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Weekly Tax Journal

Editor-in-Chief
Dr. Ikramul Haq
Editor
Mrs. Huzaima Bukhari

CASE LAW

Foreign:

Pitney Bowes India Pvt. Ltd.
v.
Commissioner of Income Tax

Cadila Healthcare Ltd.
v.
Asst.Commissioner of Income-Tax(OSD) & 1

ITA No.3647/Del/2007
Assessment Year : 2002-03

ITA No. 434(Del)2011
Assessment Year: 2006-07

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For Lahore
Office No. 14, 2nd Floor,
Sadiq Plaza, 69-The Mall,
Lahore 54000 Pakistan
Ph. (+9242) 36280015 & 36365582

For Karachi
Ms. Sadaf Bukhari at 0301-8458701
Mr. Zakir Hussain at 0333-2104425
For Other Cities:
Mr. Aftab Sajid 0305-5199004, 0344-4987197

Figure-fudging syndrome continues

by
Huzaima Bukhari & Dr. Ikramul Haq

It is sad that the Federal Board of Revenue (FBR) has not learnt any lessons from earlier fiascos in over reporting tax collection figures—by taking funds in advance and blocking due refunds, besides taking credit of the same amount at various places. As a New Year gift, FBR informed the nation that it had provisionally collected Rs. 840.7 billion during July-December (2011-2012) as against Rs. 661.7 in the corresponding period of last year, reflecting an increase of 27.05 percent. Once again, the exact amount of refunds due (but not paid) was not revealed so that actual net collection could have been ascertained. Similarly, the fact that major portion of collection of Rs. 201.7 billion during December 2011 included huge funds taken from taxpayers in advance—not relating to the period for which accounting is made—was deliberately concealed.

Only six months back, FBR high-ups claimed that revised target of Rs. 1588 billion was exceeded, calling it a "historic achievement". However, it did not take long before the media exposed this claim and proved that through an act of fraud, FBR grabbed Rs. 43 billion from some big taxpayers, returning the amount by way of refunds within a few days. In reality, there was a huge shortfall of over Rs. 40 billion. Since FBR Chairman successfully avoided any punitive action, he continues with figure-fudging exercise for showing "wonderful results"—the purpose reportedly is to obtain extension in service.

The News in '**Revenue target met through artificial figure**' of 22 July 2011claimed that "the revenue amounting to Rs. 1590 billion was not accumulated in the national exchequer till the night of June 30. The FBR had managed to secure about Rs. 43 billion from major banks and oil companies to show that the target was met. However, the amount was reimbursed in the first 10 days of July 2011...this was one of the reasons for resignation of Governor State Bank".

FBR, in the wake of publication of above story in *The News* tried to control the damage by feeding a statement to a newspaper which said that: "the net revenue collection of the Federal Board of Revenue (FBR) for 2010-11 stood at Rs 1550 billion against the annual target of Rs 1588 billion, reflecting a shortfall of Rs 38 billion. Earlier, the figures of Rs 1590.462 billion were the gross revenue collection of 2010-11. The final figures of net revenue collection as on July 22, 2011 were Rs 1550 billion for 2010-11 against thrice downward revised target of Rs 1588 billion, showing a shortfall of Rs 38 billion. The net figures of Rs 1550 billion have been computed and calculated after refund payments and reconciliation of data during the period under review".

This was not the first time that FBR tried to hoodwink both the international lenders and public at home—it has a long history of overstating revenue collections by manipulating figures. Way back in 1999, tax bureaucrats inflicted shame on us by gross misreporting of data to the International Monetary Fund (IMF). Subsequently, a commitment was made to the IMF to review fiscal data from financial year (FY) 1989-90 onwards. The data compiled for FY 1994 to FY 2000 confirmed that tax revenues were inflated by Rs. 5.2 billion. The tax collectors—data manipulators is a more appropriate term for them—showed higher tax collections through fudging figures and the nation had to pay a heavy cost for it (not only in terms of fine paid to the IMF) but by the embarrassment of a more tarnished image in the international community that nothing is transparent in this society.

Persistent manipulation of revenue collection figures by FBR is a cause of grave concern. Time and again, independent analysts and foreign institutions have expressed their indignation over this fraud, but the It is a serious matter that requires independent probe by the National Assembly's Standing Committee on Finance has failed to hold any meaningful inquiry, let alone taking appropriate action. Never ever does FBR disclose in its statements how much undisputed and established refunds are payable, which must be subtracted from the gross revenue receipts to record correct revenue collection. It only shows the actual refunds issued, whereas accrued and ascertainable liability of refunds should also be taken into account to reflect the true picture of net revenue realized during a financial year.

Such acts of deceit, manipulation, fraud and highhandedness by FBR testify to the criminal culpability of political masters as well. They want to show higher collection figures to foreign lenders, especially IMF, World Bank and Asian Development Bank to secure more and more funds for their personal gains. FBR on its own cannot indulge in this criminal act unless backed by the government of the day. And if it is doing this at its own behest, the matter is even more serious; as it proves ineffectiveness of the government.

It is now well-established that FBR is hooked on figure-fudging. The latest effort to show 27% growth during the first six months of current fiscal year by "borrowing money" from taxpayers rather than collecting due taxes from the rich and mighty, is yet another shocking act. It is a sad reflection on our fiscal management. The data manipulators, as before, would escape accountability as they are reportedly backed by the political masters whom they serve faithfully.

The State Bank of Pakistan (SBP), in its annual report for 2010-11, estimated revenue deficit of 3.6 percent of GDP. The overall fiscal deficit was 6.6 percent of GDP. In order to meet monstrous fiscal deficit and give more money to badly-managed corporations running in losses, the government resorted to heavy borrowing—domestic and foreign. According to SBP "it has become a regular feature of Pakistan's fiscal operations that at the time of the budget planning, quite an ambitious target is set for FBR tax collection: that is revised several times during the year and at the end of the year this target is also missed."

The SBP's report exposes "brilliant performers" of FBR, who should be taken to task for perpetual jugglery of figures—it is a national disgrace. It is abuse of authority at the highest level. The top tax bureaucrats sitting in FBR always accuse lower level tax officials of corruption but what they themselves are doing is by no means less unpardonable.

False claims of "exceeding target" have exposed the credibility of the entire tax system. Such malpractice has distorted the image of the entire tax machinery—rendering the achievements of those who genuinely achieved their budget targets as doubtful. Since reporting of collection by FBR has lost its credibility and Auditor General too has failed to bring this before the Public Accounts Committee, it has become imperative for the Parliament's Select Committee on Finance to order audit of FBR's revenue collection system by an independent reputed firm of auditors.

Sales tax on services provided or rendered by construction industry

by
Zafar Azeem[*]

A builder, did ask our firm a specific question by stating that he is engaged in selling of apartments and buying of land for construction of buildings, and whether or not in the light of provisions of Sindh Sales Tax on Services Act, 2011,[1] service rendered and provided by him (land development, sale of apartments and plots) do attract Sales Tax? This write up examines the legal position regarding the levy of Sales Tax on service provided or rendered by the construction industry.

In order to regulate the levy of Sales Tax on services provided, rendered, initiated, received or consumed in the province of Sindh, the provincial government enacted, the Sindh Sales Tax on Services Act, 2011, which became enforceable from the first day of July 2011.[2]

For the purpose of this levy, a service has been defined, it include (and does not limit), the activities listed in column (2) of the first schedule to the act read with Chapter 98 of the Pakistan Customs Tariff.[3] A study of the said listed items shows that construction activities have been included in the schedule and Sales Tax is payable.[4]

Sales tax is chargeable, levied and collected on the value of taxable service at the rate specified in the schedule.[5] The term taxable service

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[*] The writer is an advocate and is currently working as an associate with Azim-ud-Din Law Associates.

has been defined to include a service which is listed in the second schedule to the Act,[6] and for that an individual or a business engaged in rendering services is required get a registration with the Sindh Sales Tax Department.

For the levy of tax, the term services include a service rendered even to a non-resident.

A service provided by non-resident persons to resident person is also taxable.[7] For the purposed of this act an office of a builder or of a construction company outside the province of Sindh will be a separate legal entity.

For charging tax on service rendered by a non-resident, his services become taxable if they do fall within the definition of the term, 'economic activity'.[8] The term 'service' also includes a business, supply of moveable property by lease, or other similar arrangements including license to use the property, and the trading business.[9]

The value of taxable service for the purpose of charging of tax is consideration in money (and includes all other taxes) received from the recipient of the service; however, deduction of trade discount is permissible from the sale price.

Permissible consideration will be an open market price.[10] The open market is to be determined in the prescribed manner.[11] The service attracts tax at the rate of16%,[12] and the tax is payable on a monthly basis.[13]

The liability to pay the tax is on the person rendering the services.[14] Services provided or rendered by property developers or promoters are also taxable.[15] The term services in respect of property developer and constructor includes:[16]

a) Development of purchased or leased land for conversion into residential or commercial plots.

b) Construction of residential or commercial units.

Under the law, a builder engaged in the supply of service is required to be registered, that means a legal person engaged in the development of land and construction of residential or commercial units will get them registered with the Sindh Sales Tax department immediately after the commencement of the Act.

In respect of services relating to residential or commercial units, sale tax is chargeable under the provisions of the Act.

The tax is payable by taxable person at the time of filing of the tax return.[17] The taxable services stands provided during a tax period in which it was provided, or when a tax invoice was served to the recipient of service, or when consideration for the supply was received.[18] The mode, manner or time for the tax payment is chargeable by the competent authority.[19] The tax is to be deposited in a designated bank on the prescribed payment challan as specified in Form SST-04 or through electronic payment system devised for this purpose.[20] In case of sale or change of ownership tax is payable by the new purchaser.[21]

Where a dispute arises regarding payment of tax, the dispute will be resolved by an officer not below the rank of an Assistant Commissioner by adjudicating the issue in the prescribed manner.[22]

Application for registration (Form SST-01) shall be submitted electronically to the Sindh Board of Revenue[23] (hereinafter referred to a board).

The registration of service provider may be transferred from one jurisdiction to another jurisdiction by the Board.[24]

All registered persons shall file a return in the Form SST-03 along with required documents.

This return shall be filed electronically in the specified manner.[25] A revised return for making payment of tax is also permissible,[26] in some cases it is subject to grant of permission by the competent authority.[27] For the determination of Input Tax procedure has been laid down.[28] For claiming Credit or Debit, mechanism has been provided in the rules.[29]

From the study of these legal provisions, it is evident that a number of issues will arise in the implementations of this enactment, and these issue include, capital goods schemes, issues of dwellings, residential and charity buildings, construction works, conversions, renovations, sales and lettings, refund schemes, and time of supply etc.

The provisions of the act on these issues are wanting.

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1. Sindh Act No XII of 2011, enacted on 10.6.2011.
2. See sub-section (3) of Section 1 of The Sindh Sales Tax on Service Act, 2011. (hereinafter referred to as 'Act')
3. Sub-section (35) of Section 2 of the Act.
4. Heading 9807.0000 of the Second Schedule to the Act.
5. Section 8 of the Act.
6. Section 3 of the Act.
7. See sub-section(2) of Section 3 of the Act.
8. See Section 4: Economic activity.
    1) An economic activity means any activity carried on continuously or Regularly by a person that involves or is intended to involve the provision of services to another person and includes
        a) an activity carried on in the form of a business, including a profession, calling, trade, or undertaking of any kind, whether or not the activity is undertaken for profit;
        b) the supply of moveable property by way of lease, license or similar arrangement; and
        c) a one-off adventure or concern in the nature of a trade.
    2) Anything done or undertaken during the commencement or termination of an economic activity is part of the economic activity.
    3) An economic activity does not include -
        a) the activities of an employee providing services in that capacity to an employer;
        b) a private recreational pursuit or hobby of an individual;
        c) an activity of a person other than an individual, which is essentially carried on as a private recreational pursuit or hobby of a member, owner, or associate of the person; or

d) an activity carried on without a reasonable expectation of profit by an individual or an association of persons, all of the members of which are individuals.

9. Section 3 of the Act.
10. Section 5 of the Act.
11. Open market price.
    (1) The open market price of a service is:
    (a) the price the service would fetch in an open market transaction freely entered into between persons who are not associated persons; or
    (b) if it is not possible to determine an amount under paragraph (a), the price a similar service would fetch in an open market transaction freely made between persons who are not associated persons, adjusted to take account of the differences between the similar service and the actual service, determined on the basis of the market conditions prevailing at the time and place at which the service is provided.
    (2) If the open market price of a service cannot be deter mined under subsection (1), it may be determined using any method approved by the Board for calculating an objective approximation of the price the service would fetch in an open market transaction freely made between persons who are not associates.
12. Id n.7.
13. Sub-section (42) of Section 2 of the Act.
14. Section 8 of the Act.
15. Heading 9807.0000 of the Second Schedule to the Act.
16. Id n.7.
17. Sub-section (1).
18. Id n.19.
19. Id n.19.
20. Rule 14 of the rules.
    Where due date has been prescribed as 15th of a month, the tax due shall be deposited by the 15th and return shall be submitted electronically by 18th of the same month
21. Section 19 of the Act.
22. Section 23 of the Act.
23. Rules of the Sindh Sales Tax on Service Rules 2001 (hereinafter referred to Rules).
24. Rule 8.
25. The manner to file the return is provided below:
    i. A registered person shall obtain a unique User-ID and password be e-Enrolling with. Sindh Revenue Board web portal and electronically file a return (available on the website) from the web portal.
    The return data shall be filled in a web form and will be submitted online to Sindh Revenue Board by using e-SRB Web portal at http://e.srb,gos.pk.
    The Sindh Revenue Board web portal would also provide instructions on how to fill this e return.
    ii. The electronic return can be filed by a registered person (self) or through an e-intermediary licensed under rule 19 of these rules.
    iii. To file the return, the registered user shall logon to e-portal of Sindh Revenue Board at http:// e.srb.gos.pk using the assigned User ID and password.
    Stepwise procedure for electronic filing of return would be as follows –
    (a) select Sales Tax on Services return from declaration menu;
    (b) select the Tax Period, month, quarter from the drop down list;
    (c) click the monthly or quarterly return link to open the return Form;
    (d) return Form will be displayed which will be filled in accordance with the instructions provided;
    (e) taxpayer shall fill out the relevant Annexes of return Form by providing the invoices details, amount value and sales tax charged.
    The uploading facility for data files is available in all Annexure forms;

(f) based on the details entered in the relevant annexes of return, the total values of main Return Form will be auto calculated;

(g) the payable Sales Tax column will be showing the Sales Tax payable by the registered person;

(h) registered person shall verify all the details displaying in the prepared return Form;

(i) the e-payment Challan in-Form (SST-04) shall be generated automatically from the system after verification of the prepared return by the registered person.

Iv. E-filing can be completed in the following stages -

(a) the user shall fill in all the relevant fields.

(The return may be saved at any time during preparation process to avoid data loss);

(b) the returns may be verified by the person having access to Personal Identification Number (PIN) code.

He shall press the Verify Button given at the bottom of form and follow the instructions;

(c) this option may be availed by person opting to deposit tax amount in an National Bank of Pakistan branch or other designated bank which is online with Sindh Revenue Board server for e-payments.

After verifying the return, epayment button can be clicked which will generate the payment Challan Form (SST-04) with payment slip identifier (PSID) and SID number.

Registered person should print the Challan Form (PSID) and deposit the payable amount against the same.

The bank shall accept the payment and provide computerised payment receipt, (CPR) to the registered person as an acknowledgement.

v. The user will be required to enter the CPR ID received from National Bank of Pakistan Branch on his return Form.

On entry of CPR ID the submit button on Return will be enabled.

The registered person will click the submit button and a message shall appear at the top of screen, stating that your return has been submitted.

Acknowledgement shall be printed by clicking the Print Acknowledgement button.

The submitted return shall also be printed and saved on user's computer in PDF format.

The registered person are advised to quote the Computer generated number of the e-filing acknowledgement in all their future correspondence with Board.

vi. The responsibility for filing the returns and all the information contained therein is that of registered person.

Registered person should hence keep his user ID and Password allotted by the department strictly confidential.

vii. The electronic Sales Tax return and its relevant attachment, if any, shall be kept in electronic record of the registered person and shall be produced to the officer-in-charge in demand along with supportive documents.

26. Rule 17
27. Id n.17
28. Rule 22
29. Rule 23

SECP automates e-challan verification

The Securities and Exchange Commission of Pakistan (SECP) has enabled automatic verification of e-Challans for payment of fee to it which shall be implemented with effect from Tuesday and will available for online applications only, a statement of the commission said.

Previously, at least one day was required in e-Challan verification after payment by the depositor at the bank. Under the new procedure, systems of both the SECP and MCB Bank have been linked online and now payments can be verified automatically within a few hours' time.

As soon as the user shall make payment at the designated branch of the MCB Bank the branch will automatically send intimation to the SECP of receipt of payment, for further processing.

This new procedure is expected to enhance facilitation to the SECP's e-Services users and substantially improve the turnaround time in disposal of online applications. – *Courtesy The News*

Information about accountholders: FBR, PBA agree on mechanism

There will be no binding on banks to provide accountholders information to the Federal Board of Revenue in cases where notice to seek data under section 176 of the Income Tax Ordinance 2001 is without the name/nomenclature, or Computerised National Identity Card number and bank account number/title of account.

Sources told here on Monday that the FBR and the Pakistan Banks Association (PBA) have agreed on a mechanism for sharing information about the accountholders under section 176 of the Income Tax Ordinance 2001.

Under the agreed arrangement, the banks will not be obliged to provide information if the notice under Section 176 of the Ordinance, does not contain the name/nomenclature and/or Computerised National Identity Card number (in case of individuals) and incorporation number (in case of companies), or the bank account number/title of account.

In case such a notice is received, the focal person in the concerned bank will be entitled to decline it with a copy thereof to the Chief Commissioner concerned.

In this regard, the FBR and the bank's representatives have jointly chalked out an implementation mechanism of section 176 of the Income Tax Ordinance, 2001.

Under section 176, the FBR can serve notice any department to obtain information or evidence.

In order to streamline and smoothly implement Section 176 of the Income Tax Ordinance, 2001, which has recently emerged as an irritant in the FBR-Banking sector's relations, it was decided that: Firstly, every scheduled bank will nominate (by name) at least two officers of adequate seniority in order of hierarchy divulging their complete contact details (including their cell phones, email address etc).

Any change in focal persons will be communicated to Chief (Operations) FBR, during next two working days, who, in turn, will transmit it down the line immediately.

Secondly, the departmental officers from all-over Pakistan, instead of issuing notices under section 176 of the Ordinance 2011 to local branch managers, will, hereinafter, direct their notices to the designated focal persons at the Head Office of each scheduled bank.

Thirdly, the banks' focal persons, after scanning their complete list of accountholders in all branches wherever located, will be obligated to respond to the notice issuing authority within 10 days.

If, however, the focal person is unable to provide the required information within the stipulated time, he/she will make a request in writing to the notice-issuing authority for extension, which under normal circumstances should be granted.

All banks will be liable to provide the information by the expiry of the extended period, and within a fortnight under all circumstances.

Fourthly, the banks will not be obliged to provide information if the notice under Section 176 of the Ordinance, does not contain the name/nomenclature and/or Computerised National Identity Card Number (in case of individuals) and incorporation number (in case of companies), or the bank account number/title of account.

In case such a notice is received, the focal person will be entitled to decline it with a copy thereof to the Chief Commissioner concerned.

Fifthly, both the FBR and PBA will circulate this mechanism to the field offices and other stakeholders for compliance to ensure implementation mechanism of section 176 of the Income Tax Ordinance, 2001.

Under section 176, the commissioner may, by notice in writing, require any person, whether or not liable for tax under this Ordinance to furnish to the Commissioner or an authorised officer, any information relevant to any tax.

The commissioner may require any person to attend at the time and place designated in the notice for the purpose of being examined on oath by the commissioner or an authorised officer concerning the tax affairs of that person or any other person and, for that purpose, the commissioner or authorised officer may require the person examined to produce any accounts, documents, or computer-stored information in the control of the person.

The commissioner may impound any account or document produced and retain it for so long as may be necessary for examination or for the purposes of prosecution, section added. – *Courtesy Business Recorder*

FBR on operations/enforcement side: tax policy, budget finalisation may be carved out by Revenue Division

The tax policy including finalisation of the federal budget is expected to be carved out by the policymakers of the Revenue Division and the Federal Board of Revenue would be confined to operations/enforcement side while giving their vital input on budgetary proposals to the Revenue Division.

Sources told on Monday that the government is in the process of clearly defining the role of tax officials dealing in tax policy under the Revenue Division and Members of the FBR.

The first proposal is that three Additional Secretaries be appointed for Tax Policy under the Revenue Division.

These are Additional Secretary Customs, Additional Secretary Sales Tax and Additional Secretary Income Tax.

In case this proposal is not materialised, there should be Additional Secretary Inland Revenue and Additional Secretary Customs to deal with the tax policy matters.

As per first proposal, at least three Additional Secretaries would operate under the Revenue Division for tax policy.

The second option is to create posts of two Additional Secretaries for Tax Policy within the said Division.

At present, officials of the Revenue Division are mulling over different proposals to work out some viable organisational structure under which a viable tax policy be formulated every year with the input of the FBR.

So far, various options are being considered to finalise the structure of the proposed unit to deal with the tax policy under Revenue Division.

The basic idea behind the proposal is to separate policy from operations of the tax related issues.

The separation of tax policy from operations would ensure accountability, transparency and smooth functioning of the tax machinery for enforcement, recovery and tax collection at the level of the field formations.

According to the proposal, the tax policy would be taken over by the policymakers of the Revenue Division.

The FBR would be given the basic task of enforcement and operations with input in the federal budget.

Under the proposal, federal budget, which is the biggest instrument of the tax policy, would be handled by the Revenue Division with the input of the FBR.

It has been proposed to set up a small unit comprising 4-5 senior tax officials to run the Tax Policy Unit of the Revenue Division.

The Tax Reform Co-ordination Group (TRCG) and the FBR have already strongly endorsed the creation of the new post of the Additional Secretary Tax Policy under the Revenue Division to exclusively deal with the tax policy matters.

The rationale behind the creation of the post of the Additional Secretary Tax Policy is that the Revenue Division should deal with the policy side whereas the FBR would handle the operational side of the tax-related matters.

The policy matters would be handled by the Revenue Division and operational issues would be looked after by the tax machinery.

This structural change in the tax policy would facilitate the FBR to obtain direct input of policymakers in finalisation of the new tax policy. – *Courtesy Business Recorder*

Zero-rated ST regime: tax expert issues 'Highlights'

The Federal Board of Revenue (FBR) will collect 5 percent sales tax, along with one percent sales tax on value-addition, on the import of finished goods under SRO 1125(I)/2011.

Arshad Shehzad, a leading sales tax expert of Karachi, on Monday issued highlights of SRO 1125(I)/2011 dated December 31, 2011.

The highlights explain the key decisions of the new sales tax zero-rating regime from January 1, 2012.

Following are the highlights of SRO 1125(I)/2011:

1. Single rate of 5 percent, instead of earlier two different rates--4 percent and 6 percent.
2. Import by commercial importer @ 2 percent along with 1 percent value-addition /tax.
3. Adjustment of input allowed with output.
4. Simplification in procedure.
5. Sales for reduced rate import to other than five sectors were allowed @ 5 percent. Earlier, it applied standard rate ie 16 percent.
6. Import of industrial input by manufacturer of five sectors would remain zero-rated.
7. Import of finished goods would attract 5 percent sales tax along with 1percent value addition tax.
8. Retailer would attract 5 percent sales tax on purchase of these goods with the facility of adjustment & not liable to pay turnover tax under special procedure.

However, they have to pay turnover tax on sales of items other than listed in notification, Arshad said. – *Courtesy Business Recorder*

Sales tax on services: SRB again asks FBR to return Rs 1.4 billion amount

Sindh Revenue Board (SRB) once again has asked Federal Board of Revenue (FBR) to return the Rs 1.4 billion amount of Sindh province which had been collected by FBR in the head of sales tax on certain services of June 2011, learnt on Monday.

Though, Sindh government had established its own official tax-collection-body after the passage of 18th constitutional amendment, which had started its work from 1st July 2011, but it could not collect sales tax on services of June 2011, due to some technical issues, sources said.

The SRB had collected services tax of month of July in August 2011, and it had collected over Rs 11 billion in the second half of 2011.

The FBR had collected sales tax on services (which became the provincial domain after the passage of 18th amendment) of June from Sindh amounted Rs 1.4 billion, sources said.

The SRB had asked many times to the FBR for the return of said amount to Sindh government but nothing happened practically yet in this regard, sources said.

The Chairman FBR had also promised to give back the amount within a few days during his meeting with Chairman SRB but this promise also could not be fulfilled despite lapse of more than two months, sources added.

It may be noted here that Chairman FBR Salman Siddique visited SRB's Head-office here on October 27, 2011. – *Courtesy Business Recorder*

Implementation of court orders: FTO terms delay by Customs 'maladministration'

Federal Tax Ombudsman (FTO) Dr Muhammad Shoaib Suddle has noted with concern the neglect, inattention and delay by the customs department in implementation of the high court orders saying this is nothing but maladministration of the customs officials.

In a recent order of the FTO, the case of M/s Nizami Wire Industries (Pvt) Ltd of Lahore has been declared as a clear case of maladministration of customs department.

The FTO has ruled that prompt implementation of orders of the superior judiciary is a constitutional responsibility of every state functionary.

Neglect, inattention and delay on the part of Customs in implementing the of high court order, after it has been confirmed by the apex court, is tantamount to maladministration in terms of Section 2(3)(ii) of the FTO Ordinance, 2000.

In this specific case, the high court held the Customs Department responsible for delay in clearance and directed it to bear the burden of demurrage charges.

Details of the case revealed that the complaint has been filed alleging maladministration for illegal rejection of refund claim of demurrage charges filed by the complainant.

The unit had imported a consignment of 256 coils of prime quality low carbon wire rods from UAE, and filed GD for customs clearance.

At the time of examination, the Customs staff suspected that the goods were of secondary quality due to which the matter was referred to the Pakistan Steel Mills Karachi and the Peoples Steel Mills Karachi for expert opinion.

The laboratory tests by both confirmed that the goods were of prime quality, as declared by the importer.

The Karachi Port Trust charged Rs 1,006,200/- from the importer on account of demurrage charges due to delayed clearance of goods.

The Customs House Karachi on the request of importer issued delay and detention certificate for claiming refund of demurrage charges as delay was on account of dispute about quality of goods.

But Karachi Port Trust did not accept the refund application of the Complainant.

The Complainant contended that consignment of wire rods was not allowed clearance due to dispute in which he was not at fault.

He requested for directions to the KPT to refund the demurrage charges.

Or ask the Customs Department should compensate the loss as delay in clearance was on their part.

The complaint was sent to the Revenue Division for comments in terms of Section 10(4) of the Establishment of the Office of the FTO Ordinance, 2000.

The Model Customs Collectorate, Karachi, in its comments received through the Revenue Division stated that quality of goods was not declared in the import documents.

At the time of examination, most of the coils of wire rods were found rusty and these appeared to be of secondary quality.

Further investigation about quality was made in good faith to amass more revenue.

However, laboratory tests confirmed prime quality of goods as per declaration of the importer and delay and detention certificate was issued for waiver of demurrage charges to mitigate the hardship faced by the importer.

The KPT authorities were bound to accept the delay and detention certificate to provide relief to the importer.

The grievance of the Complainant was against the KPT authorities who were not allowing relief to him.

During the course of hearing, the AR submitted that the decision of the President on the representation of the KPT in complaint No 940-L/2006 was challenged by the Complainant in the Islamabad High Court Islamabad.

The High Court held the Customs Department responsible for delay in clearance and directed it to bear the burden of demurrage charges.

The Customs appeal filed in the Supreme Court of Pakistan against the decision of the Islamabad High Court was dismissed, and leave refused.

The AR requested for directions to Customs Department to implement the orders of the Islamabad High Court.

The departmental representative reiterated the arguments as contained in the comments received from the Revenue Division.

FTO has directed the FBR to direct the concerned officials to refund the demurrage charges the Complainant paid to the KPT within 15 days and report compliance within 7 days thereafter. – *Courtesy Business Recorder*

Effectively checking underground economy: World Bank lauds FBR for steps taken through TARP

The World Bank (WB) has acknowledged the steps taken by the Federal Board of Revenue (FBR) to effectively check underground/cash economy in Pakistan under the Tax Administration Reform Project (TARP).

Sources told here on Monday that the WB report has highlighted measures taken by the FBR for checking black economy.

According to the report, important measures were also implemented under TARP to control the underground/cash economy.

In particular, the requirement of payment through cheques for amounts above Rs 50,000 to qualify for sales tax input credit was introduced.

Also, the withholding system was expanded and now sales to large taxpayers are subject to a two percent withholding tax collected by the large taxpayers.

These measures are complemented by the recent law disallowing tax input credit in the sales tax (adjustments) and deductions (expenses) in the income tax resulting from purchases from non-active taxpayer.

The report said that the TARP's achievements included improvement in taxpayer registration, control of stop-filing, control of tax arrears, audit, refund, and taxpayer services.

The project has also assessed how the tax administration legal framework affected TARP progress, and how TARP achievements may help in reducing the underground/cash economy.

The TARP has been successful in improving the FBR taxpayer registration system.

A single taxpayer registration number has been introduced and will be the only number to be applied to register taxpayers in all taxes.

Also, the FBR has been successful in identifying and flagging inactive taxpayers as "dormant" taxpayers, which is crucial for improving control of non-filers.

FBR has also started cleaning up the economic activity code assigned to each taxpayer, which is critical for producing tax statistics by economic sectors and for performing risk analysis.

The number of registered and active taxpayers has increased sustainably in the last 3 years - from July 2008 to July 2011 the number of active taxpayers grew from 3.139 million to 3.766 million taxpayers (almost 25 percent), the report said.

At the same time, the electronic filing has also been improved consistently.

Now all sales taxpayers and the companies are required to e-file their annual income tax returns.

More recently, the e-filing requirement has been extended to withholding statements.

The e-filing improves considerably the quality on the return data: most of the common errors made by taxpayers are eliminated, data -entry costs were reduced and information on e-filed returns is immediately available for enforcement actions.

The control of non-filers has significantly benefited from the introduction of e-filing, particularly for sales tax.

It has also benefited from enforcement measures with a focus on identifying inactive taxpayers and notifying non-filers (e-notification) in a massive way.

A landmark in enforcement measures is introduction of the active taxpayers list (ATL), which includes taxpayers that are active, ie regularly submit their tax returns.

The ATL was successfully implemented for sales tax and now is being extended to income tax.

The FBR now has the ability to disallow sales tax input credit (adjustment) originated from taxpayers (suppliers) who are not on the ATL.

Similarly, the FBR can disallow deductions claimed as expenses in the income tax paid to suppliers that are not included in the ATL.

To increase effectiveness of non-filers control, the FBR's Enforcement Wing is prioritising non-filers control actions according to the size of the revenue at risk.

ST non-filing has been brought down considerably (less than 2 percent in LTUs) and around 11 percent in RTOs.

The non-filing of companies in the income tax has also been reduced and is now in the range of 10 percent in LTUs and 16.5 percent in RTOs.

The same has happened with withholding tax for companies.

Although the non-filing rate has been brought down to 37.7 percent; it is still too high.

However, there is still enough room for improvements in non-compliance control, particularly in withholding taxes and income tax advanced payments.

The non-filing rates are very high in the RTOs and even in LTUs (Islamabad and Lahore) for the period July 2010 thru June 2011, the report added.

The legal framework for tax administration has improved considerably, even though it is still inadequate.

An extensive harmonisation has been made between the sales tax and income tax legislations.

The penalties have been harmonised in the sales tax and income tax legislations.

The main penalties harmonised were for the following faults: do not register, do not inform changes in registration, do not file a return, do not pay the full amount of the tax due in the return, repeating erroneous calculation in the return, issuing tax invoices without being registered/authorised, issuing invoices without complying with invoices regulation, do not issue invoices for a taxable transaction, do not maintain records required under the sales tax act, under report tax, do not withhold tax when required, do not withhold tax, late payment of withheld taxes when required, do not present statements or other information required by FBR, do, not produce records to the FBR, and do not pay the tax resulting from an audit assessment.

The tax acts have also been harmonised with regard to the application of the ATL.

Also, legislations have been improved by bringing up to the FBR Board critical enforcements powers.

Now the FBR Board has the powers to select taxpayers for auditing, to send e-notifications, to apply penalties, etc.

The FBR Board also can delegate these powers down to the relevant commissioners, the WB report added. – *Courtesy Business Recorder*

Cement block makers to be brought into ST net

The Federal Board of Revenue (FBR) has decided to bring all units, engaged in manufacture of cement blocks used in buildings including ready mix concrete blocks' and 'ready mix concrete' into sales tax net.

Sources told here on Tuesday that the FBR has issued instructions to the Chief Commissioners of Regional Tax Offices (RTOs) to bring manufacturers of 'Building blocks of cement including ready mix concrete blocks' and 'ready mix concrete' within the sales tax regime.

The FBR has clarified the issue on a representation filed by the RTO-II Lahore.

The FBR has examined the issue in legal perspective as per sales tax rules and regulations.

According to the FBR, prior to June 4, 2011, 'ready mix concrete blocks' were exempt from sales tax under S.No 35 of Table-I of Sixth Schedule of the Sales Tax Act, 1990.

This serial number has been deleted vide Finance Act, 2011 from June 4, 2011; hence, 'ready mix concrete blocks' have become chargeable to sales tax from June 4, 2011.

'Ready mix concrete' has, however, always been chargeable to sales tax because it was not covered under Serial No 35 of Table I of Sixth Schedule of the Sales Tax Act, 1990.

All RTOs are, therefore, directed to bring all units engaged in manufacture of 'Building blocks of cement including ready mix concrete blocks' and 'ready mix concrete' in the sales tax net, FBR's directive added. – *Courtesy Business Recorder*

FBR convinces banks to provide accountholders' data

The Federal Board of Revenue (FBR) has managed to convince the banking sector to submit required information of their accountholders in the monthly withholding statements to facilitate the tax department in documentation of the economy.

Sources told here on Tuesday that FBR Member Shahid Hussain Asad, Member Inland Revenue and the representatives of Pakistan Banks Association (PBA) had discussed the crucial issue of filing of monthly withholding statements by banks.

Tax authorities have informed the bank representatives that banks can play an important role in increasing revenue collection and improving tax compliance by submitting complete information of their accountholders in the monthly withholding statements under the relevant provisions of the Income Tax Ordinance 2001.

According to sources, it was a major breakthrough in improving co-ordination between the FBR and the banks in proper filing of withholding tax statements according to the Ordinance 2001.

The FBR has agreed to introduce necessary changes in the tax laws keeping in view suggestions of the banks.

It has also been agreed that all banks will continue to co-operate and comply with the Inland Revenue Service field formations' requirements as stipulated in the law wherein particulars of the account holders, namely computerised national identity card number (CNIC) or account number/title of accounts are conveyed and generalised information is not sought.

According to FBR sources, the PBA underscored the need of respect for the secrecy of the bank accountholders under relevant provisions of the operating laws.

They expressed concern over filing of withholding statements wherein the banks now have to divulge complete particulars of their accounts holders in the wake of amendments introduced in Section 165 of the Income Tax Ordinance, through Finance Act, 2011.

Member, Inland Revenue, while accepting the PBA's position, in principle, stated that the "days of banking secrecy are over," and in order for Pakistan to move in rhythm with the rest of the world, it had to come out of the traditional paradigm of confidentiality of and by the banking sector even at the cost of the state exchequer.

He further desired PBA to cooperate with FBR in the process of nation-building through increase in revenue and improved tax compliance particularly when quite a few of the banks who were providing complete information of the their account holders in the monthly withholding statements had neither faced any litigation nor any extra-legal problems from the side of the tax department.

The PBA delegation in unison lent support to Member, Inland Revenue's assertions, but raised their liability concerns including possibility of institution of liability suits against banks for violation of confidentiality provisions/l aws.

Accordingly, it was decided that PBA, within a fortnight, will forward to FBR a complete inventory of laws/provisions/regulations/rules, which in their view, need amendment/modification so as to be consistent with the provisions of the Income Tax Ordinance, 2001, enabling FBR to introduce required changes therein after due diligence and consultations with the stakeholders including the State Bank of Pakistan and the Ministry of Finance.

However, in the meantime, all banks will continue to co-operate and comply with the IRS field formations' notices/requirements as stipulated in the law wherein particulars of the account holders, namely CNIC or account number/title of accounts are conveyed and generalised information is not sought.

In connection with the matter of filing of Withholding Statements, it was decided that as soon as all branches of National Bank of

Pakistan (NBP) are made to issue CPRs the banks will file them electronically.

The banks are required to identify the branches of NBP that are not issuing CPRs due to which their e-statements are rejected at e-portal of FBR.

It was further agreed that all technological bottlenecks faced by banks in this connection with filing of e-statements under section 165 shall be brought to the notice of Chief (Operations), FBR, who will get them resolved in consultation with PRAL experts on priority basis, sources added. – *Courtesy Business Recorder*

Recovery from bank accounts: circular to ensure compliance of Section 140 of IT Ordinance to be issued

The Federal Board of Revenue and banks have agreed to issue instructions/circular to banks to ensure strict compliance of section 140 of the Income Tax Ordinance 2001 for recovery from tax defaulters through their bank accounts.

Sources told on Wednesday the FBR and the Pakistan Banks Association (PBA) have mutually finalised an implementation mechanism of section 140 of the Income Tax Ordinance, 2001.

Under section 140, the FBR can ask banks to recover the unpaid amount of tax from the defaulter's bank accounts.

However, the issue is mainly related to the compliance of the section 140 by the banks for recovery of tax from defaulters through attachment of their bank accounts, etc.

The section 140 deals with the recovery of tax from persons holding money on behalf of a taxpayer.

For the purpose of recovering any tax due by a taxpayer, the Commissioner may, by notice require any person owing or who may owe money to the taxpayer; holding or who may hold money for, or on account of the taxpayer; holding or who may hold money on account of some other person for payment to the taxpayer or having authority of some other person to pay money to the taxpayer, to pay to the Commissioner so much of the money as set out in the notice.

According to sources, the Inland Revenue Service officials flagged the issue of delaying tactics adopted by some of the bank branch managers particularly those at remote locations upon service of a notice under section 140 of the Income Tax Ordinance 2001 by making excuses such as soliciting guidance from their head/regional offices, opinion from legal experts, and even consent from the accountholders, which scenario creates friction and at times compels IRS field formations to resort to initiation of punitive action.

Tax authorities categorically stated that, by virtue of unequivocal formulation of the provision, a notice under Section 140 of the Ordinance has to be executed (implemented) the moment it is served - under all circumstances.

It was decided that the banking sector will issue an instructional but binding circular to all bank branches throughout the country outlining the mechanics of implementation of section 140 of the Ordinance, which will be cleared with Inland Revenue Wing, FBR, before issuance.

The main thrust of the Circular will be that a notice under section 140 of the Ordinance 2011 has to be implemented immediately upon service (receipt) and the bank's action in compliance thereto has been fully indemnified by the law.

Once the bank has complied with the notice to the extent of the amount held by them the notice so issued shall be withdrawn immediately, sources added. – *Courtesy Business Recorder*

MCCs directed to check limited number of fresh fruit consignments

The Federal Board of Revenue (FBR) has directed the Model Customs Collectorates (MCCs) to only check limited number of fresh fruit consignments meant for export to avoid 100 percent physical examination for checking of suspected drugs in the export cargo.

Sources told here on Wednesday that the exporters of fruits and vegetables have expressed serious concern over 100 percent physical examination of export consignments by customs officials in the field formations.

All Pakistan Fruit and Vegetable Exporters, Importers and Merchants Association has informed the FBR that the opening of refrigerated, cargo for checking drugs disturbs the temperature and thus renders the fruits/vegetables vulnerable to decay.

It was also explained that such decayed fruits/vegetables are not acceptable to the buyers and Pakistan may loss genuine export business in this field.

Accordingly, exporters were given exemption from 100% examination and advised to the concerned custom authorities by the FBR to carry out only 5% random checks, keeping in view the perishable nature of 'Kinnow' (fruit).

This arrangement was agreed in the past between the customs department and the association.

However, despite having several meetings with the concerned customs authorities and their firm assurances in setting down this vital issue of 100% examination, no action has so far been taken and fruit exporters continue to suffer miserably as field formations have not followed the FBR's directives in letter & spirit, association added.

Responding to this, FBR has now issued instructions to the Collectors of Customs MCCs to follow Board's instructions issued in the past regarding examination of 'Kinnow' containers.

In the past, the FBR had directed the field formations that the Pakistan Horticulture Development and Export Board approached the Board with the submissions that export of Kinnow consignments under the Duties and Tax Remission for Export Scheme (DTRE) may be exempted from customs examination keeping in view the perishable nature of the commodity.

The issue was examined in the Board and it was decided that examination of Kinnow exports to a maximum of 5% random may be carried out.

The Collectorates were, therefore, requested to comply with the decision besides extending extra facilities to Kinnow exporters.

These instructions were issued in the past by the FBR.

Similarly, in the past the association was of the view that opening of refrigerated cargo for checking drugs disturbs the temperatures, thus renders the fruits/vegetable vulnerable to decay.

Such decayed fruits and vegetables are not acceptable to the buyers and Pakistan may lose genuine business in this field.

In the past, the Board had allowed export of fresh produce in terms of export policy.

All Pakistan Fruit & Vegetable Association Karachi had taken the responsibility for such certification and in case drugs or narcotic are found in any consignment certified by the association then the association will be held responsible. – *Courtesy Business Recorder*

Documentation drive: DG I&IIR to collect information from entities through RTO

The Directorate General of Intelligence and Investigation Inland Revenue (IR) has to collect information or evidence from any government department or private sector organisation through the relevant Regional Tax Office (RTO) under the ongoing drive of documentation of economy.

Sources told on Wednesday that the RTOs have the legal mandate to collect evidence or information under section 176 of the Income Tax Ordinance 2001.

The information collected by the RTO would be onward submitted to the directorate of intelligence IR for discovering new potential cases of taxes.

Legally, the information collected by the RTOs could be submitted to the directorate for further investigation.

The collection of evidence for documentation of investors in stock/shares under section 176 (notice to obtain information or evidence) could be done through the relevant RTO under legal provisions of the Income Tax Ordinance 2001.

The issue came to the light when the RTO Lahore had asked the FBR to clarify the powers and jurisdiction of the directorate of intelligence IR for collection of information under section 176 of the Income Tax Ordinance 2001.

The FBR's directorate of intelligence IR has informed the RTO Lahore, "It needs to be appreciated that as a newly created unit; this Directorate General is severely handicapped both in manpower and resources.

The Regional Tax Offices, which are far better positioned in both human and other resources, could depute a team of keypunch operators (KPOs) to convert the data from the PDF to Excel.

The RTO Lahore reference to the mandate of the directorate for collection of information is also on the wrong side of the facts.

Since no authority has been created in terms of section 207 of the Income Tax Ordinance, 2001 for the directorate, therefore it does not have mandate to collect information u/s 176 of the Ordinance.

However, such authority for collection of information does rest with the Officers of the RTOs which could be exercised for collecting the required information," the FBR added.

The income tax authorities created under the Income Tax Ordinance are Chief Commissioner Inland Revenue; Commissioner Inland Revenue; Commissioner Inland Revenue (Appeals); Additional Commissioner Inland Revenue; Deputy Commissioner Inland Revenue; Assistant Commissioner Inland Revenue; Inland Revenue Officer; Inland Revenue Audit Officer and Superintendent Inland Revenue. – *Courtesy Business Recorder*

Tax collection growth during July-December 2011 highest in region

The growth in revenue collection by the Federal Board of Revenue (FBR) during the first half of FY12 is claimed to be the highest against the tax collection by other regional countries.

“The revenue collection for the first half of 2011/12 is the highest as per the study conducted by the revenue authority,” said Shahid Hussain Asad, Member Inland Revenue (IR), Federal Board of Revenue (FBR), on Wednesday.

The FBR collected Rs842 billion during the first six months of the current fiscal year against Rs662 billion collected in the corresponding months last year, depicting a growth of 27 percent.

The study compiled the data of growth in tax collections of regional countries, including India, Hong Kong, Singapore, Malaysia, Bangladesh, Turkey, etc.

“The study reveals that India has the highest growth of 22 percent, while other countries have nominal growth,” the member added. The member, however, said that the efforts still required to maintain the growth target by the end of the current fiscal year to meet gigantic target of Rs1,952 billion and improve the tax-to-GDP ratio.

The tax-to-GDP ratio in Pakistan is the lowest in the world having single-digit ratio, the World Bank reported in its latest study.

The member attributed the revenue uptick, especially in direct taxes, which increased by 30 percent, to broadening the tax base and monitoring of the withholding tax. “Monitoring of withholding taxes resulted in Rs14 billion during the period,” the member added.

Regarding broadening the tax base efforts, he said, the number of taxpayers has been increased, but the revenue impact is small.

"But it has long-term impact on the revenue collection," he added.

The FBR officials in different tax departments, however, said that the rise in the tax collection is mainly due to massive fall in the rupee value and higher prices of POL products.

"The fall in the rupee value resulted in increased import duty," an official said on the condition of anonymity.

"Similarly, the rise in prices of POL products also gave boost to sales tax collection," the official added.

The rupee fell over four percent since the start of the current fiscal year as its value was at 85.97 to a dollar on June 30, but it fell sharply to a record low of 90.20 on Tuesday.

Another FBR official said that the recovery through audit is another major contributor towards revenue collection, besides collection of advance tax also gave boost to the collection efforts.

The FBR collected 43 percent of the total revenue collection target and still required Rs1,110 billion in the remaining six months of the current fiscal year. – *Courtesy The News*

NLC, FWO, DHAs, others: big withholding agents not filing statements regularly

The Sales Tax Enforcement Plan (2012) framed by the Federal Board of Revenue has disclosed that some of the large withholding agents such as National Logistic Cell (NLC), Frontier Works Organisation (FWO), Defence Housing and Development Authorities, National Highway Authority (NHA), Railways and Military Accountant General were not regularly filing sales tax returns and withholding tax statements for income and sales taxes withheld from payments made to the vendors.

Sources told here on Thursday that the FBR will allocate Withholding Tax Identification Numbers to all withholding agents by January 31, 2012 and sales tax withholding agents would also be allocated numbers by the given deadline.

The FBR plan (2012) has focused on the filing of sales tax returns pertaining to withheld sales tax by different withholding agents.

According to the sales tax registration plan (2012), various persons such as Federal and Provincial Governments and their attached departments, Large Tax Payer Units (LTUs) taxpayers and certain other categories are required to withhold Sales Tax also.

Here again, the position is disappointing as out of around 1000 persons holding free tax numbers (FTNs), only 34 are e-enrolled for filing statements.

The FBR plan stated that there is huge default in filing of annual as well as monthly statements.

Out of 27,282 withholding agents who actually filed statements for tax year 2011, 8215 defaulted in filing all the four quarterly statement.

Some of the large Withholding Agents such as NLC, FWO, Defence Housing and Development Authorities, NHA, Railways, Capital Development Authority (CDA) and Military Accountant General have not been filing the ST Returns and Withholding Tax Statements for Income Tax and Sales Tax withheld from payments made by them to the vendors.

Out of 900 registered persons of LTU Karachi, 204 registered persons did not intimate about sales tax withheld by them.

Likewise, 129 of 360 registered persons of LTU Lahore behaved on the similar lines while position of LTU, Islamabad is also not different, the FBR analysis said.

The FBR has proposed an action plan for enforcing Sales Tax Withholding Statements:

1. Identification of persons liable to file statements U/S 165, unit wise, by PRAL by January 10, 2012.
2. Determining the number of persons actually filing statements U/s 165 - unit wise by PRAL by January 15, 2012 and identification of defaulter.
3. Pakistan Revenue Automation limited (PRAL) to convey number of defaulters to the respective Chief Commissioner under intimation to Board within 07 days after the last date of submission of statements unit-wise each month.
4. Identification of new persons liable to file withholding tax statements by RTOs/LTUs on periodic basis including diplomatic missions particularly by RTO, Islamabad.

   They may be requested to file Withholding Tax Statement at least in respect of payments of rent and deduction of tax thereon without disclosing identification of property for security reasons.

5. Introduction of a scheme and allotment of Withholding Tax Identification numbers to all withholding agents across the board by January 31, 2012.

   Similar scheme will be implemented for Sales Tax Withholding Agents as some of the prescribed persons will be common.

6. Issuance of notices to defaulters with 60 days of their enlistment.

7. Enforcement of Statements within 90 days, the FBR plan (2102) added. – *Courtesy Business Recorder*

FBR drafts new ST Registration Plan 2012

The Federal Board of Revenue has drafted a new Sales Tax Registration Plan (2012) for documentation of vendors, employees, suppliers and agents engaged in making huge quantity/turnover of taxable supply of goods and services without filing sales tax returns and statements.

Sources told here on Thursday that the FBR has finalised sales tax registration plan which will be communicated to the Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs).

The sales tax plan has been chalked out by the enforcement authorities of the FBR which would be disseminated to the field formations for compliance and registration of vendors, employees and suppliers etc to bring this untapped supply chain within the documented regime.

Sales tax registration pan will be implemented in January 2012 targeting registration of vendors, employees, suppliers and agents engaged in taxable supply of goods and services.

According to the registration plan (2012), another important area falling in the jurisdiction of Board is control over non-filing through registration of those unregistered.

There is a fairly large number of vendors/employees/suppliers/agents and other stakeholders of the withholding agents who make substantial taxable supply of goods and services.

They must be having income from other sources also by law of average.

Most of them are not filing the returns or periodic statements.

They need to be registered under the sales tax also for making substantial taxable supplies.

The plan said that since numbers are large, a special scheme will be required for issuing the sales tax (ST) and income tax (IT) numbers preferably at the door steps of prescribed persons to facilitate the withholding agents for registration of their vendors/payees.

Later, the complete documentation can also be ensured by indicating complete particulars in the returns and statements (that is most often agitated and creates enforcement problems by various tax payers/groups) more so an account of enforcement of CNIC/NTN from January 1, 2012.

It will not be out of place to mention that enforcement activities being undertaken by the FBR have not produced the desired results and have not addressed concerns of all the stakeholders.

Taxpayers on their part have complained of tax procedures including IT applications as too cumbersome and too complex to be followed.

Field officers major reservation is about lack of adequate technological support from PRAL regarding automation.

The World Bank, while reviewing achievement vis-à-vis targets of TARP, has taken exception to lack of enforcement particularly in area of non-filing where non-compliance is in excess of 42 percent, the FBR plan said.

The FBR plan further stated that Auditor General of Pakistan in the Annual Reports has also taken swipe at inadequacy of the systems to provide effective enforcement environment for meeting the tax obligations and for true audit of the tax system and processes in I.T environment.

Therefore, the FBR needs to immediately put in place a comprehensive plan for enforcement of various sales tax and income tax provisions so as to create an enabling environment for improvement of compliance of tax laws in the country.

Simultaneous support will be needed from Pakistan Revenue Automation Limited (Pral) due to huge volumes and for proper control by supervisory officers for which IT infrastructure and a vibrant tax management system is absolutely necessary.

As per sales tax registration plan, while stating the timelines, effort has been made by taking into account the ground realities regarding enforcement environment and state of information technology.

It is presumed that Pral will fully cooperate for these purposes as application of manual processes can hardly enable us to start and complete the entire life cycle of the related enforcement processes.

Monitoring tools will be developed through PRAL or other sources, if need be, for effective followed up and proper evaluation of performance of each unit as provided under concerned jurisdiction order.

Mid-period review of the Action Plan thus may involve some adjustments in line with specific circumstances of each unit, sources added. – *Courtesy Business Recorder*

SECP, revenue body fail to reach

Securities and Exchange Commission of Pakistan (SECP) and Federal Board of Revenue, in their meeting held on Thursday at Islamabad, failed to reach a consensus on which rule should be amended to dilute the impact of Capital Gains Tax (CGT) on shares transaction, an FBR official told The News.

"However, the officials of the SECP and the FBR expressed commitment to do something to revive the trading volumes at stock markets of the country," he said. The CGT involves disclosure of the source of income of the investors, which is one of the causes for trading volumes falling to 10 year lows at the Karachi Stock Exchange and closure of some brokerage houses.

SECP officials, led by its chairman Muhammad Ali, made a point that FBR should collect CGT under Presumptive Tax Regime (PTR) instead of on sale, the official said. "But officials of FBR refused to do so and explained that the aim of CGT was to know the sources of income and expense on shares transaction of each and every investors. Charging of such tax under PTR does not allow FBR to audit and come know sources of income and expense on shares transactions," he added.

He said that officials of SECP and FBR would meet again next Tuesday and SECP was likely to come up with a different proposal on softening rules for CGT. Moreover, SECP was yet to give proposal on the subject in writing, he added.

It would be worth mentioning here that FBR had invited proposals from SECP and Karachi Stock Exchange (KSE) on the subject in writing about three weeks ago, but they were yet to do so. He said that FBR was seriously considering doing something to dilute CGT impact on shares transaction, as it wanted to revive trading volumes at the local bourses.

Earlier, Finance Minster Hafeez Shaikh had reportedly agreed to collect investors' shares trading data from the date the capital gains tax (CGT) was imposed on shares transaction. "At present, FBR is demanding such data for the last five years prior to CGT imposition," he added. – *Courtesy The News*

Missing containers cost exchequer Rs 55 billion: FBR informs Senate panel

The Federal Board of Revenue (FBR) has reportedly informed the Senate Standing Committee on Finance that as many as 28,802 missing commercial containers under Afghan Transit Trade have caused Rs 55 billion revenue loss on account of duties and taxes.

According to a Finance Ministry official, FBR during a briefing on the missing Nato containers informed the committee that based on various inquiries and confirmations made so far, as many as 28,802 commercial Afghan Transit Trade containers and 3,542 non-commercial containers (Nato/Isaf) have been identified as missing defined as their crossing the Pak-Afghan border could not be established and were prima facie, pilfered/smuggled en-route during the period January 1, 2007 to December 31, 2010.

The committee headed by Member Taxpayers Audit, who has also been appointed in charge of matters pertaining to recoveries, etc, has submitted eight progress reports to the apex court.

The Senate body was informed that actual quantum and nature of goods smuggled into Pakistan under the garb of Afghan Transit Trade may be much higher, based on declarations made to customs at the time of import.

The estimated revenue loss in terms of duties and taxes on commercial containers comes to around Rs 55 billion, in addition to the loss of revenue on 3,398 containers.

The meeting was informed that show cause notices to importers, clearing agents, border agents and the National Logistics Cell (NLC) with respect to 24,047 commercial containers have been issued and the remaining are being issued.

Besides, first information reports (FIRs) are also being lodged for determining criminal liability of the culprits; so far a list of about 580 containers has been forwarded by the probe committee to the Directorate General of Intelligence & Investigation FBR for lodging FIRs against the culprits including customs officials.

The FBR also informed the committee that on directives of the apex court, cases of top eight clearing agents have been referred to the NAB as a first batch, and more cases are being fine-tuned for the purpose.

The imports affected by US military are also being reconciled by the probe committee.

Data provided by Model Customs and Collectorates Pakistan Automated Customs Computerised System (PaCCS) shows that 157736 containers were imported by the US military for transit to Afghanistan.

In PaCCS system, after gate-out from Ports/Terminals at Karachi, the information gets flashed on the screens accessible to border collectorates.

It is the responsibility of border collectorates to record the "Gate-in" ie due arrival of cargo at border stations and "Cross-border" events in the system by using the ID assigned to the border collectorates.

Investigation revealed that "gate-in" event of 77,884 containers is missing in PaCCS and "cross-border" event of 95,374 containers is missing.

It is improbable that such huge numbers of containers may have gone missing, but failure on the part of relevant customs field formations to ensure proper monitoring and reconciliation through system is glaring.

It appears that the computerised system put in place for proper reconciliation of cross-border event of US cargo was totally ignored by the concerned authorities, with the result that a massive exercise is required to reconcile cross-border event of each consignment through manual record.

The meeting was informed that efforts made by the FBR in unravelling the crime and improving the systems have started yielding positive results and study conducted in this regard reveals that as against 71,569 commercial AU containers imported during the period February 2010 to December 2010, the quantum of such imports in the corresponding period of this year has fallen to 28,255 containers, signifying a massive fall by approx. 60%.

Similarly, non-commercial AU imports have also fallen by 39% from 15,061 containers imported during February 2010 to December 25, 2010 to 9,372 containers imported in the corresponding period of this year.

A simultaneous diversion of illegal trade to regular import channels of 15 smuggling prone items has contributed to additional revenue of Rs 8344 million at import stage (after factoring in the natural growth) during the period of Feb-December 25, 2011.

The dividends in the shape of domestic taxes and industrial output gains are in addition to the gains quantified at import stage. – *Courtesy Business Recorder*

Buildings hired by foreign missions, diplomats: FBR to scrutinise data to verify WHT deduction

The Federal Board of Revenue (FBR) has decided to scrutinise data of buildings hired by the diplomatic missions, foreign diplomats and non-resident persons, to verify whether withholding tax has been dully deducted on rental income under section 155 (income from property) of the Income Tax Ordinance, 2001.

Sources told here on Friday that the FBR has implemented an action plan (2012) to check enforcement of statements by the prescribed persons under the law.

The action plan has been finalised by the FBR for dispatching to the field formations.

The action plan has given top priority to the area of income from property under section 155 of the Income Tax Ordinance, 2001 to improve collection under this head from January 2012 onwards.

Under section 155, withholding tax is applicable on rent of immovable property (including rent of furniture and fixtures, and amounts for services relating to such property).

According to FBR's action plan (2012), an important segment of taxpayers, that continues to be neglected from taxation, is the one which derives income from property.

Total collection of withholding tax under section 155 of the Income Tax Ordinance, 2001 was Rs 2.4 billion during last year.

If tax is withheld at an average rate of Rs 100,000 from every withholdee, it would mean that rent payment in respect of only 24,000 properties of all types was subjected to withholding tax.

Diplomatic missions are also among biggest payers of rent and are one of the prescribed persons and, yet withholding tax statements are not being enforced from concerned persons, FBR said.

Under the action plan (2012), the FBR has also decided to identify defaulters of statements under section 165 of the Income Tax Ordinance, 2011.

The position of enforcement of statements by the prescribed persons under the Income Tax and Sales Tax laws is also far from satisfactory.

At present, only 34,357 withholding agents of income tax are e-registered, out of which 29,927 are filing withholding statement.

On the other hand, the number of registered corporate entities alone is 48,679.

Federal and Provincial Governments, attached departments and persons other than corporate entities, who are required to file the Statements, are yet to be added to this number.

The FBR has devised a separate strategy to identify defaulters of statements under section 115(4) of the Income Tax Ordinance 2001.

As per action plan (2012), a large chunk of persons under obligation to file statements U/S 115(4) of the Income Tax Ordinance, 2001 particularly importers and exporters is not filing the requisite statements.

The following course of action has been envisaged by the FBR:

Firstly, identification of persons liable to file statements U/S 115(4) by the PRAL.

Secondly, identification of defaulters of statements U/S 115(4) along with names and National Tax Numbers (NTNs) from among the existing taxpayers by PRAL by January 15, 2012.

Thirdly, dissemination of above information to the concerned field units by PRAL by January 15, 2012.

Fourthly, the Pakistan Revenue Automation Limited (PRAL) would send e-intimation to all the defaulters by January 15, 2012.

Fifthly, The Large Taxpayer Units and Regional Tax Offices would complete legal action against defaulters by March 31, 2012, FBR's action plan (2012) said. – *Courtesy Business Recorder*

IT returns, WHT statements filing: FBR to implement enforcement plan

The Federal Board of Revenue (FBR) has to implement a national enforcement plan (2012) to enforce filing of income tax returns and withholding tax statements for the tax year 2011 by the non-filers and defaulted units, including companies, business units, associations of persons, and individuals during January 2011.

Sources told here on Friday that the action plan would be implemented at the level of Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) for immediate compliance.

The national enforcement plan (2012) would shortly be issued to the field formations to deal with the non-filers and defaulters on the direct taxes side.

It is expected that over 48 percent of persons, who have been e-enrolled with the tax department and not filed returns electronically would be served notices under Income Tax Ordinance 2001.

The FBR has also decided to take action against non-filer government employees in BS-19 and above in the public sector, who are deriving income above Rs 500,000.

These employees of BS-19 and above in public sector stood at around 13,654 and department would check whether they are filing returns or not.

Similar exercise would be done for employees working in private sector having annual income above Rs 500,000.

The following Enforcement Action Plan (2012) is contemplated to address non-filing of returns and withholding tax statements: Firstly, the FBR will identify non-filers, individuals and the AOPs, liable to e-file the returns of income.

Last date for filing of returns for taxpayers including corporate entities has lapsed.

Data of persons liable to e-file returns of income shows that almost 48 percent of persons e-enrolled have not yet filed their returns of income, as is evident from the database.

According to data made available by Pakistan Revenue Automation Limited (PRAL) at tax system, total 410,390 taxpayers have been e-enrolled.

Returns had been e-filed by 215,605 persons by December 21, 2011 as per data available at tax system.

The number of defaulters notified by Pakistan Revenue Automation Limited (PRAL) at tax system by December 21, 2011 stood at 194,785.

It is pertinent to mention that although PRAL has available with it the data of persons e-enrolled, yet the data of persons actually liable to e-file returns of income are thus obliged to get e-enrolled and resultantly liable to e-file returns of income is not readily available, FBR plan said.

The FBR has devised an action plan for the e-enrolled persons liable to file returns electronically category is suggested.

As per action plan (2012), the FBR will send e-intimation to all identified defaulters by PRAL by January 15, 2012, if not done already done.

The Large Taxpayer Units and Regional Tax Offices would issue statutory notices to the defaulters under section 114(4) by January 31, 2012.

The LTUs/RTOs would identify persons actually liable to e-file returns of income ie having income exceeding Rs 500,000 through information from Project Director, Project to Improve Financial Reporting and Auditing (PIFRA) regarding payments of salaries, for contracts of goods and services and hiring of office/residential property by the government and other potential sources like banks, multinationals and major local companies, etc, in respect of pay and other perquisite in cash or otherwise to salaried persons and resultant action against them, sources said.

The FBR action plan (2012) said that the information obtained from PIFRA shows that the number of employees in BS-19 and above in the public sector alone is 13,654 ie who must be deriving income in excess of Rs 500,000.

Private sector employees' number is still larger, and majority of them is neither e-enrolled nor is filing returns of income, sources added. – *Courtesy Business Recorder*

S.R.O. 842(I)/2011, Islamabad, the 6th September, 2011.– In exercise of the powers conferred by section 19 of the Customs Act, 1969 (IV of 1969), and clause (a) of sub-section (2) of section 13 of the Sales Tax Act, 1990, the Federal Government is pleased to direct that the following further amendment shall be made in its Notification S.R.O.575(I)/2006, dated the 5th June, 2006, namely:–

In the aforesaid Notification, in the Table, in column (1), against S.No. 1, in column (2), under the caption "(E) Harvesting and Threshing Machinery", against sub-serial number (2), in column (3), for the figure "8201.6000", the words "Respective Headings" shall be substituted.

S.R.O. 851(I)/2011, Islamabad, the 17th September, 2011.– In exercise of the powers conferred by section 3 of the Customs Act, 1969 (IV of 1969), and section 30 and 31 of the Sales Tax Act, 1990, the Federal Board of Revenue is pleased to direct that the following further amendments shall be made in its Notification No.S.R.O.967(I)/2007, dated the 20th September, 2007, namely:–

In the aforesaid Notification, in the SCHEDULE, in column (1),–

(a) against serial number 3, in column (3), in entry (i) after the word "Karachi", the words and comma ", excluding all containerized cargo routed through QICT," shall be inserted; and

(b) against serial number 6, in column (3), in entry (i), for the words and comma "but excluding the work assigned to the Model Customs Collectorate of PACCS, Karachi", the words "including containerized cargo routed through QICT" shall be substituted.

S.R.O. 884(I)/2011, Islamabad, the 19th September, 2011.– In exercise of the powers conferred by section 3 of the Customs Act, 1969 (IV of 1969), and sections 30 and 31 of the Sales Tax Act, 1990, the Federal Board of Revenue is pleased to direct that the amendments made in the Notification No.S.R.O.967(I)/2007, dated the 20th September, 2007, *vide* Notification No.S.R.O.851(I)/2011, dated the 17th September, 2011, shall come into force with effect from 23rd September, 2011.

S.R.O. 1127(I)/2011, Islamabad, the 28th December, 2011.– In exercise of the powers conferred by section 19 of the Customs Act, 1969 (IV of 1969), the Federal Government is pleased to direct that the following further amendment shall be made in its Notification No. S.R.O. 567(I)/2006, dated the 5th June, 2006, namely:–

In the aforesaid Notification, in the Table-III, under heading 'C', against S. No. 19, in column (3), after serial number (lxxv), the following new entry and the corresponding entry relating thereto in column (4) shall be inserted, namely:–

"(lxxvi) Temozolomide 0%".

S.R.O. 1128(I)/2011, Islamabad, the 28th December, 2011.– In exercise of the powers conferred by section 19 of the Customs Act, 1969 (IV of 1969), the Federal Government is pleased to direct that the following further amendment shall be made in its Notification No. S.R.O. 567(I)/2006, dated the 5th June, 2006, namely:–

In the aforesaid Notification, in Table-III, under item 'D', in column (1) against S. No. 30, in column (3), after entry 'v', the following new entry shall be inserted, namely:–

"(vi) Printed Aluminum Bag for I.V. Solutions/Infusion.".

S.R.O. 1(I)/2011, Islamabad, the 2nd January, 2012.– In exercise of the powers conferred by sub-section (1) of section 71 of the Sales Tax Act, 1990, read with clauses (9) and (46) of section 2, sections 3 and 4, sub-section (2) of section 6, sub-sections (3) and (4) of section 7, section 7A, clause (b) of sub-section (1) of section 8, clause (a) of sub-section (2) of section 13, sub-sections (2A) and (3) of section 22, proviso to sub-section (1), and sub-sections (3) and (4) of section 23 and section 60 thereof, the Federal Government is pleased to direct that the following further amendment shall be made in the Sales Tax Special Procedure Rules, 2007, namely:–

In the aforesaid Rules, in rule 58H in sub-rule (6), after the full stop, the following shall be added namely:-

> "However, the steel melters and re-rollers paying sales tax on fixed rates through electricity bills shall be entitled to claim adjustment or refund of the sales tax paid on local procurement of plant, machinery and equipment."

2012 PTR 1 (H.C. Del.)

HIGH COURT OF NEW DELHI

A.K. Sikri, Acting Chief Justice and Siddharth Mridul, J.

Pitney Bowes India Pvt. Ltd.
v.
Commissioner of Income Tax

FACTS/HELD

1. **Amount paid for non-compete rights while acquiring business is capital expenditure**
2. The assessee acquired the mailing business of Kilburn Office as a going concern on a slump sale basis pursuant to a Business Transfer Agreement. The consideration for the transfer was Rs. 18.92 crores which included Rs. 5.94 Crores by way of non-compete fee for a period of 5 years. In the accounts, the expenditure was treated as a capital payment though a **deduction** was **claimed** in the computation u/s 37(1). The AO disallowed the claim though the CIT (A) allowed it as deferred revenue expenditure. On appeal by **the department**, the Tribunal reversed the CIT (A) following **Tecumesh India** 132 TTJ 129 (Del) (SB) though it directed the AO to consider whether the payment was an "intangible asset" for purposes of depreciation. On appeal by the assessee, HELD dismissing the appeal:

    In the books, the assessee treated the non-compete expenditure as capital in nature. **Warding off competition in business even to a rival dealer will constitute capital expenditure. It is not necessary that the non-compete fee has to be paid to create monopoly rights**. The non-compete agreement was to last for 5 years, which period is sufficient to give **enduring benefit** (**Tecumesh India** 132 TTJ 129 (Del) (SB) approved; **Eicher Ltd** 302 ITR 249 (Del) distinguished; Q whether depreciation is eligible left for determination by AO).

Order accordingly.

ITA No.784 of 2011.
Heard on: 13th September, 2011.
Decided on: 30th November, 2011.
Present at hearing: C.S. Aggarwal, Sr. Advocate with Prakash Kumar, Advocate, for Appellant. M.P. Sharma, Sr. Standing Counsel, for Respondent.

JUDGMENT

A.K. Sikri, Acting Chief Justice.–

1. The facts leading to the filing of this appeal may first be recapitulated and these are as follows:

> The appellant/assessee company was incorporated on 23.4.2004 under the Companies Act, 1956 and is a wholly owned subsidiary of Pitney Bowes Inc., USA. The assessee is engaged in the business of wholesale trading, selling and marketing of hi-tech documents and providing maintenance and after sales service of its products. During the year under consideration, the assessee company had acquired mailing business from M/s. Kilburn Office Automation Limited (hereinafter referred to as "KOAL") as a going concern on a slump sale basis pursuant to Business Transfer Agreement dated 15.10.2004 entered into by the appellant with the later. The consideration for such transfer was stated as Rs.18.92 Crores which included a sum of Rs.5.94 Crores by way of non-compete fee which was limited for a period of 5 years. Seller Company (KOAL) before the transfer of said business has been acting as a distributor of Pitney Bowes' products in India and Nepal. In the year under consideration, the Pitney Bowes Inc., USA (holding company of the assessee) had decided to enter in the Indian market directly and consequently has caused the incorporation of the assessee company as its wholly owned subsidiary.

2. For the instant assessment year 2005-06, the assessee company filed its return of income, declaring a total loss of Rs.2,59,84,980/- as was computed in the computation of income.

3. In the said return, the assessee claimed deduction of non-compete fee of Rs.5.94 Crores as business/revenue expenditure in the computation of income filed with the return of income. The Assessing Officer (AO), however, disallowed the same on the ground that the payment of non-compete fee was a capital outlay, non-allowable under Section 37 of the Act. The assessee filed appeal against this order before

the CIT (A). The CIT (A) held that the expenditure incurred on non-compete fee by the assessee needs to be allowed on deferred revenue basis, i.e., in five years as the period of non-compete fee agreement is for five years. As such, the CIT (A) allowed Rs.1,18,89,458/- being 1/5th of the total amount of Rs.5,94,47,290/- paid to KOAL by the assessee as non-compete fee.

4. The Revenue preferred an appeal before the Tribunal. The assessee filed a cross-objection.

5. The Income Tax Appellate Tribunal ("the Tribunal" for brevity) held that non-compete fee paid by the assessee is capital in nature, as such disallowed the claim. Further, while dealing with the cross-objection filed by the appellant, the Tribunal restored the alternate plea in respect of allowance of depreciation under Section 32(1)(ii) of the Act, to the file of the Assessing Officer for deciding it.

6. It is in this backdrop that the present appeal is filed. Submitting that the non-compete fee, in the circumstances of this case, was to be treated as revenue expenditure and non-compete expenditure. It is also submitted that in any case, the Tribunal should have accepted the alternate plea to allow depreciation @ 25% under Section 32(2) (ii) of the Income Tax Act (hereinafter referred to as "the Act") instead of remitting the case back to the AO for decision on this issue. The appeal was accordingly admitted on the following substantial questions of law:

> "1. Whether the Income Tax Appellate Tribunal was correct in law in holding that the claim of deduction of expenditure incurred as non-compete fee aggregating to Rs.5,94,47,290/- could not be allowed to it either in the instant year or even in five years on deferred basis?
>
> 2. Whether the Income Tax Appellate Tribunal was justified in law in remanding the issue in respect of alternate plea of the assessee, instead of directing the Assessing Officer to allow depreciation @25% under Section 32(1)(ii) of the Income Tax Act, 1961?"

Re: Non-compete fee, whether capital or revenue:

7. It was submitted in this behalf that under the agreement entered with KOAL, the assessee did not acquire the business of photocopiers and drawing office equipment business of the seller. In consideration for the sale of the business by the seller including the transfer of assets, the assessee agreed to pay Rs.17,91,15,000/-. Under this Business Transfer Agreement, KOAL had agreed that it shall not compete with the assessee for a limited period of five years, who has acquired the running mail business as a going concern. Clause 33.2 of the Agreement provided for certain adjustments and deductions to be made at closing, from the aforesaid consideration. Under the aforesaid

agreement, Clause 7 provided that the seller shall comply with the non-compete obligations set forth in Annexure 1.1(B). From the perusal of the Annexure 1.1(B), it would be seen that it was specifically provided that there is a non-compete obligation of the transferor when it undertook that it shall not either on its own account or in conjunction with any of its affiliates or others and whether directly or indirectly for a period of five years from the closing date establish, develop, carry on or assist in carrying on or be engaged, concerned, interested, or employed in or provide technical, commercial or professional advice to any other business enterprise or venture which supplies goods and/or services which are competitive with or are of the type supplied by the business at the closing date within the whole of India. It is, thus, evident that the assessee company incurred an expenditure to eliminate the competition for a limited period of five years and was part of lump sum consideration of Rs.17,91,15,000/-. It is, thus, crystal clear that there existed an obligation of the transferor, who could not enter into a competition to carry on the business of trading for a limited period of five years to establish, develop, carry on or assist in carrying on or be engaged, concerned, interested or employed in or provide technical commercial or professional advice to any other business enterprise or venture which supplies goods and/or services which are competitive with or are of the same type as supplied by the business.

8. It was, thus, the non-compete fee which had been incurred as a consideration to eliminate competitionwith the transferor for a limited period of five years and such an expenditure could not be treated as capital in nature. The learned counsel referred to the following judgments in support of his submission:

(i) *CIT (A) vs. COAL Shipment (P) Ltd.,* 82 ITR 902;

(ii) *CIT vs. Eicher Ltd.,* 302 ITR 249.

9. Learned counsel argued that in *COAL Shipment (P) Ltd. (supra)*, the Apex Court has held that although payment made toward off competition in business to a rival dealer would constitute capital expenditure if the object of making that payment was to derive an advantage by eliminating the competition over some length of time, the same result would not follow if there was no certainty of the duration of the advantage and the same could be put to an end at any time. It specifically held that how long the period of contemplated advantage should be in order to constitute enduring benefit would depend upon the circumstances and the facts of each individual case. This Court in *Eicher Ltd. (supra)* reported in 302 ITR 249, has held, after applying the principles laid down by the Apex Court in the case of *CIT vs. Madras Auto Services Pvt. Ltd.* reported in 233 ITR 468 that since the assessee did not acquire any capital asset by making the payment of non-compete fee, it merely eliminates competition in the two wheeler business, for a while. In the said case, t was not clear how long the restrictive covenant

was to last but it was held that the same was neither permanent nor ephemeral. It was argued that in the instant case, the situation is identical and in fact, far-better namely that the benefit was to be derived only for a period of five years and was not ephemeral. It is also undisputed that by incurring the expenditure to eliminate competition it was able to deter M/s KOAL who was trading in the same automation equipment. It was able to increase its revenues thereby earning profits, which is the revenue profit and, thus, the expenditure incurred was in the commercial field.

10. The learned counsel for the Revenue, on the other hand, relied upon the reasons given by the Tribunal in holding the expenditure to be capital in nature. He drew our attention to Para 3 of the impugned order of the Tribunal where the Tribunal had recorded that both the parties agreed that the issue about the non-compete fee by the assessee was covered by the decision rendered by the Tribunal, Principal Bench, Delhi vide judgment dated 30.7.2010 in the case of *M/s Tecumesh India Pvt. Ltd. vs. Addl. CIT*, 132 TTJ 129.

11. We have considered the submissions of both the parties. We find that in the return filed by the assessee, it had given its Notes to the computation and Note file pertained to non-compete fee, which was stated in the following terms:

> "5. Non-Compete fee paid to KOAL
>
> During the year, the Company had acquired the mailing business from KOAL as a going concern in pursuance of the BTA on a slump sale basis for a total purchase consideration of Rs. 1892 lacs. A part of the purchase consideration so paid was also towards non-compete fee which restricts the KOAL and its directors to engage itself in the competing business for a period of 5 years. The value of the non-compete fee has been **considered as per the valuation report and has been treated as a capital expenditure in the books of account. It is paid to KOAL for the loss of business that they would suffer for not competing with the Company and therefore, it is in the nature of revenue expenditure**. Accordingly, the same has been treated as revenue expenditure in the tax return. Reliance in this regard is placed on the judgment of *Smartchem Technologies Ltd. vs. ITO* [2005] 97 TTJ 818 (Ahmedabad Tribunal)."

(emphasis supplied)

12. Thus, the assessee itself treated the expenditure as capital in the books of accounts. However, at the same time, it was maintained that since it was paid for loss of business that KOAL would suffer for non-compete fee, the same was treated as revenue in nature. Likewise, in Schedule 2 to the balance sheet disclosing „fixed assets‟, payment of non-

compete fee is treated as „intangible assets‟. This also shows that the assessee treats this as asset acquired, which is intangible in nature. The issue regarding forwarding of payment was discussed by the Special Bench of the Tribunal in *M/s Tecumesh India Pvt. Ltd. (supra)* in greater details and after applying the ratio of various judgments of different High Courts including jurisdictional Court as well as the Supreme Court, the Tribunal summarized in the following terms:

> "129. According to above observations it can be seen that warding off competition in business even to a rival dealer will constitute capital expenditure and to hold them capital expenditure it is not necessary that non-compete fee is paid to create monopoly rights.
>
> 130. The assessee also cannot get any help from the decision of Hon‟ble Delhi High Court in the case of CIT vs. Eicher Company Ltd. (supra) as in that case their Lordships have clearly found from the record that it was not clear that how long the restrictive covenant was to last and what the assessee had done was that it eliminated the competition in the two-wheeler business for a while. Their Lordships have also found that the benefit received by the assessee in that case was neither permanent nor ephemeral. Therefore, the said decision is not applicable to the facts of the present case as in the case of assessee the non compete agreement is applicable for 5 years, which period has been considered to be sufficient to give enduring benefit in the case of Assam Bengal (supra).
>
> 131. With these observations we hold that the expenditure of Rs.2.65 crore claimed by the assessee in pursuance of non-compete agreement dated 10th July, 1997 are capital expenditure, the deduction of which cannot be granted to the assessee as revenue expenditure. The main issue is decided against the assessee and in favour of the revenue."

13. The position in the instant case is almost identical. That was a reason that even the learned counsel for the appellant had conceded before the Tribunal that the matter was covered by the aforesaid Special Bench decision.

14. Agreeing with the aforesaid view, we are of the opinion that the Tribunal rightly held that the expenditure was capital in nature. Question No.(1) is answered accordingly.

Re: Applicability of Section 32(1)(ii):

15. Alternate submission of the learned counsel for the appellant was that no doubt, once the expenditure is held capital in nature, the assessee would be entitled to depreciation. The AO had allowed 1/5th of the fee treating the same as deferred revenue expenditure, as this fee

was for five years. The argument of the learned counsel for the appellant was that when the expenditure was treated as capital in nature, there was no question of treating the same as deferred revenue expenditure. In such circumstance, the depreciation was allowable under Section 32 of the Act. The reason, which is given by the Tribunal for remitting the issue back is that this alternate plea has not been decided by any of the Authorities below, i.e., either the AO or the CIT (A). For this reason, the Tribunal felt it appropriate that the matter needed to be heard by the AO afresh along with verification of the records by the Revenue Authorities.

16. No doubt, the Tribunal had itself determined the nature of payment, viz., treated the non-compete fee as capital in nature. The order of the Tribunal would further reflect that the alternate submission of the assessee was countered on the ground that no asset was created by making the said payment and there was no question of allowing the depreciation. It was also argued that non-compete fee was for five years and the assessee itself had been pleading that it was revenue expenditure. Such a contention of the Revenue cannot be allowed, which is self-contradictory. When nature of payment is discussed and at that stage, Department pleads that the expenditure is not revenue in nature, but is of capital nature, there is no reason to remit the case back to the AO to determine the nature of expenditure. At the same time, it is still a moot question as to whether depreciation can be allowed thereupon under Section 31(1)(ii) of the Act or not. We may note here that the learned counsel for the Department had referred to the judgment of the Kerala High Court in the case of *B. Raveendran Pillai vs. CIT*, 332 ITR 531 (Ker.), on the basis of which, argument was raised that goodwill is not specifically mentioned in Section 32(1)(ii) of the Act and depreciation is allowable, apart from tangible assets, on such intangible assets, which are specifically enumerated in the said Clause. Though the AO would not have to consider the nature of expenditure, as that has been determined by the Tribunal, at the same time, whether depreciation thereupon is to be allowed or not under Section 32(1)(ii) of the Act has to be decided.

17. We, thus, find no fault in the order of the Tribunal remitting the case back on this aspect to the AO. As a result, question No.(2) is decided in the affirmative, consequence would be to dismiss this appeal. We order accordingly.

2012 PTR 8 (H.C. Guj.)

HIGH COURT OF GUJRAT

Akil Kureshi and Sonia Gokani, J.

Cadila Healthcare Ltd.
v.
Asst.Commissioner of Income- Tax(OSD) & 1

FACTS/HELD

1. **Section 147: If AO disputes Audit objection, she cannot use that as "reason to believe"**
2. The Revenue Audit raised an objection that the assessee had made remittances to foreign parties without deduction of TDS u/s 195 and that the expenditure ought to have been disallowed u/s 40(a)(i). In reply, *the AO wrote back stating that as the amounts remitted to the foreign parties were not chargeable to tax in India, the assessee was under no obligation to deduct tax u/s 195 and that the expenditure was not disallowable u/s 40(a)(i).* However, she still issued a notice u/s 147 and reopened the assessment to disallow the said expenditure. The assessee filed a Writ Petition to challenge the reopening. HELD allowing the Petition:

   U/s 147, it is **only the AO's opinion** with respect to the income escaping assessment which is relevant for the purpose of reopening an assessment. **While it is true if the audit party brings certain aspects to the notice of the AO and thereupon, the AO forms his own belief, it may be a valid basis for reopening assessment, the mere opinion of the Audit Party cannot form the basis for the AO to reopen an assessment**. On facts, the **AO had categorically come to the conclusion that the objection of the audit party was not valid and that the assessee's explanation with respect to non-requirement of collection of TDS was required to be accepted**. Accordingly, the AO could have no "reason to believe" that income had escaped assessment and so the s. 148 notice was without jurisdiction (**P. V. S. Beedies**

237 ITR 13 (SC) & **Indian & Eastern Newspaper** 119 ITR 996 (SC) distinguished; **Lucas TVS** 249 ITR 306 (SC) followed).

Disposed of accordingly.

Special Civil Application No. 15566 of 2011.
Decided on: 14th December, 2011.
Present at hearing: R.K. Patel, for Petitioner. M.R. Bhatt, Sr. Advocate, with Mauna M Bhatt, for Respondent.

JUDGMENT

Akil Kureshi, J.–

Petitioner is a company registered under the Companies Act. It is assessed regularly to tax under the Income Tax Act, 1961 (Act for short). The petitioner has in the present petition, challenged the validity of notice dated 18.3.2011 issued by the Assessing Officer seeking to reopen the assessment previously framed on a scrutiny for the assessment year 2004-05. The petitioner has also challenged the order dated 11.10.2011, by which the petitioner's objections to such reopening of the assessment came to be disposed of.

Brief facts are as follows:

For the assessment year 2004-05, the assessee filed its return of income along with necessary documents including Auditors Reports in prescribed forms. Such return was taken in scrutiny assessment under section 143(3) of the Act.

Such assessment previously framed after scrutiny was sought to be reopened by notice dated 28.10.09 on the ground that book profit under section 115JB of the Act was not computed correctly and further that excess deduction under section 80HHC was allowed. The petitioner approached this Court by filing Special Civil Application No.3580 of 2010 which was allowed by this Court by an order dated 4.5.2010 quashing the notice of reopening dated 28.10.2009.

Once again the Assessing Officer issued a fresh notice dated 18.3.2011 seeking to reopen the assessment of the same year. At the request of the assessee, the reasons recorded by the Assessing Officer for reopening were supplied. The petitioner raised its objections vide communication dated 16.8.11. Such objections, however, were disposed of by the Assessing Officer by his order dated 11.10.11. At this stage, the petitioner has approached this court raising various grounds challenging the impugned notice for reopening the assessment.

Before adverting to the rival contentions, we may notice that the Assessing Officer had recorded following reasons for reopening the assessment.

> "Assessee filed return of income on 29/10/2004 declaring the total income at Rs.23,54,96,900/-. Order u/s.143(3) was passed on 26/12/2006 at assessed income of Rs.24,19,86,700/-.
>
> As per section 40(a)(i) of the IT Act, 1961, if no tax is deducted at source or after deduction, it is not paid on payment of interest, royalty, fees for technical services or other sums payable outside India or to a non resident on which tax is deductible, then no deduction is available on such payments in computing income under the head "Profit & gains of Business or Profession" in the hands of the remitter.
>
> It is seen from the assessment records of the assessee company that the company has made following international transactions with associated enterprises:

A.Y.	Particulars of Expenditure	Amount in Rs.
2004-05	Payment for Product registration services availed	51,94,204

> The assessee was liable to deduct TDS on these expenditures as per income tax Act. Failure to deduct TDS attracted the provisions of section 40(a)(i). So, the expenditure of Rs.51,94,204/- was required to be disallowed and added to total income. By not disallowing this amount while making computation of taxable income the assessee has failed to disclose fully and truly all material facts necessary for his assessment for this assessment year.
>
> Therefore, I have reasons to believe that income to the tune of Rs.51,94,204/- has escaped assessment within the meaning of sec.147 of the Act."

Counsel for the petitioner submitted that the assessment previously framed after scrutiny is sought to be reopened beyond the period of four years from the end of relevant assessment year without any material on record to suggest that the income chargeable to tax had escaped assessment for the reasons of the assessee having failed to disclose fully and truly all material facts necessary for the assessment. Counsel for the petitioner submitted that the initial assessment was framed after thorough inquiry. The assessee had disclosed full facts. He drew our attention to the return filed by the assessee and the documents annexed therewith to contend that the petitioner had made full disclosures about the transactions with associated enterprise.

Counsel submitted that even on facts, the Assessing Officer is not correct in contending that the assesseee was required to deduct TDS on payment of Rs.51.94 lacs as suggested by the Assessing Officer.

Counsel vehemently contended that the entire issue has cropped up on the insistence of the Audit Party. He submitted that mere opinion of the audit party cannot form a basis for the Assessing Officer to believe that the income chargeable to tax has escaped assessment. In this regard, counsel relied on the following decisions:

(i) *CIT vs. Lucas T.V.S. Ltd.*, 249 ITR 306 in which the Apex Court upheld the the decision of the High Court in which the High Court had quashed the reopening proceedings wherein apart from the information furnished by the audit party, the Income Tax Officer had no other information for reopening the assessment.

(ii) *Agricultural Produce Market Committee vs. ITO*, (2011) 15 Taxmann.com. 170(Gujarat) wherein Division Bench of this Court was pleased to quash the notice for reopening where the only basis was the revenue audit objection as regards the eligibility of the assessee for exemption.

(iii) *Adani Exports vs. Deputy C.I.T.*, 240 ITR 224 wherein Division Bench of this Court held as under:

"It is true that satisfaction of the assessing officer for the purpose of reopening is subjective in character and the scope of judicial review is limited.When the reasons recorded show a nexus between the formation of belief and the escapement of income, a further enquiry about the adequacy or sufficiency of the material to reach such belief is not open to be scrutinised. However, it is always open to question existence of such belief on the ground that what has been stated is not correct state of affairs existing on record. Undoubtedly, in the face of record, burden lies, and heavily lies, on the petitioner who challenges it. If the petitioner is able to demonstrate that in fact the assessing officer did not have any reason to believe or did not hold such belief in good faith or the belief which is projected in papers is not belief held by him in fact, the exercise of authority conferred on such person would be ultra vires the provisions of law and would be abuse of such authority. As the aforesaid decision of the Supreme Court indicates that though audit objection may serve as information, the basis of which the ITO can act, ultimate action must depend directly and solely on the formation of belief by the ITO on his own where such information passed on to him by the audit that income has escaped assessment. In the present case, by scrupulously analysing the audit objection in great detail, the assessing officer has demonstrably shown to have held the belief prior to the issuance of notice as well as after the issuance of notice that the original assessment was not erroneous and so far as he was concerned, he did not believe at any time that income has escaped assessment on account of erroneous computation of benefit u/s 80HHC. He has been consistent in his submission of his report to the superior officers. The mere fact that as a subordinate officer he added the suggestion that if his view is not accepted, remedial actions may be taken cannot be said to be belief held by him. He has no authority to surrender or abdicate his function to his superiors, nor the superiors can arrogate to themselves authority. It needs hardly to be stated that in such circumstances conclusion is irresistible that thebelief that income has escaped assessment was not held at all by the officer having jurisdiction to issue notice and recording under the office note on 8.2.97 that he has reason to believe is a mere pretence to give validity to the exercise of power. In other words, it was a colourable exercise of jurisdiction by the assessing officer by recording reasons for holding a belief which in fact demonstrably he did not held that income of assessee has escaped assessment due to erroneous computation of deduction u/s 80HHC, for the reasons stated by the audit. The reason is not far to seek."

On the other hand, learned counsel Shri Bhatt appearing for the Revenue opposed the petition contending that the petitioner had not made full and true disclosures in the return filed. Relying on the explanation to section 147, counsel submitted that mere indication that any tax was required to be deducted at source in the return would not absolve the assessee from disclosing other relevant aspects.

Counsel further submitted that the Assessing Officer, on the basis of what is pointed out by the audit party, can still form his own opinion with respect to escapement of income and merely because it was pointed out by the Audit party would not render his opinion invalid or the notice illegal. In this regard, counsel relied on the decision of *C.I.T. vs. P.V.S.Beedies Pvt. Ltd.*, 237 ITR 13 and in the case of *Indian & Eastern NewspaperSociety vs. C.I.T.* 119 ITR 996.

Having thus heard the learned counsel for the parties, we are not required to go into several contentions put forth by both sides. This is so, because on the available material on record, we are inclined to hold that the Assessing Officer could not have reopened the assessment by issuing the impugned notice.

The petitioner has been contending that the Assessing Officer had no independent reason to hold a belief that income chargeable to tax has escaped assessment. It is only at the insistence of the audit party that he had issued notice for reopening. In the petition, it is averred that "*the issue on which the case of the petitioner has been reopened is based on the objection raised by the audit party. It is a matter of record that the Audit Party had raised an objection in regard to non deduction of tax under section 195 of the Income-tax Act, 1961 in respect of international transactions with associated enterprises in regard to payment for product registration services availed amounting to Rs.51,94,204/- and based on the same opined that the said expenditure was liable to be disallowed under section 40(1)(i) of the Act. The petitioner respectfully submits that since this objection had been raised on the basis of the information available on the assessment records of the petitioner's case for the A.Y. 2004-05, it clearly establishes that there was no default on the part of the petitioner in fully and truly disclosing the primary facts.*"

Since the specific case of the petitioner was that the Assessing Officer had acted at the behest of the Audit Party and held no independent opinion on its own with respect to the income escaping assessment, we had called for the original records pertaining to the files of the assessee from the Revenue Department. Learned counsel Shri Bhatt after detailed search, made available a copy of the letter dated 21.5.2009 from one Ritu Singh Sharma, Asstt. Commissioner of Income-tax, in charge of this case at the relevant time addressed to the Senior Audit Officer. In the said letter, she has stated that the audit party has observed that for the amount in question TDS was required to be deducted. Thereupon, details were called for. She concluded that looking to the Board's circular dated 8th August 1995, TDS was not required to be deducted. Taking note of the explanation of the assessee she stated as under:

> "In view of the above explanation, there was no under assessment in the assessee company's case in both the assessment years i.e. A.Y.2004-05 & A.Y. 2005-06.
>
> Further, basis requirement of deducting tax u/s.195 is that whether payment of sum to an non-resident is chargeable to tax under the provisions of the Act or not. TDS liability u/s.195 arises only when income is credited to account of payee or on actual payment of same.
>
> Therefore, as the above mentioned expenditure is in the nature of reimbursement of expenses no TDS is required to be deducted in view of Board's circular No.715 dt. Aug 8,1995."

Under the circumstances, it clearly emerges from the record that the Assessing Officer was of the opinion that no part of the income of the assessee has escaped assessment. In fact, after the audit party brought the relevant aspects to the notice of the AO, she held correspondence with the assessee. Taking into account the assessee's explanation regarding non-requirement of TDS collection and ultimately accepted the explanation concluding that in view of the Board's circular, tax was not required to be deducted at source. No income had therefore escaped assessment. Despite such opinion of the Assessing Officer, when ultimately the impugned notice came to be issued the only conclusion we can reach is that the Assessing Officer had acted at the behest of and on the insistence of the audit party. It is well settled that it is only the Assessing Officer whose opinion with respect to the income escaping assessment would be relevant for the purpose of reopening of closed assessment. It is, of course true, as held by the decisions of the Apex Court in the case of *P.V.S.Beedies Pvt. Ltd.* (supra) and *Indian & Eastern Newspaper Society* (supra), if the audit party brings certain aspects to the notice of the Assessing Officer and thereupon, the Assessing Officer forms his own belief, it may still be a valid basis for reopening assessment. However, in the other line of judgment noted by us, it has clearly been held that mere opinion of the Audit Party cannot form the basis for the Assessing Officer to reopen the closed assessment that too beyond four years from the end of relevant assessment year.

In the present case, the Assessing Officer had categorically come to the conclusion that the objection of the audit party is not valid and that the assessee's explanation with respect to nonrequirement of collection of TDS was required to be accepted. In that view of the matter, we have no hesitation in striking down the notice for reopening. Consequently, the order rejecting the objections of the petitioners must also go. In the result, the petition is allowed. The impugned notice is quashed. The petition stands disposed of accordingly.

2012 PTR 14 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "A" BENCH, DELHI

I.P. Bansal, Judicial Member and A.N. Pahuja, Accountant Member

FACTS/HELD

1. **Transfer Pricing: CUP method will determine ALP of interest-free loan**
2. The assessee advanced Rs. 7.39 crores to its AE on interest-free terms. For transfer pricing purposes, It claimed that no external comparable uncontrolled price was available for benchmarking the transaction and so the Transactional Net Margin Method (TNMM) was applicable to determine the arm's length basis of the loan. Applying TNMM, the assessee claimed that the notional interest was factored in the **software development** income and no separate addition could be made. This was rejected by the TPO & CIT (A) on the ground that the giving of interest-free loans to the AE was an entirely separate transaction not in conjunction with the activity of software development and hence merited a separate analysis. On appeal by the assessee, HELD by the Tribunal:

   The assessee was required to comply with the transfer pricing provisions of s. 92 to 92F with respect to the transaction of interest-free loan to its subsidiary. **The CUP method is the most appropriate method in**

order to ascertain the ALP of such international transaction by taking into account prices at which similar transactions with other unrelated parties have been entered into. For that purpose, an **assessment** of the credit quality of the borrower and estimation of a **credit rating**, evaluation of the terms of the loan e.g period of loan, amount, currency, interest rate basis, and additional inputs such as convertibility and finally estimation of arm's length terms for the loan based upon the key comparability factors and internal and/or external comparable transactions are relevant. None of these inputs have anything to do with the costs; they only refer to prevailing prices in similar unrelated transactions instead of adopting the prices at which the transactions have been actually entered in such cases, the hypothetical arms length prices, at which these associated enterprises, but for their relationship, would have entered into the same transaction, are taken into account. **Whether the funds are advanced out of interest bearing funds or interest free advances or are commercially expedient for the assessee or not, is wholly irrelevant in this context**. As the transaction is of lending money, in foreign currency, to its foreign subsidiary, the comparable transaction should also be of foreign currency lending by unrelated parties (**Perot Systems** 130 TTJ 685 (Del) followed).

Appeal allowed.

ITA No.3647/Del/2007 Assessment Year : 2002-03.

Heard on: 23rd November, 2011.

Decided on: 9th December, 2011.

Present at hearing: Abhishek Gupta, AR, for Appellant. Geetmala Mohanany, DR, for Respondent.

JUDGMENT

Per A.N. Pahuja, (Accountant Member):–

This appeal filed by the assessee on 14th August, 2007 against an order dated 23rd May, 2007 of ld. CIT(A)-VI, New Delhi, raises the following grounds:–

"1. "The order passed by the Ld. Assessing Officer and the Ld. Transfer Pricing Officer is bad in law and on the facts and circumstances of the case.

2. The ld. Assessing Officer/ld. Transfer Pricing Officer has erred in law and on the facts and circumstances of the case in:

a) holding that the transaction between the appellant and its associated enterprise has not been carried out at arm's length price. The said conclusion has been arrived at, ignoring the principle of commercial expediency.

b) Charging notional interest on the loan given by the appellant to its wholly owned subsidiary in USA (i.e. Aithent Inc).

3. The following contentions of ld. AO/ld. TPO, amongst others, are bad in law and on the facts and circumstances of the case:

a) Extending interest free loans to associate enterprise was an entirely separate transaction which was not in conjunction with the main activity of software development and hence merited a separate analysis.

b) The loan was not given from the funds received from ITG Investments (a company which has invested money in the appellant company).

c) The method adopted by the appellant to justify the arm's length price i.e. Transactional Net Margin Method is not justified.

4. The ld. AO has erred in law by not providing an opportunity of being heard to the appellant before passing the order of assessment on the basis of Arm's length price determined by the ld. TPO.

5. The ld. TPO and the ld. AO has erred in law and in the facts and circumstances of the case in applying the Transfer Pricing provisions mechanically and without appreciating the facts and circumstances of the case.

6. The ld. AO and the ld. CIT(A) has erred in calculating deduction u/s 10B of the Act. They have erred in law and in the facts and circumstances of the case by computing deduction u/s 10B of the Income Tax Act, 1961 on the total income of the appellant as against the deduction claimed by the appellant u/s 10B of the Act on the unit-wise income, earned by it.

7. The appellant craves leave to add, modify, amend or forgo any of the grounds of appeal at the time of hearing."

2. This appeal, earlier disposed of vide order dated 19.7.2010, was recalled in MA no. 553(Del.) of 2010 in terms of order dated 3.6.2011.Adverting now to ground nos. 1 to 5 in the appeal, facts, in brief,

as per relevant orders are that return declaring income of Rs.73,13,540/- filed on 31st October, 2002 and subsequently revised on 05.03.2003 returning loss of Rs.2,47,28,350/-. by the assessee, engaged in the business of development of software, after being processed u/s 143(1) of the Income Tax Act, 1961,(hereinafter referred to as the Act) was selected for scrutiny with the service of a notice u/s 143(2) of the Act. Since the assessee entered into international transaction of sale of software of Rs. 16.55 crore with its subsidiary company M/s Aithent Inc, USA (AE in short),the matter was referred to Transfer Pricing Officer (TPO),who vide order dated 18.03.2005 accepted the Arm Length Price (ALP) in respect of international transactions relating to sale of software. However, in respect of interest free loan of USD 15,15,000/- (Rs.7,39,16,850), the TPO observed as under: -

> *"The assessee has during the year given periodic interest free loans to its AE totaling to USD 1,51,5,000 corresponding to Rs. 73,916,850. The assessee has claimed that these loans advanced to the subsidiary were for the purpose of funding the operatins and expansions of business. The arguments put forth by the assessee for not charging any interest can be summarized as:–*
>
> *i) The loan has been granted by the assessee to promote its own business interests as the assessee is getting all its business revenue from the transactions entered into with the Associated Enterprise.*
>
> *ii) The amount of interest is already included into the cost of software development costs charged to the AE.*
>
> *iii) Considering the nature of transaction between the assessee and the AE, there is no data available in the public domain which could be comparable to the transactions between these entities.*
>
> *Accordingly, the assessee has inferred that no external comparable Uncontrolled Price was available for benchmarking this transaction and thus, it proceeded to apply Transactional Net Margin Method (TNMM) to determine the arm's length basis of this loan. The detailed discussion on this has been given in page 28 of the Transfer Pricing Report.*
>
> *The assessee has further argued that this loan would have fetched on interest of 10% as per the lending rate authorized by the Reserve Bank of India. The assessee has used overall TNMM in which this notional interest has been factored in the software development income. The notional amount of interest of Rs. 31.51 lacs (page xxxi of the TP report) has been deducted from the Software development income of Rs. 16.64 crores. The operating expenses of the assessee during the year were Rs. 14.91 crores. The net operating margin ratio after deduction of the notional*

interest element was higher than the average net margins of the comparable. Accordingly, the assessee has concluded that the interest free loan given to its subsidiary was at arm's length.

On analysis of the transactions it was observed that extending of the interest free loans to the AE was an entirely separate transaction which was not in conjunction with the main activity of software development and hence merited a separate analysis. This was also necessary for the reason that the risk/reward profile of a loan is entirely different when compared to that of software development activity. In view of the same, vide letter dated 21.02.2005, it was proposed to the assessee that this interest free loan be analyzed and benchmarked separately.

A detailed reply dated 25.02.2005 was furnished by the assessee on 03.03.2005. Vide this submission, the assessee contended that the associated enterprise Aithent Inc. USA is a wholly owned subsidiary of the assessee. Both the companies are completely aligned in their business and have exclusive business arrangement whereby the entire development and execution of off shore projects of the AE are outsourced to the assessee. Cent percent of the assessee's US based business and revenues have been generated from Aithent Inc. Aithent Inc. does the marketing and customization in the US and other overseas market and the assessee is responsible for the contact execution and software/product development. For further leverage to Aithent Inc's position, in the E business services market, it needed further investment for its growth and expansion plans. Being a 100% holding, further investment for its growth and expansion plans. Being a 100% holding company, it was the onus of the assessee to invest money in the subsidiary. It could have either invested the same in the form of capital contribution or given it as a loan as per RBI approval. The assessee has further argued that investment in the form of capital may not return back while the loan amount will come back to India once the subsidiary has funds available.

It was also claimed that the loan to the AE had been funded from an amount received from a Singapore based venture capital fund as investment in the assessee company and did not bear any cost to the assessee.

Determination of Arm's Length Price of Interest on loan to subsidiary

The arguments put forth by the assessee were examined. The claim regarding catalyzing the business by infusing funds, in whatever form is not refuted. The expansion of business is liable to devolve fruitfully on the assessee as well as the subsidiary *entity. In the light of the same, it is not clear as to why the interest on the funds infused in the form of a loan would have to be forgone by the assessee. Under the arm's length conditions, i.e. if there is no relation between the two persons other than the normal business relation, no person will give loan without charging any interest. Whenever, a person advances a loan to other person, it forgoes its income which it would have earned if the same amount would have been invested in some other financial instrument or deposit. Besides, foregoing the income, it undertakes the risk of loosing the entire amount if the borrower defaults in repayment of loan. Under the arm's length condition no person would undertake such a big risk without expecting any return.*

Secondly, on an analysis of the financial transactions of the assessee, it was observed that the amount received from the Singapore based venture capital fund has been received in the F.Y. 2000-01. The Singapore based company ITG Investment had contributed an amount of USD 7 million as share application money. A major part of this share application money amounting to Rs. 32.61 crore remained invested in the form of FDRs as in the beginning of the financial year. The assessee had exclusive rights on this money and it cannot be compared with interest free borrowing from a third party. At the end of the year, a major part of the FDR stood withdrawn which apparently was used to fund the interest free loan to the subsidiary. Hence, the claim that the money was advanced out of interest free funds is not acceptable.

Therefore, the argument of the assessee regarding not charging of interest from the AE is not persuasive and without any force. As per the Transfer Pricing guidelines, every transaction has to be analyzed separately and the arm's length price has to be benchmarked. Therefore the method adopted by the assessee in factoring the notional interest with the software development function under the TNMM analysis is not acceptable. As discussed above, the amount would have fetched interest in any arm's length transaction. Considering a risk free return from the subsidiary a notional interest of 10% on this loan is considered as the arm's length value of the interest. This notional amount as calculated by the assessee on page xxxi of the TP report works out to Rs. 31,51,259/-. This amount is to be added to the total income of the assessee."

3. On the basis of aforesaid findings of TPO, the AO added an amount of Rs. 31,51,259/- by way of notional interest @ 10% of the loan of Rs.7,39,16,850/- (USD15,15,000 .

4. On an appeal, the ld. CIT(A) upheld the findings of AO/TPO in the following terms:–

> *2.3 "I have considered the arguments of ld. AR and gone through the observations of the AO. My findings on the issue of addition of Rs. 31,51,250/- u/s 92(c)(4) of the I.T. Act are as under:*
>
> *(i) The appellant had advanced Rs. 7,39,16,850/- as interest free loan to its AE situated in USA. The AO has charged the notional interest @ 10% against such interest free loan as to determine arm's length price and consequently he made the addition of Rs. 31,51,259/-.*
>
> *(ii) The ld. AR has objected the aforesaid addition on the ground that the AO did not provide opportunity to the assessee before making addition on the report given by the TPO. The ld. AR relied on the Delhi High Court decision in Sony India Pvt. Ltd. (supra). On going through the said decision containing in para 25(e), I find that the Hon'ble Jurisdictional High Court has observed, "the AO is not bound to accept the ALP as determined by the TPO. He can always be persuaded by the assessee at that stage to reject the TPO's report and proceed to still determine the ALP by himself."*
>
> *(iii) Further on going through the case records, I find that the TPO has given the report dated 18.3.05 while the assessment was made u/s 143(3) vide order dated 29.03.2005. Thus, there was difference between the TPO report and the assessment order for 11 days. Further,I find that the representative of the assessee appeared before the AO on 23.03.05 and 29.03.05 i.e. after data of TPO report and date of assessment and filed certain details before the AO.*
>
> *(iv) Though the record does not speak, whether the AO has given any specific opportunity with reference to TPO report dated 18.3.2005, yet the copy of TPO's report was marked to the assessee and the representative of the assessee appeared twice before the AO after the receipt of TPO's report. Hence, the assessee was fully aware about addition recommended by the TPO and it had sufficient opportunity to file the objection before the AO, if it has any grievance against the TPO's report. Thus, there was default from both the sides, i.e. first the AO failed to provide the specific opportunity with reference to TPO report, on the other hand the assessee failed to file the objection before the AO against the TPO's report dated 18.3.2005, though it had already received the TPO report.*
>
> *(v) Further, considering the fact that the representative of the assessee appeared before the AO twice after receipt of the TPO*

report dated 18.3.05 it can safely be presumed that the appellant had been provided implied opportunity against the TPO report by the AO but it failed to avail it. Thus, it can be said that the appellant has not come to equity with clean hand. Hence, the ld. AR plea for not providing the opportunity is not justified.

(vi) On going through the judgment of Hon'ble Delhi High Court in Sony India Pvt. Ltd. (supra) in para 25(e), If find that the assessee was required to persuade the AO to reject the TPO's report and determine the ALP afresh. Thus, the appellant failed to discharge its duty and the ld. AR is not justified to raise this objection before the appellant authority.

(vii) Further without prejudice to the finding given in clauses (iv), (v) of such para 2.3 of this order, on going through the judgment of Hon'ble Delhi High Court in Sony India Pvt. Ltd. in para 20, I find that the Hon'ble jurisdictional High Court has observed, "the AO is required to provide opportunity to the assessee after receipt of the TPO's report before finalizing the assessment", yet, there was no finding about the consequences, in case the AO has failed to provide specific opportunity, though the opportunity was provided impliedly in this case with reference to TPO's report. Thus, it is very difficult to annul the assessment only on the ground that the AO did not provide specific opportunity on receipt of TPO's report to the assessee before making the addition with reference to arm's length price, though, the appellant had appeared before the AO twice after the receipt of TPO's report dated 18.03.05 and before completion of assessment vide order dated 29.03.05.

(viii) Further, the provision relating to assessment of arm's length price as contained in Chapter X are new provision and it was the first year of such a special provision. Moreover, there was no specific provision and judicial precedent for providing the specific opportunity with reference to the TPO's report by the AO. In the light of these facts and circumstances of the case, I hold that there is no need to interfere with the assessment order merely on the ground that no specific opportunity with reference to TPO's report dated 18.3.05 was provided. Moreover, having co-terminus power with the AO, I am going to consider the appellant's objection on merit which will amount to proper opportunity to the appellant and meet out the principle of natural justice, if at all not followed by the AO, in respect of the TPO's report.

(ix) In respect of merit of the case, I find that the appellant has provided interest free loan amounting to Rs. 7,39,16,850/- to

its "Associated Enterprises (AE) situated in USA and used Transactional Net Margin Method (TNMM) to bench mark the international transactions. In this regard, the TPO observed, "that extending of the interest free loans to the AE was an entirely separate transaction which was not in conjunction with the main activity of software development and hence merited a separate analysis." Considering the fact of the case, the TPO in his report dated 18.3.05 further observed, "under arm's length condition i.e. if there is no relation between the two persons other than the normal business relation no person will give loan without charging any interest".

(x) With these observations, the TPO rejected the ld. AR argument for not charging the interest from the AE and further observed as under:

> *"As per transfer price guidelines, every transaction has to be analyzed separately and the arm's length price has to be bench marked. Therefore, the method adopted by the assessee in factoring the notional interest with the software development function under the TNMM analysis is not acceptable."*

Accordingly, the AO worked out the notional interest @ 10% against the interest free loan advanced to the appellant AE situated in US. Considering the TPO report, the AO made an addition to the extent of Rs. 31,51,259/- in the assessment order dated 29.3.2005.

(xi) On the other hand, ld. AR argued that the interest free loan was given with a view to assist the AE as its business was badly affected in 2001 terrorist attack in U.S. considering the fact of the case and legal provision, I find that this argument may deserve for personal sympathy but legally it is not acceptable as the appellant was separate entity than its AE situated in USA. The appellant had its legal duty to pay the due taxes against the income derived in India before rendering help to its AE. In other words, it can be said that the appellant was required to support its AE situated in US after paying the due taxes in India.

(xii) In respect of argument about 100% income deductible in India u/s 10B and payment of taxes by its AE situated in U.S. is also not tenable. The appellant is required to determine the arm's length price as per provision contained in Chapter X of I.T. Act, 1961 and pay the taxes thereon. It is immaterial, whether appellant income was fully deductible u/s 10B and it did not prevent the TPO/AO to determine the

> *assessee's ALP. Moreover, as per first provision to clause 4 of sec. 92C, no deduction u/s 10B shall be provided against the enhanced income by way of determination of ALP. Moreover, the charging of notional interest while determining the ALP is permissible as the Transfer Pricing Provision is different than the normal provision relating to determination of income.*
>
> *Considering the fact of the case, I hold that the TPO was justified to determine the arm's length price of the appellant after charging the notional interest @ 10% against the interest free loan advanced to its AE situated in US. Thus, Grounds No. 2 & 3 relating to Transfer Pricing are decided against the appellant."*

5. The assessee is now in appeal before us against the aforesaid findings of the ld. CIT(A). The ld. AR on behalf of the assessee while carrying us through the impugned orders and the findings of the TPO contended that the ld. CIT(A) was not justified in upholding the addition, the amount having been advanced to wholly owned subsidiary in USA and the transaction was exceptional in nature. Though the cost of funds so advanced was factored in determining the ALP of transactions of sales made to the AE, no separate addition should be made in view of certain exceptional circumstances since the subsidiary was facing financial crunch. To a query by the Bench, the ld. AR admitted that the transaction of advancing of loan to AE was an independent transaction and while making transfer pricing study, the assessee could not identify any uncontrolled transaction. While relying on the decision dated 20th May, 2011 of the of Chennai Bench of the ITAT in the case of M/s Shiva Industries & Holdings Ltd. in ITA No. 2148/Mad./2010 for the A.Y. 2006-07,the ld. AR further pointed out that in the said decision LIBOR rates were considered as bench mark while determining the ALP of the transaction in respect of loan given in foreign currency. To a query by the Bench, the ld.. AR admitted that the LIBOR rate was considered by the Bench but in view of 6% p.a. rate charged by the assessee in that case no interference was made, LIBOR rates being 4.42%.

6. On the other hand, the ld. DR supported the findings of ld. CIT(A)/TPO and further pointed out that while adopting the rate of interest of 10%, the TPO/AO considered the RBI rates.

7. We have heard both the parties and gone through the facts of the case as also the decision relied upon by the ld. AR. Indisputably, the aforesaid international transaction of interest free loan to the AE is an independent transaction ,requiring determination of ALP. The assessee in their transfer pricing study inferred that no external comparable uncontrolled price was available for benchmarking this transaction and thus, it applied Transactional Net Margin Method (TNMM) method and concluded that transaction was at arms length. However, the TPO noticed on an analysis of the financial transactions of the assessee that

the amount of USD 7 million was claimed to have been received from the Singapore based venture capital fund in the F.Y. 2000-01 through the ITG Investment as share application money. A major part of this share application money amounting to Rs. 32.61 crore remained invested in the form of FDRs as in the beginning of the financial year. At the end of the year, a major part of the FDR stood withdrawn which apparently was used to fund the interest free loan to the subsidiary. Accordingly, the TPO while rejecting the assessee's method considered a risk free return from the subsidiary, a notional interest of 10% on this loan as ALP amounting to Rs.31,51,259/-.Consequently, this amount was added to the income and the ld. CIT(A) upheld the findings of the AO. Before us, the ld. DR relied upon a decision of a co-ordinate Bench in *Perot Systems TSI(India) Ltd. vs. DCIT*, 2010-TIOL-15-Del, where in the assessee granted interest-free loans to two of its wholly owned subsidiaries in Canada and Dubai. In its Transfer pricing study, the assessee adopted CUP method and justified the interest free loan on the basis that it had sufficient interest free funds. The TPO rejected the claim and computed notional interest at the rate of 14percent, based on certain domestic borrowings of the assessee.. On appeal, the Tribunal observed that the cost incurred by the assessee was not a relevant consideration under the CUP method and held that it was irrelevant whether the loans were advanced out of own funds or out of borrowed funds and whether the interest free loan were commercially expedient for the assessee or not. However, the Tribunal held that since the transaction was of lending in foreign currencies to its foreign subsidiaries, the comparable transaction should be foreign currency lending between unrelated parties. Since, the assessee had a foreign currency loan from a bank, it held that the rate of lending by the bank would be an appropriate comparable, irrespective of whether such funds were actually used for lending monies to the subsidiaries. On this basis, the Tribunal directed the TPO to recompute the ALP considering the rate at which the assessee had borrowed in foreign currency from the bank. In the light of aforesaid view taken by a co-ordinate Bench and considering the facts and circumstances of the case, we are of the opinion that the asseseee, in the instant case, was required to comply with the provisions of the Act containing the legislation relating to transfer pricing, namely, sections 92 to 92F of the Act , with respect to the said transaction of interest free loan to its subsidiary. In the instant case, neither the AO/TPO nor the ld. CIT(A) recorded any findings on the most appropriate method to be followed in such a transaction. In line with the reasoning in the aforesaid decision in *Perot Systems TSI(India) Ltd.* (supra), we are of the opinion that CUP method is the most appropriate method in order to ascertain arms length price of the aforesaid international transaction by taking into account prices at which similar transactions with other unrelated parties. For that purpose assessment of the credit quality of the borrower and estimation of a credit rating, evaluation of the terms of the loan e.g period of loan, the amount, the currency, interest rate basis, and any additional input such as convertibility and finally estimation of arm's length terms for the loan based upon the key comparability factors and internal and/or external comparable transactions are relevant. None of these inputs have anything to do with the costs; they only refer to prevailing prices in similar unrelated transactions instead of adopting the prices at which the transactions have been actually entered in such cases, the hypothetical arms length prices, at which these associated enterprises, but for their relationship, would have entered into the same transaction, are taken into account. Whether the funds are advanced out of interest bearing funds or interest free advances or are commercially expedient for the assessee or not, is wholly irrelevant in this context. The transaction in the present case is of lending money, in foreign currency, to its foreign subsidiary. The comparable transaction therefore should be of foreign currency lending by unrelated parties. The ld. AR relied on decision of Chennai Bench in M/s Shiva Industries & Holdings Ltd.(supra) and suggested to adopt LIBOR rates. However, we find that though Chennai Bench referred to LIBOR rates of 4.42%, since the assessee charged interest @6% , no further addition was made.

7.1 Since in the instant case, neither the assessee nor the TPO/AO and the ld. CIT(A) have examined the applicability of CUP method as the most appropriate method in order to determine ALP of the international transaction of interest free foreign currency loan to its subsidiary by the assessee, we consider it fair and appropriate to vacate the findings of the ld. CIT(A) and restore the matter to the file of the AO for fresh adjudication with the directions to recompute the ALP of the aforesaid international transaction in the light of our aforesaid observations, following CUP method, keeping in view various judicial pronouncements, including those referred to above and of course, after allowing sufficient opportunity to the assessee. Since onus is on the assessee to establish ALP of the international transaction ,the assessee shall also provide all necessary relevant inputs for establishing ALP of the transaction in accordance with CUP method. With these directions, ground nos. 1 to 5 in the appeal are disposed of.

8. The next ground no. 6 relates to computation of deduction u/s 10B of the Act. During the course of assessment proceedings, the AO noticed that the assessee claimed deduction u/s 10B of the Act on its entire business income in the original return. However, in the revised return, the assessee restricted its claim to those units which earned business profit and carried forward loss of unit having business loss. While referring to provisions of sec. 10B(1) of the Act, the AO concluded that the assessee is entitled to deduct u/s 10B of the Act only from its total income. Accordingly, the deduction u/s 10B of the Act was determined as under:–

		[In Rs.]
Profit from Unit, Gurgaon		*5,07,25,646/-*
Loss from Unit, Bangalore	*95,03,940*	
Loss from Unit, Chennai	*1,25,59,456*	
Loss from Unit, Gurgaon	*95,88,881*	
Loss from Unit, Canada	*14,47,490*	***3,30,99,767/-***
	Gross business income	*1,76,25,879/-*

9. On an appeal, the ld. CIT(A) upheld the findings of AO as under:–

1.3 "I have considered the arguments of ld. AR and gone through the observations of the AO. I have also perused the provision of sec. 10B of the Act and case laws as relied upon by the ld. AR. My observations on the issue are as under:

(i) The appellant has claimed deduction u/s 10B in the original return against the total income, i.e. after setting off losses of 4 units from profit of one unit, while in the revised return, the deduction was claimed unit wise. On going through the details, I find that there was positive income in unit-1 as Gurgoan, while there was losses from Bangalore, Chennai, unit-II of Gurgaon and Canada unit. In the revised return the appellant had claimed deduction from the profit of first unit of Gurgaon and claimed carry forward losses from remaining 4 units. On the other hand, the AO has set off the losses of the remaining 4 units with the profit of first unit of Gurgaon and allowed the deduction on the balance profit of Rs. 1,76,25,879/-.

*(ii) I further find that all the units are deriving income from the software development and exporting the same. On going through the provisions of sec. 10B(1), it is evident that the deduction under this section shall be allowed "**from the total income of the assessee**".*

(iii) I further find that the phrase 'total income' has been defined u/s 2(45) of the I.T. Act, which reads as under:

> *"That the total income means the total amount of income rendering in sec. 5 computed in the manner laid down in this Act."*

*Further on going through the provisions of sec. 5(1), I find that "**the total income includes of income from whatever source derived**".*

(iv) Considering the provisions of sections 10B(1), 2(45) and 5(1) of the I.T. Act, I find that the deduction u/s 10B is allowable against the 'total income' of the assessee, which means that the losses first from other units shall be set off from the profit of first unit of Gurgoan and the deduction shall be allowed on

the balance income, i.e. the net income which works out after setting off the loss of other units.

(v) As regards arguments based on explanatory note and CBDT Circular about the allowability of deduction from the profit of the business of the undertaking, I find that it may be applicable in case where the assessee was doing different types of business in different undertaking. On the contrary, in the appellant's case I find that all the units are doing the same nature of business and deriving income from export of software. In this situation, the argument of ld. AR for claiming deduction u/s 10B from the positive profit of one unit and claiming losses of other units to be carried forward for setting off in subsequent years is not tenable.

(vi) Further, I do not find substance in the arguments that sec. 10B(c)(ii) permits the assessee to carry forward the losses incurred by remaining four units to be set off in subsequent years before setting off such losses from the positive income derived in 1st unit of Gurgoan in appellant case. On the other hand, I find that as per provisions of sec. 70(1) of the I.T. Act, the loses, incurred in same sources of business under the same head is required to be set off against the income of any other source under the same head. Since the appellant has derived income from the first unit of Gurgaon and derived losses in the remaining 4 units, the losses for the remaining 4 units are required to be set off from the positive income of first unit of Gurgoan and the deduction u/s 10B shall be allowed on the net income.

(vii) On going through the case laws as relied upon by the ld. AR, I find that M/s Mahavir Spinning Mills was relating to allowability of deduction u/s 80HHC and exemption u/s 10B while in the present case the facts is relating to allowability of deduction u/s 10B after setting off the losses of remaining 4 units from the profit of one unit. Thus, there is substantial difference in the facts and the principle laid down in such case is not helpful to the appellant. Similarly, the principle laid down by Mumbai ITAT in DCIT Vs. Decibelle Electronics P Ltd. is also relating to exemption u/s 10A. Hence, the facts was different in that case that the appellant. Further, on going through decision of the ITAT in IIS Infotech Ltd., (supra) I find that the question of allowability of exemption u/s 10B was disputed after amalgamation from export business while in the appellant case the facts are altogether different. Hence, the principle laid down in that case is also not applicable in the appellant's case.

> *Considering the fact of the case and on going through the provisions of sections 10B(1), 2(45) and 5(1), I find that the deduction u/s 10B was allowable from the 'total income of the assessee', i.e. after setting off the losses from 4 units from the profit derived in one unit, i.e. first unit of Gurgaon. In this situation, the action of the AO for allowing the deduction from the 'net income' of Rs. 1,76,25,879/- is justified and the same is upheld. Thus, this ground of appeal is decided against the appellant."*

10. The assessee is now in appeal before us against the aforesaid findings of the ld. CIT(A). At the outset, the ld. AR on behalf of the assessee invited our attention to the decision of Hon'ble Bombay High Court in the case of *Hindustan Liver Ltd. vs. DCIT*, 191 Taxmann 119 (Mum.), wherein it was held that the assessee entitled to deduct u/s 10B in respect of profits of the eligible units while the loss sustained by the four units could be set off against the normal business income. On the other hand, ld. DR relied upon the decision in the case of *CIT vs. Patspin India Ltd.*, 15 Taxman.com 122 (Ker.) and *CIT vs. Himatasingike Seide Limited* ,286 ITR 255 (Karnataka).

11. We have heard both the parties and gone through the facts of the case as also the afore-cited decisions relied upon by both the parties. The extant provisions of sec. 10B(1) of the Act provide for deduction of such profits and gains as are derived by a hundred per cent. Exportoriented undertaking from the export of articles or things or computer software for a period of ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer, software, as the case may be from the total income of the assessee. Indisputably, each of the five unit is 100%EOU and carry on the business of computer software. The assessee in its revised return claimed deduction of profits of its Gurgaon unit and carried forward the loss of other units. The AO ,on the other hand, set off loss of other units against profit of Gurgaon unit and allowed the deduction accordingly. In this connection, the Hon'ble Bombay High Court in their decision in the case of Hindustan Unit Liver Ltd. (supra) while adjudicating a similar issue concluded as under:

> *24. "There is merit in the submission which has been urged on behalf of the assessee that the Assessing Officer has while reopening the assessment ex facie proceeded on the erroneous premise that sec. 10B is a provision in the nature of an exemption. Plainly, sec. 10B as it stands is not a provision in the nature of an exemption but provides for a deduction. Section 10B was substituted by the Finance Act of 2000 with effect from 1.4.2001. Prior to the substitution of the provision, the earlier provision stipulated that any profits and gains derived by an*

assessee from a hundred per cent Export Oriented Undertaking, to which the section applies "shall not be included in the total income of the assessee". The provision, therefore, as it earlier stood was in the nature of an exemption. After the substitution of section 10B by the Finance Act of 2000, the provision as it now stands provides for a deduction of such profits and gains as are derived by a hundred per cent Export Oriented Undertaking from the export of articles or things or computer software for ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce. Consequently, it is evident that the basis on which the assessment has sought to be reopened is belied by a plain reading of the provision. The AO was plainly in error in proceeding on the basis that because the income is exempted, the loss was not allowable. All the four units of the assessee were eligible under section 10B. three units had returned a profit during the course of the assessment year, while the Crab Stick Unit had returned a loss. The assessee was entitled to a deduction in respect of the profits of the three eligible units while the loss sustained by the fourth unit could be set off against the normal business income. In these circumstances, the basis on which the assessment is sought to be re-opened is contrary to the plain language of sec. 10B."

12. As regards decision relied upon by the ld. DR in the case of *Petspin India Ltd. (supra)*, following the view taken in *CIT vs. Himat Singike Ltd.* (supra), we are of the opinion that the said decision is not applicable to the facts of the instant case since in the cited decisions the issue related to of set off of unabsorbed depreciation brought forward u/s 32(2) of the Act. The Hon'ble High Court while referring to provisions of sec. 28 to 43D of the Act observed that business profit has to be first determined based on sections 32 to 43D of the Act as provided u/s 29 and it is with reference to the profits so determined, deduction eligible u/s 10B(4) has to be computed. Such are not the facts and circumstances before us since the issue before us relates to deduction u/s 10B(4) of the Act in respect of each unit separately without setting of losses of other units. Therefore, reliance on the cited decision is misplaced.

13. In *Honeywell International (P) Ltd. vs. DCIT*, 26 SOT 503(Delhi), the ITAT allowed set off of loss of amorphous unit, which was otherwise eligible for deduction u/s 10A of the Act, against the profit of other units as per sec. 70 of the Act.

14 Since the lower authorit ies did not have the benef it of the view taken in the aforesaid decision *Hindustan Unit Liver Ltd.* (supra), we consider i t fai r and appropriate to set aside the order of the ld. CIT(A) and restore the mat ter to the f ile of the AO for deciding the issue of deduct ion u/s 10B of the Act raised in the ground no. 6 in this appeal , af

resh in accordance with law in the light of various judicial pronouncements, including those referred to above, af ter allowing suf f icient opportunity to the assessee.. With these observat ions, ground no 6 in the appeal is disposed of .

15. No addi t ional ground having been raised before us in terms of residuary ground no.7 in the appeal, accordingly, this ground is dismissed.

16. No other plea or argument was made before us.

17. In the result, appeal is al lowed but for stat ist ical purposes as indicated hereinabove.

Order pronounced in the court

2012 PTR 30 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "G" BENCH, DELHI

A.D. Jain, Judicial Member and Shamim Yahya, Accountant Member

FACTS/HELD

1. **Section 194H TDS: Tests to determine "Principal-Agent" Relationship Explained**
2. The assessee entered into agreements with hospitals etc ("collection centres") in accordance with which the centres collected samples from ***patients*** seeking laboratory tests and forwarded it to the assessee. The centres raised a bill on the **patient**, retained their "discount" and paid the balance to the assessee. The assessee claimed that it had rendered "professional services" & that the centres had rightly deducted TDS u/s 194J. The AO held that in collecting the sample and forwarding it to the assessee, the centres acted as an "agent" of the assessee and that the "discount" retained by it was "commission" and that the assessee ought to have deducted TDS u/s 194H. He consequently disallowed the "discount" u/s 40(a)(i) in the hands of the assessee. This was upheld by the CIT (A). On appeal by the assessee, HELD **reversing** the AO & CIT(A):

(i) To fall within s. 194-H, the payment must be by a "person acting on behalf of another person". **The element of "agency" has necessarily to be there**. If the dealings between the parties is not on a "principal to agent" basis, s. 194-H does not get attracted;

(ii) On facts, the **relationship between** the assessee and the Centres was not on a "principal & agent" basis because (a) under the agreement, the Centres availed the professional services of the assessee to test the samples and were under **no obligation** to always forward these samples to the assessee; (b) The Centres issued its **own bill to thepatient**, collected the fees and issued the **receipt**, (c) the assessee raised its invoice on the Centres after giving a "discount" over the standard **price list**; (d) the rates charged by the Centres from its customers were **not decided** by the assessee, (e) there was **no privity of contract between the assessee & the patient**, (f) **the amounts collected by the Centres was not on behalf of the assessee**. Consequently, the relationship between the assessee and the Centres was on **principal to principal** basis and s. 194H did not **apply** (**Ahmedabad Stamp Vendor Association** 257 ITR 202 (Guj), **Bhopal Sugar Industries** AIR 1977 (SC) 1275, **Singapore Airlines** 319 ITR 29 (Del), **Qanrztas Airways** 332 ITR 25 (Bom) considered);

(iii) Further, the obligation of TDS u/s 194 H arises only at the time of "payment" or "credit". **As the assessee had not paid or credited any amount to the account of the Centres**, s. 194H had no application. The assessee had only credited the net amount received from the Centres as its income.

Appeal allowed.

ITA No. 434(Del)2011 Assessment Year: 2006-07.

Decided on: 16th December, 2011.

Present at hearing: Ajay Vohra, Advocate and Rohit Garg, CA, for Appellant. Gajanand Meena, CIT, DR, for Respondent.

JUDGMENT

Per A.D. Jain, (Judicial Member):–

This is assessee's appeal for assessment year 2006-07 against the order dated 10.11.2010 passed by the Commissioner of Income Tax(Appeals)XII, New Delhi. The following grounds have been raised:–

"1. That on the facts and circumstances of the case and in law the CIT(A) erred in confirming disallowance of Rs.11,78,24,030/- out of total disallowance of Rs.16,80,66,667/- made by the Assessing Officer under section 40(a)(ia), for alleged failure of the appellant to deduct tax at source under section 194 H of the Income Tax Act, 1961 ("the Act.").

2. That the CIT(A) erred on facts and in law in not appreciating that there existed no principal-agent relationship between the appellant and the Collection Centres, which is sine qua non for invoking section 194 H of the Act.

2.1 That the CIT(A) erred on facts and in law in not appreciating that the amount retained by the Collection Centres was in the nature of discount and not commission.

2.2 Without prejudice that the CIT(A) erred on facts and in law in not appreciating that since no payment was made by the appellant to the Collection Centres, the provisions of section 194 H of the Act, could not, in any case, have been complied with.

3. That the CIT(A) erred on facts and in law in not adjudicating the ground of appeal raised by the appellant assailing the finding of the AO that discount offered by the appellant to Collection Centres was in the nature of payment for 'work' on which tax was deductible under section 194C of the Act."

2. The facts are that for the year under consideration, i.e., assessment year 2006-07, the assessee company filed its return of income declaring nil income after adjustment of brought forward loss of Rs.8,18,11,190/-. The assessment was completed vide assessment order dated 24.12.08 u/s 143(3) of the Income Tax Act, determining the income at Rs.25,32,44,857/-. While doing so, the AO made a disallowance of ` 16,80,66,667/- concerning discount offered by the assessee company to Collections Centres/Franchisees u/s 40(a)(ia) of the I.T. Act, on the basis that the assessee had not deducted tax thereon under sections 194 H/194 C of the Act.

3. By virtue of the impugned order, the learned CIT(A) restricted the disallowance from Rs.16,80,66,667/- to Rs.11,78,24,030/-. However, the ld. CIT(A) affirmed the disallowance in principle, holding that the relationship between the assessee and the Collection Centres/Franchisees was that of Principal and Agent, attracting the provisions of Section 194 H of the Act.

4. Before us, the learned counsel for the assessee has contended that existence of a Principal – Agent relationship is a must for the applicability of the provisions of Section 194 H of the Act; that the learned CIT(A) has erred in failing to appreciate that there did not exist any such relationship of Principal and Agent between the assessee company and the Collection Centres; that the ld. CIT(A) failed to consider that since the assessee had not made any payment to the Collection Centres, the provisions of Section 194 H of the Act could not, even otherwise, have been complied with; that the method of working between the assessee and the Collection Centres is that the assessee enters into nonexclusive agreements with domestic and international Collection Centres comprising of hospitals, nursing homes, clinics and other laboratories/entrepreneurs also; that in accordance with these agreements, the Collection Centres collect samples from patients/customers seeking various laboratory testing services; that their request forms to be sent along with the samples to be tested are filled up; that the Centres forward the samples to specialized testing laboratories like the assessee; that the Centres may avail the services of any such specialized testing laboratory, including the assessee; that it is only if the patient/customer insists that the required test be got done from the assessee, that a Centre forwards the sample of that patient/customer to the assessee for testing it; that the Centres issue their own bills/invoices to the patients/customers; that the Centres collect the fees for the tests conducted and issue receipts for the fees collected; that the Collection Centre acts as an Authorized Collector for collecting samples and avails the professional services of the laboratories like the assessee with respect to testing of samples and issuance of necessary reports; that in cases where the tests are done by the assessee, the assessee raises periodical invoices on the Collection Centre; that the Collection Centre, in turn, makes the payment to the assessee after deducting tax at source u/s 194 J of the Act for the professional services rendered; that the assessee, in terms of its agreements with the Collection Centres, extends its laboratory testing services at a discounted price, as compared to the standard price list; that the Authorities below have erred in treating the said discount offered by the assessee to the Collection Centres as commission on which tax was required to be deducted u/s 194 H of the Act; that the provisions of section 194 H of the Act are not attracted, there being no Principal – Agent relationship between the assessee and the Collection Centres; that the Collection Centres act not only for the assessee, but for other laboratories as well; that the choice of laboratory is with the Collection Centre, unless otherwise directed by the patient/customer; that moreover, the Collection Centre charges the customer rates fixed by the Centre itself and not that fixed by the assessee; that the risk of loss or damage of samples during transit is that of the Collection Centre; that the payment of invoice amount by the Collection Centre to the assessee does not depend on the realization of

such amount by the Centre from its patient/customer; that so, the risk of loss/profit is that of the Collection Centre; that the Collection Centres have totally different and independent infrastructure, administration and accounts from those of the assessee; that it is the assessee who provides professional services to the Collection Centres and not vice versa; that if the Collection Centres were acting as the agents of the assessee, the entire receipt would be collected by them on behalf of the assessee and so, they would not have to deduct tax at source out of the payments made to the assessee for professional services u/s 194 J of the Act; that in such a situation, the amount retained by the Collection Centres would have been regarded as income of the assessee and the commission allegedly paid by the assessee to the Collection Centres would have been considered as deductible expenditure; that however, it has not so been done; that though it has been so observed by the Authorities below, providing/bailment of packing material by the Collection Centres does not at all establish any Principal – Agent relationship between the assessee and the Collection Centres; that such bailment is to ensure that the samples reach the assessee laboratory in the requisite temperature, under prescribed conditions, so as to assure error free testing; that the Authorities below have erred in observing that the assessee had imposed any geographical restrictions on the Collection Centres; that rather, the Collection Centres are free to engage the services of other laboratories; that the restriction on the Collection Centres is against collaborating with the competitors of the assessee, so as to prevent divulging the specific and confidential know-how of the assessee to the competitors; that such a restriction is necessary to preserve and save the assessee's business interest; that even otherwise, such a restriction does not result in any Principal – Agent relationship between the assessee and the Collection Centre; that since the assessee does not pay or gift any amount to the account of the Collection Centre either directly or indirectly, Section 194 H of the Act does not apply; that there was no amount of discount/commission paid by the assessee and/or debited in the accounts of the assessee and therefore, any obligation to deduct tax at source u/s 194 H of the Act even otherwise did not get attracted; that since no payment goes to the Collection Centres from the assessee, there is no question of deduction of any tax at source; that the amount received by the assessee from the Collection Centres is the amount of invoice, net of discount; that this cannot be said to be expenditure incurred by the assessee, liable to attract the provisions of section 40(a)(ia) of the Act; that it has wrongly been held that the transaction/arrangement between the assessee and the Collection Centres is in the nature of "work" for the purpose of Section 194 C of the Act; that in the facts of the case, it has not been proved by the Department that the Collection Centres are carrying out any work for and on behalf of the assessee; that the payments received by the assessee from the Collection Centres are for rendering of professional services by way of testing of samples, subject to with-holding of tax u/s 194 J of the Act; that if the Collection Centres were carrying out any work for and on behalf of the assessee, no tax would have been required to be withheld by the Collection Centres u/s 194 J of the Act; and that also, because no payment is made by the assessee to the Collection Centres and there is no expenditure incurred by the assessee, the provisions of section 194 C read with those of section 40(a)(ia) of the Act are not at all attracted. To support the contentions on behalf of the assessee, the learned counsel for the assessee has relied on various case laws, which shall be dealt with here-under.

5. The learned DR, on the other hand, has placed strong reliance on the impugned order. It has been contended that the learned CIT(A) has correctly confirmed the disallowance of ` 11,78,24,030/- out of the total disallowance of Rs.16,80,66,667/- made by the AO u/s 40(a)(ia) of the Act, since the assessee had failed to deduct tax at source u/s 194 H of the Act; that Section 40(a)(ia) of the Act clearly provides, inter alia, that where any commission is payable to a resident for carrying out any work, on which tax is deductible at source under Chapter XVII – B and such tax has not been deducted, the said commission shall not be deducted in computing the income chargeable under the head "profits and gains of business or profession"; and that the expression employed in the section is 'shall' and so, whereas in the present case, tax is not deducted on commission paid for carrying out work, it is mandatory that such commission be not deducted. The ld. DR has sought to place reliance on "*ACIT, Circle 57, Kolkata vs. Bharati Cellular*", 105 ITD 129 (Kolkata) and "*Hindustan Coco Cola Beverages Pvt. Ltd. vs. ITO*, *TDS, Range 7*", 97 ITD 105(JP). In "Bharati Cellular" (supra), it was held, *inter alia*, that the assessee was liable to deduction of tax at source u/s 194 H of the I.T. Act on commission paid to its franchisees and the AO was justified in treating the assessee as a defaulter and then computing TDS and interest thereon and the ld. CIT(A) was not justified in vacating the AO's order.

6. In "Hindustan Coco Cola Beverages" (supra), it was held, inter alia, that where the relationship between the assessee company and the distributor was on a Principal and Agent basis, the assessee was liable to deduct tax on commission.

7. We have heard the parties and have perused the material on record. The issue before us is the interpretation of section 194 H of the I.T. Act – as to whether it is applicable to the facts of the present case or not. At the outset, it would be appropriate to reproduce the provisions of section 194 H:–

> ***"194H. Commission or brokerage.***
>
> *Any person, not being an individual or a Hindu undivided family, who is responsible for paying, on or after the 1st day of June, 2001, to a resident, any income by way of commission (not being insurance commission referred to in section 194D) or*

brokerage, shall, at the time of credit of such income to the account of the payee or at the time of payment of such income in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of ten per cent :

***Provided** that no deduction shall be made under this section in a case where the amount of such income or, as the case may be, the aggregate of the amounts of such income credited or paid or likely to be credited or paid during the financial year to the account of, or to, the payee, does not exceed five thousand rupees:*

***Provided further** that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such commission or brokerage is credited or paid, shall be liable to deduct income-tax under this section:*

***Provided also** that no deduction shall be made under this section on any commission or brokerage payable by Bharat Sanchar Nigam Limited or Mahanagar Telephone Nigam Limited to their public call office franchisees. Explanation.—For the purposes of this section,–*

(i) "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities;

(ii) the expression "professional services" means services rendered by a person in the course of carrying on a legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or such other profession as is notified by the Board for the purposes of section 44AA;

(iii) the expression "securities" shall have the meaning assigned to it in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956 ;

(iv) where any income is credited to any account, whether called "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly."

8. Thus, Section 194 H, brought in from 1.6.2001, provides that any person, other than an individual or a Hindu Undivided Family, responsible for paying commission or brokerage to a resident, shall deduct tax at source; and that the tax shall be deducted at the time of credit of such income to the account of the payee or at the time of payment of such income or by issue of a cheque or draft or by any other mode, whichever is earlier. To fall within the provisions of section 194 H, the payment received or receivable, directly or indirectly, is to be by a person acting on behalf of another person (i) for services rendered, not being professional services, or (ii) for any services in the course of buying or selling of goods or (iii) in relation to any transaction relating to any asset, valuable article or thing. The element of agency is necessarily to be there in cases of all the services or the transactions contemplated by the section, as held in "*Mother Dairy India Ltd. vs. ITO*", 28 SOT 42 (Del), "*Delhi Milk Scheme vs. CIT*", 173 Taxmann 54 (Del), and "*ABP Pvt. Ltd. vs. CIT*", 23 SOT 28 (Kolkata).

9. Where the dealing between the parties is not on a Principal to Agent basis, Section 194 H does not get attracted, as held in "*Ahmedabad Stamp Vendor Association vs. Union of India*", 257 ITR 202 (Guj), "*Kerala Stamp Vendors Association*" 282 ITR 7(Ker) and "*ACIT vs. Samaj*", 77 ITD 358 (Cuttack).

10. In the present case, the business working of the assessee is that it signs agreements with the Collection Centres, on a non-exclusive basis. It is under these agreements, that the Collection Centres avail the professional services of the assessee regarding testing of samples. These Centres operate as authorized Collectors for collecting the samples. Now, these Collection Centres are working in this manner with various concerns, of which, the assessee is one. The Collection Centre is under no obligation to *always* forward these samples to the assessee. It is only in case the patient/customer insists that the laboratory testing be done by the assessee, that the Collection Centre forwards the sample of such a patient to the assessee, for testing. The Collection Centre also fills up the necessary test requisition forms to be sent along with the sample. The assessee conducts the test/tests and issues the report with regard thereto, to the Collection Centre. The Collection Centre issues its own bill/invoice to the patient/customer. The fees for the testing is collected by the Collection Centre and the receipt is also issued by the Collection Centre. The assessee raises its periodical invoices on the Collection Centres. The Collection Centre makes the payment to the assessee after TDS u/s 194 J of the Act. Under the Agreement, the services are rendered by the assessee in the form of laboratory testing at a discounted price from the price given in the standard price list. This discount has been considered by the Authorities below as commission and they have held that tax was required to be deducted thereon u/s 194 H of the Act.

11. Now, it has not been shown that these facts, as canvassed on behalf of the assessee, are not the correct facts. It has not been shown that the rates charged by the Collection Centre from its customers are not decided by the Collection Centre, but by the assessee. It has not been shown that the Collection Centre is under any obligation to forward the samples for testing only and only by the assessee and not by other laboratories as well. The set- ups of the Collection Centres are also entirely different from that of the assessee. Their expenditure has also not been shown to be interlacing with that of the assessee. The staff of the two are also distinct and separate. The accounts are not either inter-mixed or inter-twined. On the other hand, there exists a privity of contract between the Collection Centres and their customers. Out of the payment made to the assessee, tax is deducted at source for professional services rendered, u/s 194 J of the Act. The receipt by the Collection Centres is not established to be on behalf of the assessee. The receipt of the Collection Centres, as such, is the income of the Collection Centres themselves and not that of the assessee. To bring home this point, it is enough to consider that the amount, alleged to have been paid by the assessee to the Collection Centres, has not been considered to be deductible expenditure.

12. In "*CIT vs. Jai Drinks Pvt. Ltd.*", 211 – TIOL-52-HC-DEL-IT, under similar circumstances, similar payments made by "Jai Drinks", to its distributor, were held to be incentives and discounts and not commission. The distributor had been permitted to sell its product in a specified area exclusively. It was as per the agreement that the distributor was to purchase the products of Jai Drinks and was to be allowed discount per case on the printed maximum retail price. The breakage, leakage, etc., was the liability of the distributor and not that of Jai Drinks. All the approvals, consents, registration, licence, etc., required from Departments or Authorities were to be obtained by the distributor. The purchase of the products by the distributor from Jai Drinks was against one hundred per cent advance payment or, at times, on credit, at the discretion of Jai Drinks. No element of Principal – Agent relationship was found to exist, as is the case herein.

13. The ld. CIT(A) has observed that the submission of the assessee that it provided professional services in the form of medical diagnostic services to the Collection Centres, was not acceptable. For arriving at this observation, the learned CIT(A) noted that the assessee provides professional services to the patients and not to the Collection Centres, which work on behalf of the assessee to collect samples from patients. In this regard, it is seen, as noted hereinabove, that the assessee had appointed Collection Centres under nonexclusive agreements to collect samples and to forward them for testing to the assessee. The professional services in the form of medical diagnostic services were provided to the Collection Centres and not to the patients/customers of the Centres. The Collection Centres and the Patients/customers are the ones which have

privity of contract inter se. The Collection Centres deducted tax at source from the payment made to the assessee, for professional services, u/s 194 J of the Act, establishing that the Collection Centres were not the agents of the assessee. Were it otherwise, the entire receipt would have been collected *on behalf of the assessee* by the Collection Centres. It has not been shown to be so. Moreover, the amount retained by the Collection Centres was not regarded as the income of the assessee and the commission allegedly paid by the assessee to the Collection Centres was not treated as the deductible expenditure.

14. The assessee's contention that the Collection Centres have the option to conduct the tests themselves or to out-source their medical services to other laboratories, has been simply brushed aside by the ld. CIT(A) stating it to be of no significance. This, however, to our mind, is not correct. Firstly, this contention has not been disproved. It is borne out from the agreements. Then, if this averment on behalf of the assesssee is correct, the element of agency in the relationship between the assessee and the Collection Centres goes away. True, the Collection Centres have to follow the terms of the contract entered into by them with the assessee. However, no violation of the terms of these agreements has been shown. The ld. CIT(A) has concluded that the assessee's contention that the Centres can out-source their services to other laboratories, is factually incorrect. This is based on the recital in the agreement that the Collection Centres cannot collaborate with the competitors, even on the termination of the agreement. The assessee's stand in this regard has been that such a restriction was imposed simply to prevent the Collection Centres from divulging the assessee's specific and confidential know-how which may have come to their notice during their engagement with the assessee, to the competitors of the assessee. This contention has neither been rebutted, nor can be thrown out neck and crop. This is a perfectly plausible explanation. Prudence demands the imposition of such-like restrictions in the agreement, so as to safe-guard the assessee's interests. Further, as contended, it has not been shown that there is any restriction on the Collection Centres from continuing to act as such Collection Centres. The assessee has only sought to prevent the Collection Centres from collaborating with the competitors of the assessee. In the event of absence of such a covenant in the agreement, there would be no safe-guard against the Centres divulging the assessee's confidential specific know-how to its competitors, thereby prejudicing the assessee's business. And not only this, the mere existence of such alleged restriction does not, by itself, establish a Principal – Agent relationship between the assessee and the Collection Centres. In this regard, in "*Bhopal Sugar Industries vs. STO*", AIR 1977 (SC)1275, it has been observed, inter alia, that the concept of a sale has under-gone a revolutionary change, having regard to the complexities of the modern times and the expanding needs of the society, which has made a departure from the doctrine of laissez faire by including a transaction within the fold of a sale, even though the seller

may, by virtue of an agreement, impose a number of restrictions on the buyer, e.g., fixation of price, submission of accounts, selling in a particular area or territory and so on; and that these restrictions per se would not convert a contract of sale into one of agency, because in spite of these restrictions, the transaction would still be a sale and subject to all the incidents of a sale.

15. It has further been the observation of the ld. CIT(A) that there were geographical restrictions imposed on the Collection Centres. However, as rightly contended, it has not been shown that any such restrictions were ever imposed on the Collection Centres. Rather, no restrictions have been shown to have been imposed on the Collection Centres from referring the tests to laboratories other than the assessee. It has been contended on behalf of the assessee that all through, i.e., in the past, as well as in the present, the Collection Centres have been and are engaging the services of other laboratories. This has not been disputed.

16. The ld. CIT(A) has also objected that it is not true to contend, as done on behalf of the assessee, that the Collection Centres are free to charge a rate as desired by them from their patients; that the advertisement clearly specifies the rate which is to be charged by the Collection Centres; and that from this, it is clear that the assessee has control over the pricing of the test.

17. In this regard, the contention on behalf of the assessee has been that the findings of the ld. CIT(A) is incorrect. It has been reiterated that the Collection Centres are free to charge the desired rates from the customers/patients. It has been submitted that though in the advertisement attached as Annexure-A to the CIT(A)'s order, the rates have been specified, the Collection Centres charge the rates fixed by the Collection Centres themselves and not at those decided by the assessee; that in certain cases, the Collection Centres have charged over and above the standard price list provided by the assessee to the Collection Centres. In this regard, attention has been drawn to pages 96 to 98 and 99 to 102 of the Assessee's Paper Book.

18. Apropos this issue, it is seen that APB 96 shows that Sapra Diagnostic Centre, a Collection Centre, bearing Code No. P 00000075/, is charging Rs. 975/- against SRL DOS price of Rs. 915/-. APB 97 is a copy of receipt issued by Sapra Diagnostic Centre to whom Khanna Renu, for payment of Rs. 975/- for various medical tests. Then, APB 98 contains the copy of price list (Systems) of the assessee, as on 17.12.09. This list reads as follows:–

Test Code	**Test name**	**SRL Test Price (Rs.)**
5111	CBC+PS+ESR	285
1302H	FASTING BLOOD SUGAR	60

1302	GLUCOSE PP	60
1209AD	CORONARY RISK PROFILE, SERUM	390
1310H	URIC ACID, SERUM	120
	TOTAL	915

19. Further, APB 99 to 102 contain the relevant extracts of the standard price list of the assessee. All these documents were placed before the Authorities below. In the impugned order, however, the ld. CIT(A) has not taken those into consideration. In fact, no reference whatsoever has been made to this documentary evidence. Therefore, the contention of the assessee regarding the Collection Centre free to charge the rates as desired by them from the customers/patients does not stand rebutted and the ld. CIT(A) has wrongly based his finding in this regard merely on the advertisement attached with the impugned order as Annexure-A. The rates contained in the said advertisement are, no doubt, the specified rates, but the assessee has been able to show that the Collection Centres *do* the charge rates over and above such specified rates, as desired by them. The observation of the ld. CIT(A) against the assessee in this regard is, therefore, not correct.

20. The ld. CIT(A) has also observed that the assessee is bound to the Collection Centres in terms of the report issued in respect of samples referred by the Centres to the assessee and tested by the assessee. However, it has not been shown as to how this acts detrimentally to the assessee. No Principal – Agent relationship stands established by this sole fact. Obviously, since the assessee renders professional services, and that too, professional services by way of medical testing, there is a strict professional conduct which has to be abided by the assessee. The assessee is under a strict obligation. If there is any negligence or deficiency on the part of the assessee, it is the assessee who is answerable.

21. As seen from the above, it is evident that there is no Principal – Agent relationship existing between the assessee and the Collection Centres. The findings of the learned CIT(A) in this regard are, therefore, incorrect and we hold so.

22. Besides the above, it is patent on record that the assessee does not pay or credit any amount to the account of the Collection Centres, either directly or indirectly. That being so, the provisions of section 194 H of the Act do not get attracted on this score also. It is obvious that the obligation of deduction of tax at source u/s 194 H of the Act comes up only at the time of payment or credit of the amount in the books of account of the payer, whichever is earlier. Herein, the amount received by the assessee has been credited in its books of account. This is based on the invoices raised by the assessee on the Collection Centres. No debit in the books of account of the assessee for any discount and/or commission paid towards the Collection Centres has been shown to exist. On the contrary, the assessee has been taxed on the gross receipt of Rs.50.42 crores, which stands reflected in the books of account of the assessee.

23. Then, the disallowance in terms of section 40(a)(ia) read with section 194 H of the Act can be made only in respect of expenditure in the nature of commission paid/credited to the account of the recipient, or to any other account. In the present case, the assessee receives the amount of the invoice raised, net of discount, from the Collection Centres. This, discount, indisputably, cannot, in any manner, be said to be expenditure incurred by the assessee and so, section 40(a)(ia) of the Act is not attracted.

24. In "*United Exports vs. CIT*", 330 ITR 549(Del), it was held, with reference to section 40 A(2) (b) of the Act, that since trade discount offered by the assessee could not be said to be expenditure incurred, there was no question of disallowance under the said section.

25. From this angle also, the Authorities below erred in disallowing the discount offered by the assessee, by invoking the provisions of section 40(a)(ia) of the Act.

26. Coming to the case laws referred to on behalf of the Department, these are as follows:–

1. "*CIT vs. Singapore Airlines Ltd.*", 319 ITR 29 (Del);
2. "*CIT vs. Director, Prasar Bharti*", 325 ITR 205(Ker);
3. "*Delhi Milk Scheme vs. CIT*", 301 ITR 373(Del);
4. "*ACIT vs. Bharti Cellular Ltd.*", 105 ITD 129(Kol); &
5. "*Hindustan Coca Cola Beverages vs. ITO*", 97 ITD 105(JP).

27. Apropos "*CIT vs. Singapore Airlines Ltd.*" (supra), it was observed, inter alia, that in the area of travel business, the airline appoints agents who are accredited with IATA. These agents maintain blank ticket stock of the airline. The agents are authorized to issue tickets to passengers against collection of consideration. When a ticket is issued by the agent, a contract comes into existence between the passenger and the airline, for carrying the passenger on the scheduled flight (for which the ticket is booked). The amounts collected by the agents are credited to the airlines on a fortnightly basis. The agent receives a pre-agreed commission, which is fixed for the industry as a whole, after deducting tax at source under section 194 H of the Act. In that view of the matter, there is no dispute that there is a Principal – Agent relationship between the airline on the one hand and travel agent on the other.

28. In the aforesaid background of facts, the question arose whether the supplementary commission retained by the travel agents was in the nature of 'Commission' for the purposes of section 194 H of the Act, on which, tax was required to be withheld, or it was in the nature of discount.

29. In the undisputed position that the approved agent acted vis-à-vis airline in the capacity of an agent, it was held that the supplementary commission received from sale of tickets was no different from the commission normally received by the agent, on which tax was being deducted under section 194 H of the Act.

30. In the present case, however, there is no Principal – Agent relationship that subsists between the assessee and the Collection Centres. On the contrary, it is the assessee which renders lab testing services to the Collection Centres, on which necessary tax is deducted under section 194 J of the Act. Therefore, 'Singapore Airlines' (supra) is clearly non-applicable hereto.

31. That apart, it was held by the Hon'ble Bombay High Court in the recent decision of "*CIT vs. Qantas Airways*", 332 ITR 25(Bom) that the discount offered by the airlines to travel agents on the standard price of tickets could not be said to be income in the nature of commission/brokerage, warranting deduction of tax at source under section 194 H of the Act.

32. Apropos "*CIT vs. Director, Prasar Bharti*", (supra), it was held that under the advertising trade too, the advertising agencies, which are accredited with Advertising Standards Council of India (ASCI), release advertisements to the media (print or electronic) and are entitled to commission from the media. The advertising agencies which receive payment from the advertisers retain the commission and pass on the balance to the media. Tax is deducted under section 194 H of the Act on the amount of commission retained by the advertising agency, in view of the admitted Principal – Agent relationship between the media and the advertising agency.

33. In the facts of the given case, it was observed that the advertising agency was an agent for Prashar Bharti, considering that the agent was entrusted to canvass advertisement on behalf of Doordarshan, the advertisement charges recovered from the customers were also in accordance with the tariff prescribed by Doordarshan, which was incorporated in the agreement, the advertisement material had to conform to the discipline introduced by Doordarshan, Doordarshan was bound by advertisement contract canvassed by advertising agencies and it was under obligation to telecast advertisements in terms of the contract which the agency signed with the customer.

34. On the aforesaid facts, it was held that the commission of 15% retained by the agent out of advertisement charges collected by the agent on behalf of Doordarshan was subject to deduction of tax at source under section 194 H of the Act, since the transaction was a pure agency agreement between Doordarshan and the advertising agency, in view of the fact that one acted for the other and the act of the agent bound Doordarshan in its capacity as Principal of the Agent. It was held that

the parties understood their relationship as that of Principal and Agent and what was paid to the agent by Doordarshan was 15 per cent of the advertisement charges collected and remitted the agent which was in the form of commission payable to the agent by Doordarshan. Further, it was found on facts that the advertisement contract entered into between the customer and the agency was for telecasting advertisement on Doordarshan channels.

35. In the present case, on the contrary, the collection center has no authority to bind the assessee in any form. The collection centers, acting in their own right, engage the assessee for lab testing services and do not, in any manner, act as agents of the assessee. That being so, 'Director, Prasar Bharti' (supra), does not come to the aid of the revenue.

36. In "Delhi Milk Scheme" (supra), the assessee appointed a large number of agents/concessionaires all over Delhi to sell milk/ milk products owned by the assessee. The assessee did not charge any rent for the use of booths from the concessionaires. The milk booths were, in fact, owned by the assessee. The assesee had a right to enter the milk booth and take charge thereof at any time, without assigning any reason or without any intimation to the concessionaires. The unsold milk was taken back by the assessee from the concessionaires. The cash collection was daily handed over to the assessee by the concessionaires. The concessionaires only rendered a service to the assessee for selling milk to the customers, and the ownership of the goods did not pass from the assessee to the concessionaires, inasmuch as there was no sale of the milk/milk products to the concessionaires.

37. It was observed that looking at the facts of the case, namely, that the ownership of the milk booth rests with the assessee who does not charge any rent for the use of the booths from the concessionaires; the unsold milk is taken back by the assessee from the concessionaires who are prohibited from selling any other product of any other brand; the sale collections of the concessionaires are collected in cash by the assessee from concessionaires on a daily basis, there can be no doubt that the concessionaires are selling milk for and on behalf of the assessee and were being paid a commission for it.

38. On the basis of the aforesaid undisputed facts, it was held by the Hon'ble High Court, confirming the decision of the Tribunal, that the commission paid to the agents for the goods sold attracted the mischief of section 194H of the Act.

39. In the present case, however, the collection centre has its own premises, infrastructure, staff and necessary licenses/approvals. The collection centre acts as an authorized collector for collecting samples and avails the professional services of the appellant with respect to testing of samples and issue of necessary reports. The assessee raises periodical invoices on the collection centers. The amount collected by the collection

center from the patients is not on account of or on behalf of the assessee. The collection center, in turn, makes payment to the assessee after deducting tax at source u/s 194J of the Act for the professional services rendered. The collection centre has the flexibility and freedom to choose the laboratory to which samples have to be sent for testing, unless the same is mandated by the patient/customer. Moreover, the collection centre charges the customer rates fixed by the collection centre (and not decided by the assessee) though at the same time, keeping in mind the amount that would have to be paid by the collection centre to the assessee or to any other laboratory to which the samples have to be sent for testing. In fact, in certain cases, the collection centers have, as also brought on record before us, charged over and above the standard price list provided by the assessee to all collection centers, which averment has gone unrebutted. Hence, 'Delhi Milk Scheme'(supra) is also not of any avail to the Department.

40. In "Bharti Cellular"(supra), the assessee was providing cellular mobile telephone services in specific area through distributors by providing SIM and pre-paid cards at fixed rates below the market price, which were further sold to retailers, who ultimately sold the SIM cards and pre-paid cards to customers. As per the agreement between the assessee and the franchisees, the rights, title, ownership and property rights in the pre-paid cards, at all times, vested with the assessee. The franchisee's price and payment thereof was decided by the assessee itself, which showed that the difference between price charged by the assessee and that charged by the franchisee was commission and not discount.

41. In the background of the aforesaid facts, taking into account that there was no transfer of title in the property (SIM cards) by the assessee to the distributor, it was held that the distributor acted as an agent of the assessee and the relationship between the parties was not on a principal to principal basis. It is in these circumstances that the Kolkata Bench of the Tribunal held the provisions of sec. 194H of the Act to be applicable to the amount which was regarded as being in the nature of commission.

42. The present case, on the other hand, is not one of sale of goods, but one of rendering of services. The assessee renders diagnostics services to the collections centers against payment, on which necessary tax is deducted at source u/s 194 J of the Act. There is no element of agency between the assessee and the collection centers. 'Bharti Cellular' (supra), therefore, has no application whatsoever to the facts of the present case.

43. Apropos "*Hindustan Coca Cola Beverages*" (supra), it has been submitted on behalf of the assessee that the Hon'ble Rajasthan High Court has, vide order dated 25.08.2005 (copy placed on record) stayed the operation of the aforesaid decision, holding the same as not being in accordance with the law laid down by the apex court.

44. Moreover, in the said case, it was found during survey that the assessee had credited 'commission' to the account of the distributors in its books of account. It was further found that (a) loss due to reduction in price and due to expiry of goods was borne by the assessee; (b) the assessee met expenses on diesel and petrol, vehicle repair, salary of salesmen, etc., incurred by the distributors in certain cases; (c) the assessee had borne the loss due to leakage and breakage claims made by the distributors; (d) the assessee provided vehicles to distributors, for distribution of its products; and(e) that statements of three distributors recorded by the AO suggested that the distributors were clear in their minds that they were commission agents acting on margin and fixed responsibility.

45. On the other hand, in the present case, no income was found credited to the account of the collection centers. The loss on account of any damage was to be borne by the collection centers. The expenditure on salary/staff of the collection centers was to be borne by the collection centers on their own and the collection centers were free to charge any amount from the customers/patients. Therefore, due to these differences on facts also, 'Hindustan Coca Cola Beverages' (supra) has no parity herewith.

46. In view of the above discussion, we find the grievance of the assessee to be perfectly justified. We hold that (i) there is no Principal-Agent relationship between the assessee and the Collection Centres and that being so, the provisions of section 194 H of the Act have been wrongly invoked; (ii) The provisions of section 194 H of the Act could, even otherwise, not have been met, since no payment has been shown to have been made by the assessee to the Collection Centres; (iii) The payment made to the assessee by the Collection Centres was at the rates agreed to inter se between them; and (iv) The ld. CIT(A) erred in confirming the disallowance of ` 11,78,24,030/- made u/s 40(a)(ia) of the Act for the alleged failure of TDS by the assessee u/s 194 H of the Act.

47. GroundNo.3 states that the ld. CIT(A) erred in not adjudicating the challenge of the assessee to the AO's findings that the discount offered by the assessee to the Collection Centres was in the nature of payment for work, on which, tax was deductible u/s 194 C of the Act.

48. Since the claim of the assessee has been allowed as above, there remains no requirement to go into this aspect of the matter and we are not doing so.

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

Order pronounced in the open court on 16.12.2011.
