreement (DTAA) or “business profit.” The income from such receipts is liable to be taxed as business profits in India the AAR said. Giving its ruling, the AAR held that as the receipts under the contract with GAIL, signed in July 2003, were not in nature of royalties , “income from such receipts are liable to be taxed as business profits in India”.

Sourcing arms of NRIs not to pay tax

In a landmark decision, the Bangalore Tribunal has ruled that the income arising from non-resident Indians' (NRIs') sourcing operations through liaison offices in India is not taxable.

The liaison offices have of late come under the scanner of the revenue department. The tax authorities are of the view that sourcing goods from India through agents is a revenue-generating activity and so income from it should be taxed.

The ruling is a breather for NRIs buying goods through agents in India for exports. The ruling is also important as it sets a principle that the purchase activity is not taxable in India, irrespective of whether the goods are purchased by the principal or the agent.

The tribunal had last week ruled this in favour of a global sports apparel firm headquartered in the US. "It has affiliates in various countries. The assessee assists its affiliates in procuring goods from manufacturers in many parts of the world as a buying agent and gets remuneration on a commission basis," said an official involved in the process.

The assessee has entered into an agreement with manufacturers in India for procurement of goods, which are directly shipped to the affiliate's location. The assessee had set up a liaison office in the country with the approval of the Reserve Bank of India (RBI). The

activities included giving opinion on prices and supervising progress and quality at the manufacturing workshop.

The revenue authorities said the activities of the liaison office extended beyond the RBI approval. They further argued that the exclusion to business connection in respect of "purchase of goods by a non-resident for the purpose of export" would not apply to the assessee since it does not take title to the goods. A percentage of the value of exports was considered as income attributable to the India operations.

The Bangalore Tribunal held that irrespective of whether the principal purchased directly or through an agent, the activity would be excluded from the gamut of business connection so long as the purchase is exports-related. Hence, no income is accrued or deemed to accrue or arise in India.

The tribunal also observed that the assessee is not representing the manufacturer but is an agent of the affiliates. The liaison office only ensures and supervises the manufacturing activity as an agent of the affiliates. The manufacturer does not receive any services from the liaison office or the assessee. The activities of the liaison office were well within the limits prescribed by the RBI, it said.

Expenditure on exempt income

The Mumbai Income-Tax Tribunal has held that expenditure incurred in relation to an exempt income can be disallowed only if the assessee has earned such income. In the relevant case, an

assessee had not received any dividend income from its investments in shares during the previous year. However, it claimed deduction for interest paid on loan obtained for making such investments. The assessing officer (AO) was of the view that though there was no dividend income earned by the assessee during the year, even if any income was to accrue to the assessee it would have been dividend, which is exempt from tax. Accordingly, he disallowed claim of assessee, under section 14A of the Income-Tax Act, 1961. The tribunal held that disallowance under section 14A of the Act can be made in respect of that expenditure which has been incurred in relation to income which does not form part of total income. Otherwise, words 'does not form part of the total income' used in section 14A of the Act would become otiose. As there was no dividend income earned by the assessee, provisions of section 14A were not applicable and accordingly, interest paid on loan was allowable as a deduction.

Leading I.T. Case Laws

When business can be said to have been set up/commenced by assessee in case of consultancy business (Third Member Order of ITAT) - The business is set up and commences when the assessee is ready to give consultancy to its prospective customers, and merely because no actual amount is received as charges, it cannot be said that the business is not set up - *Styler India Pvt. Ltd. v. Jt. CIT [ITA No. 498/PN/2003]*

Treatment of income generated out of sale of shares held by assessee as personal investment - Income generated out of sale of said shares which had been held by assessee for more than one year was liable to be treated only as long-term capital gains - ITO v. V.N. Aggarwal [ITA No. 2030/Del/2006 and 1663/Del/2006]

Whether the tax deductible at source can be excluded from the tax payable while computing the liability on account of advance tax even in cases where tax has not actually been deducted at source? - The tax deductible at source has to be excluded while computing the advance tax liability as provided in section 209(1)(d) of the Income-tax Act, 1961; even if the tax has not actually been deducted - DCIT v. Pride Foramer SAS [ITA NOS. 4043,4044,4046-50 and 4053/del/2007]

Employee not liable to pay interest under section 234B of the Income-tax act, 1961 for the default of deduction/non-payment of TDS by employer in respect of payments of salary/perquisites made to the employee - Basically the liability to deduct tax at source, in relation to payment made to the employee in the nature of salary which includes perquisite, is that of the employer, which liability is absolute and for non-deduction of same by the employer, the employee is not liable to pay interest under section 234B - ACIT v. VIJAY GOPAL JINDAL [ITA NO. 1021/DEL/04]

Allowability of expenditure on brokerage paid to brokers in connection with renting

out of the property - The brokerage payable by the assessee for renting out the premises neither can be deducted from the rent under section 23 of the Income-tax Act, 1961 nor the same is allowable as a deduction under section 24 of said Act - Tube Rose Estates Pvt. Ltd. v. ACIT [ITA NO. 4530/DEL OF 2004]

Treatment of expenses incurred in respect of business or profession newly set up or a source of income newly coming into existence- If there is a new source of income newly coming into existence, the date of coming into existence of the new source of income will be material to allow the claim for deduction of revenue expenses; till the time of the coming into existence of a new source of income, all expenses whether revenue or capital connected with setting up of such business, would be capital expenditure and not allowable as deduction - DCIT v. Sterling Synergy Systems (P.) Ltd [ITA NO. 7280/MUM/04]

[FEMA]

Overseas Investment-Liberalisation/ Rationalisation

The Reserve Bank of India vide A.P. (DIR Series) Circular No. 48 dated June 03, 2008 has made certain liberalizations as per the Annual Policy Statement for the year 2008-09:-

- i. Overseas investment in Energy and natural resources sectors- to allow Indian companies to invest in excess of 400 per cent of their net worth, as on the date of the last audited balance sheet, in the

energy and natural resources sectors such as oil, gas, coal and mineral ores. The investments in excess of 400 per cent of the net worth shall be made only with the prior approval of the Reserve Bank

- ii. Investment overseas in unincorporated entities in Oil sector- ONGC Videsh Ltd (OVL) and Oil India Ltd (OIL) are also now permitted, on par with Navaratna Public Sector Undertakings (PSUs) which were earlier allowed to invest in overseas unincorporated entities in oil sector (i.e. for exploration and drilling for oil and natural gas, etc.), which are duly approved by the Government of India, without any limits, under the automatic route.

Similarly, it has now been decided, in consultation with the Government of India, to allow a similar facility to other Indian entities to invest in overseas unincorporated entities in oil sector, provided that the proposal has been approved by the competent authority and supported by a certified copy of the Board resolution approving such investment.

- iii. Capitalisation of exports- an Indian Party making direct investment outside India in accordance with the Regulations, by way of capitalization, in full or part of the amount due to the Indian Party from the foreign entity on account of payment for export of plant, machinery, equipment and other goods / software to the foreign

entity, has to obtain the prior approval of the Reserve Bank where such export proceeds have remained unrealized beyond a period of six months from the date of exports. In order to align this provision with the Foreign Trade Policy, Indian parties may, henceforth, approach the Reserve Bank for capitalization of export proceeds only in cases where the exports remain outstanding beyond the prescribed period of realisation.

Overseas Direct Investment by Registered Trust/ Society

The Reserve Bank of India vide A.P. (DIR Series) Circular No. 53 dated June 27, 2008 has widened the ambit of entities that are permitted to make overseas direct investment to allow Registered Trusts and Societies engaged in manufacturing / educational sector to make investment in the same sector(s) in a Joint Venture or Wholly Owned Subsidiary outside India, with the prior approval of the Reserve Bank.

Export of Goods and Services- realization and repatriation of Export proceeds- liberalisation

The Reserve Bank of India has vide A.P. (DIR Series) Circular No. 50 dated June 03, 2008 enhanced the present period of realization and repatriation to India of the amount representing

the full export value of goods or software exported, from **six months** to **twelve months** from the date of export, subject to review after one year. The provisions in regard to period of realization and repatriation to India of the full export value of goods or software exported by a unit situated in Special Economic Zone (SEZ) as well as exports made to warehouses established outside India with the permission of Reserve Bank remain unchanged.

[SEBI]

SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 notified

As per PR. No. 124/2008 dated June 19, 2008 the SEBI has highlighted the amendment to Securities Contracts (Regulation) Act, 1956 (SCRA) which enabled SEBI to provide for disclosure based regulation for public issue of or listing of securitized debt instruments on the recognized stock exchanges with a view to develop market for securitized debt instruments. Accordingly, SEBI has notified SEBI (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 on May 26, 2008 taking into account the market needs, cost of the transactions, competition policy, the professional expertise of credit rating agencies, disclosures and obligations of the parties involved in the transaction and the interest of investors in such instruments

Some its key features are stated hereunder:-

- (a) The special purpose distinct entity i.e. issuer shall be in the form of a trust, the trustees thereof will require registration from SEBI. The registration granted to a trustee shall be permanent subject to compliance with the provisions with the SCRR and the regulations and payment of appropriate fees.
- (b) If a debenture trustee registered with SEBI or a securitization company or a asset reconstruction company registered with Reserve Bank of India or National Housing Bank or the NABARD is the trustee of the issuer no registration from SEBI to act as such shall be required.
- (c) The securitized debt instruments issued to public or listed on recognized stock exchange shall acknowledge the beneficial interest of the investors in underlying debt or receivables assigned to the issuer. The regulations provide flexibility in terms of pay through / pass through structures and do not restrict any particular mode.
- (d) The assignment of assets to the issuer shall be a true sale. The debt or receivables assigned to the issuer should be expected to generate identifiable cash flows for the purpose of servicing the instrument and the originator should have valid enforceable interests in the assets and in cash flow of assets prior to securitization.
- (e) The issuer shall be a bankruptcy remote from the originator. Originator shall be an

independent entity from the issuer and its trustees and the originator and its associates shall not exercise any control over the issuer. However, the originator may be appointed as a servicer. The issuer may appoint any other person as servicer in respect of any its schemes to co-ordinate with the obligors, manage the said pool and collection therefrom, administer the cash flows of asset pool, distribution to investors and reinvestments. The issuer shall not acquire any debt or receivables from any originator who is part of the same group or which is under the same management as the trustee. Regulations require strict segregation of assets of each scheme.

(f).The issuer may offer securitised debt instruments to public for subscription through an offer document containing disclosures of all relevant material facts including financials of the issuer, originator, quality of the asset pool, disclosure of various kinds of risks, credit ratings including unaccepted ratings, arrangements made for credit enhancement, liquidity facilities availed, underwriting of the issue etc. apart from the routine disclosures relating to issue, offer period, application, etc.

(g)Rating from atleast two credit rating agencies is mandatory and all ratings including unaccepted ratings shall be disclosed in the offer documents. The rating rationale should include reference to the quality of the said pool and strengthen of cash flows, originator profile, payment

structure, risks and concerns for investors, etc.

(h) The instrument shall be in dematerialized form.

(i)The draft offer document shall be filed with SEBI atleast 15 days before opening of the issue.

(j) In case of public issuances listing will be mandatory. The instruments issued on private placement basis may also be listed subject to the compliance of simplified provisions of the regulations. The securitised debt instruments issued to the public or listed on a recognized stock exchange in accordance with these regulations shall be freely transferable.

(k). It has been proposed to introduce simplified and relaxed listing agreement. Listing of private placement is also permitted subject to the compliance of simplified provisions of the listing agreement and the regulations. The simplified listing agreement is under preparation.

HEAD OFFICE:

Mr. U.N. Marwah, Senior Partner
4/80, Janpath
New Delhi-1100 01
(India)
Tel: +91-11-2332 2685 2332 0601
Fax: +91-11-23322520
E-mail: rnm@rnm.in

BRANCH OFFICE:

Mr. Narendra Sanklecha
813 Oxford Towers,
139 Airport Road,
Bangalore-560 008
Tel.: +91-80-23612337, +91- 98440 62721
E-mail: bangalore@rnm.in

AFFILIATE OFFICES

Mumbai

Mr. Harshal Aggarwal
204, Mhatre Pen Building,
Senapati Bapat Marg, Dadar (W),
Mumbai-400 028
Tel. +91 22 24314881, +91 22 24314882
Fax. +91 22 24363312
E-mail: harshal@rnm.in

Pune

Mr. Nitin Khangaonkar
9 'B' & 'C' Wing,
Supriya Gardens, Aundh,
Pune- 411 007
Tel: +91 98230 81701
E-Mail: nitin@rnm.in

Chennai

Mr. Ashok Deora
SF 6, Golden Enclave,
184 Poonamallee High Road,
Chennai- 600 010
Tel: + 91 44 4217 8153, + 91 44 2641 5805
Fax : + 91 44 2641 5805
E-mail: ashok@rnm.in

Mauritius

Mr. Kamal Hawabhay,
365 Royal Road Rose Hill, Mauritius
Tel : + 230 4542110
Fax : + 230 4549671
E-mail: kamal@rnm.in

Hong Kong

Mr. Raymond Choi
3705 Bank of America Tower
12 Harcourt Road
Central
Hong Kong
Tel: +852 2115 9878
Fax: +852 2115 9818
E-mail: raymond@rnm.in

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