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CASE LAWS

Foreign:

Dattani and Co.
v.
Income Tax Officer

ITA No.: 7408/Mum/2010
(Assessment year: 2002-2003) &
ITA No.: 7641/Mum/2010
(Assessment year: 2002-2003)

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Kind regards

Mrs. Huzaima Bukhari
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Check on Real Estate to trace real investment

by
T.V. Ganesan

The Finance Act, 2013 has made amendments which will have far reaching implications on the real estate transactions, especially during the Financial Year 2013-14 relating to the Assessment year 2014-15. One of the amendments relates to taxation of a deemed income in the same manner as gift wherein an immovable property, namely, land, building, flat, etc., if purchased for a consideration of less than the stamp duty valuation, viz., the circle rate in which the difference is more than Rs. 50,000. This article highlights the various amendments which will have a bearing on the real estate transactions, with special reference to the impact on the real estate builders as well as on the investors.

Introduction

1. It is true that almost everyone would like to own a residential flat as it is one of cherished desires of an individual during his lifetime. It is not uncommon that people already owning residential flats are aspiring for a second home, villa or weekend home due to various tax benefits and also from investment perspective. Government is also equally trying to get maximum tax on these real estate transactions by imposing VAT and service tax apart from the stamp duty charged according to the State Stamp Act. The Finance Act, 2013 and its amendments relating to some of the real estate transactions have received a mixed response and will have far reaching consequences, both for the real estate companies as well as for the individuals who are aspiring to have apartments, especially large sized apartments costing above a threshold limit. In this article, the author has enumerated the important amendments relating to taxing the notional income in real estate transactions as against the real income of both, real estate companies as well as of the investors. These amendments and provisions should be properly understood before entering into real estate transactions during the fiscal year 2013-14, or else the real estate players will face serious consequences in concluding the transactions.

Service Tax on real estate transactions applicable w.e.f. 8-5-2013

2. The service tax on value of the real estate transactions would be levied as per the table below:–

Service Tax on 25% of the gross amount charged as determined as per the Notification No. 26/2012-ST	Service tax on 30% of the gross amount charged as determined as per the Notification No. 26/2012-ST
Conditions:–	***Applicability:*** The following fall under this case–
1. Property is Residential property; and	1. property is non-residential; or

2. Property has carpet area of less than 2000 sq.ft.; and	2. property is residential property having carpet area of more than or equal to 2000 sq.ft. or
3. Amount charged for property/flat is less than Rs. 1 crore.	3. amount charged is Rs. 1 crore or more.

Note : The provisions that existed prior to 8-5-2013 have been ignored for the purposes of analysis under this Article.

Here, for determining taxable value the amount actually charged from the customer as consideration shall be taken (as determined as per the Notification No. 26/2012-ST) and the stamp duty valuation is irrelevant.

Comments

3. It can be inferred from the provisions that the rate of abatement on residential units sized 2000 sqft. or more or those price Rs. 1 crore or more has been reduced by 5% from 75% to 70%. This will result in an increase in service tax outflow. It is to be noted that the rate of abatement or deduction is used in the calculation of service tax to be paid by developers. It can be said that the lower the abatement, higher would be the service tax liability.

Circle rate to be adopted for computation of profits and gains of business or profession

3. The Finance Act, 2013 has introduced a new section 43CA wherein stamp duty value to be considered for the purpose of computation of income under the head "Profits and Gains of Business or Profession" is covered in respect of all transactions relating to land or building or both. Said amendment would affect the real estate builders. This is because the income would be computed on the basis of notional income and not on the basis of real income appearing in the books of the taxpayer.

3.1 ***Comments and observations on circle rates to be adopted for transactions relating to land or building*** - If X sells a property for Rs. 95 lakhs and during the registration of the Sale Deed at the office of Registrar, he finds the valuation of the property as per circle rate to be Rs. 105 lakhs, then the stamp duty shall be payable on Rs. 105 lakhs, even though X received a payment of Rs. 95 lakhs only. The stamp duty is being paid by the buyer. But in view of the provisions contained in section 50C of the Income-tax Act, 1961, X will be liable to payment of capital gains by treating the sale price as Rs. 105 lakhs, which is the circle rate or the stamp duty authority's value of the said property. Hence, for all purposes while computing the capital gain X will have to take into consideration the sale price as Rs. 105 lakhs, being the value adopted by the stamp duty authority for the purpose of charging stamp duty on sale consideration. The aforesaid provision is applicable to all taxpayers and assessees who earn income by transferring/selling real estate assets and, thus, are liable to capital gains tax. This provision creates a very difficult situation for the seller of the property, as he is required to pay tax on extra money which he never received. Alternatively, if seller wants to claim exemption by investing in a residential house or capital bonds, depending upon the facts of his case, then he is required to invest an extra amount which he never received on sale. However, this provision is not applicable to persons deriving business income by selling immovable property, *i.e.* , these provisions do not apply to transfer of immovable property, which is held by the transferor as his stock-in-trade. The Allahabad High Court in the case of *CIT* v. *Kan Construction & Colonizers (P.) Ltd.*

The Limitation of Benefits Clause in Double Taxation Avoidance Agreements

by
Abhinav Kumar & Devanshu Sajlan

Introduction

1. The need for Agreement for Double Tax Avoidance arises because of conflicting rules in two different countries regarding chargeability of income based on receipt and accrual, residential status, etc. As there is no clear definition of income and taxability thereof, which is accepted internationally, an income may become liable to tax in two countries. In such a case, the two countries have an Agreement for Double Tax Avoidance, in which case the possibilities are: (i) the income is taxed only in one country, (ii) the income is exempt in both countries, (iii) the income is taxed in both countries, but credit for tax paid in one country is given against tax payable in the other country. In India, the Central Government, acting under section 90 of the Income-tax Act, has been authorized to enter into double tax avoidance agreements. The aim of the article is to ascertain whether a 'Limitation of Benefits' clause is necessary in DTAA's to prevent revenue loss or in other terms whether the absence of a 'limitation of benefits' clause in a Double Taxation Avoidance Agreement would lead to revenue loss for contracting States?

Treaty Shopping-Pros and Cons of

2. Treaty shopping is defined as the practice of some investors of 'borrowing' a tax treaty by forming an entity (usually a corporation) in a country having a favourable tax treaty with the country of source, that is, the country where the investment is to be made and the income in question is to be earned.[1]

Successful treaty shopping generally consists of following two elements:

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[1] Rosenbloom, David (1994) Derivative Benefits: Emerging US Treaty Policy [1994] 22 Intertax 83. For a description of various treaty-shopping arrangements see OECD Conduit Companies Report in OECD, Committee on Fiscal Affairs of the OECD, International Tax Avoidance and Evasion, Four Related Studies, Double Taxation Conventions and the Use of Conduit Companies, Issues in International Taxation Series, No. 1 (OECD, Paris, 1987).

- a favourable income tax treaty with the country in which investment has to be done
- Attractive internal tax laws.[1]

Treaty-shopping is arguably, an instrument of international tax planning. What is about this kind of tax planning that makes it objectionable? A number of arguments have been advanced in the international tax community.[2]

2.1 *Arguments in favour of Treaty Shopping* - In *Union of India v. Azadi Bachao Andolan*,[3] the Supreme Court emphasized on that in developing countries treaty shopping was often regarded as a tax incentive to attract scarce foreign capital or technology.

Developing countries need foreign investments. The treaty shopping opportunities can be additional factors to attract them.[4] The developing countries allow treaty shopping to encourage capital and technology inflows, which developed countries are keen to provide to them. The loss of tax revenues could be insignificant compared to the other non-tax benefits to their economy.[5] Many of them do not appear to be too concerned, unless the revenue losses are significant compared to the other tax and non-tax benefits from the treaty, or the treaty shopping leads to other tax abuses. Treaty shopping may be a necessary evil, tolerated in a developing economy in the interest of long-term development.[6]

IT can be argued that when treaty-shopping increases economic activity, the overall economic gain might exceed source country's losses.

2.2 *Arguments against Treaty Shopping* - Treaty shopping is perceived as harmful by both, the OECD[7] and the UN[8]. The revenue loss due to treaty shopping is massive if the statistics are looked at.[9] India's tax treaty with Mauritius was reviewed because the tax department had estimated a revenue loss of over Rs. 5,000 crore caused by treaty shopping.[10]

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1 See Johnson, Antilles Treaty Termination Favored, But Period of Uncertainty in Bond Market Lies Ahead, 36 TAX NOTES 127, 129 (1987), See generally Belotsky, The Prevention of Tax Havens Via Income Tax Treaties, 17 CAL. W. INT'L L.J. 43, 97 (1987).

2 Avi-Yonah, Reuven S. and Panayi, Christiana Hji, Rethinking Treaty-Shopping Lessons For The European Union, Public Law And Legal Theory Working Paper Series, Working Paper No. 182, January, 2010, p.6.

3 [2003] 132 Taxman 373 (SC).

4 Eduardo Baistrocchi, "The Use and Interpretation of Tax Treaties in the Emerging World: Theory and Implications", [2008] 4 British Tax Review 352.

5 Ibid, p. 281.

6 Ibid.

7 O.E.C.D., International Tax Avoidance and Evasion, Four Related Studies, Issues in International Taxation Series , Committee on Fiscal Affairs, at 90 (1987).

8 U.N. Ad Hoc Group of Experts on International Co-operation in Tax Matters, 4th Meeting, Prevention of abuse of tax treaties , United Nations Secretariat, New York, 1987, at 96 (1987).

9 Manju Menon, India asks Mauritius to review tax treaty, Times of India, Jan. 19, 2007.

10 Ibid.

2.2-1 *Treaty Shopping breaches the reciprocity of a tax treaty* - Firstly, it has been argued that treaty-shopping is an instance of tax avoidance and, as such, improper and contrary to the purposes of tax treaties.

IT has also been argued that treaty-shopping breaches the reciprocity of a treaty and alters the balance of concessions attained therein between the two contracting States.[1] Treaty shopping certainly leads to revenue loss as it violates the principle of reciprocity.[2] The State of residence receives disproportionate benefits[3] as compared to the source State due to treaty shopping. When a third country resident 'shops' into a treaty, then the treaty concessions are extended to a resident, whose State has not participated in this arrangement and may not reciprocate with corresponding benefits (*e.g.*, exchange of information). The usual quid *pro quo* of the treaty is therefore, compromised and the process subverted.[4]

2.2-2 *Treaty Shopping leads to revenue gains for third countries* - Another argument is based on the principle of economic allegiance. Pursuant to economic allegiance, a taxable base is attributable to the jurisdiction in which it is thought to owe its economic existence. Tax treaties are premised on the allocation of taxing rights according to this principle. Treaty concessions are of a personal nature and are not to be extended to third country residents. As a result of treaty-shopping, the third country gains revenue power, in the absence of any (substantial) claim to economic allegiance.[5]

Furthermore, it is often claimed that treaty-shopping creates a disincentive for countries to negotiate tax treaties. If third countries can get the benefits of reduced taxation for their residents without conferring reciprocal benefits to non-resident investors, then there is no need to enter into a tax treaty, especially if there are concerns that the treaty might be imbalanced.[6] This may put countries which comply with their duties of fiscal co-operation arising through tax treaties (e.g., exchange of information), at a competitive disadvantage internationally. Furthermore, lack of fiscal co-operation enhances opportunities for international tax evasion.[7]

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1 See Income Tax Treaty Shopping: An Overview of Prevention Techniques, 5 Nw. J. Int'l L. & Bus. 626 1983-84.

2 Simon M. Haug., The United States Policy of Stringent Anti Treaty Shopping Provisions: A Comparative Analysis, Vol. 29, Vanderbilt Journal of Transnational Law, 1996, p. 217. ("The principle of reciprocity states that favours, benefits, or penalties that are granted by one State to the citizens or legal entities of another, should be returned in kind.").

3 Ibid. ("The fact that in 1981, 68 per cent of US source income flowed to only five US treaty countries, three of which were tax havens, indicates that many third country investors took advantage of an existing treaty network for their investments in US.").

4 Avi-Yonah, Reuven S. and Panayi, Christiana Hji, Rethinking Treaty-Shopping Lessons For The European Union, Public Law And Legal Theory Working Paper Series, Working Paper No. 182, January, 2010, p.8.

5 Ibid.

6 Conduit Companies Report, paragraph 7 (c); Becker & Würm (1988) 6.

7 Ibid.

2.2-3 *Treaty Shopping leads to revenue loss* - Finally, it is argued treaty-shopping is often linked with (undesired) revenue loss.[1] Tax treaties are based on a perceived level of balance of actual and potential income and capital flows between one country and the other. When the benefits of the given treaty are abused, the level and balance of these flows are distorted, with a resulting distortion in the share of the relevant chargeable income channelled to each State. Treaty-shopping expands the normal bilateral relationship of the treaty. A generous treaty with one trading partner becomes a treaty with the world. This de facto multilateralisation of the tax treaty is thought to entail a large and indeterminate cost to the source country.[2]

An analysis of Limitation of Benefits clause

3. An LOB provision is an anti-abuse provision that sets out which residents of the Contracting States are entitled to the treaty's benefits. The purpose of an LOB provision is to limit the ability of third country residents to obtain benefits under the said treaty. This type of use of the treaty, where third country residents establish companies in a Contracting State with the principal purpose to obtain the benefits of the treaty between the Contracting States, is commonly referred to as 'treaty shopping'.

> "Treaty shopping" is a graphic expression used to describe the act of a resident of a third country taking advantage of a fiscal treaty between two Contracting States. According to Lord McNair, "provided that any necessary implementation by Municipal law has been carried out, there is nothing to prevent the nationals of 'third States', in the absence of any expressed or implied provision to the contrary, from claiming the right or becoming subject to the obligation created by a treaty".[3]

A limitation of benefits clause usually includes the following: "substantial nexus" tests for a corporate entity to be eligible for tax treaty benefits; have its principal class of shares regularly traded on a recognized securities exchange;[4] satisfy more than fifty per cent ownership test and

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[1] Rosenbloom, David & Langbein, Stanley, United States Tax Treaty Policy: An Overview (1981) 19 Colum. J. Transnational Law 84.

[2] Rosenbloom, David (1994) Derivative Benefits: Emerging US Treaty Policy [1994] 22 Intertax 84.

[3] Lord McNair, THE LAW OF TREATIES, Oxford, at the Clarendan Press, 1961, p. 336.

[4] Draft U.S. Model Income Tax Treaty, June 16, 1981, reprinted in [Feb. 1993] 1 Tax Treaties (CCH) 211 ("[A] 'publicly traded' safe harbor provision is ordinarily included in a limitation of benefits provision. [A] corporation organized in Country A will be treated as a Country A corporation if its shares are publicly traded there."); Convention for the Avoidance of Double Taxation, U.S.-Russ., art. 20(2), reprinted in [Feb. 1993] 3 Tax Treaties (CCH) 1 10,660.41.

not more than fifty per cent base erosion test[1]; or be a "not for profit" entity.[2]

Better transparency and information exchange for tax purposes are keys to ensuring that taxpayers have no place to hide their income and assets and that they pay the right amount of tax in the right place.[3]

3.1 *'Limitation on Benefits' clause as a solution* - USA remains the most vocal opponent to such practices. The US Model, which defines treaty-shopping non-exhaustively, contains an unequivocal statement in that "tax treaties should include provisions that specifically prevent misuse of treaties by residents of third countries".[4] The 'Limitation on Benefits' clause (LOB) is contained in Article 22 of the U.S. Model Tax Treaty. In general, the provision does not rely on a determination of purpose or intention, but instead sets forth a series of objective tests. A resident of a Contracting State that satisfies one of the tests will receive benefits regardless of the motivations in choosing its particular business structure. The LOB provision attempts to distinguish between treaty shopping arrangements (the target of the LOB clause) and *bona fide* transactions of enterprises operating internationally.

Article 22 contains anti-treaty-shopping provisions that are intended to prevent residents of third countries from benefiting from what is intended to be a reciprocal agreement between two countries. The structure of the Article is as follows:

> Paragraph 1 states the general rule that residents are entitled to benefits, otherwise accorded to residents only to the extent provided in the Article. Paragraph 2 lists a series of attributes of a resident of a Contracting State, the presence of any one of which will entitle that person to all the benefits of the Convention. Paragraph 3 provides that, regardless of whether a person qualifies for benefits under paragraph 2, benefits may be granted to that person with regard to certain income earned in the conduct of an active trade or business. Paragraph 4 provides that benefits also may be granted if the competent authority of the State from which benefits are claimed determines that it is appropriate to provide benefits in that case. Paragraph 5 defines certain terms used in the Article.

3.2 *Three Principal Test* - A limitation of benefits clause usually includes the following: "substantial nexus" tests for a corporate entity to

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1 W. P. Streng, Treaty Shopping: Tax Treaty "Limitation Of Benefits" Issues , 15 HOUS. J. INT'L L. 1, 32-33 (1992) ("[A] base erosion test ordinarily requires that no more than a specified percentage e.g., fifty per cent of the taxpayer company's gross income can flow-through the corporation to non-eligible persons.").

2 Convention for the Avoidance of Double Taxation, art. 28(1)(c) & (f), Aug. 29, 1989, 5 U.S.T. 2769 ("[T]he German-U.S. Income Tax Treaty entered into force on August 21, 1991, effective retroactively to years beginning in 1990.").

3 Information of the OECD website.

4 See Technical Explanation on Article 22 of US Model.

be eligible for tax treaty benefits; have its principal class of shares regularly traded on a recognized securities exchange;[1] satisfy a more than fifty per cent ownership test and not more than fifty per cent base erosion test[2]; or be a "not for profit" entity.[3]

The LOB Clause uses following three principal tests to determine eligibility for treaty benefits:

(i) Public company test;

(ii) Ownership/Base-erosion test; and

(iii) Active Business Test/Economic Substance Doctrine

Note the tests are not concurrent tests. Only one test needs be satisfied.

3.2-1 *The public company test* - The public company test is based on the assumption that a publicly traded company has sufficient connection to the country in which its shares are listed. Where shares are not listed on a Stock Exchange of the country of residence, treaty benefits are not available, unless the company's primary place of management and control is located in the country of residence.[4]

The public company test applies to publicly traded companies and subsidiaries of publicly traded companies. Under this test a company must satisfy the following criteria:

(i) the principal class of its shares and any disproportionate class of shares are regularly traded on one or more recognized Stock Exchanges, and

(ii) the company's principal class of shares is primarily traded on one or more recognized Stock Exchanges located in the State of residence, or

(iii) the company's primary place of management and control are in State of residence.[5]

3.2-2 *The ownership and Base Erosion Test* - The ownership and base erosion test is a two-part test. Both prongs of the test must be satisfied

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[1] Draft U.S. Model Income Tax Treaty, June 16, 1981, reprinted in [Feb. 1993] 1 Tax Treaties (CCH) 211 ("[A] 'publicly traded' safe harbor provision is ordinarily included in a limitation of benefits provision. [A] corporation organized in Country A will be treated as a Country A corporation if its shares are publicly traded there."); Convention for the Avoidance of Double Taxation, U.S.-Russ., art. 20(2), reprinted in [Feb. 1993] 3 Tax Treaties (CCH) 1 10,660.41.

[2] W. P. Streng, Treaty Shopping: Tax Treaty "Limitation Of Benefits" Issues , 15 HOUS. J. INT'L L. 1, 32-33 (1992) ("[A] base erosion test ordinarily requires that no more than a specified percentage e.g., fifty per cent of the taxpayer company's gross income can flow-through the corporation to non-eligible persons.").

[3] Convention for the Avoidance of Double Taxation, art. 28(1)(c) & (f), Aug. 29, 1989, 5 U.S.T. 2769 ("[T]he German-U.S. Income Tax Treaty entered into force on August 21, 1991, effective retroactively to years beginning in 1990.").

[4] Report of the OECD on Fiscal Affairs - "Double Taxation Conventions and the Use of Conduit Companies" (2005).

[5] Avi-Yonah, Reuven S. and Panayi, Christiana Hji, Rethinking Treaty-Shopping Lessons For The European Union, Public Law And Legal Theory Working Paper Series, Working Paper No. 182, January, 2010, p.17.

for the resident to be entitled to treaty benefits under this test. The ownership/base erosion test attempts to ensure that if a State of residence company enjoys benefits as a resident of the State R, the ultimate beneficiaries of treaty relief are residents of the State R, and not residents of third States.

The ownership prong of the test requires that 50 per cent or more of each class of shares in the State of residence enterprise is owned, directly or indirectly, on at least half of the days of the taxable year of the State R enterprise by persons who are residents of State R and that are themselves entitled to treaty benefits under one of the tests for benefits eligibility. In the case of indirect owners, however, each of the intermediate owner must be a resident of State R.[1]

The base erosion test ordinarily requires that no more than a specified percentage, *e.g.*, fifty per cent of the taxpayer company's gross income can flow through the corporation to non-eligible persons. The base erosion prong is not satisfied if 50 per cent or more of the gross income of a State R enterprise for the taxable year, as determined under the tax laws of State R, is paid or accrued to persons who are not residents of State R entitled to benefits under one of the tests for benefit eligibility, in the form of payments deductible for tax purposes in State R.[2]

3.2-3 *Economic Substance Doctrine* - Under the Economic Substance Doctrine, the Court may decline tax benefits arising from transactions that do not result into a meaningful change to the taxpayer's economic position other than purported reduction in federal income-tax.[3] In *Aiken Industries, Inc . v. Commissioner*[4], a US subsidiary borrowed funds from its parent company in Ecuador, and in order to be able to exempt the interest payments under the US-Honduras treaty, paid the interest to a subsidiary in Honduras. The US Tax Court disallowed treaty benefits in this back-to-back loan, because in the absence of a business purpose, the Honduran affiliate acted as a conduit for passing the interest payments to its parent in Ecuador.[5]

The court in *ACM Partnership v. Commissioner* [6] scrutinized the transaction under the economic substance test, which it described as containing separate, but interrelated inquiries:

> 'The inquiry into whether the taxpayer's transactions [have] sufficient economic substance to be respected for tax purposes turns on both the "objective economic substance of the

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1 Explanation of proposed protocol to the income tax treaty between the United States and Denmark, DIANE Publishing, 2007, p. 31.

2 Philip J. Warner, LUXEMBOURG IN INTERNATIONAL TAX PLANNING, IBFD, 2004, p. 496.

3 Joseph Bankman, "The Economic Substance Doctrine", Southern California Law Review, Vol. 74:5, 2000, p. 9.

4 56 T.C. 925, 1971 WL 2486 (1971).

5 Ibid.

6 157 F.3d 231 (3d Cir. 1998).

> transactions" and the "subjective business motivation" behind them. However, these distinct aspects of the economic sham inquiry do not constitute discrete prongs of a "rigid two-step analysis," but rather represent related factors both of which inform the analysis of whether the transaction had sufficient substance, apart from its tax consequences, to be respected for tax purposes.'[1]

The Court defined the objective test as asking "whether the transaction has any practical economic effects other than the creation of income-tax losses."[2] The subjective leg of the economic substance test looks to business purpose.

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[1] Ibid, at 247.
[2] Ibid, at 248.

Germany

Germany Mulls end to Flight Ticket Tax

Germany's prospective Grand Coalition partners, the Christian Democratic Union (CDU) and the Social Democrats (SPD), are edging nearer to plans to end the country's controversial flight ticket tax (*Luftverkehrsteuer*).

Within the framework of ongoing coalition negotiations, a "transport working group" concluded that the levy should be abolished in the new legislative period, without, however, endangering plans to increase investment in transport infrastructure in Germany.

Although party leaders have yet to provide their endorsement, German Transport Minister Peter Ramsauer, who co-chaired the working group discussions, has championed the idea of repealing the levy for some time now.

Environmental lobby groups will be bitterly disappointed with the outcome. On November 19, Friends of the Earth Germany (BUND) had underlined the need for the future Grand Coalition to maintain the ticket tax, and even to extend the scope of the levy.

The association advocated that the rate of the tax be increased and that the levy be differentiated according to the type of ticket purchased. Furthermore, the group stressed that the tax should better reflect the polluter pays principle. These measures would increase the ecological steering effect of the tax and generate additional revenue for climate protection, BUND said.

Defending its position, BUND cited the findings of a recent university study, which refuted claims by the German aviation industry that the levy merely leads to passengers electing to fly from neighboring airports abroad and reduces the competitiveness of airline companies, thereby risking job losses.

Introduced in Germany at the beginning of 2011 to ensure that the aviation industry contributions to fiscal consolidation, the levy serves to generate around EUR1bn (USD1.4bn) annually for the state. The tax is currently imposed at a rate of EUR7.50, EUR23.43, or EUR42.18 on flights departing from German airports, depending on the destination.

Germany's aviation industry fiercely criticized the levy from the outset, arguing that the tax costs airline companies around EUR500m a year. – *Courtesy tax-news.com*

Switzerland

Switzerland Adopts Proposals on Multiple Tax Accords

The Swiss Federal Council has adopted proposals on multiple double taxation agreements (DTAs), together with a proposal on the first tax information exchange agreements (TIEAs).

The DTAs are with with Australia, Hungary, and China, replacing the currently valid agreements, and containing administrative assistance provisions in accordance with the internationally applicable standard. Furthermore, the treaties aim to promote the development of bilateral economic relations.

The revised agreement with Australia was signed on July 30, 2013, with Hungary on September 12, 2013, and with China on September 25, 2013.

Aside from an OECD administrative assistance clause, the three accords provide for reductions in withholding tax, and sometimes even tax exemption, in the case of dividends, interest and royalty payments in the source state. The agreements thereby facilitate the activities of the export economy, promote bilateral investments, and contribute to the prosperity of Switzerland and that of the partner states.

The first tax information exchange agreements are with the Isle of Man, Guernsey, and Jersey.

Like DTAs, TIEAs are instruments for concluding an administrative assistance clause in accordance with the international standard. Unlike DTAs, which are aimed primarily at avoiding double taxation and therefore contain other material provisions, TIEAs merely govern the exchange of information upon request.

The bilateral TIEA with the Isle of Man was signed on August 28, 2013, with Guernsey on September 11, 2013, and with Jersey on September 16, 2013.

The agreements will now be submitted to parliament for approval, before they can enter into force. Further, they are subject to an optional referendum. The Swiss cantons and business associations concerned have welcomed the conclusion of the treaties.

Tax information exchange agreements with other jurisdictions are currently being negotiated. – *Courtesy tax-news.com*

France

French Union Slams Corporate Land Tax Reform

France's independent workers' union UNAPL has vehemently denounced the Government's proposed reform of the country's corporate land tax contribution (CFE), provided for within the framework of the 2014 finance bill (PLF 2014).

Alluding to the relentless tax onslaught on independent professionals in France, UNAPL lamented the Government's decision to subject independent professionals, taxed under the non commercial profits regime (BNC), to a significantly greater corporate land tax contribution than their counterparts operating under the commercial and industrial profits tax regime (BIC).

Outraged by the sheer "injustice" of the plans, the union underscored that the "vast majority" of self-employed workers in France operate under the BNC regime. Categorically refuting the Government's claim that BNC taxpayers have a greater contributive capacity than other taxpayers, the union insisted that independent professionals are facing unprecedented economic difficulties in the current challenging economic climate.

The PLF 2014 provides for a reform of the existing tax scale for the minimum CFE contribution, to better take into account the limited contributive capacity of small taxpayers and to eradicate any disproportionate levels of taxation.

The new tax scale for the minimum CFE contribution comprises six tax brackets, compared to three currently, and new thresholds have been introduced for determining the basic minimum charge. By adjusting the number of tax brackets, the Government hopes to better distinguish the various categories of taxpayers, by considering actual turnover or revenue realized.

However, under the provisions, local authorities may opt to apply a separate scale specifically for BNC taxpayers. This tax scale is considerably less favorable, subjecting those operating under the BNC regime to a significantly greater CFE contribution. – *Courtesy tax-news.com*

United States

US States cut taxes this year

Eighteen US states have cut taxes in the 2013 legislative year, reflecting an emphasis, following the recession, on pro-growth reforms that encourage economic expansion and competition, according to a new report by the Center for State Fiscal Reform of the American Legislative Exchange Council (ALEC).

It was pointed out by ALEC that, of the 18 states that have cut taxes during the year, some states have enacted fundamental tax reform, while others have only slightly modified their tax code. There were 25 cuts in specific tax categories, with nearly one quarter being to personal income tax, followed by reductions to various state specific taxes and to the corporate income tax. Sales tax reductions were, however, found to be the least enacted form of tax cuts this year.

ALEC lists the states that cut taxes significantly during the 2013 legislative year as Alaska, Arkansas, Florida, Idaho, Indiana, Iowa, Kansas, Mississippi, Montana, Nebraska, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Tennessee, Texas and Wisconsin.

"There is growing consensus that taxes discourage competitiveness and economic growth, with taxes on income being among the worst," said Jonathan Williams, co-author of the report and director of the Center. "To enhance competitiveness, policymakers across America are looking for ways to reduce the cost of living, working and doing business within their states."

"Over the past ten years, the nine states with no personal income tax grew their population by 150 percent and saw their gross state product grow by 40 percent more than their high-tax counterparts," added Ben Wilterdink, co-author of the report and a research analyst at the Center. "The data shows states that do not levy a personal income tax are outperforming their high-tax counterparts in just about every way."

In a newspaper article for Forbes, Wilterdink also pointed out that, "according to the latest IRS data, Texas, which does not levy a personal income tax, gained almost 1m new taxpayers over the past ten years. Florida, another no-income-tax state, gained well over 1m taxpayers during that same time period. California by contrast, which has the highest personal income tax rate, lost more than 1.5m taxpayers over that same period."

"With the federal government locked in seemingly endless gridlock," the Center noted, "it is up to the states to jumpstart their own economies. … It is encouraging to see so many pro-growth proposals from just the last legislative session."

However, it concluded, "it is also important to remember that states do not decide (fiscal) policies in a vacuum. The decisions that one state makes will affect other states whether they like it or not. When states make pro-growth policy decisions, other states are challenged to become more competitive. … As this reality sinks in, the expectation for pro-growth tax reform in the states during the 2014 legislative session will be even higher." – *Courtesy tax-news.com*

Belgium

Belgium Ups Withholding Tax Exemption for SME employers

On the recommendation of Belgian Finance Minister Koen Geens, the Council of Ministers approved a draft Royal Decree, providing for an increase in the percentage exemption from professional wage-withholding tax (*précompte professionnel*) for employers in the small- and medium-sized enterprise (SME) sector.

Consequently, the actual exemption rate for payment of the *précompte professionnel* will rise to 1.12 percent for SME employers from January 1, 2014. This measure forms part of efforts to extend the Government's stimulus strategy, designed notably to revitalize the economy and to strengthen the competitiveness of businesses in Belgium in the long-term.

The draft legislation has been submitted to the State Council for examination.

The draft Royal Decree modifies, in terms of professional wage-withholding tax exemption, AR/CIR 92, pursuant to Article 2757, paragraph 4, of the 1992 Income Tax Code. – *Courtesy tax-news.com*

Australia

Australia to Face tough Budget Choices

"Australia needs leaders prepared to make brave decisions to raise taxes and cut expenditure," a new report has claimed.

The report, "Balancing budgets: tough choices we need," was published this week by the Grattan Institute.

It points out that the Commonwealth Government – which is responsible for around 60 percent of Australian government spending and 75 percent of taxation – has had a structural budget deficit of more than 2 percent of gross domestic product (GDP) for the past five years. Commonwealth spending has risen by 2 percent over the last eight years, but the global financial crisis has hit revenues, by reducing income and corporate tax levels.

The Institute warns that the current options for "budget repair" are "not particularly appealing." The Government will need to prepare people "for pain," and should consider "how it will 'sell' change and the necessary tough reforms."

Most ominous, perhaps, is the Institute's note that it was unable "to identify expenditure cuts large enough to fix Australia's long run budget challenges." Any program of changes must therefore include tax hikes, for without them, "budget repair will be hard for Australia, given that its government is relatively small, major revenue sources like the G[oods] and S[ervices] T[ax] are in structural decline."

The Institute's key tax related recommendations are as follows:

- Increase the age of access to the Age Pension and superannuation to 70. This could improve the budget bottom line by AUD12bn a year, and lift economic activity by up to 2 percent of GDP.
- Reduce the thresholds for superannuation taxation. At present, employees aged 59 and over are taxed at 15 percent for the first AUD25,000 – AUD35,000 they place in their superannuation account each year. Lowering these to AUD10,000 could generate up to AUD6bn a year. Tax the superannuation earnings of the over-60s at 15 percent. This would yield AUD3bn in additional tax revenue.
- Include owner-occupied housing in the calculation of a retiree's eligibility for the Age Pension.
- Eliminate the capital gains tax (CGT) discount, and make owner-occupied housing liable for the CGT.
- Prevent investors from deducting losses made on investments from their wage income.
- Extend the GST to cover private spending on fresh food, health, education, childcare, water, and sewerage, and increase welfare benefits to reduce the effect on the worst off.

- Remove the threshold below which payroll tax is not payable.
- Halve the exemptions that reduce the fuel tax paid by a variety of commercial users, and reintroduce fuel excise indexation.
- Design a mining tax as a federal export tax on minerals, set at 50 percent of the portion of the price above nominated thresholds. – *Courtesy tax-news.com*

India

CII Calls on India to Stabilize Tax Regime

The Confederation of Indian Industry (CII) has called on the Government to offer greater clarity in its taxation of multinational companies, with the aim of addressing concerns and repairing investor confidence.

A new CII white paper, released in conjunction with accountancy firm Ernst & Young, surveys the emerging trends in global taxation and considers how they are impacting on India's tax policy.

CII Director General Chandrajit Banerjee said of the document: "Our country presently needs a tax system which is simple, broad-based, less litigious, and transparent, and ensures international competitiveness. We need to benchmark our systems with international best practices."

The paper focuses to a large extent on the international crackdown on tax avoidance. It notes both the publication in July of the Organization for Economic Cooperation and Development's (OECD) Action Plan on base erosion and profit shifting (BEPS), and the determination of the G20 group of nations to prevent "double non-taxation."

The CII stresses that India is actively working with the OECD on its BEPS project, but warns that tackling the problem "requires a multi-dimensional approach, especially as the apprehension is about whether companies follow the spirit of the law or whether they pay [a] fair share of taxes as per the law of the land."

The Confederation recommends that India's proposed new General Anti-Avoidance Regulations (GAAR) should be applied as an exception, rather than a rule. They should not be used in cases where Specified Anti-Avoidance Rules are already in place.

The white paper also recognizes the growing tension between multinational corporations and revenue authorities over the enforcement of transfer pricing rules. It argues that taxpayers must consider their "options of dispute resolution and determine the comparative benefits of adopting safe harbour rules, continuing with the litigation, or applying for APAs."

Finally, the CII urges the early implementation of the much-delayed goods and services tax (GST) in India. The GST should "simplify and rationalize the current indirect tax regime in the centre and states, eliminate tax cascading and put the Indian economy on a higher growth trajectory." – *Courtesy tax-news.com*

United Kingdom

Britain May Tax Foreign Property Investors

British Deputy Prime Minister Nick Clegg said on November 18, 2013 that the government is planning to impose a capital gains tax (CGT) on sales of British houses by foreign owners.

The measure is a response to fears of a housing bubble, particularly in London, where prices rose more than 10 percent in a year, largely due to demand from Russian and Middle Eastern investors.

The government is reviewing the proposal ahead of Chancellor George Osborne's Autumn Statement on December 05, but no decision has yet been reached, Clegg told a news conference.

"We certainly need to make sure that people who invest very large amounts of money into property in central London locations...pay their fair share of tax in those transactions. That is why we are looking at options like a differential application of capital gains tax to those kind[s] of transactions," he said.

Currently foreign investors are exempt from the CGT which Britons have to pay (usually at 28 percent) on any profit from the sale of property which is not their primary residence.

Mr Osborne has been hesitant about imposing CGT on foreign property owners, fearing that it might deter investors from coming to the United Kingdom. However, this concern has been somewhat allayed by the way in which London's property market has continued to grow despite the imposition of a new 7 percent top rate of stamp duty on homes worth over GBP2m. – *Courtesy tax-news.com*

United Kingdom

Tax Avoidance Tops List of UK Business Concerns

More than a third of Brits believe that tax avoidance is the main concern that businesses need to tackle, according to a new survey.

The UK's Institute of Business Ethics has for the last ten years commissioned Ipsos MORI to carry out annual public opinion surveys on the ethical behavior of businesses and the issues that most need addressing. Three questions are always asked: 'How ethically do you think British business generally behaves?' 'How do you think British business is behaving now compared with 10 years ago?', and 'In your view of company behavior, which two or three of these issues most need addressing?'

This year's survey was conducted at the start of September, and involved face-to-face interviews with 996 over-16s.

In 2012, just 48 percent of respondents said that they felt businesses were behaving ethically. This figure has now risen to 59 percent. However, the number of people arguing that business behaves less ethically than it did 10 years ago has shot up by seven percent, to 35 percent.

Remuneration no longer heads the list of public concerns, after six years as the number one issue. Topping the list is tax avoidance. The survey report suggests that people "are perhaps reacting to the frequent allegations in the media and are feeling 'very angry' that many multinational companies are apparently operating very successfully in the UK yet paying little or no corporation tax."

IBE's Director, Philippa Foster, said that the results "could indicate that business has clawed back some of the public trust lost in the wake of the financial crisis. But confidence remains fragile."

Tax is also playing its part. As Foster warned, tax "is now clearly a reputational issue and has risen very rapidly up the scale. Trust cannot be taken for granted." – *Courtesy tax-news.com*

United States

Jersey Commits to Independent Taxation

Jersey's Treasury and Resources Minister has committed to introducing independent taxation, meaning taxpayers will be taxed as individuals, regardless of their marital status.

The government of the British Crown Dependency said in a press release that the measure is directed at treating taxpayers equally, without using tax policy to influence lifestyle choices.

The Treasury has prepared a feasibility review on independent taxation and published it with the draft 2014 Budget.

Due to complexities in the island's current tax system, the changes will be phased in to avoid negatively impacting taxpayers.

"Moving towards independent taxation is an important step forward that will ultimately create a fairer and more efficient tax system for islanders," Treasury and Resources Minister Senator Philip Ozouf said. – *Courtesy tax-news.com*

IRS Prompted to Increase Online Payment Agreements

A new report from the Treasury Inspector General for Tax Administration (TIGTA), has found that, while rising numbers of taxpayers are using the internet for their tax arrangements, the United States Internal Revenue Service (IRS) has still missed its target for increasing the number of online payment agreements.

TIGTA has concluded that the Online Payment Agreement (OPA) program has actually met only 10 percent of its goal, despite increasing usage, and, as a result, the IRS is not meeting its planned objectives for increasing revenue or reducing taxpayer burden and costs.

The IRS implemented the OPA web application in 2006 to provide individual taxpayers or their authorized tax representatives a simple and convenient way to establish payment agreements, while eliminating the need for paper forms, toll-free calls, and personal interaction with the IRS.

TIGTA therefore initiated its audit to determine the effectiveness of the OPA program in achieving its goals of reducing taxpayer burden and increasing revenue through a shift from paper to online payment agreements.

Taxpayer use of the OPA program increased from nearly 18,300 taxpayers in Fiscal Year (FY) 2007 to 96,000 in FY 2012 (a 425 percent increase), and the default rate (missed payment) of streamlined installment agreements processed through the OPA program is 44 percent lower than the overall default rate, which means that more taxpayers continued to make their regular payments.

However, the IRS had projected that the OPA program would process 3.2m streamlined installment agreements for FYs 2007 through 2012. However, only 308,000 taxpayers (10 percent of the target) used the OPA program to establish their installment agreements during this period.

"The Online Payment Agreement program is providing benefits both to taxpayers and the IRS," said J. Russell George, the TIGTA. "However, more needs to be done to promote taxpayer use of the program to achieve the full extent of the intended benefits. Given the current economic environment and focus on efficient Federal Government operations, the program's increased revenue and reduced costs become even more important."

TIGTA recommended, and the IRS agreed, that the IRS should begin measuring OPA performance results against program goals, improve promotion efforts, and evaluate the OPA and installment agreement program to identify barriers and the reasons taxpayers used the methods they did to establish their payment agreements. – *Courtesy tax-news.com*

2013 TRI 1904 (H.C. Guj.)

HIGH COURT OF GUJARAT AT AHMEDABAD

M.R. Shah and Sonia Gokani, JJ.

Dattani and Co.
v.
Income Tax Officer

FACTS/HELD

ITAT duty-bound to deal with all judgements cited during hearing of appeal

1. The assessee filed an appeal against an addition for alleged bogus purchases/sales which was dismissed by the Tribunal. The assessee filed an appeal before the High Court claiming that he had relied on the judgement in CIT vs. President Industries 258 ITR 654 in the verbal and written submissions and that the Tribunal had not considered it. HELD by the High Court remanding the case to the Tribunal for fresh consideration:

> Whenever any decision has been relied upon and/or cited by the assessee and/or any party, the authority/tribunal is bound to consider and/or deal with the same and opine whether in the facts and circumstances of the particular case, the same will be applicable or not. In the instant case, the Tribunal has failed to consider and/or deal with the aforesaid decision cited and relied upon by the assessee. Under the circumstances, all these appeals are required to be remanded to the Tribunal to consider the addition made by the AO towards alleged bogus purchases/sales and to take appropriate decision in accordance with law and on merits and after considering the decision of this Court in the case of CIT vs. President Industries 258 ITR 654.

Appeals allowed.

Tax Appeal No. 847 of 2013 with Tax Appeal No. 848 & 849 of 2013.

Decided on: 21st October, 2013.

Present at hearing: R.K. Patel, Advocate, for Appellant. Pranav G. Desai, Advocate, for Opponent.

JUDGMENT

Per M.R. Shah, J.–

1.00. As common question of law and facts arise in this group of Appeals, they are disposed of by this common order.

2.00. All these Tax Appeals have been preferred by the common appellant - assessee challenging the common impugned judgement and order passed by the Income Tax Appellate Tribunal, Rajkot Bench, Rajkot in ITA Nos.1249 to 1252 of 2010 with respect to Assessment Years 2002-03, 2004-05 and 2006-07.

2.01. It is required to be noted that in the respective appeals, the appellant proposed the following substantial questions of law:

TAX APPEAL No.847 of 2013:–

"1. Whether Tribunal is right in law and on facts in confirming addition of Rs.24,151/-, Rs.4,443/- & Rs.4,70,000/- towards alleged bogus purchases/sales in contravention of settled principles of law?

2. Whether on facts and in law, the Tribunal has substantially erred in not resorting to provision of section 255 for referring the matter to Full Bench/Special Bench and deciding the disputed issue of purchases & sales in conflict with earlier Tribunal's decision of the same Bench pressed into service by the appellant?

3. Whether on facts and in law, the Tribunal's and conclusion for confirming addition towards purchases and sales for the year under consideration is in ignorance of relevant material on record and taking aid of irrelevant factors not germane to subject matter of appeal with the result that the finding and conclusion of the Tribunal is "vitiated" on facts and in law?"

TAX APPEAL No.848 of 2013:–

"1. Whether Tribunal is right in law and on facts in confirming addition of Rs.3,42,311/- & Rs.1,42,908/- towards alleged bogus purchases/sales in contravention of settled principles of law?

2. Whether on facts and in law, the Tribunal has substantially erred in not resorting to provision of section 255 for referring the matter to Full Bench/Special Bench and deciding the disputed issue of purchases & sales in conflict with earlier Tribunal's decision of the same Bench pressed into service by the appellant?

3. Whether on facts and in law, the Tribunal's and conclusion for confirming addition towards purchases and sales for the year under consideration is in ignorance of relevant material on record and taking aid of irrelevant factors not germane to subject matter of appeal with the result that the finding and conclusion of the Tribunal is "vitiated" on facts and in law?"

TAX APPEAL No.849 of 2013:–

"1. Whether Tribunal is right in law and on facts in confirming addition of Rs.6,42,769/- & Rs.1,83,168/- towards alleged bogus purchases/sales in contravention of settled principles of law?

2. Whether on facts and in law, the Tribunal has substantially erred in not resorting to provision of section 255 for referring the matter to Full Bench/Special Bench and deciding the disputed issue of purchases & sales in conflict with earlier Tribunal's decision of the same Bench pressed into service by the appellant?

3. Whether on facts and in law, the Tribunal's and conclusion for confirming addition towards purchases and sales for the year under consideration is in ignorance of relevant material on record and taking aid of irrelevant factors not germane to subject matter of appeal with the result that the finding and conclusion of the Tribunal is "vitiated" on facts and in law?"

2.02. By order dtd. 1/10/2013 passed in the respective Tax Appeals, we dismissed all these Tax Appeals so far as proposed Question Nos.2 and 3 are concerned and issued notice to consider proposed Question No.1 and observed as under:

"Now, so far as the proposed substantial question of law i.e. question No.1 is concerned, Shri Patel, learned counsel appearing on behalf of the appellant assessee has heavily relied upon the decision of this court in the case of Commissioner of Income Tax vs. President Industries reported in 258 ITR 654, which seems to be not dealt with and/or considered by the learned Tribunal.

Hence, for the aforesaid, NOTICE returnable on 21st October 2013. Direct service is permitted."

2.03. Mr.R.K. Patel, learned advocate appearing on behalf of the appellant has vehemently submitted that with respect to addition made towards alleged bogus purchases/sales, the assessee heavily relied upon the decision of this Court in the case of *Commissioner of Income Tax vs. President Industries*, reported in 258 ITR 654. It is submitted that though the said decision was cited before the learned tribunal and even the same was so stated in the Written Submission before the learned tribunal, the tribunal has not considered and/or dealt with the same at all.

2.04. Mr.Pranav Desai, learned advocate appearing on behalf of the respondent – revenue has tried to support the common order of the tribunal impugned in the main Tax Appeal, however, he has fairly conceded that the learned tribunal has not considered and dealt with the decision in the case of Commissioner of Income Tax vs. President Industries reported in 258 ITR 654, relied upon by the assessee and even cited by the assessee in the written submission before the learned tribunal.

3.00. Considering the fact that the decision of this Court in the case of Commissioner of Income Tax vs. President Industries (supra), which was relied upon by the assessee, was cited and pointed out before the learned tribunal, the learned tribunal at least ought to have considered and dealt with the same. From the written submissions, it also appears that the aforesaid decision was cited before the learned tribunal. From the impugned Judgement and Order passed by the learned tribunal it appears that the learned tribunal has not considered and/or dealt with the aforesaid decision relied upon by the assessee at all.

4.00. Whenever any decision has been relied upon and/or cited by the assessee and/or any party, the authority/tribunal is bound to consider and/or deal with the same and opine whether in the facts and circumstances of the particular case, the same will be applicable or not. In the instant case, the tribunal has failed to consider and/or deal with the aforesaid decision cited and relied upon by the assessee. Under the circumstances,all these appeals are required to be remanded to the tribunal to consider the addition made by the Assessing Officer towards alleged bogus purchases/sales and to take appropriate decision in accordance with law and on merits and after considering the decision of this Court in the case of *Commissioner of Income Tax vs. President Industries* reported in 258 ITR 654. However, it is clarified that we have not expressed any opinion on merits whether in the facts and circumstances of the case, the decision of this Court in the case Commissioner of Income Tax vs. President Industries (supra) will be applicable or not. It is ultimately for the learned tribunal to consider the same in the facts and circumstances of the case.

5.00. With this, all these appeals are allowed in part and the same are remanded to the learned tribunal to consider the issue with respect to addition made towards alleged bogus purchases/sales and to consider the decision of this Court in the case of *Commissioner of Income Tax vs. President Industries* reported in 258 ITR 654. As stated hereinabove, so far as Question nos.2 and 3 are concerned, by our earlier order dtd. 1/10/2013 we have already dismissed the present appeals. Present appeals are allowed in part to the aforesaid extent only.

2013 TRI 1908 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "K" BENCH, MUMBAI

D. Karunakara Rao, Accountant Member and Vivek Varma, Judicial Member

FACTS/HELD

Transfer Pricing: ALP of royalty for trademark usage and technical know-how fee can be determined as per TNMM. Approval of RBI & Govt. means payment is as at arms length

1. The assessee entered into an agreement with its parent company, Cadbury Schweppes, pursuant to which it agreed to pay royalty for the use of trademarks and royalty for the use of technical know-how at 1.25% each of the net sales. This was approved by the RBI and the SIA (Government). The assessee adopted the Transaction Net Margin Method ("TNMM") for computing the ALP of the international transactions by comparing the net margin of the company at entity level with that of companies engaged in food products, beverages and tobacco business. The TPO held that the transactions pertaining to payment of royalty for trademarks and technical know-how fee had to be separately and independently bench-marked using the Comparable Uncontrolled Prices ("CUP") method. He held that the ALP of royalty and technical know-how fee should be computed at 1% of sales the instead of at 1.25% of the sales. This was reversed by the CIT(A) who held that the royalty and technical know-how fee paid by the assessee were at ALP. On appeal by the department to the Tribunal HELD dismissing the appeal:

   The assessee has been paying royalty on technical know-how to its parent AE since 1993. Other group companies across the Globe are also paying the same royalty. Also, the payment is as per the approval given by the RBI and the SIA. Hence there cannot be any scope of doubt that the royalty payment on technical know-how is at arms length. As regards the royalty on trademark usage, the assessee is in fact paying a lesser amount if the payment is compared with the payment towards trademark usage by other group companies using the brand "Cadbury" in other parts of the world. Accordingly, the royalty payment on trademark usage is also within the arms' length and does not call for any adjustment (Lumax Industries (ITAT Del) (attached) followed). The Department's request for a remand to the TPO to examine the AMP expenses in the light of Maruti Suzuki 328 ITR 210 (Del) (and L. G. Electronics 140 ITD 41 (Del)(SB)) rejected.

Order accordingly.

ITA No.: 7408/Mum/2010 (Assessment year: 2002-2003) & ITA No.: 7641/Mum/2010 (Assessment year: 2002-2003).

Heard on: 22nd October, 2013.

Decided on: 13th November, 2013.

Present at hearing: J.D. Mistry & Nishant Thakkar, for Appellant. Ajeet Kumar Jain & O.P. Singh, for Respondent in ITA No.: 7408/Mum/2010. Ajeet Kumar Jain & O.P. Singh, for Appellant. J.D. Mistry & Nishant Thakkar, for Respondent in ITA No.: 7641/Mum/2010.

JUDGMENT

Per Vivek Varma:– (Judicial Member)

The Cross Appeals have been filed by the department and the assessee against the order of CIT(A) 15, Mumbai, dated 25.08.2010. For the sake of brevity and convenience, we passing a common and consolidated order.

<u>ITA No. 7641/Mum/2010: (Appeal filed by the department):</u>

2. The department has raised the following grounds of appeal:

"1. Whether on the facts and in the circumstances of the case and in Law, was the Ld. CIT(A) justified in concluding that M/s. Cadbury India Limited has received several benefits on account of payment of Technical Knowhow Royalty and whether the Ld. CIT(A) was justified in concluding that Royalty for Trademark at 1% and Technical Knowhow at 1.25% for ht entire FY 2001-02 is at Arm's Length.

2. Whether on the facts and in the circumstances of the case and in Law, was the Ld. CIT(A) justified in treating 50% the expenses incurred on Architect & Interior Design amounting to Rs. 21.94 Lacs and expenses incurred on Supply & Installation of Electrical Items amounting to Rs. 14.44 Lacs as Revenue"?

3. The facts in brief are that the assessee is in the business of manufacture, distribution and marketing of malted food drinks, cocoa powder, chocolates, toffees, drinking chocolates and sugar confectionaries. The assessee, having its head office at Mumbai, is having its factories at Thane, Induri and Malanpur and marketing offices located at Delhi, Chennai, Kolkata and Mumbai.

4. The assessee is a subsidiary of M/s Cadbury Schewepps PLC, U.K. Cadbury group has presence in more then 200 countries and it enjoys the distinction of being world's third largest soft drinks company in sales volume and is among the fourth largest confectionary company in the world.

5. Cadbury India Ltd., the assessee entered into certain international transactions with its Associated Enterprises (AEs), which are as follows:

S No.	*Name of the Associated Enterprise (AEs)*	*Country of tax residence of AEs*	*Nature of relationship*	*Description of transaction with AEs*	*Amount Received/receivable paid/payable as per books of accounts (Rs)*
(1)	***(2)***	***(3)***	***(4)***	***(5)***	***(6)***
1	*M/s Cadbury International Limited*	*U.K.*	*92A(2)(b)*	*(i) Purchase of CDM Flavor oils* *(ii) Cocoa buying service charges*	*277,238* *3,460,441*
2	*M/s Cadbury Schweppes Pty Limited, Australia*	*Australia*	*92A(2)(b)*	*Purchase of Cocoa beans*	*1,243,244*
3	*M/s Cadbury confectionery, Malaysis Sdn. Bhd, Malaysia*	*Malaysia*	*92A(2)(b)*	*Purchase of chocolates*	*10,110,412*
4	*M/s Cadbury (Pty) Limited, South Africa*	*South Africa*	*92A(2)(b)*	*Purchase of Chocolates*	*1,047,364*
5	*M/s Cadbury Middle East FZE, Dubai, United Arab Emirates*	*United Arab Emirates*	*92A(2)(b)*	*Sale of Chocolates and malted food drinks*	*4,343,153*
6	*M/s Cadbury Schweppes Overseas Limited, UK*	*U.K.*	*92A(2)(a)*	*(i) Royalty for the use of Trade Mark* *(ii) Royalty for technical know-how*	*63,668,247* *56,624,003*

7	*M/s Cadbury Schweppes Plc., UK*	*U.K.*	*92A(1)(a)*	*Payment of ERP license and maintenance fees*	*3,601,240*

The issue of ALP was referred to the TPO u/s 92CA with regard to transactions relating to Royalty for the use of trademarks at Rs. 6,36,68,247/- and Royalty for technical knowhow at Rs. 5,66,24,003/-

6. With regard to Royalty on technical knowhow, it was found that the assessee had entered into an agreement with its parent AE on 09.03.1993, with the approval(s) of SIA, Government of India, which were granted at various points of time.

7. According to the agreement, the assessee shall pay Royalty at 1.25% of internal sales and exports (Net sales), against which the parent AE shall supply and disclose and make available to CIL (Indian Co.) all knowhow, advice and assistance at all such time that may be mutually agreed between the parties.

8. The TPO, gathering information from other Cadbury units across the globe required the assessee to submit a reply, as to why 1% of gross sales be not taken to be at arm's length instead of 1.25% taken by the assessee in the case of technical knowhow.

9. Looking into the facts of the case, the TPO found out that the assessee has used TNMM for computing ALP of the International transactions by comparing the net margin of the company at entity level, with that of companies engaged in food products, beverages and tobacco business. According to the TPO transactions pertaining to payment of Royalty is not separately and independently benchmarked. He further noted that companies identified by the assessee company i.e. DFM Foods Ltd., Bakeman Industries Ltd., Modern Food Industries (India) Ltd., Parrys Confectionary Ltd and Ravalgaon Sugar Farm Ltd., did not pay any technical fee/royalty. According to him, these companies could not be used in the analysis for benchmarking the royalty payments. Since the total sales of the company is at Rs. 645 crores and international transactions pertaining to this segment is only 14.50 crores, being only 2.24% would not effect the profitability, if the ALP is to be determined at TNMM at entity level. According to the TPO, the most appropriate method, therefore, would be CUP because all other comparables, as supplied by the assessee, either developed their own technology, or they had acquired the technology long back and are no more paying for the transfer of technology. This, in the case of the assessee is not the case, because, the assessee company, i.e. Cadbury India Ltd., is required to pay royalty to its parent AE, CSDL, for the continuous upgradation of technology.

10. The TPO, therefore, concluded that in the case of royalty on technical knowhow the ALP should be computed at 1% of sales, which

comes to Rs. 4,52,99,207/- against 1.25% taken by the assessee at Rs. 5,66,24,003/-.

11. Similarly, the TPO computed royalty paid on trademarks, at Rs. 5,03,31,678/- in place of Rs. 6,36,68,247/- taken by the assessee.

12. Before the TPO, it was submitted this was the first year for the payment of royalty on trademark use, because, earlier, the payment was banned under FERA Rules.

13. After the prohibition was lifted, the assessee in the Board meeting held on 24.04.2001 authorized the company to pay the royalty on use of trademark at 1% of the net sales value, w.e. from April 2001. After getting the approval from the Reserve Bank of India (RBI) an agreement was entered into between Cadbury Limited, Trebor Bassett Limited, Cadbury Scheweppes Overseas Ltd. and Cadbury India Ltd., on 12.02.2002, according to which Cadbury and Trebor granted Cadbury overseas the exclusive rights to distribute its products and use the trademarks and technical information throughout the territory. The said agreement provided "*that Cadbury Overseas hereby grants to company and the Company hereby accepts the exclusive non transferable licence to manufacture, market and sell the products under the Cadbury Trade Marks and Trebor Trade Marks in the territory in accordance with the technical information and specifications*". Herein territory meant India, Nepal, Bangladesh, Bhutan and Sri Lanka.

14. According to the TPO, the agreements seemed to be overlapping, therefore, he asked the assessee to submit the information regarding payments received by CSOL from all group companies. The company vide its letter dated 04.02.2005 submitted the copy of email sent to it from CSOL, which is as under:

S No.	*Overseas Company*	*Territory*	*Royalty rate/ Fee Net Basis*	*Type of Agreement*
(1)	***(2)***	***(3)***	***(4)***	***(5)***
1	*Cadbury Adams Canada Inc.*	*Canada & Export Territory*	*2.50%*	*Trade mark licence- Exclusive & transferable*
2	*Cadbury Food Co. Ltd., China*	*Not specified but excludes exports*	*3.5%*	*Trademark licence sole non-transferable rights*
3	*Cadbury Egypt S.A.E.*	*Republic of Egypt Export territories listed*	*2%*	*Trade mark licence exclusive*
4	*Cadbury France*	*France and such other territories*	*2.00%*	*Trade mark licence*
5	*Cadbury Ghana Limited*	*Ghana*	*2.00%*	*Combined technical services & trademark user agreement*
6	*PT Cipta Rasa*	*The Republic of*	*2.50%*	*Trade mark licence –*

	Primatama	*Indonesia*		*Exclusive & nontransferable*
7	*Cadbury Kenya Limited*	*Kenya, Uganda and Tanzania and any other territories*	*2.00%*	*Trade mark licence*
8	*Cadbury Confectionery Malaysia SDN BHD*	*East & West Malaysia & Brunei & such other territories*	*2.00%*	*Royalty technical information and trade mark licence agreement – exclusive & nontransferable*
9	*Cadbury Nigeria plc*	*Nigeria*	*2.00%*	*Trade mark licence*
10	*Cadbury Poland Sp zo.o*	*Poland*	*2.5%*	*Trademark licence-exclusive and non-transferable*
11	*Dlrol Cadbury LLC*	*Russia plus named export territories*	*3% for confectionery ***	*Trade mark licence exclusive and non-transferable*
12	*Cadbury Dulciora SA*	*Spain and such other countries*	*3.00%*	*Trademark licence and non-transferable*
13	*Crystal Candy (PVT) Limited*	*Zimbawe and such other territories*	*2.00%*	*Trade mark licence exclusive & nontransferable*
14	*Cadbury Nigeria plc*	*Nigeria*	*2.00%*	*Technical Service Agreement*

15. From the chart, the TPO inferred that royalty on trademarks usage is 2% but the assessee company is paying the royalty between 1 to 2.5% and the average on the above comes to 2.32%. The issue was put to the assessee who replied,

> *"The company contended that, "Technical Assistance and Royalty Agreement was approved by Govt. of India, Ministry of Industry, vide letter dated 14.09.2000. The rate of royalty payable as per approval letter was authorized at 1.25%. The comparability of international transaction of payment towards technical assistance can also be judged with reference to the laws and government orders In force [Rule 10B(2)(d)]. Accordingly, under the facts of the case, the payment towards technical assistance to SQL can be said to comply with the Arm's Length Princiole."*
>
> *The company submitted the copy of application dated 30.04.2001. addressed to the General Manager, Reserve Bank of India, Exchange Control Department, Regional Office, Mumbai, for automatic approval for payment of royalty towards trademarks to Cadbury Schweppes Overseas Limited, U.K. In the application, it is mentioned that "the trademarks belonging to Cadbury Schweppes Overseas Limited, U.K. In the application, it is mentioned that "the trademarks CADBURY*

and several other trademarks belonging to CSOL are used by us on our chocolate, drinking chocolate, malted foods and sugar confectionery products which are being manufactured and sold by our company in India and certain other countries. It requested to issue the automatic approval effective 01.04.2001". The Reserve Bank of India, Exchange Control Department, vide letter dated 25.06.2001, has given the approval to enter into Technical Collaboration for manufacture/use of trademarks. The Press Note No.9 (2000 series), of the Government of India, Ministry of Commerce & Industry, Department of Industrial Policy & Promotion (SIA) allowed payment of royalty upto 2% for exports and 1% for domestic sales under automatic route on use of trademarks and brand name of the foreign collaborator without technology transfer.

From the above, it is seen that the approval was sought by the company and granted by the Reserve Bank of India, under the Exchange Control Policy of the Government of India. The branding fee payment, as a general rule is allowed by a Press Note No.9 issued by Ministry of Commerce and Industry. This approval indicates that such payments are not prevented or blocked by the Government, considering the present Exchange Control Policy. There is no intervention from the Government for such payments considering the Exchange Control Policy, but such transaction satisfies the principles of Arm's Length or not is not the concern or within the jurisdiction of the Reserve Bank of India. This requires to be decided as per the provisions of Income Tax Act, 1961. The payment should satisfy the provisions of the Act, separately and independently, irrespective of the allowability of payment as per Exchange Control Policy. Similar is the view of Tax Administration of most of the countries. The Guidelines of Tax Administration of France, on the issue, refers to "please note, finally, that, although the authorization given by the Ministry of Industries or by any other technical department, with respect to the rate of a royalty or of the amount which may be transferred abroad, is not binding on the tax administration, the Inspector, nevertheless have regard to it (source IBFD Publications)'

The company also cited CBDT Circular No.6-P, dated 06.07.1968 and the decision of Pune ITAT, in the case of Kinetic Honda Motor Limited vs. Jt. CIT [77 ITD 396), in support of Its contentions. The Board's Circular and the decision are gone through. The circular as well as the decision of ITAT, Pune, deals with payments covered u/s.40A(2)(b) of the I.T. Rules, 1962 Hon'ble Tribunal referred to the Circular No.6-P, dated 06.07.1968 and observed that, when payments are approved by *one wing of the Government, there is no question of such payments being treated s excessive or unreasonable having regard to legitimate business needs. The Tribunal's decision deals with the remuneration of director of a company approved by Company Law Board. In the present case, as discussed above, the approval by the Reserve Bank of India cannot be considered as an approval for making payments at Arm's Length. The approvals from the Foreign Investment Promotion Board/SIA/RBI, are for the purpose of satisfying the requirements of Foreign Exchange Regulations. In all the applications, the companies were required to justify the payments in Foreign Exchange, by indicating, how the country will be benefiting by the Net Foreign Exchange earning in the arrangements. These approvals are for checking the effect of agreements on the Foreign Exchange Reserve of the country.*

Due to this, the contention of the company that, the agreement is approved by the Reserve Bank of India, on its own, does not support the Arm's Length nature of the payment, accordingly, rejected.

(ii) It further contended that, "The Transfer Pricing Regulations introduced in India requires complying with Arm's Length Principle by testing the controlled transactions with that of comparable uncontrolled transactions. In other words, it is respectfully submitted that transactions entered into inter-se between associated enterprises-controlled transactions cannot be applied to test the compliance with Arm's Length principle".

16. The TPO rejected the reply of the assessee, observing that controlled transactions cannot be used for computing ALP, as per OECD guidelines in para 1.70, which classified,

"… that evidence from enterprises engaged in controlled transactions with associated enterprise may be useful in understanding the transactions with associated enterprise may be useful in understanding the transaction under review or as a pointer to further investigation. The dealings between associated enterprises, for comparison, can also be used in the cases of last resort where:

(i) There is sufficient data available to demonstrate their reliability.

(ii) Related party comparable data provides the most reliable available data upon which to determine or estimate an Arm's Length outcome.

(iii) In the FMCG Sector, most of the big companies in India, are part of Multi-National Enterprises, and their transactions would certainly be the controlled

> *transactions. There would be very few companies, in the FMCG Sector other than MNCs, wherein, any royalty is paid by them to unrelated parties. The details regarding any such company could not be found on the website of SIA/RBI "www.siadipp.nic.in/publicat/newsltr" meaning thereby in FMCG sector, such royalty payments are not approved".*

Considering the above and as the information regarding payment of royalty by the Cadbury Group entities to CSOL is available, the same is used as a bench mark to decide the Arm's Length rate of royalty and the contention of the company is rejected".

"The company, itself, vide letter dated 20.01.2005 submitted the meaning of the term "Trademark" in the commercial parlance, the same is reproduced below "a market place device by which consumers identify good and services and their source. In the context of trademark nomenclature, it is that the consumers will make future purchase of the same goods and services."

"Trademark recognition develops from years of customer service, consistent packaging, and quality control. Depending on the strength of a trademark, the maintenance of the desired consumer awareness level generally requires significant, continuing advertising investment."

In the case of company, Cadbury India is investing huge amounts in Advertising Campaigns; therefore, It is Cadbury India, who is building the brand value, without commensurate compensation from CSOL. Due to these reasons, it would be more appropriate, to club the payments made for two agreements and compare the same with the payments made by other affiliated companies.

(iv) Cadbury India argued that, "the company in conformity with the regulations and the guidelines, benchmarked the payment of brand fees by application of TNMM. The TNMM method was applied by comparing the margin earned by comparables independent enterprises. As per the said analysis, the net profit margin of the company is within the range of the margins earned by comparable companies. Accordingly, under the facts of the case, the payment towards technical assistance can be said to comply with the Arm's Length Principles/' The assessee has used Transactional Net Margin Method for computing the Arm's Length Price of the International Transactions by comparing the Net Profit Margin of the company :at entity level with that of other companies engaged in Food Products1 Beverages and Tobacco Business. The transaction pertaining to payment of

Royalty is not separately and independently benchmarked. The company has identified DFM Foods Ltd., Bakemans Industries Ltd., Modern Food Inds. (India) Ltd., Parrys Confectionery Ltd. and Ravalgaon Sugar Farm Ltd. From the Prowess/Capitaline Database, it is seen that none of these companies are paying any technical fees/royalty. Therefore, these companies cannot be used in the analysis for benchmarking the royalty payments. The total sales of Cadbury India Ltd. is nearly Rs.645 crores and all international transactions, are of value of 14.50 crores, which is only 2.24% of the turnover. The use of Transactional Net Margin Method, at entity level, for benchmarking such a small transaction, will not be the most appropriate method, because, such a transaction does not in a big way affect the profitability of the company. In the present case, the data regarding comparable, though controlled transactions are available, and therefore, Comparable Uncontrolled Price method is the most appropriate method".

"The total royalty worked out by the company is Rs.63,668,246/-. The company was asked to submit the working of royalty as per Press Note No.1 (2002 Series), issued by Secretariat for Industrial Assistance, Government of India. As per this Press Note, the formula for calculation of royalty for the use of trademark and brand name is:

"Royalty on brand name/trade mark shall be paid as a percentage of net sales, viz., gross sales less agents/dealers' commission, transport cost, including ocean freight, insurance, duties, taxes and other charges, and cost of raw materials, parts, components imports from the foreign I/censor or its subsidiary/affiliated company."

The company submitted the working for the same in Annexure 4 of the letter dated 11.02.2005. The revised royalty payment works out to Rs.61,840,438/- Tax Deduction:

The chronological events leading to payments of this royalty are

(i) Date : 26.04.2001 - Cadbury Board passes the resolution for payment of royalty w.e.f. 01.04.200 1.

(ii) Date : 30.04.2001 - Application made to RBI for approval of royalty payment.

(iii) Date : 25.06.2001 - Date of approval of Exchange Control Department of Reserve Bank of India, providing approval to enter into technical collaboration, for use of trademarks. As per the approval, the duration of agreement will be 10 years from the date of agreement or 7 years from the date of commencement of commercial production whichever is earlier.

(iv) Date : 12.02.2002 - Trademark License Agreement made, though commencement date Is mentioned at 01.04.2001.

The royalty could not have been paid without the approval of RBI, therefore, the company was asked to submit objection to the intention of this office to compute the royalty for Tax Deduction purpose, for the period of 25.06.2001 to 31.03.2002 only. The company submitted that, the Reserve Bank of India, after considering the application of the company, approved payment of trademark royalty from 01.04.2001. The application of the company made to RB! is gone through, wherein, the company requested to issue automatic approval effective 01.04.2001 so that the payment can commence from that date. The approval of RBI, does not refer to effective date of payment, therefore, the royalty for the period of July, 2001 to March, 2002 only, is allowable as Tax Deduction for the year. For these months, the Brand Royalty is computed at Rs. 51,819,324/- and the same worked out as per the computation provided in Press Note No.1 amounts to Rs. 5O,331,678/-".

He, therefore, computed the royalty payment on trademark usage at Rs. 5,03,31,678/-.

17. The TPO, therefore, suggested a net adjustment of Rs. 2,46,61,370/- on payment of both kinds of royalties, i.e. royalty on technical knowhow and royalty on trademarks as:

S. No.	***Transaction***	***As per books***	***ALP as per TPO***	***Difference***
1.	*Royalty on tech. knowhow*	*5,66,24,003*	*4,52,99,202*	*1,13,24,801*
2	*Royalty on trade marks*	*6,36,68,247*	*50,33,678*	*1,33,36,569*
	Total	***12,02,92,250***	***9,56,30,880***	***2,46,61,370***

18. The AO, in accordance with the above, made addition to the tune of Rs. 2,46,61,370/- to the income of the assessee.

19. The assessee approached the CIT(A), before whom the assessee reiterated its submissions made before the TPO/AO. The CIT(A) on examining the submissions, made proposal for enhancement for disallowing the entire payment of royalty on trademark usage technical knowhow at 1.25%, as the same were not wholly and exclusively incurred for the purpose of the appellant's business.

20. On receipt of the show cause notice for enhancement, the assessee gave a detailed reply with regard to the genuineness and correctness of royalty payments on both counts. The CIT(A), on receipt of the detailed submission from the assessee held,

"Based on the submissions filed on record, explanations provided from time to time, documents evidencing provision of technical know-how, I am satisfied that the Appellant has received several benefits on account of payment of technical know-how royalty and the same have been evidenced by supporting documents"

21. On observations with regard to brand ownership, the CIT(A) held,

"5.7 The Appellant, has submitted that the Overseas AEs have merely granted the Appellant, the rights to use the trademarks and all the rights with regard to decision making on licensing / exploitation / sa1e of trademarks, maintaining the trademarks, protecting the trademarks etc continues to lie with the Overseas AEs.

Extracts from The Report on the Attribution of Profits to Permanent Establishments dated 17 July 2008 issued by the OECD were brought to my attention that defines, economic ownership' in the context of Article 7, as under:

"The economic ownership over an intangible asset relates to the ongoing contribution and investment in the property to maintain the development and value of the intangible. This is generally evidenced by marketing expenditure but is not limited to this. It also relates to the exertion of practical control over the intellectual property and hence decision making with respect to the use and exploitation of the asset. In respect of trademarks for example, while expenditure for promotions and advertising may be contributing to the value of the asset through promotion of the brand this may not be sufficient of itself to demonstrate economic ownership of the asset."

In this regard, the Appellant submitted that the economic ownership over an intangible asset could relate to the ongoing significant contribution and investment in the intellectual property to maintain and .develop the value of .the intangible. Thus, the economic owner must have the rights to use and exploit the asset in the first instance. Thereafter the extent to which the exploitation and economic control over the intellectual property is possible subject to the legal contractual relationship between the two parties which governs the terms and conditions.

The Appellant explained that Overseas AE is the intellectual property owner of the trademarks and without access to this trademarks, the Appellant would be unable to exploit the intellectual property in the Indian market. With respect to the exploitation of the intellectual property, it was submitted that the Appellant has merely been granted the right to use the trademarks on the licensed products manufactured in accordance with the prescribed specifications. The Appellant *thereafter undertakes marketing and selling of the products using the brand "Cadbury".*

It was further explained that economic and commercial value of, a 'brand' is typically driven by the income-stream it generates. However, the Appellant has merely contributed approximately 1% of the total sales of CSOL over the years from 2001-2008. This clearly indicates the Appellant has hardly contributed to the total group turnover and hence it cannot be termed as the economic owner of the 'Cadbury' brand. In fact, it is because of the global brand that it represents that the Appellant has been able to capture approximately 75% of the market share. It was also stated that while Cadbury has been in India from 1948, the brand per-se has been in existence since 1824 and it was a well developed brand even before it was introduced in India.

5.8 Advertisement expenses incurred by the Appellant

With respect to the advertisement expenditure incurred by the Appellant, it was submitted that marketing expenditure in itself is insufficient for a claim to economic ownership over an asset.

The Appellant has contended that it is in the business of manufacturing and distribution of chocolates, sugar confectionery and malted food drinks in India based on the technology licensed by Overseas AEs, and in this regard, it incurs various business related expenses inter-alia for undertaking advertisements for the creation of "product" awareness of new products and recall value of existing product portfolio in the minds of its customers.

It was further stated the advertising expenditure is typically incurred by the Appellant for the purposes of;

a) Increasing sales of existing products by continuously reminding the customers of its products especially in case of a end in sales or when competitors launches new products / advertisement campaigns such as Kit Kat, Munch, Eclairs etc

b) Counte ring competition / acting as entry barriers for new players eg. Lindt, Mars etc

c) Informing consumers of its new product launches such as Bournville, Cadbury Silk, etc

d) Creating awareness of discounts offered on various products at a particular point of time

e) Creating a recall value of chocolates (as an alternative to Indian sweets) on festive occasions such as Diwali, New Year, Holi etc

f) Reaching out to rural markets for its low cost products *g) Marketing its health drinks/nutraceutical products (Bournvita)*

The Appellant has also placed on record sample copies of the advertisement mandates provided to the advertising agencies which evidence the objective and desired outcome of the advertising to be achieved.

It has been contended that advertisements are largely undertaken to create "product recall", "popularize products in the market" "counter competition" etc. It was reemphasized based on the advertising mandated filed by the Appellant, that creating "brand" awareness was not the objective of the advertisements since "Cadbury" brand is already well known respected in India.

It has been submitted that the Overseas AEs provide strict brand guidelines so as to ensure that the overall strategy and vision associated with the brand is adhered to by the Appellant in India. The appellant has also submitted the copy of branding guidelines before me to corroborate the above.

It has also been highlighted by the Appellant that while the increased sales may have benefited the. Overseas AEs by way of increased royalty at 1% on the incremental sales, the same is insignificant as compared to the incremental quantum of profits earned by the Appellant on the increased sales and the taxes paid thereon to the Indian Government Treasury.

The Appellant has contended that the correct way of looking at royalty payment is to see the turnover achieved by the Appellant as a result of the license. It has been contended that the payment of Rs 635.68 lakhs to achieve a turnover of Rs 63,606.53 lakhs and to realize the net profit of Rs 8,892.88 lakhs is certainly reasonable and at arm's length.

Further the Appellant has also highlighted that that the advertisement and marketing efforts undertaken by the Appellant, for promoting the sales of its products in India, does not benefit the Overseas AEs directly, as they are not involved in the business of manufacture/trading of such products in India either on its own or through any of its other subsidiaries. Hence, the entire advertisement and marketing expenses incurred are purely for its own, benefit and no direct benefit accrues to Overseas AEs as such.

5.9. With respect to points raised by me during the appellate proceedings on the ruling of the AAR in case of Fosters Australia Ltd, the Appellant submitted that even the AAR and the Revenue department, in the case of Fosters Australia Limited had accepted that the owner of the trademark and the technology was Fosters Australia, overseas company and that the Indian *company was only licensed the trademark and technology for its usage. Accordingly, it is submitted that considering the decision of the AAR in the case of Fosters Australia, the Appellant cannot be considered as the economic owner of the trademark Cadbury".*

22. The CIT(A) also took into consideration the AA Ruling in the case of Fosters Australia Ltd., where Fosters Australia was the owner of the trademark and technology and the Indian company was the licensed user. In the decision, it was held that the applicant cannot be considered as the economic user of the trademark. Before the CIT(A) the assessee also relied on certain third party agreements and other group companies, wherein terms and conditions, assigned in the agreements were similar. The assessee placed the copy of agreement with Harshey Food Corp. US, who had been given right to produce, market, advertise, promote, sell and distribute Cadbury licensed products under the trademark of Cadbury UK. It was also argued that the group companies and third parties to whom license has been granted are legally obliged to incur marketing/advertising expenditure while paying Royalty to the licensor and none of these partners' had faced any TP adjustment on the issue of royalty payment to the overseas AE, while undergoing TP audits.

23. The CIT(A), while examining the detailed arguments held,

6.5. The appellant had benchmarked its Royalty for trade mark and technical know how under the TNMM. Its operating margin on operating revenue came to 13.28% whereas those of its comparables in confectionary industry came to 2.17% only. TNMM is a profit based method. A royalty rate for the related party is determined indirectly by selecting a royalty rate that would give the licensee post royalty operating profits that are similar to what an unrelated party would earn by using the intangibles.

The theoretical basis of the TNMM takes the stance that, if intangible property is contributing to an entity nature, the entity will earn profits in excess of what could be observed in the absence of such intangible property. Applied to the facts of this case, the appellants 13.28% margin vis a vis average margin of comparables at 2.17% clearly establishes that the intangible property (Trademark and Technical Know How) has contributed to its excess profits. The TPO has no objection to the selection of comparable companies for benchmarking but has taken the stand that since they (comparables) are not paying trademark royalty and technical know how fees, hence cannot be used for benchmarking this transaction lacks force. In fact what distinguishes the appellant (Cadbury) from its competitors in the chocolate & confectionary market is its valuable brand name backed by the high quality products and it is this crucial factor that gives it a tremendous competitive advantage translating *into an operating margin of 13.28% despite huge turnover. In the absence of such intangible property the comparables average is languishing at 2.17% only. This huge gap justifies the 2.25% payment by the appellant to its AE. There is a direct co-relation between Cadbury's "intangible capital" and its performance.*

6.6. As regard the issue of period of royalty payment based on the submissions filed before me and the explanations provided, and reviewing the chain of events, I am of considered view that the Appellant always intended to pay brandname royalty from 1 April 2001 and the same was accordingly stated in its application to the RBI. The payment of brandname royalty was approved by the RBI and RBI has not raised any question on the effective date of royalty payments. It is merely that the Appellant received the RBI approval at a subsequent date. This would however not change the effective date of payment, approved by the RBI and hence the same is allowed.

6.7. To sum up the appellant has demonstrated that the royalty payment for trade mark and know how meets the Arms Length test under TNMM. It has backed it with CUP method including third party comparables like HERSHEY, unrelated third parties in Asia to whom license has been granted. It also demonstrated that its advertisement, marketing and promotion expenses are at par with other in the same line of business. Hence, for reasons recorded as aforesaid and after taking into account all facts and circumstances the royalty for trademark at 1% and technical knowhow 1.25% for the entire F.Y. 2001-02 is considered to be at Arms Length. The consequent addition of Rs. 11,13,24,801/- for technical know how and Rs. 1,33,36,564/- for Trade marks so made is deleted".

24. The CIT(A), not only dropped the enhancement proceedings, he deleted the addition made on account of TP adjustment.

25. Against this decision, the department has filed the appeal before the ITAT.

26. Before us, the DR submitted that the revenue authorities picked up two of the other international transactions, which really pertained to Royalty payment for technical knowhow and use of trademarks. It has been submitted that royalty on technical knowhow was being paid by the assessee company to its parent AE since the signing of the agreement dated 19.03.1993 which was valid upto 08.03.2000, which was extended by SIA vide approval upto 08.03.2000, which was extended by SIA vide approval upto 14.09.2000. He further submitted that since agreement dated 20.12.2000 upto present date, the assessee company has been paying royalty on technical knowhow at the rate of 1.25%. This is being in accordance with the agreements signed on various dates.

27. He further submitted that the assessee started to pay royalty on use of trademark after taking approval of the Board of Directors on 26.04.2001 and consequential approval by the RBI. It was submitted that the assessee had been paying royalty from 12.02.2002 to its parent AE.

28. The DR, advancing the objection made by the TPO submitted that the agreements entered into by group companies in other parts of the world had been paying composite royalty, which came to 2%, whereas, the assessee had been paying royalty ranging between 1% to 1.25% and that the agreements entered into by the assessee company and its parent AE have overlapping clauses, pertaining to the payment of royalty on technical knowhow and trademark usage.

29. Besides this objection, the DR submitted that in the course of proceedings before TPO, the TPO raised the issue of payment of AMP, which had been left without any comments, in respect of computation of ALP.

30. The DR also submitted that CUP method would be most suitable method, as there are no segment wise data available. The DR further submitted that the assessee brought on record fresh agreements, which have not been seen by the AO/TPO along with AMP issue and for this reason, the issue deserves to be restored to the AO who shall reexamine the issue afresh.

31. The Senior Counsel appearing on behalf of the assessee responded that in so far as the royalty on technical knowhow is concerned, 2% has been accepted in the case of the assessee over the years. He further pointed out that as per the data placed before the TPO and then before the CIT(A) the average royalty received by the parent AE from global entities is coming to 2.32% (as recorded by the revenue authorities in their orders). According to the Senior Counsel, even the guidelines issued by OECD is at a higher percentage at 2.25%, therefore, the royalty paid to the parent AE is well within the prescribed limits and therefore, no AL adjustment is called for. Similarly, the royalty payment on trademark usage, at 1% is well within the arms length and has been continued from the preceding year.

32. On the issue of AMP issue, the Senior Counsel submitted that since the issue was never before the TPO, the enhancement proceedings as initiated by the CIT(A) were dropped, after being fully satisfied.

33. The Senior Counsel placed reliance on the decision of Lumax Industries Ltd. vs ACIT, in ITA No. 4456/Del/2012, wherein the coordinate Bench at Delhi has accepted TNMM on royalty payments. He submitted that the case law relied upon by the DR, wherein the ITAT rejected TNMM and restored the issue to the file of the AO, does not have any relevance, when a definite finding from the coordinate Bench is there.

34. He further relied on the decision in the case of ITO vs Industrial Roadways, reported in 112 ITD 293, wherein the coordinate Bench at Mumbai held, "*that if additional evidence furnished by the assessee before the first appellate authority is in nature of a clinching evidence, leaving no further room for doubt or controversy, in such a case no useful purpose would be served by following evidence/material to AO to obtain report and in such exceptional circumstances, said requirement may be dispensed with*". He therefore, submitted that there is no occasion for restoring the TP issue to the file of the AO to look into the issue of AMP, which is not impugned before us.

35. The Senior Counsel, therefore, submitted that the CIT(A) was correct in holding that the payments made under both the types of royalties were at arms length and no adjustment addition needs to be made.

36. The DR in the rejoinder submitted that the in the interests of justice the issue needs to be restored to the file of the TPO.

37. We have heard the detailed arguments from both the sides. The basic issue is the correctness of ALP on the royalty payments made by the assessee company to its parent AE on account of technical knowhow and trademark usage.

38. From the arguments of the DR, made on behalf of the TPO, the agreement for paying royalty on technical know how at 1.25% and trademark usage at 1.25%, were overlapping and thus, TNMM method used by the assessee was incorrect. According to the TPO, the best method to ascertain ALP in the interest case was CUP, as the transactions were controlled. This was reasonable, as no data was available from independent source to benchmark the transactions.

39. On going through the records and the orders of the revenue authorities, we find that in so far as the payment of royalty on technical knowhow concerned, the assessee has been paying to its parent AE right from 1993, as, other group companies are paying across the globe. It has been accepted by the TPO that the payment does not effect the profitability of the assessee, if we are to examine the issue from that angle as well. In any case the payment of royalty on technical knowhow is at par with the similar payments from the group companies in other countries & region. Besides this, the payment is made as per the approval given by the RBI and SIA, Government of India. Hence there cannot be any scope of doubt that the royalty payment on technical knowhow is not at arms length.

40. Coming to the issue of royalty payment on trademark usage, we find that the assessee, in fact is paying a lesser amount, if the payments are compared with the payments towards trademark usage, by the other group companies using the Brand Cadbury in other parts of the world. On the other hand, if we examine the argument taken by the TPO with

regard to OECD guidelines. On this point the assessee's payment is coming to a lesser figure, as discussed in detail by the CIT(A).

41. We are not going into the arguments advanced by the DR/TPO on geographical differences, and payments made to Harshey, as these arguments gets merged in the interpretation and details available in the table supplied by the assessee and taken note of by the TPO and the CIT(A).

42. We are also not referring to the case of Maruti Suzuki Ltd. as we find that in so far as the instant case is concerned, there is really no relevance.

43. On the basis of the above observations, we are of the opinion that the royalty payment on trademark usage is within the arms' length and does not call for any adjustment.

44. We, therefore, sustain the order of the CIT(A) and reject the grounds as claimed by the department.

45. Ground no. 1 as raised by the department is rejected.

46. Ground no. 2 pertains to domestic issue, wherein the CIT(A) allowed the 50% of expenses incurred on renovation of office complex and other expenses pertaining to electric installation, treating the same to be revenue.

47. The facts are that the assessee undertook refurbishing of the Cadbury House and claimed an aggregate expense of Rs. 2,39,38,000/-, which is as under:

Party Name	***Description***	***Amount (Rs.)***
Dalal Consultants	*Upgradation of Cadbury House*	*21,73,793*
Dalal Consultants	*Upgradation of Cadbury House*	*5,73,924*
Nitin Parulekar Architects	*Architects, interior design work*	*88,860*
Hitesh Shah & Associates	*Plumbing/removing window frams/ debris, etc.*	*30,160*
Hitesh Shah & Associates	*Plumbing/removing window frams/debris, etc.*	*30,160*
Hitesh Shah & Associates	*Fixing Ms Steel support/bamboo scaffolding*	*29,040*
Roshan Electrical Contractor	*Supply & Installation of electrical items*	*14,44,694*
Interscape	*Civil, Exterior and Plumbing works*	*1,60,63,652*
S.R. Network	*UTP CAT 5*	*10,45,103*

	cable/connectors/cords/cabling work	
Geeta Network	*Repairing with upholstery work Board rooms chairs*	*34,240*
Geeta Network	*Repairing with upholstery work /Dir Chairs/Meeting room chairs/staff chairs*	*99,720*
Neutron Electronics	*Reinstallation charges NEC-M-100*	*50,000*
	TOTAL	***2,39,38,000***

48. The assessee in its submissions before the AO claimed that in fact the repairs, renovation, refurbishing, plumbing expenses and architects fee was much higher and much more. The assessee had suo moto capitalized all the expenses, which were in the nature of capital.

49. The AO disallowed the entire expenditure, claimed as revenue by the assessee. The AO observed in the assessment order that "*the whole exercise has resulted into the additional utilizable space and long term increase in the value and strength of the building. The items claimed as revenue expenditure are part and parcel of the total expenses incurred on renovation and therefore, only a part cannot be said as capital expenses and remaining as revenue expenditure, therefore, the entire expenditure is disallowed as capital expenditure and 10% depreciation is allowed*". He, therefore, added back Rs. 2,15,44,200/- (Rs. 2,39,38,000 0 Rs. 23,93,800/-).

50. The assessee approached the CIT(A), before whom the assessee reiterated its submissions. The CIT(A) taking into consideration the submissions placed before him, along with the evidence and details, pertaining to the issues of various renovation jobs, allowed benefit to the extent of 50% on the interior designs work at Rs. 21,94,800/- and supply and installation of electrical items at Rs. 14,44,694/-.

51. Against these allowances, the department is in appeal before the ITAT.

52. Before us, the DR submitted that the view taken by the AO was correct because the nature of renovation work is of enduring benefit and falls squarely within the capital field. On the basis of these arguments, the DR submitted that even the allowance of 50% by the CIT(A) was unjustified.

53. The AR on the other hand pleaded that the expenses incurred by the assessee are purely in the nature of repairs and maintenance and are allowable as revenue.

54. We have heard the arguments of the parties before us and area of dispute for our consideration is very limited, i.e. 50% allowance on the payment made to Nitin Parulekar Architects for interior design works at Rs. 21,984,800/- and payment made to Roshan Electric Contractors at Rs. 14,44,694/-.

55. The CIT(A) has allowed only 50%, though, on adhoc basis, the impugned expense, which according to us are quite reasonable.

56. We, therefore, sustain the order of the CIT(A) and reject the ground of appeal, as filed by the department.

57. Ground no. 2 is therefore, rejected.

58. In the result, appeal filed by the department is dismissed.

ITA No. 7408/Mum/2010: (Assessee appeal):

59. The following grounds have been raised:

"GROUND NO. 1- Expenditure incurred on rural development Rs. 1,07,891/-.

On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the action of the Additional Commissioner of Income Tax, Range 5(1), Mumbai ("the AO") of disallowing Rs. 1,07,891/-, being expenditure incurred on rural development in villages near the Appellant's factory, on the alleged ground that the said expenditure has no nexus with the business carried out by the Appellant without considering the fact that such expenditure incurred out of commercial expediency, it enhances the corporate image of the Appellant Company and also promote its business.

GROUND NO. 2: 8OHHC - Miscellaneous Income and Trade Discount Rs. 9944,920/- and Rs. 5,13,72,467/-

On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the action of the AO of treating miscellaneous income and trade discount as part of the total turnover for the purpose of computing deduction u/s. 8OHHC of the Act.

GROND NO. 3 : 8OHHC — Interest Rs. 6,47,94,044/-

On the facts and in the circumstances of the case and in law, the CIT(A) erred in confirming the action of the AO of reducing 90% of the gross interest received while computing deduction u/s. 8OHHC of the Act on the alleged ground that there is no nexus between the two without netting off the same against interest paid.

GROUND NO. 4: Payment to Third Party Manufacturer Rs. 22,64,396/-

On the facts and in the circumstances of the case and in law the CIT(A) erred in not considering and directing the AO to allow the deduction of Rs 22,64,396/- being actual payment made to the Third Party Manufacturer on account of contractual obligation

GROUND NO.5: General

> *The Appellant craves leave to add, to alter and/or amend all or any of the foregoing grounds of appeal.*

60. Ground no. 1 pertains to disallowance of Rs. 1,07,891/- on account of rural development.

61. The CIT(A) sustained the disallowance, following the order of his predecessor in the preceding year(s). We also find that the addition has been sustained by the coordinate Bench in the assessee's own case in assessment year 2001-02 in ITA No. 975/Mum/2005.

62. In the impugned order, we find that the assessee has placed reliance on the decision of *CIT vs Madras Refineries Ltd.*, reported in 266 ITR 170 (Mad). This case has not been considered by the CIT(A), rather, the CIT(A) followed his predecessor's order. As a correct judicial propriety, the issue should be held against the assessee, following the order of the coordinate Bench in the preceding year, but the fact that the assessee factory is located in the village belts at Induri, near Mumbai and Malana, in Madhya Pradesh. The upliftment of these areas, though not directly relatable to the business of the assessee but is certainly a matter of good corporate governance through corporate citizen, which is encouraged by the government. This is what has been held in the case of Madras Refineries Ltd. (supra). It may not be out of place to mention, that in the case of Indian Rayon & Industries Ltd. (now known as Aditya Birla Nuvo Ltd.), (where one of us was a party to the decision), in ITA No. 5421/Mum/2005 have allowed a similar expense.

63. In these circumstances, in the interest of justice and the current need for being a better corporate citizen, the issue is restored to the file of the AO, who shall reexamine the nature of expense in the light of Madras Refineries Ltd. (supra) and Aditya Birla Nuvo Ltd. ITA No. 5421/Mum/2005 (supra) and allow the expense, if the assessee has incurred expenditure for upliftment of local village community, as a good corporate citizen.

64. Issues raised in Grounds No. 2 to 4 are dealt with and are covered by the various orders of the coordinate Benches of the ITAT, in the case of the assessee. Since the grounds are covered on identical issues, we for the sake of brevity are not deviating from the inferences drawn by the coordinate Benches.

65. Ground no. 2 pertains to Miscellaneous income and trade discounts amounting to Rs. 99,44,920/- and Rs. 5,13,72,467/-.

66. At the time of hearing, the AR pointed out that the issue is covered by the order of the coordinate Bench in ITA No. 957/Mum/2005 in assessment year 2001-02 in assessee's own case, wherein in para 6.1, it has been held,

"6.1 After hearing both parties, we find that this issue is covered by the decision of the Tribunal in assessee's own case in assessment year 1995-96 in ITA No.1641/M/2003 dated 8.10.2010. The Tribunal in the said year noted that the miscellaneous income which included trade discounts, miscellaneous sales, sales tax, excise duty etc. had to be included in the total turnover except the sales tax and excise duty which did not contain an element of turnover in view of the judgment of the Hon'ble Supreme Court in the case of CIT vs. Lakshmi Machine Works (290 ITR 667). The facts this year are identical. Therefore, we confirm the order of CIT(A) except in relation to sales tax and excise duty which will be excluded from the total turnover.

7. The sixth dispute is regarding reduction of 90% of interest from profit of business as per Explanation (baa) while computing deduction under section 80 HHC. Assessee had received interest on FDRs, ICDs and others aggregating to Rs.5,21,04,545/-. The AO excluded 90% of the same from the profit of the business while computing deduction under section 80 HHC which in appeal was confirmed by CIT(A). Assessee has disputed the decision of authorities below to exclude 90% of the gross interest and not net interest income.

7.1 We have heard both the parties, perused the records and considered the matter carefully. Earlier the Hon'ble High Court of Bombay in case of CIT vs. Asian Star Co. Ltd. (326 ITR 56) had held that 90% of gross interest has to be reduced from the profit of business as per Explanation (baa). However the said decision of the Hon'ble High Court has not been up held by the Hon'ble Supreme Court who in the case of ACG Associated Capsules Ltd. (343 ITR 89), have recently held that 90% of net receipts have to be reduced as per Explanation (baa). We, therefore, set aside the order of CIT(A) and hold that 90% of net interest income is required to be reduced after deducting expenses incurred having nexus with earning of interest income. The issue is thus restored to AO for working out 90% of net interest income after allowing opportunity of hearing to the assessee".

67. The DR placed reliance on the orders of the revenue authorities.

68. We have gone through the orders of the revenue authorities and have also perused the order in ITA No. 975/Mum/2005 (supra). We find the issue is covered and we do not find any reason to deviate from the order in the assessee's own case. We hold accordingly.

69. Ground no. 2 is therefore allowed.

70. Ground no. 3 pertains to reduction of gross interest from the computation of deduction u/s 80HHC.

71. At the time of hearing, the AR pointed out that the issue is covered by the order in ITA No. 975/Mum/2005 in paras no. 7 and 7.1, which reads as under:

> *7. The sixth dispute is regarding reduction of 90% of interest from profit of business as per Explanation (baa) while computing deduction under section 80 HHC. Assessee had received interest on FDRs, ICDs and others aggregating to Rs.5,21,04,545/-. The AO excluded 90% of the same from the profit of the business while computing deduction under section 80 HHC which in appeal was confirmed by CIT(A). Assessee has disputed the decision of authorities below to exclude 90% of the gross interest and not net interest income.*
>
> *7.1 We have heard both the parties, perused the records and considered the matter carefully. Earlier the Hon'ble High Court of Bombay in case of CIT vs. Asian Star Co. Ltd. (326 ITR 56) had held that 90% of gross interest has to be reduced from the profit of business as per Explanation (baa). However the said decision of the Hon'ble High Court has not been up held by the Hon'ble Supreme Court who in the case of ACG Associated Capsules Ltd. (343 ITR 89), have recently held that 90% of net receipts have to be reduced as per Explanation (baa). We, therefore, set aside the order of CIT(A) and hold that 90% of net interest income is required to be reduced after deducting expenses incurred having nexus with earning of interest income. The issue is thus restored to AO for working out 90% of net interest income after allowing opportunity of hearing to the assessee".*

72. On going through the order of the revenue authorities and the order of the Coordinate Bench in assessee's own case in assessment year 2001-02, we are of the opinion that for the sake of continuity and consistency the issue be restored to the file of the AO.

73. Ground no. 3 is allowed for statistical purposes.

74. Ground no. 4 pertains to payments of Rs. 22,64,396/- made to third party manufacturers.

75. The CIT(A) has followed the decision taken by his predecessor. In the order of the ITAT in ITA No. 975/Mum/2005, in the preceding year, the addition has been sustained, wherein it has been held in paras no. 3 and 3.1,

> *"3. The second dispute is regarding disallowance of provision for contractual liability towards 3rd party manufacturers/ convertors in relation to excise duty payable amounting to Rs.61,44,628/-. The assessee was is engaged in the business of manufacturing and sale of malted foods, cocoa based products including confectionary which were being manufactured at its own factory as well as under agreement with third party*

manufacturers/converters at their factories. In respect of products manufactured at company's own factory, excise duty is paid on the basis of company's wholesale trade price less permissible deductions in the nature of post manufacturing expenses (PME) incurred by the company on freight, octroi, additional sales tax etc. The third party manufacturers converters were initially paying excise duty on the products manufactured for Cadbury on the basis of cost of raw material, packing material and conversion charges which included third party manufacturers/converters' margin of profit. However, the excise authorities disputed the said basis of valuation and claimed that excise duty on products manufactured by third party manufacturers/converters is payable on the basis of Cadbury's whole sale trade price less PME. Accordingly, the excise department issued a show cause cum demand notice and directed the manufacturers/converters to pay excise duty on the basis of normal price worked out from the prices charged by the assessee company to their wholesale dealers. The said third party manufacturers/converters disputed the basis adopted by the Excise authorities for levy of excise duty and the said dispute became the subject matter of appeal before the Excise Duty Appellate Authorities. Although the primary liability to pay the excise duty was that of the third party manufacturers/converters, the said excise duty liability was to be paid by the assessee company as per the agreements as and when was payable. Since the said dispute was not settled in the year under consideration, the assessee company retained the liability in respect of the disputed amount to the extent of Rs.61,44,628/- in view of its contractual obligations towards the third party manufacturers/converters by reducing its sales to that extent and crediting the accounts of the third party manufacturers/converters. In the result, the sales were shown less to that extent in the Profit & Loss Account and in effect, deduction was claimed on account of provision for liability towards contractual obligation to the third party manufacturers/ converters in computing the total income which was disallowed by the AO following decision in earlier year. In appeal the CIT(A) has confirmed the disallowance following the appellate order in the earlier year, aggrieved by which the assessee is in appeal before the Tribunal.

3.1 After hearing both the parties, we find that this issue had been adjudicated by the Tribunal in assessment year 1994-95 in ITA No.282/M/00. In the said year, the Tribunal noted that the assessee was following mercantile system of accounting as per which contractual liability accrued on the date of its ascertainment and was allowable in the year of ascertainment.

> *In this case, the liability was pending in dispute and therefore, the same had not been incurred during the year. Facts this year are identical and, therefore, respectfully following the decision of the Tribunal in the year 1994-95 (supra), we confirm the order of CIT(A)disallowing the claim".*

76. As the facts are identical and the reasoning given by the ITAT is one the similar basis, we, therefore, following the order of the coordinate Bench in the preceding assessment year, confirm the disallowance.

77. Ground no. 4 is rejected.

In the result, appeal filed by the assessee is partly allowed.

To sum up:

Assessee's appeal in ITA 7408 of 2010 stands partly allowed

Revenue's appeal in ITA 7641 of 2010 stands dismissed.

Order pronounced in the open Court on 13th November, 2013.