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Weekly Tax Journal

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CASE LAW

Foreign:

Ranbaxy Laboratories Ltd.
v.
The Commissioner of Income Tax

Commissioner of Income Tax
v.
SPL's Siddhartha Ltd.

Director of Income Tax
v.
Rio Tinto Technical Services

I.T. Appeal No. 1368 (Del) of 2010
Assessment Year : 2006-07

I.T.A. No.546(Bang.)/2008
Assessment Year : 2003 -2004

ITA No. 9001/Mum/10
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Why penalize association of persons?

by
Huzaima Bukhari & Dr. Ikramul Haq

Income Tax Ordinance, 2001 (hereinafter "the Ordinance") contained progressive rates for taxing both individuals and association of persons (AOPs) until Finance Act 2010 that imposed a flat rate of 25% tax on AOPs with retrospective effect. The Finance Act 2010, except for this amendment, became effective from July 1, 2010, meaning by that all the amendments were applicable from tax year 2011. AOPs, filing returns for tax year 2010, caught unawares, were made to suffer because of this retrospective amendment, levying heavy rate of tax even for those small establishments having meagre income or income below taxable limits. Of course, this was a move that was much resented and met with futile opposition but all AOPs were left with no option except to pay 25% as required under the law, as it was too late to dissolve the existing firms to take advantage of rates meant for individuals.

When two or more persons join hands for the common purpose of earning income, they are assessed to tax as a single entity known as AOP. But members or partners of AOPs are not considered separate entity as is the case between a company and its shareholders. AOP can comprise merely individuals, a group of non-individuals (firm, company etc) or a conglomeration of both individuals and non-individuals but the motive behind such arrangement is just making profits through joint business operations. Under the tax law, constituents of AOP could be either members or partners depending on partnership agreements. In order to prevent corporate bodies taking advantage of lower rates of tax enjoyed by AOPs, the law clearly provides section 88A according to which, if any company is a member it would still be taxed at 35% (corporate rate of tax) on its share in profits from the AOP.

In our society, self-employed people are involved in a variety of ways to earn their living. Most of the times, they resort to simple methods requiring low capital, less complication, fewer employees and straightforward financial records. In this process, sometimes one individual finds himself handicapped on account of expertise or even finances and looks towards another for support. Under such circumstances, resources and know-how are pooled in to form a long lasting business relationship capable of yielding profits. Thus, small and medium sized enterprises (SMEs) prefer to carry on as AOPs rather than corporate bodies. Even though there is no minimum limit of paid-up capital in order to get incorporated, there are many legal encumbrances and formalities that have to be fulfilled both at the time of registration and during the life term of a company.

Besides, another very important factor that cannot be ignored is the high level of illiteracy prevalent amongst the masses that renders them ignorant about law. Since understanding and following corporate law necessitates sound education, very few persons would consider this as a practicable option. Not that all illiterate people are imprudent enough to realize the benefits of incorporation as they could be involved in multi-million rupee companies running their business successfully. Such cases are, however, very few and too insubstantial to be considered as exemplary.

The general commercial atmosphere which exists in this country is that of small and medium-sized businesses requiring fewer legal obligations. Considering this nature of our public it comes as quite a surprise that the economic wizards of Pakistan suddenly resorted to taxing AOPs at the rate of 25% of taxable income snatching from them the earlier facility available under paragraph 1 of Division 1 of the First Schedule to the Ordinance wherein no tax was payable on taxable income of Rs. 100,000 up to tax year 2009. Now after the amendment, tax of Rs. 25,000 has been levied on this income which is an exorbitant amount on very small incomes.

Remarkably, it has escaped the attention of wizards sitting in FBR that any salary, brokerage, commission, profit on debt or any other remuneration etc. paid to partners/members of AOP is an inadmissible expense under section 21(j) of the Ordinance, which is not the case for companies subjected to tax at the flat rate of 35% or 25% in the case of small companies. If the purpose was to force corporatization then the restriction of inadmissibility of such remunerations should also have been removed. On the one hand an exorbitant rate of 25% is imposed on all levels of incomes of AOPs and on the other they cannot claim as deductible expenses any amount paid to their members/partners. Parity demands that pre-2010 position should be restored in the case of non-corporate SMEs or alternately clause (j) of section 21 should be deleted.

The different questions that come to one's mind include, (i) what could be the rationale behind this move and that too with retrospective effect? (ii) What was the need to send such a shock wave to AOPs in particular? (iii) Was the revenue increase considerable as a result of this measure? (iv) Who are the real beneficiaries of this amendment?

The obvious answer to the first three questions would be that there must have been some good increase in revenue collection as the AOPs were caught unawares and were understandably forced to pay 25% tax even if their earnings were a paltry Rs. 300,000 as per the new rates for tax year 2010. Such AOPs that would not have otherwise been liable to pay a single rupee had to pay Rs. 75,000 tax on this income. There cannot be any doubt about enhanced revenues but what about those AOPs which were not even provided any option to exercise their choice of either continuing their partnerships and be willing to pay a high rate of tax or dissolving them to avail the benefits of being assessed as individuals.

Even from the perspective of revenue, the future does not seem so bright as the unsuspecting AOPs having once been bitten must have become twice shy and resorted to either going for dissolution or incorporation. It seems that the business of auditors must have got the biggest boost from this amendment as helpless members of AOPs rushed to them for advice. One wonders if this amendment was provoked by a certain segment of service providers to sustain their faltering businesses. Perhaps it brought in the much needed respite from dwindling commercial activities hitting at the interests of some audit companies.

On the one hand, FBR facilitated through this amendment expansion of business of auditors and on the other did not take into account the best practices in the world that do not allow external auditors to act as tax advisors for the same clients. India has already passed a law to this effect [section 44AB of the Income Tax Act, 1961] which was accepted by Indian Council of Chartered Accountants barring external auditors to act as tax advisors in those cases in which they have signed audit reports. In USA after Enron case, Congress passed Sarbanes Oxlay Act, 2002, which imposed bar on auditors to act as tax advisors for the same person.

Whatever may have been the rationale or logic for abruptly depriving AOPs from beneficial tax rates, the fact remains that this has been quite a detrimental amendment for small and medium trading bodies. Remarkably no such change has been contemplated by our neighbouring country India, which continues to maintain the same rates for AOPs as for individuals. The reason could be that their revenue authorities are not influenced by auditors—many of whom in Pakistan sit in reform committees of FBR ignoring the well-established principle of conflict of interests.

Anti-avoidance mechanism in Sales Tax Act, 1990

by

Zafar Azeem[*]

Individuals and businesses make arrangements through which they alienate their real income in order to be taxed at lower rates. This effort attracts application of those provisions of law which forbid avoidance of tax schemes.

Such provisions are present both in direct and indirect taxes.

This paper examines anti-avoidance provisions present in Federal Sales Tax Law.

The Sales Tax Act, 1990 (hereinafter referred to as the Act) taxes supplies of goods[1] by registered persons on their value of supply[2] in the course of their taxable activities[3] ("output tax") but permits such persons to claim deductions for the amounts they expend in connection with those activities ("input tax deductions").

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The rate of tax is 16% and hence the "tax fraction" applicable to the deductions is one-twelfth.

At the end of each "taxable period" a person registered under the Act must make a sales tax return bringing to account both outputs and inputs and then either pay the debit balance or claim the credit balance or the sales tax refund.

"Goods" means all kinds of personal or real property other than chooses in action or money.[4] Where the consideration for a supply is a consideration in money the value of a supply is the amount of the money.[5] Where the consideration is not a consideration in money or the parties are associated persons, the value is the "open market price"[6] of the consideration.[7] The provisions of the Act, 1990, which need to be considered are, of course, the limits provided to check anti-avoidances.[8] These limits are as under:

(i) where the consideration for a supply is in kind or is partly in kind and partly in money, the value of the supply will be the open market price of the supply (excluding the amount of tax);

(ii) where the supplier and recipient are associated persons and the supply is made for no consideration (or for a consideration which is lower than the open market price), the value of supply will be the open market price of the supply (excluding the amount of tax);

(iii) where a taxable supply is made to a consumer from general public on instalment basis on a price inclusive of mark-up or surcharge rendering it higher than open market price, the value will be the open market price of the supply excluding the amount of tax;

(iv) where a trade discount has been allowed the value of the goods will be, the discounted price excluding the amount of tax;[9]

(v) where for any special nature of transaction, it is difficult to ascertain the value of a supply, the open market price;

(vi) in case of imported goods, the value determined under section 25 of the Customs Act, 1969 including the amount of customs-duties and central excise duty levied thereon;

(vii)where there is sufficient reason to believe that the value of a supply has not been correctly declared in the invoice, the value determined;[10] and

(viii) of processing, the value will be the price excluding the amount of sales tax leviable on such goods.

In the said provisions, there exists the arrangement constituting tax avoidance mechanism because in economic terms it is a conditional obligation to repay the money without having any definitive commitment to repay it irrespective of the success or failure of the venture would constitute a special nature transaction.

For example, mere completion of loan documents and the swapping of cheques would be insufficient to constitute the economic sacrifice Parliament intended in limiting the refund payment to the extent that payment is made in the period in question.

Such expressed legal obligations are generally artificial.

Where the obligation to pay the purchase price was replaced, in commercial terms, by only a conditional commitment to repay the line limiting the obligation, it stands crossed into tax avoidance.

And it is not for the court or the commissioner to say how much a taxpayer ought to spend in obtaining his income.

Nevertheless the commissioner may be satisfied that the arrangement which he wishes to treat as void has been "entered into between persons to defeat the intent and application" of the Act or any of its provisions.

The onus is on the taxpayer to show that how the commissioner could not properly stood satisfied.[11] And there must exist circumstances[12] as provided in the law so as to reject the value of supply and to bring it into the ambit of disputed transaction to constitute a tax avoidance act.

And this arrangement must have been entered into between the parties to defeat the intent and application of the law or any of the provisions of the act.

The courts are on much firmer ground disregarding subjective purpose, as they have always done in applying general anti-avoidance provisions in the income tax statutes.

In Newton v Commissioner of Taxation of the Commonwealth of Australia,[13] in giving the advice of the Judicial Committee, Lord Denning said that in the phrase

"purpose or effect" in the Australian general anti-avoidance provision of that time the word "purpose" meant not motive but the effect which it was sought to achieve - the end in view.

The word "effect" meant the end accomplished or achieved.

It was necessary, his Lordship said, to look at the arrangement itself and see its effect irrespective of the motives of the person who made it.

The position is summed up in a passage from the advice of the Privy Council in Ashton v Commissioner of Inland Revenue,[14] where Viscount Dilhorne said:

> "If an arrangement has a particular purpose, then that will be its intended effect.
>
> If it has a particular effect, then that will be its purpose and oral evidence to show that it has a different purpose or different effect to that which is shown by the arrangement itself is irrelevant to the determination of the question whether the arrangement has or purports to have the purpose or effect of in any way altering the incidence of income tax or relieving any person from his liability to pay income tax."

The intention of the act stands defeated if an arrangement has been structured to enable the avoidance of output tax, or the obtaining of an input deduction in circumstances where that consequence is outside the purpose and contemplation of the relevant statutory provisions.

Compliance and administration costs preclude perfect neutrality ever achieved.[15] It may be kept in mind that sales tax is a multi-stage tax imposed on the value-added at every stage of the business activity by which goods or services reach the ultimate consumer.[16]

The consideration on which the parties act upon can be expected to be an open market price.

Where parties are associated persons and hence are not at arm's length, there is obvious potential for adoption of an unrealistic value which may create distortion, and the act, therefore, requires an accounting on the basis of an open market price, which is either the value the goods or services would normally fetch or as determined by the commissioner in accordance with a method provided in the act, on the basis of a sufficiently objective approximation.

There is, however, potential for registered taxpayers knowingly or otherwise to create distortions at the boundary between themselves and unregistered persons.

The same can occur where transactions are between those registered on payments basis and those registered on an invoice basis (as in Ch'elle and Nicholls v Commissioner of Inland Revenue[17]).

The general anti-avoidance provision is available to stop or counteract both these distortions.

The possibility of distortion exists in the former situation because, in order to preserve neutrality where a registered person is acquiring goods from an unregistered person, it is necessary to allow the registered person to claim an input tax credit which reflects the sales tax already included in the acquisition price.

Otherwise, there would not be neutrality because taxable goods would be taxed twice and would thus bear a higher tax burden.

Neutrality can be achieved by providing a special regime in respect of specified goods,[18] which permits an input deduction for a notional tax element in the price paid by the registered purchaser notwithstanding that the unregistered vendor will not have to account for any corresponding amount of sales tax.

There is still likely to be the controlling influence of market forces where the parties are not associated persons but the absence of a sales tax accounting at both ends gives rise to the possibility of a transaction being structured so as to have the effect of producing an artificially enhanced consideration or an artificial advancement of the point at which a deduction is claimable.[19]

The whole premise of the act is that transactions will be driven by market forces: that their commercial and fiscal effects will be produced by those forces and will not contain distortions which affect (ie defeat) the contemplated application of the act.

It is when market forces do not prevail that provisions of section 2(46) are available to the commissioner.

Take an obvious example, an unregistered vendor and a registered purchaser, not being associated persons, inflate the price of goods in return for a non-recourse loan to the purchaser by the vendor.

The purchaser obtains the advantage of a higher input tax deduction/refund.

This would plainly defeat the intent and application of the act, namely that the purchaser's deduction would be no more than the tax fraction of the market price of the goods.

If the prices were influenced by the tax advantage, the purchaser may be achieving something not contemplated by the act - an artificially enhanced deduction.

It is the same if the structure of the transaction enables the purchaser to obtain an artificially early deduction, that is, one which is unrelated to the market realities of the transaction.

It may be said that to approach the question of the intent and application of the act in this way is not to respect the bargain struck by the parties and would allow the commissioner to restructure their bargain for them with different sales tax consequences, and would thus be productive of uncertainty.

But that uncertainty is inherent where transactions have artificial features combined with advantageous tax consequences not contemplated by the scheme and purpose of the act.

There will also inevitably be uncertainty whenever a taxing statute contains a general anti-avoidance provision intended to deal with and counteract such artificially favourable transactions.

It is simply not possible to meet the objectives of a general anti-avoidance provision by the use, for example, of precise definitions, as may be able to be done where an anti-avoidance provision is directed at a specified type of transaction.

Transactions which are driven only by commercial imperatives are unlikely to produce tax consequences outside the purpose of the legislation and, in any isolated case in which the commercial drivers do have unusual consequences, the existence of those consequences will surely alert the parties to the possibility that the commissioner may consider invoking the general anti-avoidance provision and may have to be persuaded that the intent of the legislation is not actually offended.

For example, an advance ruling can be sought.

Because, it is not the price but the "payment" that creates the distorting effect.[20]

It may be stated that, the commissioner may properly be satisfied that the arrangement was entered into between the parties to defeat the intent and application of the act, and he may treat such arrangements to be void for the purposes of the act.

The commissioner may then adjust the amount of the tax which is refundable "in such a manner as the commissioner considers appropriate so as to counteract any tax advantage obtained ...

from or under that arrangement".[21]

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1. Section 3 of the Sales Tax Act, 1990 (hereinafter referred to as the Act).
2. In respect of a taxable supply, the consideration in money including all Federal and Provincial duties and taxes, if any, which the supplier receives from the recipient for that supply but excluding the amount of tax.
3. Id n.1
4. Sub-section (12) of Section 2 of the Act.
5. Sub-section (46) of Section 2 of the Act.
6. Id n.4
7. Id n.4
8. Sub-section (46) of Section 2 of the Act, 1990.
9. Provided that the tax invoice shows the discounted price and the related tax and the discount allowed is in conformity with the normal business practices.
10. By the Valuation Committee comprising representatives of trade and the Inland Revenue constituted by the Commissioner.
11. In terms of the sub section (46) of Section 2
12. See the circumstances as defined in sub-section (46) of Section (2) of the Act.
13. Newton v CIT: (1958) AC 450.
14. Ashton v CIR: [1975] 32 NZLR 717.
15. Clough, A Study of New Zealand's Experience with the Goods and Services Tax (1958) Working Paper 1988/27 (Wellington: NZIER).
16. Tait, Alan A.: Value Added Tax: International Practice and Problems: International Monetary Fund Washington, D.C. (1988).
17. Nicholls v CIR (1999) 19 NZTC 15.
18. See Section 2 of the Act.
19. Ben Nevis Forestry Ventures Ltd v CIR [2008] NZSC 115.
20. Id n.3 ante.
21. See Section 2(46) of the Act.

SECP issues orders, warning letters

In order to develop an efficient and dynamic securities market and to safeguard the investors' interest, the Securities Market Division of the Securities and Exchange Commission of Pakistan took enforcement actions and penalised the market participants for non-compliance to the regulatory framework during December 2011, a statement said on Monday.

An order was passed against Zafar Moti Capital Securities Limited, member Karachi Stock Exchange (KSE), under the Brokers and Agents Registration Rules, 2001, whereby the registration of the brokerage house was suspended for 15 days for non-compliance to the commission's earlier orders.

Furthermore, a show-cause notice was served to a commercial bank under Section 15E of the Securities and Exchange Ordinance, 1969 and to a brokerage house of the KSE under Section 22 of the Securities and Exchange Ordinance, 1969, it said.

In two separate instances, warning letters were issued to two brokerage houses of the KSE and two individual investors for execution of wash trades, the statement said.

Warning letters were also issued to two brokers of the KSE and the Lahore Stock Exchange (LSE) for execution of blank sales. Moreover, two warning letters were issued to the directors of a listed company for non-compliance to Section 224 (4) of the Companies Ordinance, 1984, it said

The copies of all the warning letters are available on the SECP website. During the month, the SECP granted approval under Section 57(1) of the Companies Ordinance, 1984 to issue, circulate and publish the prospectus for issue of 12.50 million ordinary shares by the Next Capital Limited, it said, adding that 22 investor complaints pertaining to brokers and four complaints pertaining to listed companies were resolved.

Furthermore, three amendments were approved in the regulatory framework of the National Clearing Company of Pakistan Limited (NCCPL) and the Islamabad Stock Exchange (ISE), it added. – *Courtesy The News*

FBR chief for all efforts to achieve target

Chairman Federal Board of Revenue (FBR) Salman Siddique on Monday has directed the tax commissioners to expedite the process of bringing non taxpayers into the tax net and take every possible step for revenue generation so annual tax target of Rs 1952 billion be achieved at the end of June 30.

He said this while chairing a meeting of all chief commissioners of the Large Taxpayers Units (LTU) and Regional Tax Offices (RTO) at FBR headquarters. Sources told that meeting showed satisfaction over the revenue collection of the first half (July-December) of the ongoing financial year 2011-2012.

Sources said that the meeting was informed that FBR has achieved 43 per cent collection of the overall target, as it collected Rs 840 billion in July-December period against the overall target of Rs 1952 billion set for the current fiscal year. The government has collected Rs 840.7 billion during July-December 2011-2012 period against 661.7 billion of July-December 2010-2011, which showed handsome growth of over 27 per cent in one year. According to the provisional figures, the FBR through casher-porting system has collected Rs 201.7 billion during the month of December 2011 against the Rs 161 billion of the same month last year. It was agreed that more notices would be issued, to those who are enjoying luxury life but not paying taxes, in next few months.

Sources said that meeting also discussed several issues including collection of tax arrears, current demand of revenue, audit of withholding agents and post-refund audit. – *Courtesy The Nation*

Plan to phase out FED in three years readied

The Federal Board of Revenue has developed a new dynamic plan to phase out federal excise duty in three years.

The Revenue Division's Year Book 2010-11 issued by the FBR's research team of the Strategic Planning, Research and Statistics Wing here on Monday said the special excise duties and most of regulatory duties have been abolished and a plan to phase out FED in three years has been developed.

The FBR is geared to look forward and devise strategic initiatives to generate more revenues in coming years.

These included a move towards two main taxes (income tax and sales tax), which is already under way.

The report said that the FBR is in the process of developing a fully automated refund processing system to ensure expeditious settlement of refund claims.

An initiative for electronic payment is under process and is expected to be completed by end of this year.

More than 700,000 potential taxpayers were identified through data matching.

The notices have been sent and a provisional assessment is being made.

Moreover, the Afghan Transit Trade Agreement (APTTA) has been signed between Pakistan and Afghanistan.

Under the agreement it has been made mandatory to submit financial guarantees equivalent to taxes releasable on cross-match of data with Afghan Customs.

The annual report (2010-11) said that the size of Public Sector Development Programme (PSDP) was slashed which adversely affected the collection under WHT on contracts and supplies.

It may also be highlighted that the capital value tax (CVT) has been transferred to provinces from 2010-11 under the 18th Amendment whereas substantial amount was collected under CVT last year.

Similarly, it was anticipated that an amount of about Rs 5 billion would be collected on account of levy of capital gain tax on stock market.

In contrary, negligible amount of less than hundred million has been realised so far.

Keeping in view the deteriorated economic conditions and as a result low resource mobilisation, the government introduced reform initiatives effective 15th March 2011 to meet the growing need of the flood affected people and reach the assigned target.

These measures includes levy of one time 15% surcharge on income and advance taxes for 3.5 months, increase the rate of special excise duty (SED) both at import and domestic stages from 1% to 2.5%, withdrawal of special regime of assessable price for levy of GST @ 8% on actual value of sugar and removal of SRO based exemptions from fertiliser, pesticides and tractors and elimination of zero-rating from plant, machinery & equipment and also restrict zero rating to registered persons for export of textile, leather, carpet, sports goods and surgical goods.

A total of Rs 29.4 billion was realised from these measures during 2010-11.

The FBR has been able to collect net revenue amounting to Rs 1,558 billion at the end of the year; despite 76.3% higher sales tax refunds (Rs 50.8 billion in fiscal: 2011 versus Rs 28.8 billion FY: 2010.

The growth in net collection has been 17.4% over the actual realisation of Rs 1,327.4 billion during fiscal: 2009-10.

While analysing federal taxes by its contribution in total receipts, the FBR said that the contribution of direct taxes during July-June, 2010-11 has marginally decreased to 38.7% from 39.6% in previous fiscal year.

On the contrary, the share of sales tax on imports has increased to 19.8% from 18.6% during last FY.

Major reason for rapid growth in the collection is due to increase in the value of imports during the period under review.

The contribution of customs duty and federal excise has been 11.9% and 8.8% respectively, the yearbook added. – *Courtesy Business Recorder*

Second-half revenue strategy approved by FBR

The Federal Board of Revenue has approved a national revenue strategy for second half (January-June) 2011-12 to generate an additional amount of Rs 50-60 billion through administrative and enforcement actions in the remaining period of current fiscal year for meeting the laid down annual revenue collection target of Rs 1,952 billion in 2011-12.

Sources told on Monday that the strategy to generate maximum revenue in the third quarter (January-March) 2011-12 was discussed during the 8th Chief Commissioners' Conference held with the FBR Chairman Salman Siddiq in the chair at the FBR House.

The national revenue strategy to achieve the budget targets for January, February and March 2012 has been finalised by the Chief Commissioners of the LTUs/RTOs under the guidance of FBR Member Inland Revenue.

The administrative and enforcement action to be taken in the second half of 2011-12 included recovery of tax arrears, broadening the tax base, audit, recovery of illegal tax adjustments and compliance of tax laws by the withholding tax agents.

The FBR has already generated additional revenue of Rs 25-30 billion from administrative and enforcement measures and remaining amount would also be recovered during the second half of 2011-12.

It has also been decided to raise income tax demands through effective audit of the registered units to improve revenue collection.

The FBR has decided to raise the income tax demand in cases where due tax is admissible in gross cases of concealment of income and under-statements.

At the same time, FBR would focus on withholding agents to enforce filing of tax statements by the agents to obtain information about the payees and from whom tax has been deducted.

The un-registered withholding agents would be registered and amount of tax deducted by these agents would be recovered.

The recovery of income tax surcharge wherever applicable would be ensured so that all persons liable to pay surcharge must have discharge their responsibility.

The FBR has estimated to recover around Rs 20 billion from income tax surcharge from concerned units including corporate entities.

The Chief Commissioners and tax authorities also discussed the strategy for selection of cases for audit through random balloting to be held next week.

The FBR had earlier decided to convene the random balloting at the FBR House last week and later it was decided to complete the task in next week.

It has yet to be decided whether the computerised random balloting would be done and what would be the mechanism for such kind of balloting for audit selection purposes.

There was a general consensus in the conference that the Chief Commissioners of Large Taxpayer Units (LTUs) and Regional Tax Offices (RTOs) would maximise their efforts to achieve the budgetary target for third quarter (January-March) 2011-12.

This would reduce burden on the field formations in the last quarter for meeting the annual tax projections of Rs 1952 billion by the end of current fiscal year.

During the conference, tax authorities have directed the Chief Commissioners of Faisalabad, Sialkot and Gujranwala to make extra efforts for improving revenue collection in the remaining period of current fiscal.

While reviewing the overall performance of the Chief Commissioners of the RTOs, it was observed that the performance of some Chief Commissioners needs to be improved in the remaining period of current fiscal.

To check the wrong use of information during broadening the tax-base, the FBR has decided to place some checks on the users of the computers maintaining credible information about the newly discovered taxpayers to prevent any kind of misuse of the information.

In this regard, the returns data would be accessed through the computers by placing some checks in the system.

The purpose of the exercise is to check any misuse of the sensitive information of the taxpayers declared in their returns.

On the issue of broadening the tax-base, Director General Intelligence and Investigation Inland Revenue gave a presentation on the measures to further expand the tax net.

It has been decided that the data would be shared among the Chief Commissioners of RTOs to check and verify declarations made by the potential taxpayers under the ongoing exercise of documentation.

The sharing of data between the Chief Commissioners of RTOs would further facilitate the tax department in checking the authenticity of the declared data through verification with the available databank of the FBR.

The cross matching of data has been allowed by sharing of information simultaneously among the Chief Commissioners of RTOs.

It has been decided that the notices would be issued to all remaining persons who have not filed their income tax returns and statements.

The whole exercise would be competed in the next 1-2 months to ensure recovery from April 2012 from non-compliant persons and newly registered persons.

It has also been decided that the FBR will take action against non-filers of income tax returns, particularly nearly 1.6 million NTN holders, for tax year 2011 from January 2012.

Out of 3.2 million NTN holders, around 50 percent are non-filers of returns, and action would also be taken against these non-filer NTN holders.

Thus, nearly 1.6 million NTN holders have failed to file their returns for the tax year 2011.

Sources said that the FBR has also directed the Chief Commissioners of RTOs to verify the agricultural income declared by the newly discovered taxpayers.

In this connection, the Chief Commissioners of RTOs would write to the concerned Provincial Chief Secretaries to verify the authenticity of the declared agriculture income with the help of provincial database.

While congratulating the Chief Commissioners on their performance during first half of current fiscal, FBR Chairman Salman Siddiqui directed the Chief Commissioners of RTOs to bring the owners of big houses and vehicles into the tax net.

The exercise of documentation would be intensified for bringing rich persons into the tax net.

FBR Chairman was very happy over the performance of the Chief Commissioners of the LTUs and the RTOs and congregated them for showing good performance during the first half of current fiscal.

FBR Chairman and FBR Member Inland Revenue were confident to achieve the ambitious revenue collection target of Rs 1952 billion keeping in view 27 percent growth in revenue.

Tax authorities showed full confidence in the Chief Commissioners of the LTUs and the RTOs with the hope that the field formations would be able to continue to maintain momentum in growth in revenue collection during the remaining period of current fiscal.

The FBR Chairman was also happy over the teamwork and efforts made by the field formations in meeting the assigned targets during the first half of 2011-12 and it is expected that the field officers would continue to maintain momentum of revenue collection during January-June period of 2011-12.

Tax authorities have also appreciated the field formations for completing the difficult task of meeting the revenue collection targets during first half of 2011-12.

Director General Customs Intelligence also informed the conference about the update on recovery of illegal tax adjustments detected by the directorate in the past.

It was informed that the directorate of intelligence Customs had recovered an amount over and above Rs 2.4 billion from the claimants of illegal input tax adjustments.

It was prime responsibility of the field formations to check issuance of fake/flying invoices and fraudulent tax adjustments in the field formations.

Similarly, field formations have to take proper measures to avert such kinds of mega scams.

However, the field formations should be more careful in future to check the fraudulent input tax adjustments through proper audit and verifications of payments within the entire supply chain under relevant provisions of the Sales Tax Act 1990.

The Director General Intelligence Customs was hopeful to recover the remaining amount of nearly Rs 30 billion in future, DG intelligence informed the conference.

On the issue of new amnesty scheme for the sales tax defaulters or claimants of illegal input tax adjustments, the conference has not taken any decision for the announcement of the scheme.

It was pointed out that one way is to legally pursue these cases in courts to recover the illegal adjustments claimed by the registered persons.

The second option is to pt the method to recover defaulted amount more quickly without fighting in the courts.

However, the FBR has not taken any final decision during the conference on any amnesty scheme for the tax defaulters.

FBR Member Legal gave an overview on court cases and recovery position in major cases.

FBR Member Taxpayer Unit also shared latest position of the Isaf/Nato containers case.

The conference also reviewed the progress on liquidation of sales tax refunds up to Rs 100,00 up to December 2011 and strategy to liquidate the balance returns by January 31, 2012 has been finalised during the conference, sources added. – *Courtesy Business Recorder*

GST paid on uncollected power bills: Pepco claims Rs 29.557 billion adjustment by FBR

An amount of Rs 29.557 billion was paid up to June 30, 2011, by Pakistan Electric Power Company (Pepco) to the Federal Board of Revenue (FBR), on account of general sales tax (GST) on uncollected electricity bills.

Sources told here on Monday that Pepco has taken up the matter with the Federal Board of Revenue (FBR), arguing that it be allowed to pay GST on only those electricity bills that have been cleared by the customers, instead of the billed amount, which includes bills which have not been cleared by customers.

This issue was raised during the meetings of the Cabinet Committee on Energy, constituted by the Prime Minister.

On the recommendations of the Energy Committee, the government decided that GST on uncollected electricity bills would be adjusted against the amount due to be paid by Pepco on recently issued bills, or future billing.

Sources said that Pepco is seriously concerned, as FBR has not yet issued notification in the light of the decision taken by the Cabinet Committee on Energy for adjustment of GST paid on uncollected bills against future billing.

The FBR was collecting GST on 100 percent billing, whereas the recovery of Pepco is around 70 percent.

Sources said that Cabinet Committee on Circular Debt has, reportedly, estimated that around Rs 10 billion GST collected is attributable to un-collected power bills.

This issue can only be resolved if the FBR issues the necessary notification which, to date, it has not done.

When contacted, a tax expert said that commercial and industrial consumers of electricity are paying withholding tax and general sales tax (GST) on power bills while domestic consumers of electricity pay only sales tax on electricity bills.

Sales tax collections from electricity bills showed an increase of 38.8 percent during 2010-11 as compared to year before.

The withholding tax collected from electricity stood at Rs 14.313 billion during 2010-11 against Rs 15.471 billion in 2009-10, reflecting a decrease of 17.5 percent.

Within net domestic sales tax collection, major contribution has come from POL products, telecom, services, natural gas, electricity and cigarettes etc during this period.

The sales tax collection on electricity during 2010-11 improved by 38.8 percent despite increase of 39.2 percent higher growth in the refund payments.

The FBR data further showed that the sales tax collection from electricity amounted to Rs 8.190 billion during 2010-11 against Rs 5.900 billion in 2009-10, reflecting an increase of 2.2 percent. – *Courtesy Business Recorder*

Taxpayers face hardships due to flaws in FBR electronic system

Taxpayers are facing hardships in fulfilling obligations as electronic system of the Federal Board of Revenue (FBR) is refusing revised income tax and sales tax returns, a senior tax official said on Tuesday.

"Several taxpayers have approached the tax departments as their revised returns are not accepted," the official said. The electronic system is developed by the Pakistan Revenue Automation (Pvt) Limited (PRAL) for the FBR and from July 1 it was made mandatory for filing tax returns and statement through electronic mode.

A recent case was identified as a public sector bank was trying to update its tax return for the year 2010, but despite several attempts it failed to do so.

The bank approached PRAL support team several times, but it failed to get assistance. The tax officials at the Regional Tax Office and Large Taxpayers Unit identified several other issues pertaining to the electronic system, which PRAL failed to facilitate.

The officials informed that the taxpayers complained about filing monthly withholding tax statement. Similarly, revised return of annual income tax return, which is provided under Section 114 (6) of the Income Tax Ordinance, 2001 was also not entertained.

"The taxpayers are unable to file revised sales tax returns," an official said. "Such an issue also obstructs the tax payment because taxpayers are of the view that once their revised return is accepted then they would make payment for further period," the official added.

The tax officials said that besides these issues the electronic system is also not allowing adjustment of Workers Welfare Fund (WWF) against other taxes. They said that the system is calculating the flood surcharge itself and the taxpayers are unable to calculate it as per their interpretation.

Recently, an official communication was sent to Member Inland Revenue (IR), FBR, to expose flaws in the PRAL developed system as billions of refunds were stuck up. "Refunds worth billions of rupees have been stuck up due to problems," an official, quoting the communication, said.

The tax officials are unhappy with the performance of PRAL for providing IT support to the revenue body and identified several issues, the official said, adding that recently a detailed presentation was made before the high-ups of the revenue body about the issues.

PRAL was established in 1994 as a private limited company. It is a subsidiary and (Data Arm) of the FBR. It is providing solutions pertaining to income tax, wealth tax, general sales tax, federal excise duty, customs duty, capital value tax, provincial cess and property tax. The tax officials in the presentation stressed upon the need to improve PRAL infrastructure, especially in hardware, besides problems with the main server and slow log in. – *Courtesy The News*

Action against currency speculation: SBP reduces 2 banks' NOP, warns others

The State Bank of Pakistan (SBP) has taken action against two banks by reducing Net Open Position (NOP) and warning other banks not to take unnecessary position against the rupee, as a result the rupee strengthened by 70 paisa against dollar in inter-bank market on Tuesday.

The dollar rate declined to Rs 90.10 in inter-bank market from Rs 90.80. Although the dollar posted huge decline in the inter-bank market because of SBP move, the demand for dollars remained unabated due to growing political uncertainty in Islamabad. As a result, the rupee value against dollar stood at 91.20 in the open market.

According to sources, the Nestro limits of NIB Bank and Samba Bank were reduced by SBP on Tuesday. Officials of the State bank called treasurers of all major banks to inform them of possible SBP action in case the central bank sees that banks are speculating in rupee and creating demand for dollars without booking/backing of trade deals.

The SBP action was meant to pressurise the banks to bring back dollars held abroad to undertake commitments given to the traders against import letters of credit (LCs), they added.

According to open market sources, politicians and officials who have money to hide are aggressively persuading the Hundi and Hawala dealers for transfers of funds to abroad, especially to Dubai.

Besides rupee depreciation, real state prices have also rebounded as large numbers of people with tax evaded money are seeking to park their wealth in real state.

According to a real state broker, the difference between the registered price of property and the transaction price is gradually increasing and has reached a huge level. A thousand yards plot in Phase 8 of DHA Karachi is registered on value of Rs 1.6 million, whereas the actual transaction price was Rs 25 million, he said.

The money market appreciated the SBP's move against the NOP and said that it will put positive results on the currency market. “It was our demand to check and take action against the NOPs of banks as there were some complaints that banks were holding over limit stocks of foreign currency”.

NOP is the net balance sheet exposure of a bank in foreign currency. – *Courtesy Business Recorder*

Tariff regime to be rationalised to woo investors: CCoI meeting to be held every quarter

Prime Minister Yousuf Raza Gilani presided over a meeting of the Cabinet Committee on Investment (CCoI) on Tuesday.

The meeting was attended by Minister for Finance Dr Abdul Hafeez Sheikh, Minister for Petroleum and Natural Resources Dr Asim Hussain, Minister for Privatisation, Chairman of FBR, Chairman, Board of Investment, and the senior officials of the Planning Commission, Ministries of Finance and Industries.

The meeting decided to rationalise the tariff regime in a way so as to attract foreign investment in the country, so important to accelerate the process of national development.

It was decided that the meeting of the Cabinet Committee on Investment would be held quarterly to review the investment policy with a view to attracting foreign investment by convincing the potential foreign investors that Pakistan is the best destination to do business.

It was also decided that utmost endeavours would be put in place to enhance the capacity of BoI so that it could promptly respond to the emerging challenges and capitalise on the opportunities in the investment sector while keeping in view the imperatives of the country's economy.

It was also decided that individual cases for tariff exemptions be brought up only after examining the linkages and implications for other segments of the industry.

The meeting also discussed matters pertaining to import of CNG buses and setting up of motorcycle factory in Pakistan along with transfer of technology.

The Prime Minister referred the matter to the Committee headed by Deputy Chairman of Planning Commission to decide the matter in a way so as to facilitate foreign investment in the country.

Other members of the committee were Secretaries of the Ministries of Finance, Industry, BOI, Commerce and Chairman of FBR. – *Courtesy Business Recorder*

Parametric selection of cases: FBR finalises new plan for audit

The Federal Board of Revenue (FBR) has finalised a new plan for parametric selection of cases for audit to ensure monitoring of all stages of audit by the Centralised Tax Audit Task Force to complete the whole exercise in a transparent manner.

Sources told here on Tuesday that the parametric selection of cases for income tax and sales tax audit would be preferred instead of random balloting.

The field formations have limited their selection of cases for audit for the tax year 2010 to 50 percent.

The remaining 50 percent cases would be selected directly by FBR by applying parameters through computerised system on the basis of approved risk criteria.

The parametric selection of cases for audit would be done in cases where the Large Taxpayer Units and Regional Tax Offices (RTOs) had not picked corporate sector, associations of persons (AOPs), business individuals and withholding agents for tax year 2010 under the 'National Annual Audit Plan 2011-12'.

The FBR will shortly give final approval of the new plan for the parametric selection of cases for income tax and sales tax audit.

It is expected that 16 upgraded parameters would be applied for selection of cases in the corporate sector whereas 20 improved parameters for selection of cases of the AOPs.

Under the new procedure, the discretionary powers of the audit officials have been limited to ensure completion of the exercise without physical interaction with the taxpayers.

The Centralised Tax Audit Task Force has been given prime responsibility to monitor all stages of audit starting from issuance of notices to completion of the audit exercise.

In this regard, the FBR will first select cases for audit on the basis of refined parameters for corporate sector and AOPs.

In the next phase, the cases of business individuals and withholding agents would also be selected for audit.

The data of the selected cases would be entered in the Tax Audit Management System (TAMS) for electronic transmission of information of cases to the relevant RTO.

The Inland Revenue officials including FBR Member IR, officials of FBR Taxpayer Audit Wing and Chief Commissioners of the RTOs would simultaneously have access the “E-Folder” having information about the ongoing audit of the corporate entities and AOPs.

Without physically going to the unit, all concerned officials would have direct access to the “E-Folder” of the audited unit.

One of the important tasks of the Centralised Tax Audit Task Force is to ensure timely completion of the audit of cases selected on the basis of parameters.

The Task Force would also ensure quality of audit on the basis of available records.

This is a major initiative of the FBR's Taxpayer unit Wing in devising a methodology to ensure audit of the corporate sector and the AOPs without causing any problem to the registered unit.

The Task Force would exclusively deal with selection of risk-based audits based on analysis of information available in FBR's Data Warehouse.

In order to ensure transparency in audit process, the FBR has also decided that sample checking of cases would also be done to analyse the findings of the audit vis-à-vis parameters of selection of cases.

The sample checking of cases would result in keeping a close watch on the audit being conducted on the basis of parameters.

The Centralised Tax Audit Task Force will also provide opportunity to the registered units to file any complaints against the audit officials in cases of any harassment, if necessary.

In this way, Centralised Tax Audit Task Force would be able to ensure electronic monitoring of the audit exercise.

Sources said that the FBR will also make it mandatory for the audit officials to submit monthly report on the progress of audit in cases selected on the basis of parameters.

The FBR will continue to apply the audit policy guidelines for audit of cases selected on the basis of parameters.

According to the audit policy guidelines (2011-12), the audits of the taxpayers are to be made only for the tax year 2010 of income tax and corresponding tax periods of sales tax and federal excise.

If audit of preceding years is considered necessary, then after recording reasons in writing, the trail of audit may be extended with prior approval of the Chief Commissioner.

The reasons for initiation of audit and issuance of notice may be communicated to the taxpayers under the signatures of the Commissioners of Inland Revenue in the light of relevant statutes.

The FBR said that the cases for audits shall mainly be selected by the Commissioners based on the risk factors developed by FBR.

However, he may also select cases for audit on the basis of his local knowledge.

The number of such cases must not exceed 20 percent of the total cases selected for audit.

The FBR's audit policy guidelines further said that list of cases selected for audit for tax year 2010 and corresponding tax periods for ST & FED may be sent to the Board for record immediately after issuance of notices.

The audits under the Annual Audit Plan (2011-12) are to be finalised during the current financial year.

However, field formations may prioritise audit cases based on risk-assessment and initiate cases simultaneously, or stepwise, in view of the availability and capacity of audit officers.

The audit of withholding tax agents and sales tax refund shall continue as per existing instructions, the FBR maintained.

The audit policy guidelines further show that in case where audit of the taxpayer has already been conducted for the tax year 2009 in respect of income tax, sales tax and federal excise, the same may not generally be conducted again.

However, if in the opinion of Commissioner, audit for the tax year 2010 and corresponding tax periods of sales tax/FED is still necessary, the Chief Commissioner may then ask for permission from the Board explaining the reasons along with copies of the pervious audit reports.

The audit policy guidelines stated that the Commissioner shall assign cases for audit to the relevant audit teams to be headed by an officer of appropriate level.

Sectoral expertise of team members may also be kept in view.

Assessment in all cases selected for audit where tangible discrepancies have been found which remained unexplained or explanation offered by the taxpayers is not considered satisfactory, must be made under normal law and no agreement with the taxpayer is to be made in that respect, the FBR added. – *Courtesy Business Recorder*

Import of 128 items, raw materials and inputs: FBR decides to apply reduced rate of 1 percent IT

The Federal Board of Revenue (FBR) has decided to apply a reduced rate of one percent income tax on the import of 128 items, raw materials and inputs on which sales tax will be charged at zero-rate or reduced rate of 5 percent for five export-oriented sectors and commercial importers under new zero-rating regime.

Sources told here on Tuesday that the FBR will issue a clarification to the Model Customs Collectorates (MCCs) to charge reduced rate of one percent withholding tax on the imports made under the SRO.1125 (I)/2011.

This is a major facilitative measure to apply reduced rate on the import of raw materials, inputs and goods made by commercial importers as well as non-zero rated sectors.

Thus, all categories of importers covered under the new zero-rated regime would be entitled to concessionary rate of one percent withholding tax at the import stage.

The concessionary regime of income tax in the form of reduced rate of one percent at the import stage would continue for the persons availing the benefits of the SRO.1125 (I)/2011.

The FBR had notified list of 128 items through a SRO.1125 (I)/2011 and the final list of raw materials, inputs and goods was duly accepted by the commercial importers and all other stakeholders.

The Board has received various queries from the customs officials as well as stakeholders about the status of the applicability of the income tax to be charged on the imports made under the newly revamped zero-rating regime.

Through a clarification, the FBR will inform the field formations that the reduced rate of one percent income tax would be charged on the import raw materials and inputs under the new zero-rating regime, sources added.

Under the new notification, ie, SRO.1125 (I)/2011, the FBR has notified goods falling under the PCT headings including the goods or class of goods mentioned in the conditions stated in the new notification, to be the goods on which sales tax shall, subject to the laid down conditions, be charged at zero-rate or, as the case may be, at the rate of five percent or 16 percent wherever applicable to the extent and in the manner as specified in the conditions. – *Courtesy Business Recorder*

Poor households receive only 10 percent of Rs 350 billion tariff differential subsidies

Poor households receive only 10 percent of the 350 billion tariff differential subsidies earmarked for 2011-12 while the majority of the subsidy goes to the richest 40 percent of households, documents available exclusively with this correspondent reveal.

The tariff structure does not match the consumption pattern of poor households as there is a low cut off point for life line consumers (50 Kwh per month) while over 50 percent of the poorest households consume 50 to 100 Kwh per month.

Additionally significant subsidies are extended for the first 300 Kwh per month and not only poor households benefit from such subsidies, which is contrary to promoting conservation and efficiency, a presentation by the Planning Commission to be delivered Wednesday (today) reveals:

The inter-circular debt has escalated to around 370 billion rupees.

Each month 30 billion rupees are added to the circular debt on account of tariff differential subsidies (estimated at over 350 billion rupees) as well as lower collection, late payment surcharge to IPPs, loss of fuel adjustment surcharge and high non-technical T and D losses (estimated at around 10 to 12 percent inclusive of theft, non-payment of bills, defective meters and unmetered supply).

The stay order on fuel adjustment surcharge is further adding to the circular debt.

The accumulating circular debt has reached the proportions with the potential to cause major defaults across the economy, the presentation warns.

The impact of the circular debt and subsidy is a huge drain on government resources and estimates indicate over one trillion rupees paid to the power sector in 3 years (2.5 percent of GDP).

The loss to GDP is estimated at 3 to 4 percent and accounts for unemployment of about 10 percent of the work force.

The document acknowledges that there is lack of implementation of some critical reforms and projects.

Growth in primary energy supplies for the last three years is dismal 1.34 percent per annum.

The way forward as per the Planning Commission for dealing with significant lack of investment resources compared to projected requirements and low investor perception about Pakistan aggravated by circular debt is: (i) prioritise investments; (ii) promote public private sector partnership; (iii) introduce special purpose vehicles to meet financing needs of large hydro-power and coal projects; (iv) revitalise privatisation programme and ensure timely commissioning of 7,600MW in process IPPs by 2017; (v) allow feed in tariffs (say 5 per cent discount over average generation costs).

The Government of Sindh should, as per the presentations' recommendation assign top priority to infrastructure in Thar.

It also recommends completing the following reforms/restructuring among others: (i) enhancement of the regulatory role of NEPRA; (ii) dissolution of Pepco not yet achieved; (iii) commercialisation and improved governance of public sector energy companies and strengthening CPPA; (iii) scattered policies need to be implemented; (iv) an objective review of well head gas prices based on production costs and profitability for all on-going concessions; (vi) formation of energy ministry but suggested that prior to its formation the secretariat for the development overall co-ordination and dissemination of the energy policy document be the energy wing of the Planning Commission.

In Way Forward, the Planning Commission also recommended that an effective Planning Cell should be created to improve integrated power sector planning for efficient and timely investment, production and evacuation of power while NEPRA to be activated as a proper, independent and forceful regulator.

For power sector reforms and restructuring, it is recommended to create a Ministry of Energy.

It is also recommended to the government that to upstream policy and regulatory framework requires immediate attention of MPNR with proactive polices and incentives to exploit the huge gas resources and scattered polices need to be integrated into one comprehensive policy.

Similarly, a proactive downstream policy should be announced with proper incentives at par with the international markets.

Oil industry that stimulates efficient growth of the sector.

The Planning Commission also recommended in Way Forward that local refineries should be upgraded/expanded to improve yield value and meet Euro-II specifications with a time frame to meet Euro-III and IV specs.

The Power plants should switch to FO 380 Cst(Cheaper and readily available in international markets) while a news refinery should be initiated in the private sector, etc.

The Planning Commission further recommended the government that PSO should enhance its oil trading and vessel chartering expertise while as an alternative oil procurement can be out scoured based on performance contracts.

The OGRA should develop benchmark for import of refined products.

There should be signal ownership for logistics development, strategic stocks and linkage with oil/energy plan: i) A national oil logistics study should be conducted; ii) port capabilities should be enhanced to berth larger vessels; iii) Projects for improving port logistics should be expedited, eg, a 52km white oil pipeline linking KPT-PAPCO terminals($26 million).

It was further recommended about oil sector that a proper road map should be developed for deregulation of petroleum prices to provide correct signals to the private sector.

An announcement should be made to discontinue refinery support within three years to encourage upgrading of capacity and improve efficiency and the required amendment of the OGRA Ordinance 2002 should be expedited, etc.

A transparent mechanism be introduced for gas pricing with the following scope: i) encourage efficiency of use and trigger switching to least cost alternate fuels as an economic consumer choice; ii) charge full cost of supply from local and import sources; iii) minimise cross subsidies (unified prices except for life line consumers), etc.

Direct subsidies should be paid special consumers, eg, fertilisers to ensure uniformity of sale prices and transparency in subsidy.

Inter State Gas Systems (ISGS) should be made focal point for LNG import.

Funding support and technical assistance can be requested from international donors: expedite the pipeline to tie LNG terminal to SSGC and augment the SSGC-SNGPL network, etc.

Ministry of Petroleum and Natural Resources(MPNR) should review option for reforms: i) Arms length compensation mechanism for gas utilities which will provide the enabling environment to pursue economic expansion of gas network, maximise efficiency and reduce UFG; ii) a single entity for bulk gas transmission and a No of gas distribution companies, etc. – *Courtesy Business Recorder*

Four IR officers named in ST refund fraud

The Directorate-General, Intelligence and Investigation (DGI&I) of Federal Board of Revenue (FBR), Karachi, on Tuesday nominated four Inland Revenue officers for alleged involvement in multibillion rupees sales tax refunds fraud.

According to sources, the DGI&I in its challan, submitted in Customs Court, nominated four Inland Revenue officers--Ali Akbar Tunio, Khan Muhammad, Arshad and Azizullah Soomro--on charge of misconduct in the multibillion rupees fake sales tax refund fraud.

They said the department has also included the names of 100 fake companies, reportedly involved in this scam.

Sources said that these units, which were earlier asked to give evidence and produce documents pertaining to the sales tax refund claims, failed to produce the same.

Hence, the names of these units along with the said Inland Revenue officers were included in the challan.

They said the board had notified several items as zero rated items on supply and import to facilitate the business community but these registered units had misused the same and plotted this multibillion fake sales tax refund scam.

They said these registered units were not manufacturing units but they had shown taxable sales and got refunded billions of rupees sales tax from national exchequer.

DGI&I during initial investigation came to know that these units had provided financial shock of over Rs 6 billion to the national kitty.

The department is going to finalise the inquiry of some 3500 units in this scam and these units with the connivance of sales tax officers had fabricated this tax fraud.

Sources said they anticipated the amount involved in this scam would cross Rs 10 billion, and added that more challans would be submitted soon. – *Courtesy Business Recorder*

Netting non-taxpayers

To tighten the noose around persons who have taxable income but contribute nothing towards the national exchequer, the Federal Board of Revenue (FBR) is mulling a proposal for making NTN mandatory for all Pakistanis travelling abroad, official sources said Wednesday.

They said that the FBR has started work on proposals for the 2012-13 (FY13) budget and the prime focus in these proposals is to broaden the tax base. “One of proposals received by the FBR is to make NTN mandatory for all Pakistanis travelling abroad,” a senior tax official said while requesting anonymity.

Every year FBR invites budget proposals from all the regional tax offices (RTOs) and large taxpayers units (LTUs. These proposals are then finalised by a committee of the FBR for final recommendation to the finance ministry for making part of the federal budget.

The official said that the FBR had already identified 700,000 taxpayers through information available with the National Database and Registration Authority (NADRA). In all these cases the FBR had sent notices for filing their tax return but the result was not encouraging as most of addresses are not matched and identified persons are not taking serious towards their liabilities, the official added.

“The mandatory requirement of NTN will automatically bring people into the tax net as they will have to file their annual return,” the official said. He said another similar proposal was on the card as FBR may also make mandatory the requirement of NTN to individuals having membership of different clubs.

The FBR initiated a full-scale broadening the tax base drive in FY10 and identified several potential taxpayers. Despite clear identification due to political and other pressure groups the revenue department had failed to net those people.

According to latest data of achievement in broadening the tax base, the FBR identified 121,985 new taxpayers during first five months of current fiscal year that resulted in Rs206.75 million in revenue. This recovery is only 16 percent against notices issued worth Rs1.28 billion.

In Pakistan presently around three million people have NTN in the population of around 180 million. Experts said that efforts to broaden the tax base can double the number of taxpayers in a year but it will require political will.

The experts said that the debt burden of the country is increasing monstrously, fiscal deficit is getting beyond control, inflation is crushing the poor, taxes are being evaded and avoided by rich.

"The tragedy of the country is that rich and mighty are not only refusing to pay due taxes but also living luxurious at the taxpayers' expense," according to Dr. Ikramul Haq, a senior tax analyst. – *Courtesy The News*

Short-term action plan: FBR to fix minimum sale prices of 10 ST evasion-prone items

The Federal Board of Revenue (FBR) has decided to fix minimum sale price of 10 major retail items, prone to sales tax evasion, for improving domestic sales tax collection under a short-term action plan, which is likely to bring in Rs 1,112 billion for January-June period of 2011-12 fiscal year to meet annual target of Rs 1952 billion.

Sources told here on Wednesday that the FBR has drafted a new plan to ensure at least 24 percent growth in revenue collection figures during second half of 2011-12.

Besides administrative/enforcement measures, the FBR has proposed new procedural and legal action to improve tax collection in the second half of 2011-12.

One of the new measures is to fix minimum price, or value, of the items prone to sales tax evasion.

The fixation of minimum value, or price, of any commodity would ensure sales tax collection on the fixed value and at least revenue would start coming from major items prone to sales tax evasion.

Secondly, the fixation of minimum sale price of 10 items would suddenly improve domestic sales tax collection from these sectors which at present are contributing nothing or very negligible amount towards the sales tax.

According to the short-term revenue collection plan for January-June 2011-12, to stop the sales tax evasion due to the under-pricing of various domestic goods, Director General Intelligence and Investigation (I&I), FBR and Member (Admn), FBR shall prepare a proposal in consultation with FBR Member Inland Revenue (IR) for valuation and thereon inclusion of above 10 major evasion-prone items in the existing list of items minimum pricing at the retail level.

Sources said that FBR Chairman Salman Siddique has informed the tax managers that the FBR has achieved the first six monthly revenue collection target of Rs 840.7 billion for the period of July--

December, 2011, showing 27 percent growth over the collection of Rs 661 billion for the corresponding period of July-December, 2010.

The FBR has also quantified various factors contributing directly and indirectly to the revenue collection process and quantum.

The FBR Chairman, though, expressed satisfaction over the performance, yet stressed more upon concerns for the upcoming uphill target of Rs 1112 billion for the period of January-June, 2012, requiring 24 percent growth over the revenue of Rs 896.2 billion collected during the corresponding period of January-June, 2012.

FBR Member Strategic Planning and Statistics (SP&S) presented a projection of Rs 1112 billion for second half of 2011-12 on the basis of all possible contributing factors.

The FBR also discussed various options and workable strategies to ensure viability of the target before finalisation of short-term revenue collection plan.

The Board discussed the matter in detail with FBR Members and the following revenue collection plan for Jan-June 2011-12 has been approved: The FBR will immediately take administrative tax measures for the revenue col1ection target of January-June, 2012.

Under the revenue collection plan (January-June 2012), the audit of withholding agents is to be conducted with optimum skillfulness to recover the due revenue.

All Chief Commissioners are to report on the subject through standardised pro forma to be developed by Member (IR).

Secondly, the cases pending at various appellate courts are to be pursued vigorously to enable the recovery of stuck up arrears.

Thirdly, all Chief Commissioners and Directorate General Intelligence and Investigation Inland Revenue (IR) have to concentrate more on the preclusion of claiming illegal sales tax input adjustments and to discover and recover the said inputs if already claimed by the taxpayers.

Fourthly, D.G (I&I), FBR, D.G Withholding and D.G Valuation would take appropriate measures to improve revenue collection by plugging loopholes through enforcement and compliance by the potential sectors.

Fifthly, for declaring taxpayers for Large Taxpayers Units as withholding agents for the purposes of withholding sales tax, the

FBR Member IR and FBR Member (Admn) would prepare a proposal for presentation before the Board.

Sixthly, the broadening of tax base exercise is to be taken up on much speedy pace for achieving the targets both in terms of the number of taxpayers and the collection of due taxes, short-term revenue collection plan added. – *Courtesy Business Recorder*

Revised 'Assets Declaration Form' for MPs: FBR ready to provide help to ECP

The Federal Board of Revenue (FBR) is ready to provide technical and legal assistance to the Election Commission of Pakistan (ECP) to devise a revised 'Assets Declaration Form' for disclosure of information about assets and liabilities of Members of National Assembly and Senate and their close relatives and dependants.

Sources told that an important meeting between the FBR and the Election Commission was held here on Wednesday to explore possibilities for sharing information about assets and liabilities of Members of National Assembly and Senate.

The meeting held at the office of the ECP was attended by senior officials of the FBR as well as the ECP.

The meeting which continued for several hours discussed different areas including assessment of the declared campaign expenses of the political parties and utilisation of data pertaining to the assets and liabilities of Members of the Parliament and Provincial Assemblies.

According to sources, the FBR has shown its willingness in devising and improving the 'Assets Declaration Form' for the ECP to ensure collection of maximum information about the assets of the Parliamentarians and their family members.

Any revision in the 'Assets Declaration Form' could be done with the help of the tax officials having ample experience in devising forms for disclosure of information under returns and statements from the taxpayers.

The FBR can also help the ECP to revise the 'Assets Declaration Form' for collecting information about the assets made in the names of the family members and dependents of the Parliamentarians.

Sources said that the FBR can verify the assets related information of Parliamentarians shared by the Election Commission.

If the ECP would provide information about the Parliamentarians to the FBR for verification, the FBR can cross-match the information with its own database.

However, the FBR cannot share its own information maintained by the Board due to limitations under section 216 of the Income Tax Ordinance 2001.

If the government wanted to provide information of Parliamentarians being maintained by the Board to the ECP, amendment would be required in the Income Tax Ordinance 2001.

Presently, section 216 of the Income Tax Ordinance 2001 bars the tax department from sharing information about the taxpayers with other government departments including ECP.

Thus, the government has to introduce amendment in the Income Tax Ordinance 2001 to permit the tax department to disclose confidential information about the taxpayers to the public.

The FBR can help the ECP to reconcile assets related data being maintained by the commission with the database of the FBR.

This could be possible in cases where the ECP provides data of assets to the FBR for verification , sources added. – *Courtesy Business Recorder*

Light sentences in mega scams: I&I DG's lenient view surprises FTO

Federal Tax Ombudsman (FTO) Dr Muhammad Shoaib Suddle has expressed surprise over the lenient view taken by the Directorate of Investigation and Intelligence Federal Board of Revenue (FBR) for not filing an appeal against the light sentences awarded to masterminds of mega scam of illegal sales tax adjustment.

In an order issued here on Wednesday, the FTO expressed serious concern over light sentences given by the Special Judge Customs to masterminds of the scam involved in illegal input tax adjustments.

This is a first of its kind of case where the FTO has found that the Special Judge Customs have given light sentences to masterminds of mega scam and the concerned agency has ignored to file appeal against the light sentences given to the criminals.

While deciding a case no.

999/2011 in favour of Muhammad Yasin Butt of M Y Packages Gujranwala represented by tax lawyer of Lahore Waheed Shahzad Butt of Tax Resolution Services Company, the FTO observed that the culprits in this scheme have been able to get away with very light sentences considering the extent of their crime that involved an estimated Rs 230 million loss to the exchequer, which is indicative of the conspiracy between the perpetrators of serious financial crimes and their silent patrons within the ranks and files of FBR.

The Directorate of Intelligence and Investigation even failed to appeal against the light sentences awarded in the case by the Special Judge Customs.

One would expect the Directorate of Intelligence and Investigation to be zealously committed to bringing the perpetrators of such heinous crimes to book.

The FTO has directed the FBR to launch an investigation into the circumstances that why the officials of the Directorate of Investigation and Intelligence did not file an appeal against the apparently light sentences awarded to those who seemingly masterminded the scam.

Details of the case revealed that the complaint was filed against alleged arbitrary demand for payment of sales tax amounting to Rs 897,417/-, issuance of illegal Order in Original (O-I-O) and collusion and connivance of FBR/PRAL officials with outside rogue elements in issuance of fake sales tax invoices.

On merits, the department contends that the Directorate of Intelligence and Investigation after a detailed investigation in the matter had found that the Complainant claimed illegal input tax credit on the strength of fake sales tax invoices.

When confronted, the complainant agreed on his own violation to deposit the amount involved into government account.

A show cause notice was issued, and O-I-O passed on 29.07.2011 to levy penalty.

The Dept, though sceptical of the Complainant's claim to a clean record in the past, was of the opinion that a clean past record was no guarantee for the future.

The Dept insisted that the Complainant deposited the amount of Rs 897,417/- as he had colluded with the rogue elements and he know that serious consequences would follow if he failed to make good the loss to Government exchequer.

The complainant deposited the amount of Rs 897,417/- through four CPRs in the amount of Rs 160,133/-, Rs 272,183, Rs 90,005/- and Rs 375,096/-.

There was no formal order in the field when he deposited the amounts.

Prior authorisation, according to law, is a condition precedent for Government to hold amounts deposited by taxpayers.

In the present case, as the complainant had not been subjected to any audit and no adjudication order was passed, the retention of the amount deposited by him in Government exchequer was illegal and warranted a refund in case there was no legal order in the field at the time of recovery.

The FTO observed that the sophistication of the scam is evident from the fact that but for the insider information, the racket may not have been exposed at all.

The available evidence does not show that the informant or any other person ever identified the complainant directly as a member of the racket.

The fact that the complainant was a one-time user of fake sales tax invoices was the main reason that the Dept believed that he was an integral part of the elaborate plan to defraud the revenue.

Significantly, though the Dept retained his last five years sales tax documentation for more than a year and subjected it to rigorous scrutiny it was unable to detect any discrepancy therein.

And as soon as he came to know that fake invoices had been unwittingly used by him, the Complainant immediately deposited the amount involved.

The Dept says that he did so because he had a guilty mind.

However the fact that he wrote on the CPR that the payment was being made under protest and wanted it to be returned to him as soon as recovery was made from the persons who had masterminded the racket would appear to exonerate rather than convict the Complainant.

A person depositing the amount out of fear could not reasonably be expected to demand its return back to him in the event of recovery of the amount from the real perpetrators of the criminal scheme.

Coming to the Complainant's allegation of complicity of the Departmental and the PRAL officials with the racketeers, the ambient circumstances are certainly indicative of a nexus between them.

Otherwise, M/s Waqar Ali Chaudhry, Imran Qamar, Furqan Ahmad Rind and their companions could not possibly have got hold of the User IDs, Passwords and Pin Codes.

Nor would they have been able to set up 39 registered persons' profiles to put the scheme into operation.

No meaningful investigation has been carried out so far to unmask the Pral's role, if any, in this nefarious scheme to defraud the revenue.

So far as the O-I-O regarding levy of 100% penalty and default surcharge, the Dept was unable to establish mens rea and wilful involvement of the Complainant in the scheme, which is a condition precedent to levy of 100% penalty.

According to the findings of the FTO, The action of the Department to recover sales tax from the Complainant without passing any legal order and thereafter charging 100% penalty without proving his involvement in the tax fraud scheme is tantamount to maladministration in terms of Section 2(3) of the Establishment of the Office of Federal Tax Ombudsman Ordinance, 2000.

The FTO has recommended that the FBR to direct the Chief Commissioner to refund the amount deposited by Complainant, under protest, as there was no legal order in the field at the relevant time.

The FTO has further directed the Commissioner to cancel the Order-in-Original and conduct an enquiry to identify if any Pral officials were involved in the scheme and to proceed against the defaulters, as per law. – *Courtesy Business Recorder*

SECP reappoints KSE directors for 2012 term

The Securities and Exchange Commission of Pakistan has reappointed Muneer Kamal, Shazad G. Dada, Asif Qadir and Abdul Qadir Memon on the Board of the Karachi Stock Exchange (KSE) for the 2012 term.

They had also served on the KSE Board last year as independent directors and their appointment can be seen as a fair balance of the requisite qualifications and skills on the board.

Muneer Kamal, presently vice-chairman of the KASB Bank Limited, has over 28 years of extensive experience of the banking and financial sector during which he has served locally and internationally on senior positions at various renowned banks. Shazad Dada, CEO, Barclays Bank PLC, Pakistan, is a seasoned banker and a prominent capital market professional. He has over 20 years of major national and international financial markets' experience.

Asif Qadir, president and CEO, Engro Polymer and Chemicals Limited, has over 30 years of management and marketing experience of the chemical and fertilizer sector and has served in key management positions on the chemical giant Engro Corporation Limited.

Abdul Qadir Memon, Fellow of the Institute of Taxation Management Pakistan and President, Pakistan Tax Bar Association, is a senior resource and is a renowned tax and corporate laws expert, possessing an in-depth knowledge about the various aspects and implications of the corporate matters and company laws.

It is expected that the KSE Board in particular and the capital markets in general, will continue to benefit from the mix of extensive knowledge, global experience and diverse expertise that the above professionals possess. It is hoped that the directors will continue to contribute positively to promoting principles of good governance, transparency and will be instrumental in bringing about various capital market reforms. – *Courtesy The Nation*

CCP issues exemption to Makro, Metro

The Competition Commission of Pakistan (CCP) has issued an exemption to a joint venture agreement (JVA) between M/s Metro Cash & Carry International Holding BV (Metro) and Thal Limited (Thal).

According to CCP's announcement on Wednesday, the Commission issued exemption to a JVA dated 15-06-2011 between M/s Metro Cash & Carry International Holding BV (Metro) and Thal Limited (Thal) under Section 5 of the Competition Act, 2010 (Act).

Metro and Thal filed a joint application before CCP for the exemption of JVA from application of Section 4 of the Act. Through the JVA, the Metro and Thal agreed to restructure their respective subsidiaries in Pakistan, namely M/s Metro Cash & Carry Pakistan (Private) Limited (MCCP) and M/s Makro–Habib Pakistan Limited (MHPL), respectively by forming two separate entities namely, OpCo and PropCo.

OpCo will carry on the business of wholesale cash and carry distribution initially through the existing cash and carry centers; whereas the PropCo will own and manage, inter alia, the properties owned by MCCP and MHPL.

The exemption was sought from the non-compete clause in the JVA that expanded the scope of restraint from the business of the Metro and Thal, i.e., "whole sale cash and carry" to include "retail operations". Therefore, CCP deemed it appropriate to conduct a hearing in the matter.

While considering the conditions mentioned in Section 9 of the Act for grant of exemption, the Commission observed that JVA will facilitate the growth of the wholesale business as the entities will be able to combine their resources and take advantage of the resulting economies of scale, thereby becoming more competitive and benefiting the consumers.

The consumers may directly benefit from the proposed joint venture as OpCo will be able to provide goods to the customers at competitive prices by securing reduced price margins from suppliers and passing on the benefit to the consumers.

Additionally, OpCo will also maintain strict quality control rules to ensure that the products sold, particularly fresh foods, are of a high quality. Accordingly, CCP issued exemption to the JVA with a condition that the non-compete obligation will only continue to have effect during the life of the joint venture. – *Courtesy The News*

Standing Committee on Finance: SECP to devise medium, long-term market development plans

Securities and Exchange Commission of Pakistan (SECP) here on Thursday informed the National Assembly (NA) Standing Committee on Finance that SECP is finalising three years Stock Market Development Plan and a ten year Financial Market

Development Plan to move ahead for economic development of the country in predictable manner.

SECP has also plans to finalise four key new draft legislations, Companies Law, Insurance Law, NBFI's Law and Pension Law within next one year time, Muhammad Ali, Chairman SECP informed the National Assembly Standing Committee on Finance, which met at SECP head quarter with Fauzia Wahab MNA in the chair.

He said that once these plans are finalised, these would be shared with all the federal economic ministries and departments and decisions would be taken on such plans collectively for their smooth implementation at national level.

Proposed legislations like Securities Act, Demutualisation of Stock Exchanges Act, SECP Act are already undergoing passage process in the parliament and work is already underway from the last six months on new Companies Law and drafts of the three new legislations Insurance Law, NBFI's Law and Pension Law would be completed within next one year time, he added.

While giving detailed presentation on SECP's performance and scope of its regulatory functions, SECP Chairman informed the committee members that until the de-mutualisation of stock exchanges is not completed SECP would not be able to properly regulate the stock market. At present there are only 200 members at KSE and after mutualisation, its members could grow in thousands. Management of stock exchanges would be shifted to a specialised management instead of existing regime of its members only. He informed that futures trading are allowed in gold, wheat and in future cotton, rice and sugar future trading would also be allowed.

He said that concept of Real Estate Investment Trust (REIT) have not been able to develop itself due to stringent regulations, SECP has plans to ease out these regulations and bringing minimum financing requirement below Rs 2 billion for formation of REIT. Banks at present are not encouraged to lend to REITs and for going to stock market Rs 500 million worth company is required.

He informed that volume of Equity Funds is around Rs 120 billion, which is very low it could grow many times. He explained to the committee NSS Schemes are offering 13 percent interest, bank interest rate is high and banking spreads are also high due to which no one is encouraged to make investment in equity funds.

He explained to committee that new Insurance Law is required to properly regulate the working of insurance companies, as SECP at present does not have powers to initiate proceedings on complaints filed by the policyholders. He further informed that SECP has finalised a draft of rules for major insurance companies for allowing them create their Takaful Windows and offer Takaful products to the public through their large branch networks. These rules would be further discussed with stakeholders in the industry in February and hoped in March 2012 major insurance companies would be formally allowed to offer Takaful products to general public. Earlier, SECP had allowed new companies to offer Takaful products and due to their small size and limited branch network, these companies have not been able to promote Takaful products in required manner. Major companies after this decision would be able to increase the penetration of Takaful coverage in the country.

He informed that SECP's focus in insurance sector is to promote Crop Insurance, Micro Insurance, Health Insurance and Terrorism Insurance within the country. He informed that crop insurance is limited to the bank loans offered for crop loans and those who do not take bank loans for crops are unable to utilize such bank loan facility. He said that once the regulatory regime is changed it would be easy for farmers to get their crops insured from the insurance companies without obtaining loans. He clarified that until and unless the corporate agriculture farming is introduced in the country the agriculture sector would continue to face difficulties in obtaining loans. He said that corporatization of agriculture would help documenting the agriculture and this would encourage the banking sector to come forward and sanction loans for them as per their requirements. Documentation of agriculture sector would also help government to tax it in future upon completion of its documentation.

He informed that due to non-availability of debt market present Term Finance Certificates (TFCs) and Pakistan Investment Bonds (PIBs) auctions are routed through banks and once the debt market is developed these auctions could be done through stock exchanges and this would help ordinary investors to make investment in such government securities.

He informed that SECP would soon allow the investors to deposit company registration fee through their credit cards or through banking instruments and there would be no need for them to come to SECP offices for company registration. Similarly, electronic voting would be introduced in big companies Board of Directors and Share Holders meetings for transparency purposes, in this regard, amendments would be required in Companies Ordinance. He also informed the meeting that a Debt Committee is also being formed to develop Debt market in the country. – *Courtesy Daily Times*

FBR concerned over refund issuance on fake input claims

The Federal Board of Revenue (FBR) has expressed concerns over no solution for preventing refunds or adjustment against fake input claims, official sources said on Thursday.

“The issue was discussed at a recent commissioners’ conference and the revenue body has asked senior officials to present viable solution,” an official at the FBR said on the condition of anonymity.

The FBR had detected Rs25-30 billion fraudulently obtained by fake claimants. “The revenue body is endeavouring to improve the capacity of electronic system to verify the records of claimants’ sales and purchases,” the official added.

At the commissioners’ conference, the director general, intelligence and investigation, FBR, said that around 600 fake companies and individuals defrauded the revenue authorities with the compliance of 13,000 genuine and registered companies, the official said.

“The fake companies or individuals presented the claims after completing all the requirements, including the challans of supplies and purchases,” the official said. “The fake entities first registered with the tax department and after receiving the refunds vanished within six months, leaving no record for the authorities for verification.”

“The registered companies also availed benefits in this scam as no supply and purchases were made with those fake companies,” the official added. Under the sales tax law, if the input tax paid by a registered person on taxable purchases made during a tax period exceeds the output tax on account of zero-rated local supplies or export made during that tax period, the excess amount of input tax would be refunded to the registered person.

The official said that the intelligence and investigation director general unearthed the scam recently, which resulted in lodging of an FIR against executives of several registered companies and recovery of around Rs3 billion.

However, the issuance of refunds against fake input claims are still going on, despite introduction of expeditious refund system, which was not possible without the help of the officials at the electronic system, the official said.

"The FBR is investigating involvement of officials in Pakistan Revenue Automation (Pvt) Limited, which is responsible for automation," the official added. At the meeting, the commissioners urged the revenue body to check such leakages because it would hamper revenue collection efforts for FY12.

In the current fiscal year, the FBR is targeting Rs1,952 billion and collected around Rs842 billion in the first six months of FY12. The official said that the commissioners are unanimous on documentation of the economy because without this such incidents of leakages would happen in the future.

To check the issuance of refunds on bogus claims, the FBR had announced to undertake audit, but so far the exercise failed to materialise substantial amount. "The comprehensive audit in the electronic refund issuance is not possible because details provided by the claimants are fake," another official at the tax department in Karachi said. – *Courtesy The News*

Manufacturers misusing reduced

The Federal Board of Revenue (FBR) has detected several manufacturers, who availed reduced rate of withholding tax facility at import stage either without exemption certificate or on expired certificates, official sources said on Thursday.

The revenue body has directed the Regional Tax Offices (RTOs) to obtain the data of all manufacturers who have been allowed import of raw materials for their consumption at reduced rate, according to the sources.

The misuse of reduced rate of withholding tax facility was detected by RTO Karachi as it informed the revenue body that during the period March 2011 to August 2011 around 10 importers availed the facility and imported goods worth Rs870 million without expired or exemption certificates.

In a letter sent to Member Inland Revenue, FBR, the chief commissioner, RTO Karachi, said that during the monitoring of withholding tax for the period collected from Pakistan Customs it was identified that 28 importers of RTO Peshawar have imported goods worth Rs3.729 billion and claimed exemptions of withholding tax on the basis of Statutory Regulatory Order (SRO) issued in August 2010.

"The chief commissioner, RTO Peshawar, confirmed issuance of 22 exemption certificates," the communication said. "It shows that six importers have availed the facility without having been issued exemption certificates and imported the goods of Rs166.168 million without payment of advance income tax," it added.

"Besides, four importers have availed the facility and imported goods of Rs708.793 million on expired exemption certificates," the communication said. The chief commissioner, RTO Karachi, said that the data of importers belonging to his jurisdiction had also been examined, which revealed that eight wholesalers had availed the facility of importing raw materials at reduced rate of three percent instead of five percent applicable to commercial importers.

"Steps are being taken to recover the remaining tax," the chief commissioner added. The official communication said that the matter was discussed with the chief collector (Customs) Karachi on the issue for ensuring that import of raw materials for self use to industrial undertaking, should not be allowed until importer produces reduced rate certificate.

The RTO Karachi chief commissioner said that several trade bodies had agitated on the requirement of reduced rate exemption certificate, saying that it was against the tax laws.

Responding to the issue, the revenue board explained the RTO Karachi that the manufacturers have been allowed to import raw materials at the reduced rate of three percent on the value of imported goods and are not required to obtain any lower rate certificate.

However, it directed the tax officials to recover the defaulted amount and obtain data from the Customs authorities pertaining to manufacturers who have been allowed to import raw materials for their consumption at the lower rate of three percent.

It also directed to refer cases to FIA against those importers who availed the facility on bogus certificates. According to the latest development, Pakistan Customs circulated a notification to different departments for obtaining the data of manufacturers, who have been allowed import at reduced withholding tax rate. – *Courtesy The News*

Capital market, corporate sector boost: FBR urged to consider new taxation proposals

Securities and Exchange Commission of Pakistan has proposed the Federal Board of Revenue to consider new taxation proposals for development of capital market and corporate sector.

This includes income-based Capital Gain Tax on stock market against the existing transaction based fixed rate of CGT, major reduction in corporate tax rate and increase in the tax rates on the National Saving Schemes (NSS).

Chairman SECP Muhammad Ali on Thursday shared the tax proposals for the revival of capital market and corporate sector with the National Assembly Standing Committee on Finance, which met with Fauzia Wahab MNA in the chair at SECP head office.

The preliminary discussion on the tax proposals has been done by the SECP and FBR whereas detailed budgetary proposals will be sent to the FBR by February 2011, the SECP Chairman stated.

Sharing implications of tax on stock exchanges, the SECP Chairman informed the committee that the tax on the investors of stock exchanges should be on the basis of income and not on transactions.

The SECP does not support transaction-based tax on stock market investors because it would not encourage documentation.

Prior to 2010, there was a tax on stock market and investors made huge profits from the market.

However, most of the investors were not filing their income tax returns and even the FBR was not pressing the stock market investors to file the returns.

After the imposition of CGT on stock market, investors are not willing to invest in shares with the argument that the tax department could ask for the source of investment, as under the existing law, source of investment could be asked by the FBR from those coming to invest in the stock market.

The CGT has created a serious problem in the stock market and people have pulled out huge investment from the market and now the trading volume has touched its" lowest ebb.

He informed that the CGT collection mechanism needs to be revised in such a way that the people again start making investment in the stock exchanges.

The SECP has proposed the FBR to collect the CGT on traded stocks at the level of National Clearing House and not on transactions made in the market on day to day basis.

The SECP has further proposed the FBR to allow functioning of the new mechanism for at least two years to restore the confidence of the investors.

However, fixed tax should not be imposed on the stock market transactions.

The SECP Chairman stated that the commission is in favour of documentation along with income based CGT on stock market.

The objective of CGT collection and documentation would be met by implementation of the proposals of the SECP on the CGT.

About the impact of the CGT on the stock market, SECP Chairman informed the committee that prior to the imposition of CGT, the FBR had collected Rs 4.5 billion tax from stock market and after the imposition of CGT it''s collection has drastically reduced to Rs 500 million.

While strongly pleading the case of reduction in corporate tax rate, SECP Chairman informed the committee that globally tax rate on listed companies or corporate sector is low and high tax is charged from the non-listed companies.

In Pakistan, the tax regime on corporate sector is entirely different as compared to other best tax administrations.

The corporate sector which is more documented and making huge tax contributions to national kitty is being charged with higher tax rate of 35% rate and non-listed companies are enjoying documentation immunity as well as paying 25% tax with no regulatory requirement.

It is unfortunate to note that the units not paying tax are flourishing and those who are paying high tax in the corporate sector have to fulfil all regulatory requirements including compliance of tax laws etc.

The SECP Chairman termed the un-favourable tax regime for corporate sector as main hurdle in promoting listing of companies in stock market.

Giving a comparison of corporate sector in countries similar like Pakistan has at least one million companies.

On the other hand the number of listed companies in Pakistan is continuously declining.

Out of 60,000 registered companies, only 10% listed companies are making huge tax contributions and 90% are avoiding tax payments, being non-listed companies.

There should be incentives for the companies to come forward and list them selves in stock market, the reduction in corporate tax rate could help increase in listing of companies as well as increase in tax collection from this key sector.

He informed that initially the proposal of reduction in corporate tax rate has been discussed at the level of FBR and SECP has plans to discuss this issue with Finance Minister and Prime Minister for consideration and approval.

The SECP Chairman said that the commission would also propose rationalisation in the higher interest rate of the National Saving Schemes.

Similarly, tax rate on the NSS needs to be enhanced.

People are more interested in keeping their money in NSS keeping in view higher interest available to them rather than investing it in productive sectors.

In this way, huge public savings are being parked in un-productive area.

If such money is brought into the economy and is invested in productive economic activity of the country it could result improvement in economy GDP as well as this can in job creation in private sector.

In his presentation, SECP Chairman stressed the need for addressing the distortion created by the national saving schemes.

During the discussion on these tax proposals, SECP Chairman said that SECP"s final budget tax proposals would be shared with the Committee for it"s input.

The chairperson of the committee appreciated the proposals and asked the SECP to finalise and share it with main stakeholders in the government.

It was decided in the meeting to present comprehensive tax proposals after thorough consultations with stakeholders.

In this regard, the SECP would submit its tax proposals to the standing committee for consideration at the time of the preparation of the Finance Bill.

Former Information Minister Qamar-Zaman Kaira, MNA speaking on the occasion said that such kind of tax breaks had also been introduced in the past but failed to get desired results.

He asked the SECP to arrange a meeting of top officials of SECP, FBR, Ministry of Finance, State Bank of Pakistan and other public sector stakeholders so as to come up with concrete and agreed proposal on CGT at stock market.

Responding to this, Muhammad Ali informed the committee that all the tax proposals are being finalised in consultation with the stakeholders for onward transmission to the FBR for consideration. – *Courtesy Business Recorder*

PCDMA assured of resolution of problems

Chief Collector of Customs, Amir Mohammad Khan Marwat assures chemical and dyes merchant that their issues related to customs will be resolved on priority basis.

Speaking at a meeting of Pakistan Chemicals and Dyers Merchant Association (PCDMA), he suggested that a three-member committee should be formed to time to time hold meeting with him on issues so that they should be resolved on priority bases.

Referring to laboratory test of imported chemicals and dyes, he expressed concern over sending same consignment for test again and again and added that only one test is enough.

Former Chairman PCDMA, Arif Balagamwal pointed out that it has become regular future that invoice has been removed from containers and imposed Rs 5,000 penalty on it.

Taking notice of the complaint the chief collector advised concerned collector to take notice of the issue and make efforts so that no such complaint should be received in future.

Chairman PCDMA, Najamuddin Chughtai, apprises the chief collector about issues of delay in customs clearance of imported goods and laboratory test of imputed chemicals. – *Courtesy Business Recorder*

Identify 10 major retail items prone to ST evasion: FBR tells officials

The Federal Board of Revenue has directed the Director General Intelligence and Investigation (I&I); FBR Member Administration and FBR Member Inland Revenue to identify 10 major retail items prone to sales tax evasion.

A senior government official told here on Thursday that the Board-in-Council of the FBR has decided to fix minimum sale price of 10 major retail items prone to sales tax evasion.

However, the FBR has yet not identified the items for minimum sale price fixation.

The FBR has started the exercise to identify the items as per decision of the Board-in-Council.

So far, no names have been finalised.

Once the names of the 10 major retail items prone to sales tax evasion would be identified, the FBR will fix their minimum sale price for taxation purposes.

"The decision has been taken in the last meeting of the Board-in-Council, but names of the items have yet to be finalised," the official added.

According to the decision of the Board-in-Council, to stop sales tax evasion due to the under pricing of various domestic goods, Director General Intelligence and Investigation (I&I), FBR and Member (Admn), FBR shall prepare a proposal in consultation with FBR Member Inland Revenue (IR) for valuation and thereon inclusion of 10 major evasion prone items in the existing list of items for minimum pricing at the retail level. – *Courtesy Business Recorder*

Secrecy of account holders: FBR asks PBA to seek SBP governor's views

The Federal Board of Revenue has asked Pakistan Banks Association (PBA) to approach the State Bank of Pakistan (SBP) for obtaining expert opinion of the SBP Governor on the issue of maintaining secrecy of accountholders information at the time of filing of monthly withholding tax statements by the banks.

Sources told that the issue of secrecy of banking information was discussed during a meeting between the representatives of PBA and senior officials of the FBR at the FBR House here on Thursday.

The issue mainly related to the sharing of taxpayer's information either on service of a notice u/s 176 of the Income Tax Ordinance, 2001 or under the provisions of section 165 of the Ordinance wherein the monthly withholding tax statements are filed particularly for 'Profit on Debt' paid.

According to sources, representatives of banking sector expressed their concern over sharing of computerised national identity card numbers (CNICs) and other complete information of the payee as required in the withholding statements to be filed by the banks.

Tax authorities have requested the bank's representatives to write a letter to the Governor SBP in case they feel that divulging of particular information in the withholding statements would lead to problems for the banking company due to secrecy of information.

Tax authorities have further conveyed to the PBA that the association can further inform the SBP that the FBR is asking for complete information of the payees for filing of complete withholding tax statements required under section 165 of the Income Tax Ordinance 2001.

The viewpoint of the SBP on the issue would facilitate in proper filing of monthly withholding tax statements by the banks.

Sources added the FBR may request the ministry of finance to convene meeting of all banks to resolve the issue of submitting complete information about the accountholders as required in the withholding tax statements.

Such a meeting may only be called in case the matter still remains unresolved. – *Courtesy Business Recorder*

SECP approves regulations to ensure

The Securities and Exchange Commission of Pakistan (SECP) has approved the Companies (Investment in Associated Companies or Associated Undertakings) Regulations, 2012, to ensure transparency in transactions involving investments made by companies in their associated companies or undertakings.

According to a statement issued by the Commission on Friday, the regulations prescribe disclosure requirements and specify conditions and restrictions on the nature, period, amount of investment and terms and conditions attached to investment by a company in its associated companies or associated undertakings.

Highlighting the objectives of the regulations, the SECP statement said that this would ensure transparency in transactions involving investments made by companies and help curb the unfair practices that have been observed in such transaction by imposing certain restrictions and conditions felt necessary based on regulatory experience.

It will also introduce detailed and standardised requirements to avoid ambiguities and fill the gap in the perspective of the corporate sector vis-à-vis that of the regulator in respect of investments in associated companies or undertakings.

The regulations have been promulgated under the provisions of Section 208 of the Companies Ordinance, 1984, which requires the companies to obtain members approval for making investments in associated companies or associated undertakings and further empowers the Commission to make regulations in respect of such investments.

Since its initial publication in the official gazette in February 2010 to seek public comments, the draft of the regulations has been revised thoroughly in the light of stakeholders' feedback. The stakeholders including leading business groups, stock exchanges, renowned professionals in corporate law, professional accountancy bodies, business associations. – *Courtesy The News*

GST on tractors cut to five percent

The Government has decided to reduce general sales tax (GST) on tractors to 5 percent, from 16 percent, aimed at bringing down tractor prices up to Rs 90,000 and extending help to the troubled local industry.

However, the rate of GST will be brought to 16 percent in four to five years, official sources told.

The decision has been taken by a committee constituted by the Economic Co-ordination Committee (ECC) of the Cabinet comprising Special Assistant to the Prime Minister on Water Resources and Agriculture (Convenor), Finance Secretary, Secretary Industries and Chairman FBR with the following mandate: (i) establish facts of the case, including increase in price of tractors due to imposition of sales tax and reduction in production; (ii) determine level of reduction in rate of sales tax, if required; and (iii) suggest other ways and means to help the farming community.

However, the Cabinet in its meeting on January 4, 2012, included Minister for Religious Affairs Khurshid Ahmad Shah and Minister for Kashmir Affairs Manzoor Ahmad Wattoo in the committee.

Minister for Industries Perez Elahi took special interest to resolve this issue as both the industry and the growers were suffering from 16 percent GST.

"We have decided to slash GST on tractors from 16 percent to 5 percent.

However, this rate will be graduated to the same position in four to five years," said committee's convenor Kamal Majid Ullah who is also Prime Minister's Advisor on Agriculture and Water.

These recommendations will be submitted to the ECC in its next meeting for ratification.

He said that the Zarai Taraqiati Bank (ZTBL) has also restarted loaning to farmers for tractors.

Sources in Industries Ministry told that previously agricultural tractors were not subject to sales tax, under the policy introduced with effect from 11th June, 2008.

Consequently, agricultural tractors were available to the farming community at affordable prices.

The facility of zero-rating was, however, withdrawn in March, 2011, resulting in substantial increase in prices of agricultural tractors.

Increase in prices had made it difficult for the farmers to purchase new tractors and convert traditional farming into mechanical farming for higher yield, especially when cost of other agriculture inputs has gone up substantially.

Besides, Zarai Taraqiati Bank (ZTBL) is also not extending loans for purchase of tractors since April 2010, creating another impediment for the farmers, sources added.

Ministry of Industries, sources said, has submitted the following options for consideration of the ECC: (i) sales tax zero-rating on agricultural tractors may be restored; or (ii) deemed price (say 25-30 percent of the actual price) may be fixed for sales tax purposes, as has been done in the case of sugar and fertilisers; and/or (iii) levy of sales tax may be phased in three to four years instead of imposition in one go ie @ 4 percent per year.

Sources said those opposed to this proposal argued in the ECC meeting that due to various measures taken by the Government, including substantial increase in support prices of various crops, income level of farmers had improved manifold and they were now in a position to buy tractors.

Government protection to tractor industry, they maintained, had not improved the quality of tractors.

The need to encourage investors for setting up of new tractor manufacturing/assembling units to overcome the shortage of tractors and to stabilise their prices was also highlighted.

Some members argued that the Government needs to extend loan facility to farmers through ZTBL for purchasing agricultural tractors.

Overwhelming view was that sales tax on agricultural tractors should either be removed altogether or a staggered reduction may be implemented in three to four years.

It was also stated that farmers in rural areas are also agitating against Government decision to impose sales tax on agricultural tractors.

It was also explained to the ECC that this was not the issue of tractor industry; rather it was the issue of the entire taxation system.

Tractor industry gets input adjustment and final rate of sales tax comes to 11 percent.

A number of structural changes have been made in the taxation system, which is now showing positive results.

Removal of sales tax from the tractor industry is likely to offset the positive results of structural changes introduced by the Government.

However, if any segment of economy needs Government protection, it can be made available through subsidies. – *Courtesy Business Recorder*

Illegal input tax adjustments claims: FBR putting in place preventive mechanism

The Federal Board of Revenue is likely to introduce some major changes in the existing sales tax adjustment procedure by proposing amendments to the Sales Tax Act 1990 to put in place a preventive mechanism on illegal input tax adjustments claims, which caused huge loss to the national exchequer.

In this connection, the FBR on Friday issued an office order for constitution of a high-level committee headed by FBR Member

Legal Muhammad Aqil Usman (BS-21 officer) to deal with the issue at policy level.

This important task of drafting legislation for preventing illegal sales tax adjustments in future has been assigned to FBR Member Legal keeping in view his vast experience in legal matters, drafting of tax laws and dealing with tax frauds.

According to sources, the FBR has started developing a preventive system to check illegal sales tax adjustments in future.

The committee has been given the task to finalise its recommendations and submit them to the Board by January 25, 2012.

The seriousness of the issue is evident from the fact that the Director General Intelligence and Investigation (I&I) FBR has detected illegal adjustments to the tune of Rs 32.04 billion.

Aqil Usman along with his team of tax managers would scrutinise the existing data of illegal input tax adjustments claims detected by the Directorate General of Intelligence and Investigation FBR and field formations with reference to classes of business, area like Regional Tax Office (RTO)/person and quantum of evasion for trend analysis

Secondly, the committee would further probe the modus operandi of fraudsters and present tactics (legal sales tax, income tax systems and connivance of the department, etc).Thirdly, the committee has been given the mandate to analyse the risk area relating to the existing procedures, processes and system involved in payment of input tax adjustment.

Fourthly, the committee has been given the assignment for conversion of sales tax input claims from invoice-based to payment based.

This means that the tax adjustment would only be allowed after making payment to the relevant supplier after completion of the transaction.

This would require amendment in section 7 of the Sales Tax Act 1990 as it would change procedure for claiming input tax adjustment, sources stated.

Fifthly, the committee would examine the existing legislation and required amendments in the law/rules with analysis of present litigation.

Sixthly, the committee would propose systemic solution of problems ensuring uniformity of actions and other administrative measures needed to control illegal input tax adjustments claims.

The committee headed by Aqil Usman has been constituted following decision of the last Chief Commissioner conference.

Director General Intelligence and Investigation (I&I) FBR made a presentation on illegal input adjustments to the FBR and stated that total detection on the subject has been of Rs 32.04 billion.

The DG intelligence also highlighted the other steps and actions taken in this regard.

The issue was discussed at length and a committee has been constituted to evaluate the issue of illegal input adjustments.

A separate Office Order has been issued by the FBR for constitution of the committee, sources added. – *Courtesy Business Recorder*

Major litigations: 'Callow' representatives irk FBR!

The Federal Board of Revenue (FBR) has expressed serious concern over the repeated representation of inexperienced or junior departmental representatives to plead tax-related cases at the level of tribunals and courts.

Sources told here on Friday that the issue of the court cases was discussed during the last Chief Commissioners' conference.

FBR Member (Legal) made a presentation on major litigation issues.

It was highlighted that despite clear directions on the court cases, the field units have failed to ensure the appearance of legal counsels according to the cause lists.

The inadequate preparedness of the departmental representatives was also highlighted mainly owing to posting of the inexperienced or junior officers for representing the department before the tribunals.

The FBR Member (Legal) stressed upon the need of a proper co-ordination with the advocates for preparation of the case.

It was decided all Chief Commissioners would look into these aspects and give due importance to ensure representation of senior officials to effectively pursue cases in tribunals and courts in future. – *Courtesy Business Recorder*

WeBOC causing severe financial shocks to traders

Instead of facilitating trade in customs process, the Web Based One Customs (WeBOC), a so-called alternative of PaCCS, is providing severe financial shocks to the traders, due to its faulty modules.

According to a letter issued by Karachi Customs Agents Association (KCAA) to Member Customs, FBR, the system is presently charging double freight from traders, despite mentioning the same, separately.

The system is accumulating landing cost and insurance even when assessable value including VR, criteria, guideline; agreed value is applied.

Besides, the same is not being displayed in stakeholders' system.

In spite of having access to review the lab samples in PaCCS, this module is still not incorporated in WeBOC, creating problems for traders to check lab reports in their system.

Although the Authority claimed to have replaced PaCCS with fully automated WeBOC, the traders in case of section 82 Waiver and Auction Release are required to process the same, manually.

Moreover, the letter said, the Refund Management System and the option of UN acceptance remained inactive since the commencement of WeBOC operation.

The association suggested that the Import General Manifests (IGMs) should be uploaded in shape of Vessel Information Reports (VIRs) like PaCCS and the Goods Declaration (GDs) with bill of lading numbers well before arrival of vessel.

Meanwhile, experts said the WeBOC is a security risk as the system produces IGMs for the clearance of consignments as it is not capable to VIRs before the ship is anchored at port, creating security issues and added that the FBR has no option but to post IGMs including military related cargos on its website for clearance purpose.

They said that although the WeBOC is an improved version of One-Customs, it could not be compared with PaCCS operations as it was line-interpreter and coded in GW-Basic.

However, the PaCCS was based on XML, which is globally recognised.

They fear that the access to cargo information on a single click might pave the way for wrongdoers to flare up their heinous activities in Pakistan where the spate of indoor terrorism and extremism is getting severe every passing day. – *Courtesy Business Recorder*

Corporate returns desk audit: field formations given a go-ahead

The Federal Board of Revenue has given go ahead to the field formations to immediately start desk audit of all income tax returns filed by the corporate sector.

Sources told here on Friday that the performance and plan in respect of desk audit of corporate returns was discussed during the last Chief Commissioners' conference.

The issue was discussed in detail and it was decided that since corporate returns have been received by the field formations, 100% desk audit of corporate returns be completed by January 31, 2012.

During the Chief Commissioners' conference, FBR Member (Inland Revenue) stressed upon the importance and need of proper monitoring of withholding agents as it is a major contributory of revenue.

It was, therefore, decided that future plans for audit of withholding agents be prepared by each Chief Commissioner and sent to the Board by January 31, 2012.

Sources said that it was noted that there is a huge gap between the number of NTN's issued vis-à-vis returns filed. – *Courtesy Business Recorder*

S.R.O. 10(I)/2011, Islamabad, the 2nd January, 2012.– In exercise of the powers conferred by section 219 of the Customs Act, 1969 (IV of 1969), the Federal Board of Revenue is pleased to direct that the following further amendment shall be made in the Customs Rules, 2001, namely:–

In the aforesaid Rules, in rule 564, for sub-rule (2), the following shall be substituted:–

(2) "the permit shall be deemed cancelled if goods are not transported to the destined customs station for export within thirty days of its issuance or within such extended time not exceeding forty five days in all as may be allowed by the Collector of Clearance"

S.R.O. 20(I)/2011, Islamabad, the 11th January, 2012.– In exercise of the powers conferred under Section 40B read with clause (u) of subsection (4) of section 20 and clauses (fa) and (g) of subsection (6) of section 20 of the Securities and Exchange Commission of Pakistan Act, 1997 (XLII of 1997), the Securities and Exchange Commission of Pakistan issues the following directive.

1. This directive is issued to all insurers registered under the Insurance Ordinance, 2000.

2. Every insurer shall develop detailed procedures to counter the potential threat of usage of their services for money laundering.

3. Internal procedure and control.

Internal procedure, polices and controls shall be developed by the insurer to determine the true identity of all existing policy holders and customers/potential policy holders and compliance of other anti-money laundering obligation. Following internal procedure, policies and controls shall be developed by the insurers:

(i) Customer Due Diligence/Know Your Customer policy which shall *inter alia* include procedures for identifying customers/ policy holders, risk profiling of the customers/policy holders, procedures for obtaining minimum information/set of documents given in Annexure-I, from various types of policy holders for examination and verification at the time of issuance policy;

(ii) guidelines for conducting Enhanced Customer Due Diligence depending upon the customers/policy holders' background, country of origin, public or high profile position, nature of business, etc., to ascertain the identity of the beneficiary of the policy with respect to the source of funds used for soliciting the policy, establishing and/or maintaining relationships with approval of senior management and regular monitoring of source of funds of the customer/policy holder, etc.;

(iii) policy and program for training for its employees regarding compliance of this directive and other anti-money laundering obligations; and

(iv) internal procedure to ensure compliance of this directive and procedures for audit of compliance of this directive and other anti-money laundering obligations.

4. Risk profiling

Every insurer shall classify the customers/policy holders into high risk and low risk categories, based on the customer/ policy holder's profile and product profile. Insurer shall ensure implementation of guidelines for conducting Enhanced Customer Due Diligence when dealing with high-risk customers/policy holder, business relationship or transactions and when an existing low risk customer/policyholder becomes a high risk customer/policyholder.

(i) Insurer shall according to its policy ascertain whether new customers/potential policy holders should be classified as High Risk or not. The policy shall categorize the following as High Risk customers:

I. non-residents;

II. such body corporate, partnerships, associations, trusts and other legal arrangements including non-governmental organizations or non-for-profit organizations which receive donations;

III. customers/policy holders belonging to countries which are non-compliant with anti-money laundering regulations according to Financial Action Task Force;

IV. customers/policy holders with known links to any state or a country or territory where certain taxes are levied at a low rate or not at all;

V. customers/policy holders with dubious reputation as per public information available;

VI. high net worth customers/policy holders with no clearly identifiable source of income;

VII. customers/policy holders dealing in high-value items;

VIII. persons soliciting services through non face to face mode such as telesales, internet sales, etc.;

IX. persons who have been refused business relationship by another financial institution as defined in section 2(f) of the Anti-Money Laundering Act, 2010;

X. Politically Exposed Persons (PEPs) as defined by Financial Action Task Force, including foreigners or persons holding public or high profile positions;

XI. family members or close associates of PEPs; and

XII. counterparts from or in countries not appropriately applying Financial Action Task Force recommendations.

(ii) Low risk customers shall include such persons whose identity and the details relating to beneficial ownership in case of body corporate are publicly available. This category shall include:

I. Financial institutions as defined in section 2(f) of the Anti-Money Laundering Act, 2010; and

II. listed companies.

5. Record Updating

(i) Insurers are required to:

I. at all times maintain and keep in place systems to monitor all business related transactions on regular basis;

II. update customer/policy holder information records regularly; and

III. maintain proper records of the customer/policy holder identifications and clearly specify in record, if any exception is made in fulfilling the Customer Due Diligence/Know Your Customer measures.

(ii) Insurers shall keep records regarding the identification data obtained through the Customer Due Diligence/Know Your Customer and Enhanced Customer Due Diligence process i.e. copies or records of official identification documents like Computerized National Identity Card, passport, driving license or similar documents etc., policy files and business correspondence for at least five years after the business relationship is ended.

6. General Directions

(i) Where the insurance premium is paid by persons other than the person insured, insurer shall in addition to the documents stated in Annexure-I also obtain identification data such as attested copy of the Computerized National Identity Card or Passport of the person paying the premium to verify the identity of the beneficiary of the relationship. The insurers shall also verify the relationship between the customer/policy holder and such other person.

(ii) For customer/policy holders that are legal person, insurers shall take reasonable measures to determine the natural persons who beneficially owns or control the customer. This includes those persons who exercise ultimate effective control over a legal person or arrangement.

(iii) The Insurers shall conduct ongoing due diligence and scrutiny i.e. perform ongoing scrutiny of the transactions and account throughout the course of the business relationship to ensure that the transaction being conducted are consistent with the insurer's knowledge of the customer/policy holder, its business and risk profile.

(iv) In case of new insurance contract/policy is issued through Insurance Broker, the collection of documentation shall be completed within 15 days of the issue of policy.

(v) In case of existing customers/policy holders, Know Your Customer (KYC) exercise shall be completed within one year of the date of this directive.

(vi) Before issuing any insurance contract/policy, the insurers shall verify Computerized National Identity Card of the customer by utilizing online facility of National Database Registration Authority (NADRA). In case insurers or its branches do not have access to the online facility of NADRA, the Computerized National Identity Card shall be verified from the nearest Regional Office of NADRA or such facility provided by the NADRA. The cost of verification of Computerized National Identity Card from NADRA shall not be passed on to the existing or prospective customers of the insurers.

7. Appointment of compliance office:

(i) All Insurers shall designate a "Compliance Officer" in their respective organization, who will primarily be responsible for the areas including, but not limited to:

I. the insurer's effective compliance to the relevant provisions of the Anti-Money Laundering Act 2010, the Anti-Money Laundering Regulations 2008 and the Anti-Money Laundering Rules 2008;

II. ensuring that the internal polices and procedures approved by the Board of Directors of the respective insurers for prevention of money laundering and terrorist financing are effectively implemented;

III. providing assistance in compliance to other departments and branches of the insurer;

IV. timely submission of accurate data/returns as required under the applicable laws;

V. monitoring and timely reporting of the suspicious transactions to the Financial Monitoring Unit, Government of Pakistan; and

VI. such other responsibilities as the insurers may deem necessary in order to ensure compliance with this directive.

(ii) All insurers are hereby advised to furnish to Securities and Exchange Commission of Pakistan, not later than June 30, 2012, the contact details including the full name, designation, address, phone number, fax number, mobile number and email address of their designated Compliance Officer.

(iii) Any subsequent change in the nomination of the Compliance Officer should immediately be reported to the Securities and Exchange Commission of Pakistan, along with the reason for change.

8. Internal control and compliance

(i) It shall be the duty of the directors of the insurers to ensure that this directive is complied with in latter and spirit.

(ii) The appointment of a Compliance Officer shall not absolve the Directors of the insurers from their onus and obligations under the applicable laws.

9. Any failure on part of any insurer to comply with the above directions of the Securities and Exchange Commission of Pakistan is punishable under section 156 of the Insurance Ordinance, 2000.

Annexure-I

Customer/Policyholder Identification Procedure for Insurance Contracts

Type of Customer	Information/	Documents Required
Individual Customer/Policyholders	– Name – Father's Name – Address – Telephone Number – Source of Income with sufficient documentary proof. – Business/Employment Proof – National Tax Number (NTN)	– Customer/policyholder identity verification through Attested copy of CNIC or Passport; – residence/address verification through documentary proof that may include; lease agreement, rent receipt not older than three months, sale deed, last paid telephone bill not older than three months;

Corporate/Group customers/policyholders	– Name of company and its directors – Registered Address/principle place of business Mailing address – Telephone Numbers – National Tax Number (NTN) of the company	Certified copy of Certificate of Incorporation. Attested copies of CNIC or Passport of all directors – Last Audited accounts of the company Certified copies of Memorandum and articles of association – Board Resolution in original or an attested copy of the same to open an account and identification of those having authority to operate. - Certified copy of latest Form A of the company
Trusts	– name of trustees – names of beneficiaries – National Tax Number (NTN) of the trust	– attested copies of CNIC or passport of trustees – proof of residence – attested copies of CNIC or passport of beneficiaries if the beneficiaries are not the public at large – certified copy of registered trust deed Copy of latest financials of the trust Trustee resolution
NGOs/Charitable Institutions	– persons responsible for the management of NGO/charitable institution – office address – National Tax Number (NTN) of the NGO/Charitable Institution.	– certified copy of registered charter or articles – attested copy of No Objection Certificate/License from the concerned authority, if any, – attested copies of the CNIC or passport of the persons responsible for the management of such NGO/charitable institution – proof of office address – certified copy of the power of attorney or attested copy of authority letter in favour of any person acting on behalf of or for such NGO/charitable institution.
Partnership Firms	– legal name – names of partners and their addresses Office address Telephone number of firm and	Certified copy of partnership deed, – certified copy of firm registration certificate – attested copies of CNIC or passport of all the partners

	partners – National Tax Number (NTN) of the firm.	– proof of office address

No.NBFCD/CIRCULAR/2012 Islamabad, the 12th January, 2012

SECP CIRCULAR NO. 01/2012

Subject: **Reporting of Suspicious Transaction Reports (STRs)/Currency Transaction Reports (CTRs) to Financial Monitoring Unit (FMU) Under AML Act, 2010.**

In exercise of the powers conferred under section 282B(3) of the Companies Ordinance, 1984, read with Regulation 9 of Non Banking Finance Companies Notified Entities Regulation 2008, the Securities and Exchange Commission of Pakistan hereby issues the following instructions to NBFCs:–

a) NBFCs, being "Financial Institutions" under the Anti-Money Laundering Act 2010, are required to submit Suspicious Transaction Reports (STRs) and currency Transaction Reports (CTRs), as per Section 7 of the AML Act, 2010, to the Financial Monitoring Unit (FMU). The standard templates for STRs & CTRs are part of the AML Regulations 2008, issued under the AML Ordinance 2007 and protected under the AML act, 2010.

b) In this respect, NBFCs are advised to meticulously follow the requirements of the law, and report STRs and CTRs manually or electronically, as per Section 7 of AML Act, 2010, directly to the Financial Monitoring Unit (FMU).

c) It may be noted that Section 33 of the AML Act 2010, inter alia specifically provides for criminal sanctions on failure to file above mentioned reports and for providing false information. Furthermore, in case any NBFC is found to be in violation of above legal requirements, the regulatory authority may also revoke its license or registration or take such other administrative action as it may deem appropriate.

2012 PTR 47 (H.C. Del.)

HIGH COURT OF NEW DELHI

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

Ranbaxy Laboratories Ltd.
v.
The Commissioner of Income Tax

FACTS/HELD

1. **AO's self-determination of ALP without referring to TPO is "erroneous & prejudicial to interests of revenue"**
2. The assessee entered into international transactions with its AEs, the value of which exceeded Rs. 5 crores. The AO passed an order u/s 143(3) in which *he recorded the finding that he had examined the transactions and found them to be at arms' length and no transfer pricing adjustment was required to be made*. The CIT thereafter passed an order u/s 263 on the ground that in view of **Instruction No. 3 of 2003** dated 20.5.2003, the AO *ought to have referred the issue to the TPO instead of himself determining the arms' length price of the transactions* and that the assessment order was consequently "erroneous and prejudicial to the interests of the revenue". On appeal, the Tribunal (114 TTJ (Del) 1) upheld the revision order. On further appeal by the assessee, HELD dismissing the appeal:

   > Though s. 92CA enables the AO to refer an international transaction to the TPO if he considers it "*necessary or expedient*" to do so, **Instruction No. 3 dated 25.5.2003 makes it *mandatory* for the AO to make a reference to the TPO if the aggregate value of the international transaction exceeds Rs. 5 crores.** This Circular, having been issued u/s 119, is binding on the AO. **The AO ought to have referred the matter to the TPO having regard to the fact that Specialized Cell was created to deal with complicated and complex issues arising out of the transfer mechanism. *The AO's omission to***

follow the binding Circular amounted to making assessment without conducting proper inquiry and investigation and resulted in the order becoming "erroneous and prejudicial to the interest of the Revenue". The observations in **Sony India** 288 ITR 52 (Del) (*while upholding the constitutional validity of the aforesaid Circular*) that the said Circular was a "*Guideline*" which did not take away the discretion of the AO was made in a different context.

Appeal dismissed.

ITA 504 of 2008.
Heard on: 10th October, 2011.
Decided on: 18th November, 2011.
Present at hearing: M.S. Syali, Sr. Advocate with Satyen Sethi, Mahua Kalra, Sumit K. Singh and Tunsal Syali, Advocates, for Appellant. Sanjeev Sabharwal, Sr. Standing Counsel, for Respondent.

JUDGMENT

A.K. Sikri, Acting Chief Justice.–

1. This appeal was admitted on the following two substantial questions of law:–

"1. Whether on the facts and circumstances of the case, the Tribunal erred in law in holding that CIT had validly assumed jurisdiction under Section 263 of the Act?

2. Whether on facts and circumstances of the case, the Tribunal erred in not holding that in terms of Section 92C (3) read with Section 92CA (1) of the Act, the Assessing Officer was fully competent to determine the arm‟s length price of international transactions even if the aggregate value thereof exceeded Rs. 5 crores, without making reference to TPO?"

2. The aforesaid questions have cropped for consideration under the following circumstances.

The appellant is a company incorporated under the Companies Act, 1956 engaged in the business of manufacture and sale of pharmaceutical products, such as, patented and/or generic drugs and medicines. For the relevant previous year, the return of income of the appellant was filed on 29th October, 2004 declaring an income of Rs. 330,64,05,014/-. The appellant entered into certain international transactions with its Associated Enterprises (AEs) in the various overseas foreign jurisdictions, viz., (a) Sale of Active Pharmaceutical Ingredients (API) and spare parts;(b) Sale of dosage formulations: (c) Provision of technical assistance and know-how, etc. The transfer pricing in respect of the said international transactions was carried out by M/s RSM Advisory Services Pvt. Ltd, Chartered Accountants, who issued the certificate in Form 3CEB on the basis of Transfer Pricing study of documentation maintained as per section 92D of the Act read with rule 10D of the Income-Tax Rules, 1962. The international transactions were certified to be at arm‟s length, based on the study carried out. A certificate from a Chartered Accountant in Form 3CEB was appended alongwith the return of income. It is the case of the appellant that the Assessing Officer in the course of scrutiny assessment required the appellant to, inter alia, explain as to whether, in terms of provisions of Section 92 of the Act, transfer price of the various 'international transaction', entered into by the appellant during the relevant previous year, were at arm's length. In response thereto, the appellant vide letter dated 24th March, 2005 submitted before the Assessing Officer complete transfer pricing documentation alongwith the details and an elaborate note justifying that the 'international transactions' were at arm's length having regard to the Transfer Pricing provisions. The Assessing Officer, accepted the transfer price of the 'international transactions' entered into by the appellant as being at arm's length. The Assessing officer in the assessment completed under Section 143(3) of the Act recorded his finding, in this regard, as follows:–

> "in response to the above, the assessee has filed a note alongwith its letter dated 24th March, 2005 and has also produced a copy of transfer pricing document prepared by M/s RSM Advisory Services Pt. Ltd. The assessee has also produced copies of audited accounts of the above AEs for the year 2003 as well as documents/information maintained in support of the Transfer Pricing. After going through the report filed in for No. 3CEB, transfer pricing documents and other details/information furnished, it is observed that M/s RSM Advisory Services Pte. Ltd. after analyzing the comparable data compiled from EXTL & Hoovers Online and doing functional, assets and risks analysis, have reached to the conclusion that as compared to the other prescribed methods, in case of the assessee, TNMM is the Most Appropriate Method. The net margins realized by the uncontrolled comparable companies were identified on similar type of transactions applying the TNMM method. On comparison of the transfer prices charged by the assessee from its Associated Enterprises and net margins thereon, in respect of these international transactions, it is observed that the prices charged by the assessee on international transactions with its Associated Enterprises (AE) were at arm's length. I have also observed that the declared margins/profits as per the books, are higher than the profits/margins computed as per the Most Appropriate Method and, therefore, I hold that the assessee was in compliance of the Transfer Pricing Provisions and the prices charged during the

previous year relevant to the assessment year 2004-05 from its AE in respect of goods and services were at arm‟s length and, therefore, no further adjustment is required".

The assessment was completed on 30th March, 2005 under Section 143(3) of the Act at book profit of Rs.398,48,42,660/- under section 115JB of the Act and at an income of Rs.363,45,44,931/- under regular provisions of the Act as against income of Rs.330,64,05,614/- returned by the appellant, i.e. after making additions/disallowances amounting to Rs.32.81 crores. Thereafter, notice dated 9th March, 2007 was issued by the Commissioner of Income-Tax, Delhi-V, New Delhi (CIT) under Section 263 asking to show cause why the assessment completed under Section 143(3) of the Act be not revised on the grounds that the same was erroneous and prejudicial to the interests of Revenue with regard to determination of arm's length price of international transactions with AEs. It was stated in the show cause notice that the assessment was erroneous and prejudicial to the interests of the Revenue on the following grounds:–

(i) No referring the matter to the TPO as required by instruction no. 3 of 2003 dated 20th May, 2003.

(ii) Taking overseas AEs as tested parties.

(iii) The operating profit/sales in the case of the assessee company worked out to 20.16% as opposed to 26.57% calculated for 4 comparable Indian Companies.

(iv) Non-consideration of findings of audit of the Central Excise department.

In response to the said notice, the appellant vide letter dated 23rd March, 2007 made elaborate submissions before the CIT explaining the various issues raised in the show cause notice. More specifically, the assessee submitted that–

(i) The Assessing Officer was competent to determine the arm‟s length price without reference to the TPO. CBDT instruction no.3 of 2003 was not mandatory and did not take away the jurisdiction of the assessing Officer to himself determine the arm‟s length price;

(ii) The assessee company being a complex entity carrying on multiple functions and owing intangibles, was not taken as the tested party. The foreign AEs being least complex were, therefore, adopted as the tested party. There is no bar in law on taking the foreign AEs as the tested party;

(iii) The comparison made by the CIT of the results of the assessee company with 4 comparable Indian companies suffered from arithmetical inaccuracies. On a proper analysis, on uniform basis, it was seen that the operating profit/sales of the assessee company worked out at 19.45% as against 14.55% for the very same comparable Indian companies taken by the CIT. No adjustment was, therefore, required to be made to the arm‟s length price in respect of international transactions;

(iv) Although the Central Excise Department had carried out the audit, no audit report was issued to the assessee company. No adverse findings were recorded or communicated to the assessee company which is further reinforced by the fact that till date the assessee has not received any show cause notice for the said period from the Central Excise authorities.

3. The CIT (A) however did not countenance the aforesaid submissions of the appellant and passed orders dated 29th March, 2007 holding that assessment completed under Section 143(3) of the Act was erroneous and prejudicial to the interests of the Revenue on account of (i) non-reference of the case to TPO,(ii) taking overseas AEs of assessee as tested party and (iii) non consideration of findings of audit of Central Excise Department. The assessment was set aside on the three grounds as aforesaid. The assessing officer was directed to refer the case to the TOP for determination of arm's length price. Being aggrieved by the aforesaid order, the appellant filed an appeal before the Tribunal. The Tribunal vide order dated 22nd January, 2008 upheld assumption of jurisdiction under Section 263 of the Act by the Commissioner of Income-Tax, Delhi-V, New Delhi.

4. Challenging the aforesaid order of the Tribunal, present appeal is preferred in which aforesaid two questions of law have been formulated for determination. With this background, we take up these questions for our answer.

5. We find from the perusal of the judgment of the Tribunal that the Tribunal has affirmed the invocation of powers by the CIT (A) under Section 263 of the Act on the ground that the Assessing Officer had made the assessment without considering the relevant question without application of mind. It is settled position in law that powers under Section 263 of the Act can be invoked only when assessment is established to be erroneous and prejudicial to the interest of the Revenue. It cannot be invoked merely for making a finding inquiry. Further the order of the Assessing Officer cannot be reviewed merely because any reasonable view of the matter is possible in the case. Thus, when it is found that the Assessing Officer had held an appropriate inquiry and made necessary investigation, on the relevant facts where after he arrived at a particular conclusion, such a conclusion was not to be interfered with by the Commissioner in exercise of his revisionary jurisdiction under Section 263 of the Act. If the view of the Assessing Officer was plausible and taken after due consideration of the entire material that would be the end of the matter. However, the interference with the assessment order was permissible if it is found that the assessment was made without conducting proper inquiry and investigation as enjoyed by law and warranted in the facts of the case.

Than such an order can be termed as erroneous and prejudicial to the interest of the Revenue. This principle of law is supported by the judgment of Supreme Court in *Malabar Industrial Co. Ltd. vs. CIT* 243 ITR 83, wherein it was held:–

> "An incorrect assumption of facts or an incorrect application of law will satisfy the requirement of the order being erroneous. In the same category fall orders passed without applying the principles of natural justice or without application of mind."

In that case the Court found justification in the order of the Commissioner passed under Section 263 of the Act on the following basis:–

> "In the instant case, the Commissioner noted that the Income-tax Officer passed the order of nil assessment without application of mind. Indeed, the High Court recorded the finding that the Income-tax Officer failed to apply his mind to the case in all perspective and the order passed by h8im was erroneous. It appears that the resolution passed by the board of the appellant company was not placed before the Assessing Officer. Thus, there was no material to support the claim of the appellant that the said amount represented compensation for loss of agricultural income. He accepted the entry in the statement of the account filed by the appellant in the absence of any supporting material and without making any inquiry. On these facts the conclusion that the order of the income-tax Officer was erroneous is irresistible. We are, therefore, of the opinion that the High Court has rightly held that the exercise of the jurisdiction by the Commissioner under Section 263(1) was justified."

6. The Tribunal also took note of the following observation contained in *Jagdish Kumar Gulati vs. CIT*, 269 ITR 71:–

> "It is well settled that if the Assessing Officer fails to make a proper enquiry this is erroneous and prejudicial to the interest of the Revenue vide *K.A .Ramaswamy Chettiar vs. CIT* (1996) 220 ITR 657 (mad; *Addl. CIT vs. Mukur Corporation* (19978) 111 ITR 312 (Guj); *Gee Vee Enterprises vs.Addl. CIT* (1975) 99 ITR 375 (Del); *Malabar Industrial Co. Ltd. vs. CIT* [2000] 243 ITR 83 (SC); *CIT vs. Active Traders 9P) Ltd.* [1995] 214 ITR 583 (Cal); *Swarup Vegetable Products Industries Ltd. (No.1) vs. CIT* [1991] 187 ITR 412 (All.); *CIT vs. Rampiyari Khemka* [1067] 63 ITR 367 (Cal.); *Bagsu Devi Bafna vs. CIT* [1967] 63 ITR 333 (Cal); *CIT vs. Kiran Debi Singhee* [1967] 65 ITR 167 (MP); *CIT vs. Everest Cold Storage* [1996] 220 ITR 241 (MP) and *Duggal and Co. vs. CIT* [1996] 220 ITR 456 (Delhi), etc."

7. This position of law was not disputed by the learned counsel for the appellant before the Tribunal or before us. The entire case, therefore rest on the issue as to whether the Assessing Officer had made the

assessment without application of mind or without making proper inquiry into the facts and without considering the statutory provision applicable thereof whereas the Tribunal has held it to be so while affirming the order of the CIT (A), the appellant feels otherwise.

8. In this behalf, the submission of Mr. Syali, learned Senior Counsel appearing for the appellant was that the only basis of interference with the order of the Assessing Officer was that the Assessing Officer took the view himself that the price determine was arm‟s length price without referring the matter to the Transfer Pricing Officer. It was submitted that the CIT (A) or for that matter the Tribunal was wrong in holding that without referring the question of determination of arm's length price to the TPO, the Assessing Officer could not have determined the same. The submission was that the Assessing Officer had ample power and discretion to carry out this exercise. In any case, failure to make reference was only 'procedural irregularity' which could not be the basis of treating the assessment as erroneous and prejudicial to the interest of the Revenue. In support of this submission, Mr. Syali referred to the provisions of Rule 10B of the Income-tax Rules as well as Section 92C of the Act. Predicated on these provisions, the submission was that Section 92C of the Act provides for computation of arm's length price in relation to an 'international transaction'. Sub-Section (3) thereof empowers the Assessing Officer to determine the arm's length price and computation of total income of the assessee subject to conditions provided in clauses (a),(b),(c) and (d) thereof. It was argued that Section 92CA (1) of the Act provides that, where the Assessing Officer considers it 'necessary or expedient' so to do, he may refer computation of arm's length price in relation to an international transaction to the TPO with the previous approval of the CIT. Even in a case where reference is made to the TPO, the Assessing Officer is the final adjudicating authority for determining the arm‟s length price of international transactions; the Assessing officer is not bound by the determination made by the TPO (prior to the amendment in Section 92CA(4) w.e.f. 1.6.2007). Thus, it was argued that when the ultimate authority was the Assessing officer himself, it did not make any difference if he chose not to make the reference to TPO as according to him it was not "necessary or expedient" so to do.

9. Mr. Syali further submitted that while holding that such a reference was compulsory in case the aggregate value of transaction exceeds Rs. 5 crores, the CIT (A) and the Tribunal had relied upon the CBDT instruction no.3 dated 20th May, 2003 by CBDT. According to Mr. Syali, this was misreading of the said instruction which was only in the nature of a guideline as held by this Court in Sony India Pvt. Ltd. vs. Central Board of Direct Taxes and Another 288 ITR 52. Relevant portion of this instruction reads as under:–

> "…wherever the aggregate value of international transactions exceeds Rs. 5 crores, the cases should be picked up for scrutiny and reference under Section 92CA be made to the TPO. If there

are more than one transaction with the associated enterprise or there are transaction with more than one associate enterprise, the aggregate value of which exceeded Rs. 5 crores, the transaction should be referred to the TPO."

He submitted that judgment in *Sony India* (supra) would bring forth the following principle qua the aforesaid instruction viz-a-viz powers of the Assessing Officer under Section 92C of the Act:–

"a. The assessing officer may refer the case for determination of the arm's length price to the TPO where the assessing officer considers it necessary and expedient to do so.

b. Prior approval of the CIT is required before making the reference.

c. Instruction No.3 of 2003 is in the nature of guideline to the AO.

d. Even pursuant to issue of the said Instruction, the powers of the assessing Officer are not usurped by the TPO or any other authority, contrary to the scheme of the Act.

e. The Instruction supplements the discretion of the assessing officer and does not supplant the same.

f. The exercise of discretion by the assessing officer in referring the case to the TPO is subject to judicial review by the appellate authority

g. The assessing officer may even refer cases to the TPO where the aggregate value of international transactions is below Rs. 5 crores, where the assessing officer considers it necessary or expedient to do so

h. The assessing officer is not bound to accept the arm's length price as determined by the TPO."

10. He argued that CBDT instructions did not seek to supplant the discretion of the Assessing Officer by making it mandatory for the Assessing Officer to refer the case to the TPO. Relying upon the judgment of the Apex Court in the case of *Kerala Financial Corporation vs. CIT* 201 ITR 129, Mr. Syali argued that a circular in any case could not control the quasi judicial discretion of the Assessing Officer. He also referred to another judgment of this Court in *Maruti Suzuki India Ltd. vs. Addl. CIT*, 328 ITR 210 and particularly the following observations therein:–

> "Section 92CA of the Income-tax Act 1961 (hereinafter referred to as the Act) provides that where the assessee has entered into an international transaction and the Assessing Officer considers it necessary or expedient to do so he may, with the previous approval of the Commissioner, refer computation of the arm"s length price, in relation to the said international transaction, under Section 92CA , to the TPO. Since the reference to the TPO is not mandatory, ordinarily the assessing Officer would make

> reference to TPO in those cases, where he is not in agreement with the price disclosed by the assessee or where, on account of the complex nature of the transaction, he feels that the arm‟s length price needs to be determined by the TPO."

Mr. Sabharwal, on the other hand argued that all these submissions of the appellant which were advanced before the Tribunal as well were duly taken note of and after due consideration by a well reasoned order, the Tribunal has repelled these contentions. He read out those portions of the order of the Tribunal and submitted that the reasons given by the Tribunal were valid.

11. It is not in dispute that under Section 92CA of the Act enables the Assessing Officer to refer computer of arm‟s length price in relation the an international transaction, under Section 92C of the Act, when the Assessing Officer considers it „necessary or expedient‟ to do so. Thus, discretion lies with the Assessing Officer. Having regard to the circumstances of a particular case and reference to the TPO is not mandatory. In *Maruti Suzuki* (supra) this Court observed that ordinarily the Assessing Officer would make reference to the TPOs in those cases where he is not in agreement with the particular price disclosed by the assessee or where, on account of complex nature of the transaction, he feels that the arm‟s length price needs to be determined by the TPO. So far so good. However, further question that has arisen for consideration is as to whether it becomes mandatory on the part of the Assessing Officer to make reference wherever the aggregate value of international transaction exceeds Rs. 5 crores? Instruction no.3 of the CBDT dated 25th May, 2003 makes a stipulation to this effect. The Central Board of Direct Taxes, therefore, have decided that wherever the aggregate value of international transaction exceeds Rs. 5 crores, the case should be picked up for scrutiny and reference under Section 92CA be made to the TPO.

12. It was a common case that the CBDT has issued this Circular in exercise of its powers under Section 119 of the Act. Special Bench of the Tribunal in the case of *Aztec Software & Technology vs. ACIT*, 2009 TIOL 170 has upheld the validity of this circular. While doing so, the Special Bench has relied upon the judgment of this Court in *Sony India* (supra). The contention of the appellant before the Tribunal, which was repeated before us was that the aforesaid view of the Special Bench is erroneous and rather contrary to the decision of this Court in *Sony India* (supra). Dismissing this contention of the appellant, the Tribunal had stated as under:–

> "on careful consideration of decision of Sony India P. Ltd.(supra) and that of Special Bench I the case of Aztec Software (supra), we do not find any good reason to accept the argument of Shri Vohra and interpretation he has put on the decision in the case of Sony India P. Ltd. leading to his inference that it is not necessary for Assessing officer to make a reference to TPO even the value of international transaction exceeds Rs. 5 crores. The constitutional

validity of above instructions dated May 20, 2003 was challenged under Article 226/227 of the constitution and contentions of the petitioner are recorded at page 59 of the report. It was claimed that classification of international transaction into two categories, those of value exceeding Rs. 5 crore and others less than Rs. 5 crores was not based on any intelligible differentia and, therefore, such instructions were violative o f Article 14 of the Constitution. Instructions issued u/s 119 of the I.T. Act were ultra vires of the statutory provision. The quasi-judicial discretion of the Assessing Officer has been taken away. 69. Their Lordships considered relevant scheme of the Act relating to transfer pricing under Indian regulation, its purposes and the legal validity of above instructions. The matter for consideration was taken in two parts: Firstly, statutory provisions were considered in detail without going into the question of validity of the instruction; and secondly, the question of validity of instructions was considered in the light of Article 14 of the Constitution. It is quite clear from what is stated above in paras 12, 29 and 31 of the judgment. Shri Vohra has referred to that part of the decision where discretion of Assessing Officer to determine Arm‟s Length Price in respect of transaction of value of less than Rs. 5 crore remaining unaffected is discussed. While maintaining the validity of the instructions, their lordships made pertinent observations in para 32 and 37. Para 37 has already been quoted. Para 32 is as under:–

> 32. Applying the above test, the impugned instruction cannot be held to violate article 14. The classification brought about by the impugned instruction is based on a straightforward recognizable basis giving no room for confusion. Transactions of a high value require a careful examination to determine if the declared price is in fact an acceptable ALP. It may not be expedient for the Assessing Officer to efficiently deal with the assessment involving such an exercise. In that sense it achieves the expeditious disposal of the assessment by the Assessing Officer if the exercise is referred for a specialized determination by the Transfer Pricing Officer. The classification certainly bears a nexus to this objective. We are of the considered view that the challenge to the impugned instruction on the ground of "suspect classification" must fail.

13. On the basis of aforesaid reasoning, the Tribunal concluded that once validity of CBDT Circular was upheld, as per the said circular the Assessing Officer was duty bound to refer the matter to the TPO having regard to the purpose of Specialized Cell created by the Revenue Department to deal with complicated and complex issues and since this channel was not resorted to by the Assessing Officer in the instant case, the Commissioner was right in passing the order under Section 263 of the Act.

14. No doubt, the validity of the said instruction was upheld on the touch stone of Article 14 of the Constitution holding that it was based on reasonable classification and there was rationale nexus with the objectives sought to be achieved. At the same time, we feel that while doing so this Court had also laid down the rigors of the said Circular. No doubt, this Court observed, in the process that the said Circular acted as a guideline to the Assessing officer. However, much mileage cannot be drawn by the appellant from those observations as these observations were made while dealing with the contention of the petitioner in the said petition. That instruction completely takes away the discretion of the Assessing Officer in relation to an international transaction if the aggregate value thereof exceeded Rs. 5 crores. This contention was turned down in the following words:–

> "37. The other ground on which the instruction is challenged is that it completely takes away the discretion of the AO in relation to an international transaction of the value exceeding Rs. 5 crores. A reading of the impugned instruction indicates that it acts as a guideline to the AO in the exercise of the discretion conferred under Section 92CA(1). This instruction is in fact helpful in ensuring that the discretion of the AO will not be abused. It correctly interprets the law as requiring only a formation of a prima facie opinion by the AO at the stage of the reference. Therefore, the question of the CBDT supplanting the judicial discretion of the AO does not arise. It is perfectly possible that, independent of the circular, the AO might still "consider it necessary or expedient" to refer an international transaction of such value to the TPO for determination of the ALP. At the same time it is not as if the transactions of the value of less than Rs. 5 crores cannot be referred to the TPO by the AO. Ultimately, any exercise of discretion by the AO is bound to be judicially reviewed by the statutory appellate authorities as well as by courts. Therefore, it is not as if there is no check on the exercise of discretion by the AO.
>
> 39. For these reasons, we hold that the impugned Instruction No. 3 dated 20.5.2003 issued by the CBDT is consistent with the statutory objective underlying Section 92CA(1) and acts as a guidance to the AO in the exercise of discretion in referring an international transaction to the TPO for determination of its ALP. It is neither arbitrary nor unreasonable, and is not ultra virus the Act.

15. It is clear from the above that this Court held that referring of the matter to the TPO for determination of arm‟s length price acts as a guide to the AO and is, in fact helpful in ensuring that the discretion of the Assessing Officer will not be abused.

16. We thus agree with the view taken by the Tribunal that the judgment of Special Bench in *Aztec Software* (supra) is not in conflict with *Sony India* (supra) once the validity of said instruction is upheld by this Court. The followup thereof is that the Assessing Officer was supposed t refer the matter to the TPO having regard to the fact that Specialized Cell was created by the Revenue Department to deal with the complicated and complex issues arising out of the transfer mechanism. The Tribunal was right in holding that even the instant case itself provides a good example for need to refer the matter to TPO in such cases. When circular is issued under Section 119 of the Act and its validity is upheld it is binding on the Assessing Officer. Not taking recourse thereto and passing the order amounted to making assessment without conducting proper inquiry and investigation as enjoyed by law which was also warranted in the facts of this case and, therefore, the Commissioner was right in holding that such assessment was erroneous and prejudicial to the interest of the Revenue in the light of law laid down by the Apex Court in *Malabar Industrial Co. Ltd.* (supra).

17. We thus answer both the questions in favour of the Revenue and against the assessee. As a result, this appeal is dismissed.

18. No order as to costs.

2012 PTR 58 (H.C. Del.)

HIGH COURT OF NEW DELHI

A.K. Sikri, and Siddharth Mridul, J.

Commissioner of Income Tax
v.
SPL's Siddhartha Ltd.

FACTS/HELD

1. **Section 147: Sanction of CIT instead of JCIT renders reopening invalid**
2. The AO issued a notice u/s 148 to reopen an assessment. As a s. 143 (3) order had not been passed & 4 years had elapsed, the AO *ought to have obtained the sanction of the Joint/Additional CIT u/s 151(2)*. Instead, *he routed the file through the Additional CIT and obtained the sanction of the CIT*. On appeal by the assessee, the

Tribunal struck down the reopening on the ground that *correct sanction had not been obtained*. On appeal by the department, HELD upholding the Tribunal:

(i) S. 151(2) requires the sanction to be accorded by the Joint/Additional CIT. The AO sought the sanction of the CIT. **Though the file was routed through the Addl. CIT, the latter only made an endorsement "*CIT may kindly accord sanction*". This showed that the Addl. CIT did not apply his mind or gave any sanction**. Instead, he requested the CIT to accord approval. This is not an irregularity curable u/s 292B;

(ii) The different authorities specified in s. 116 have to exercise their powers in accordance with law. **If powers conferred on a particular authority are arrogated by other authority without mandate of law, it will create chaos in the administration of law and hierarchy of administration will mean nothing. Satisfaction of one authority cannot be substituted by the satisfaction of the other authority**. If the statute requires a thing to be done in a certain manner it has to be done in that manner alone. Also, the designated authority should apply his independent mind to record his satisfaction and it should not be at the behest of a superior authority.

Appeal accordingly dismissed.

ITA No.836 of 2011.
Decided on: 14th September, 2011.
Present at hearing: Sanjeev Rajpal, Sr. Standing Counsel, for Appellant. Dr. Rakesh Gupta, Advocate with Ashwani Taneja, Rani Kiyala and Kunal Nagpal, Advocates, for Respondent.

JUDGMENT

A.K. Sikri, J.–

1. The notice issued by the AO under Section 147 read with Section 148 of the Income Tax Act (hereinafter referred to as 'the Act') for reopening the assessment for the Assessment Year 2002-03 has been set aside by the Income Tax Appellate Tribunal ('the Tribunal' for brevity) on the ground that the requisite approval of Additional Commissioner of Income Tax, which is mandatorily required, was not taken. Income tax return in this case was filed on 26.9.2002 at the loss of Rs.27.63 lacs. The same was processed under Section 143(1) on 26.2.2003. Thereafter, notice under Section 147 read with Section 148 of the Act for reassessment was

issued on 12.3.2009. This was much after the expiry of four years from the end of the relevant assessment year. The basis for issuance of the notice was that the inquiries conducted by Investment Wing of the Department had revealed that Mr. Dipak Gupta was indulging in providing the accommodation entries and he had admitted that he had taken cash from various parties and given them Demand Drafts/Cheques by charging commission. DDs/Cheques then were introduced as share capital or loan in their books of accounts. On that basis, it was alleged that insofar as the assessee is concerned, three bogus parties had given accommodation entries for a total sum of Rs.5 lacs. Since four years had elapsed, the AO was required to take approval of the Competent Authority under Section 151 (1) of the Act. This provision reads as under:

> **<u>Section 151. Sanction for Issue of Notice:</u>**
>
> (1) In a case where an assessment under sub-section (3) of section 143 or section 147 has been made for the relevant assessment year, no notice shall be issued under section 148 by an Assessing Officer, who is below the rank of Assistant Commissioner or Deputy Commissioner unless the Joint Commissioner is satisfied on the reasons recorded by such Assessing Officer that it is a fit case for the issue of such notice:
>
> > Provided that, after the expiry of four years from the end of the relevant assessment year, no such notice shall be issued unless the Chief Commissioner or Commissioner is satisfied, on the reasons recorded by the Assessing Officer aforesaid, that it is a fit case for the issue of such notice.
>
> (2) In a case other than a case falling under sub-section (1), no notice shall be issued under section 148 by an Assessing Officer, who is below the rank of Deputy Commissioner, after the expiry of four years from the end of the relevant assessment year, unless the Joint Commissioner is satisfied, on the reasons recorded by such Assessing Officer, that it is a fit case for the issue of such notice."

2. As per the aforesaid provision, it is only Joint Commissioner or Additional Commissioner, which can grant the approval. The argument of the assessee before the Tribunal was that the approval was not granted by the Joint Commissioner. Instead, it was taken from the CIT, Delhi-III, New Delhi, who was not competent to approve even when he was a higher Authority inasmuch as Section 151 of the Act specifically mentions Joint Commissioner as the Competent Authority. This contention of the respondent-assessee has been accepted by the Tribunal thereby quashing the assessment proceedings. The contention of the Revenue that it was merely an irregularity committed by the AO and was rectifiable under Section 292B of the Act, has not been found convincing by the Tribunal.

3. During the course of the argument, learned counsel for the appellant submitted that the matter was routed through the Additional Commissioner of Income Tax and therefore, it should be treated that the Additional Commissioner of Income Tax had granted the requisite sanction. In order to verify the contention, we had called the records. From the records, we find that the Notings dated 12.3.2009 was prepared by the AO after recording his reasons, insofar as seeking approval is concerned. Relevant portion of the Note is as under:

> "Since 4 years have been elapsed, the assessment record is being submitted for kind perusal and approval of the Commissioner of Income tax, Delhi-III, New Delhi according to section 151(1) of the IT Act, 1961 for issuance of notice u/s 148 of the I.T. Act.
>
> Sd/-
> (D.D. YADAV)
> Asstt. Commissioner of Income tax
> Circle 9(1), New Delhi.
>
> **Addl. CIT, Range – 9, New Delhi**
>
> *CIT may kindly accord sanction.*
>
> CIT-III, Delhi
>
> Sd/-
>
> 12.03.09"

4. The aforesaid noting in the file does not reflect what learned counsel for the Revenue argued. In the first instance, it would be seen that the AO had specifically sought the approval of the Commissioner only. Therefore, it cannot be said that the Joint Commissioner/Additional Commissioner had granted the approval. Further, no doubt, the file was routed through Additional Commissioner. However, he also, in turn forwarded the same to the Commissioner by giving the following endorsement:

"CIT may kindly accord sanction."

5. It is clear that the Additional CIT did not apply his mind or gave any sanction. Instead, he requested Commissioner to accord the approval. It, thus, cannot be said that it is an irregularity curable under Section 292B of the Act.

6. It is relevant to point out that sub-Section (1) and sub-Section 2 of Section 151 of the Act are two independent provisions. The definition of Joint Commissioner is contained in Section 2(28C) and the definition of Commissioner given in Section 2(16), which are as under:

> "Joint Commissioner means a person appointed to be a Joint Commissioner of Income Tax or an Additional Commissioner of Income Tax under sub-Section (1) of Section 117.

> "Commissioner" means a person appointed to be a Commissioner of Income Tax under sub-Section(1) of Section 117."

7. Section 116 of the Act also defines the Income Tax Authorities as different and distinct Authorities. Such different and distinct authorities have to exercise their powers in accordance with law as per the powers given to them in specified circumstances. If powers conferred on a particular authority are arrogated by other authority without mandate of law, it will create chaos in the administration of law and hierarchy of administration will mean nothing. Satisfaction of one authority cannot be substituted by the satisfaction of the other authority. It is trite that when a statute requires, a thing to be done in a certain manner, it shall be done in that manner alone and the Court would not expect its being done in some other manner. It was so held in the following decisions:

(i) *CIT vs. Naveen Khanna* (dated 18.11.2009 in ITA No.21/2009 (DHC).

(ii) *State of Bihar vs. J.A.C. Saldanna & Ors.* AIR (1980) SC 326.

(iii) *State of Gujarat vs. Shantilal Mangaldas*, AIR (1969) SCN 634.

8. Thus, if authority is given expressly by affirmative words upon a defined condition, the expression of that condition excludes the doing of the Act authorised under other circumstances than those as defined. It is also established principle of law that if a particular authority has been designated to record his/her satisfaction on any particular issue, then it is that authority alone who should apply his/her independent mind to record his/her satisfaction and further mandatory condition is that the satisfaction recorded should be "independent" and not "borrowed" or "dictated" satisfaction. Law in this regard is now sell-settled. In *Sheo Narain Jaiswal & Ors. vs. ITO*, 176 ITR 35 (Pat.), it was held:

> "Where the Assessing Officer does not himself exercise his jurisdiction under Section 147 but merely acts at the behest of any superior authority, it must be held that assumption of jurisdiction was bad for non-satisfaction of the condition precedent."

5. The Apex Court in the case of *Anirudh Sinhji Karan Sinhji Jadeja vs. State of Gujarat*, (1995) 5 SCC 302 has held that if a statutory authority has been vested with jurisdiction, he has to exercise it according to its own discretion. If discretion is exercised under the direction or in compliance with some higher authorities instruction, then it will be a case of failure to exercise discretion altogether.

6. We are, therefore, of the opinion that the Tribunal has rightly decided the legal aspect, keeping in view well-established principles of law laid down in catena of judgments including that of the Supreme Court.

7. No question of law arises. This appeal is accordingly dismissed.

2012 PTR 63 (H.C. Del.)

HIGH COURT OF NEW DELHI

Sanjiv Khanna and R.V. Easwar, JJ.

Director of Income Tax
v.
Rio Tinto Technical Services

FACTS/HELD

1. **Even if not assessable as "fees for technical services" under DTAA, bar in s. 44D against deduction of expenses will apply**

2. The assessee, an Australian company, set up a permanent establishment (PE) in India to render technical services for evaluation of coal deposits and conducting feasibility studies for transportation of iron ore. The AO & CIT (A) held that the payments received by the assessee were taxable as "fee for technical services" u/s 9(1)(vii) read with s. 115A on a gross basis without any deduction in view of s. 44D at the rate of 20%. On appeal, the Tribunal (39 DTR 327 (Del)) held that as the assessee had a PE in India, the receipts were chargeable to tax as "business profits" after deduction of expenses under Article 7 of the DTAA and s. 44D & 115A did not apply. On appeal by the department, HELD partly reversing the Tribunal:

   (i) As the assessee had a PE in India from which the income arose, **the income was chargeable to tax as "business profits" under Article 7** of the DTAA and not as "fees for technical services" under Article 12;

   (ii) Article 7(3) permits a deduction of expenditure "in accordance with and subject to limitations of the law" relating to tax in India including executive and general administrative expenses so incurred regardless whether they have incurred in India or elsewhere. The words "in accordance with and subject to limitation of the law relating to tax" **applies not only to the "executive and**

general administrative expenses" but to all expenditure;

(iii) **The income received by the assessee, though not assessable as "fees for technical services" under the DTAA, is "fees for technical services" under Explanation 2 to s. 9(1)(vii)** because it is for providing technical information and does not arise from a "project". **Consequently, s. 44D, which provides that no deduction shall be admissible while computing income of the nature of "fees for technical services" shall apply.**

Accordingly disposed of.

Income Tax Appeal Nos. 486/2011, 491/2011 & 492/2011.
Heard on: 21st October, 2011.
Decided on: 4th January, 2012.
Present at hearing: Sanjeev Sabharwal, Advocate, for Appellant. Salil Kapoor, Ankit Gupta, Sanat Kapoor and Vikas Jain, Advocates, for Respondent.

JUDGMENT

Sanjiv Khanna, J.–

Revenue has preferred these appeals under Section 260A of the Income Tax Act, 1961 (Act, for short) and vide order dated 8th August, 2011 the following substantial questions of law were framed:–

"(1) Whether learned ITAT erred in holding that the assessee's activities are not FTS within the definition of FTS stated in Articles 12 of the Double Definition of FTS stated in Articles 12 of the Double Taxation Avoidance Agreement?

(2) Whether learned ITAT erred in holding that Articles 7 of the Indo-Australia DTAA will be applicable and hence such income has to be construed as business income?

(3) Whether provisions of Section 115A read with Section 44D of the Income Tax Act, 1961 are not applicable in the facts present case?"

2. The respondent assessee-Rio Tinto Technological Resources TY Limited, during the years in question i.e. the Assessment Years 1999-2000, 2000-01 and 2001-02 had operated in India through its division Rio Tinto Technical Services. The respondent-assessee had filed returns on 2nd February, 1999, 17th November, 2000 and 22nd October, 2001 declaring loss of Rs.2,00,970/-, positive income of Rs.23,88,700/- and Rs.12,50,930/- in respect of the three assessment years mentioned above. The three returns were taken up for regular assessment under Section

143(3) of the Act and the Assessing Officer vide assessment orders dated 25th February, 2002, 21st March, 2003 and 27th January, 2004 held that the payments received by the assessee from Rio Tinto India Private Limited and Rio Tinto Orissa Mining Limited (RTIPL and RTOML respectively, for short) were taxable as fee for technical services under Section 9(1)(vii) read with Section 115A of the Act and the gross receipts without any deduction were taxable at the rate of 20% in view of Section 44D of the Act. It was held that Articles 7 and 12 of the Double Taxation Avoidance Agreement between India and Australia (DTAA, for short) were not applicable. The income of the assessee for the three years was enhanced to Rs. 30,05,20,535/-, Rs. 1,41,46,440/- and Rs.36,53,188/- for the Assessment Years 1999-2000, 2000-01 and 2001-02, respectively. This income or the gross receipts were held as taxable at the flat rate of 20% without deduction of expenses.

3. The assessee was unsuccessful in the first appeal.

4. However, the Income Tax Appellate Tribunal (the tribunal, for short), by their common order for the three assessment years dated 19th March, 2010 has accepted the stand and stance of the assessee. Paragraph 4.3 of the said order, which is the operative portion and gives the ratio of the findings recorded by the tribunal, for the sake of convenience is reproduced below:–

> "4.3 Thus, applying these provisions to the facts to the present case, it is noticed that the assessee having admitted that it has PE in India and the income of the assessee is taxable in India and the assessee having opted to be taxed as per the provisions of the DTAA it is Article 7 of the DTAA which applies to the assessee's case in so far as the assessee has a PE in India. Thus, as per Article 7(2) of the DTAA, the PE of the assessee would have to be treated as a wholly independent enterprise, which is liable to be taxed in India. Once it is held that the assessee is liable to be taxed as per Article 7 of the DTAA, sub-clause (3) of Article 7 of the DTAA would come into play and deduction in accordance with the subject to the law relating to the tax in India would apply. Since it is held that Article 7 of the Act would no more be applicable as Article 7(2) of the DTAA specifies that the PE of the assese is to be treated as a wholly independent enterprise and it is the profits of such PE in India which are to be taxed. Since Article 7 of the DTAA is applied, Section 44D and Section 115A of the Act also will not apply in so far as they relate to foreign companies, whereas clause (2) of Article 7 of the DTAA specifies that the PE in India is to be treated as a wholly independent enterprise in India. In such a situation, sub-clause (3) of Article 7 of DTAA would come into play and the income of the assessee would have to be assessed by applying the regular provisions of the Indian Tax Laws. In

short, the assessee herein would be liable to be assessed as an entity separately assessable in its own independent capacity in India and the provisions of Sections 28 to 43C of the Act would be available to the assessee. What is to be understood here is that it is the business profits which are chargeable under Article 7 of the DTAA. So as to what the business of the assessee is, is also to be considered. The business of the assessee is as per the contracts entered into by the assessee with the various persons. The contracts are inclusive contracts of technical nature, as also drilling, etc., as extracted earlier. Thus, it cannot be said that he activities of the assessee is purely technical service. The drilling and excavation and testing cannot be de-linked from the evaluation and the feasibility studies. It is a consolidated activity. Thus, the activities of the assessee cannot be held to fall within Article 12 of the DTAA also. In these circumstances, the assessee having opted to be taxed under the DTAA, this option cannot be denied to the assessee and as per sub-clauses (2) and (3) of Article 7. The assessee is to be taxed as an independent enterprise in India and the regular provisions of the Indian tax Laws would apply to the exclusion of Section 9(1)(vii), section 44D and 115A of the Act. In these circumstances, the orders of the lower authorities are reversed and the appeals of the assessee are allowed."

5. A dissection of the said paragraph shows that the tribunal has held as follows:–

(i) The assessee had a permanent establishment (PE, for short) in India. This is a very important fact and is not disputed or denied by the Revenue or the assessee.

(ii) Assessee had opted to be taxed under DTAA and in terms of Article 7(2), the PE in India was to be treated as an independent enterprise, that was liable to be taxed in India.

(iii) Once income is held to be taxable under Article 7, then paragraph 3 of the said Article has to be given full effect to and accordingly (1) deduction in accordance with and subject to the law relating to tax in India will apply; (2) Section 9(1)(vii) of the Act is not applicable; (3) Section 44D and Section 115A will also not apply, but provisions of Section 28 to 43C of the Act are applicable and the assessee is entitled to deduct expenses before computing taxable income.

(iv) The contracts under which payments have been made were inclusive contracts of technical services and drilling and excavation etc. and, therefore, the activities of the assessee were not of purely technical nature. The activities of the assessee were consolidated activities of multifarious character and include drilling, excavation and testing.

(v) In view of "composite activities" Article 12 of DTAA is not applicable.

6. In order to appreciate the controversy, it is important to examine and interpret Articles 7 and 12 of the DTAA and Sections 90, 9(1)(vii) and 44D of the Act. These have been reproduced below:

"AGREEMENT BETWEEN THE GOVERNMENT OF THE REPUBLIC OF INDIA AND THE GOVERNMENT OF AUSTRALIA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

Article 7--BUSINESS PROFITS

(1) The profits of an enterprise of one of the Contracting States shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to:

(a) that permanent establishment; or

(b) sales within that other Contracting State of goods or merchandise of the same or a similar kind as those sold, or other business activities of the same or a similar kind as those carried on, through that permanent establishment.

(2) Subject to the provisions of paragraph (3), where an enterprise of one of the Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment or with other enterprises with which it deals.

(3) In the determination of the profits of a permanent establishment, there shall be allowed as deductions, in accordance with and subject to the limitations of the law relating to tax in the Contracting State in which the permanent establishment is situated, expenses of the enterprise, being expenses which are incurred for the purposes of the business of the permanent establishment (including executive and general administrative expenses so incurred), whether incurred in the

Contracting State in which the permanent establishment is situated or elsewhere.

(4) No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

(5) Where the correct amount of profits attributable to a permanent establishment is incapable of determination by the taxation authority of one of the Contracting States or the ascertaining thereof by that authority presents exceptional difficulties, nothing in this Article shall affect the application of any law of that State relating to the determination of the tax liability of a person, provided that the law shall be applied, so far as the information available to that authority permits, in accordance with the principles of this Article.

(6) For the purposes of the preceding paragraphs of this Article, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

(7) Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article.

(8) Nothing in this Article shall affect the operation of any law of a Contracting State relating to tax imposed on profits from insurance with non-residents provided that if the relevant law in force in either Contracting State at the date of signature of this Agreement is varied (otherwise than in minor respects so as not to affect its general character) the Contracting States shall consult with each other with a view to agreeing to any amendment of this paragraph that may be appropriate.

(9) Where:

(a) a resident of one of the Contracting States is beneficially entitled, whether directly or through one or more interposed trust estates, to a share of the business profits of an enterprise carried on in the other Contracting State by the trustee of a trust estate other than a trust estate which is treated in that other State as a company for tax purposes; and

(b) in relation to that enterprise, that trustee would, in accordance with the principles of Article 5, have a permanent establishment in that other Contracting State, the enterprise carried on by the trustee shall be deemed to be a business carried on in that other Contracting State by that resident through a permanent establishment situated therein and that share of business profits shall be attributed to that permanent establishment.

Article 12---ROYALTIES

(1) Royalties arising in one of the Contracting States, being royalties to which a resident of the other Contracting State is beneficially entitled, may be taxed in that other State.

(2) Such royalties may also be taxed in the Contracting State in which they arise, and according to the law of that State, but the tax so charged shall not exceed:

(a) in the case of:

(i) royalties referred to in sub-paragraph (3)(b);

(ii) payments or credits for services referred to in sub-paragraph (3)(d), subject to sub-paragraphs (3)(h) to (I), that are ancillary and subsidiary to the application or enjoyment of equipment for which payments or credits are made under sub-paragraph (3)(b); or

(iii) royalties referred to in sub-paragraph (3)(f) that relate to equipment mentioned in sub-paragraph (3)(b): 10 per cent. of the gross amount of the royalties; and

(b) in the case of other royalties:

(i) during the first five years of income for which this Agreement has effect:

(A) where the payer is the Government or a political sub-division of that State or a public sector company: 15 per cent. of the gross amount of the royalties; and

(B) in all other cases: 20 per cent. of the gross amount of the royalties; and

(ii) during all subsequent years of income: 15 per cent. of the gross amount of the royalties.

(3) The term "royalties" in this article means payments or credits, whether periodical or not, and, however described or computed, to the extent to which they are made as consideration for:

(a) the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark, or other like property or right;

(b) the use of, or the right to use, any industrial, commercial or scientific equipment;

(c) the supply of scientific, technical, industrial or commercial knowledge or information;

(d) the rendering of any technical or consultancy services (including those of technical or other personnel) which are ancillary and subsidiary to the application or enjoyment of any such property or right as is mentioned in sub-paragraph (a), any such equipment as is mentioned in sub-paragraph (b) or any such knowledge or information as is mentioned in sub-paragraph (c);

(e) the use of, or the right to use:

(i) motion picture films;

(ii) films or video tapes for use in connection with television; or

(iii) tapes for use in connection with radio broadcasting;

(f) total or partial forbearance in respect of the use or supply of any property or right referred to in sub-paragraphs (a) to (e); or

(g) the rendering of any services (including those of technical or other personnel) which make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or design;

but that term does not include payments or credits relating to services mentioned in sub-paragraphs (d) and (g) that are made:

(h) for services that are ancillary and subsidiary, and inextricably and essentially linked, to a sale of property;

(i) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;

(j) for teaching in or by an educational institution;

(k) for services for the personal use of the individual or individuals making the payments or credits; or

(l) to an employee of the person making the payments or credits or to any individual or firm of individuals (other than a company) for professional services as defined in article 14.

(4) The provisions of paragraphs (1) and (2) shall not apply if the person beneficially entitled to the royalties, being a resident of one of the Contracting States, carries on business in the other Contracting State, in which the royalties arise, through a

permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the property, right or services in respect of which the royalties are paid or credited are effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

(5) Royalties shall be deemed to arise in a Contracting State when the payer is that State itself or a political sub-division or local authority of that State or a person who is a resident of that State for the purposes of its tax. Where, however, the person paying the royalties, whether the person is a resident of one of the Contracting States or not, has in one of the Contracting States or outside both Contracting States a permanent establishment or fixed base in connection with which the liability to pay the royalties was incurred, and the royalties are borne by the permanent establishment or fixed base, then the royalties shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

(6) Where, owing to a special relationship between the payer and the person beneficially entitled to the royalties, or between both of them and some other person, the amount of the royalties paid or credited, having regard to what they are paid or credited for, exceeds the amount which might have been expected to have been agreed upon by the payer and the person so entitled in the absence of such relationship, the provisions of this article shall apply only to the last mentioned amount. In that case, the excess part of the amount of the interest paid or credited shall remain taxable according to law, relating to tax, of each Contracting State, but subject to the other provisions of this Agreement.

<u>Income Tax Act, 1961</u>

Section 9-- Income deemed to accrue or arise in India.

(1) The following incomes shall be deemed to accrue or arise in India –

X X X X

(vii) income by way of fees for technical services payable by--

(a) the Government ; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day April, 1976, and approved by the Central Government.

Explanation 1.--For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.

Explanation 2.--For the purposes of this clause, “fees for technical services” means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recepient or consideration which would be income of the recipient chargeable under the head “Salaries”.

Section 44D-- Special provisions for computing income by way of royalties, etc., in the case of foreign companies.--Notwithstanding anything to the contrary contained in sections 28 to 44C, in the case of an assessee, being a foreign company,--

(a) the deductions admissible under the said sections in computing the income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern before the 1st day of April, 1976, shall not exceed in the aggregate twenty per cent. of the gross amount of such royalty or fees as reduced by so much of the gross amount of such royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property;

(b) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern after the 31st day of March, 1976.

Explanation.--For the purposes of this section,--

(a) “fees for technical services” shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;

(b) “foreign company” shall have the same meaning as in section 80B;

(c) “royalty” shall have the same meaning as in the Explanation 2 to clause (vi) of sub-section (1) of section 9;

(d) royalty received from Government or an Indian concern in pursuance of an agreement made by a foreign company with Government or with the Indian concern after the 31st day of March, 1976, shall be deemed to have been received in pursuance of an agreement made before the 1st day of April, 1976, if such agreement is deemed, for the purposes of the proviso to clause (vi) of sub-section (1) of section 9, to have been made before the 1st day of April, 1976.

Section 90. Agreement with foreign countries.–(1) The Central Government may enter into an agreement with the Government of any country outside India –

(a) for the granting of relief in respect of–

(i) income on which have been paid both income-tax under this Act and income-tax in that country ; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India

> under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.
>
> Explanation.—For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company, where such foreign company has not made the prescribed arrangement for declaration and payment within India, of the dividends (including dividends on preference shares) payable out of its income in India."

7. Section 90(2) mandates that where the Central Government has entered into a DTAA under sub-section 1 for granting relief of tax or, as the case may be, avoidance of double taxation, then in relation to the assessee to whom the agreement applies, the provisions of the Act apply to the extent they are more beneficial to the assessee. In other words, where an Article in a DTAA and a provision of the Act apply to the assessee, then the Article of the DTAA or the provision the Act will apply depending upon which one of the two is more beneficial/advantageous to the assessee. The first requirement, therefore, is to see whether provisions of the Act apply to a particular transaction undertaken/income earned by an assessee, which is taxable in India under the Act. In case the transaction/income is not taxable under the Act, the income earned would not be taxed. In case the said transaction or income of an assessee is taxable under the Act, then the provisions of DTAA, if applicable, may be resorted to if they are more beneficial and advantageous to the assessee i.e. if they negate or reduce the tax liability. In *Azadi Bachao Andolan vs. UOI* (2003) 263 ITR 706 (SC) after referring to the said section it has been held:–

> "**21**. The provisions of Sections 4 and 5 of the Act are expressly made "subject to the provisions of this Act", which would include Section 90 of the Act. As to what would happen in the event of a conflict between the provision of the Income Tax Act and a notification issued under Section 90, is no longer res integra.
>
> XXXXX
>
> **28.** A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that Section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement. When that happens, the provisions of such an agreement, with respect to cases to which they apply, would operate even if inconsistent

> with the provisions of the Income Tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the legislature to make a departure from the general principle of chargeability to tax under Section 4 and the general principle of ascertainment of total income under Section 5 of the Act, then there was no purpose in making those sections "subject to the provisions of the Act". The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under Section 90 towards implementation of the terms of DTACs which would automatically override the provisions of the Income Tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of DTAC."

8. At the outset, we may notice one fact that there is no dispute that the assessee had a PE in India as defined in Article 5 of the DTAA. This judgment proceeds on the said admitted fact, which is extremely relevant and material.

9. Articles 7 and 12 of DTAA make a distinction between income earned by way of "royalties" and "business profits". The term "royalty" has been defined in Article 12 paragraph 3, which consists of sub-paragraph a to l. As noticed above, the tribunal has held that Article 12 of DTAA is not applicable as the payments received were of composite character for diverse work and were not covered by the term "royalty" as defined in paragraph 3 of Article 12. This is clear from the observations recorded by the tribunal on the nature of activity undertaken by the PE of the assessee in India mentioned in paragraph 4.3. On this aspect we have adversely commented and reversed the findings of the tribunal, in a subsequent portion of this decision.

10. Paragraph 4 of Article 12 states that paragraphs 1 and 2 of Article 12 will not apply if "royalty" arises through a PE situated in the contracting State where business is carried on, of which the assessee is not a resident. Paragraph 4 states that in such cases Article 7 or 14 would apply. Tribunal is, therefore, right in holding that Article 12 of DTAA is not applicable but the reason is paragraph 4 of Article 12. Once an assessee has a PE in the contracting state of which he is not resident, then paragraphs 1 and 2 of the said Article do not apply.

11. Thus, for the reasons different than those, mentioned by the tribunal we hold that Article 12 of the DTAA is not applicable. Sequitor is Article 7 of the DTAA is applicable. Interpretation and provisions of Article 7 have been examined while answering question No.3. Question Nos. 1 and 2 are accordingly answered.

12. Article 7 deals with business profits and will apply, once it is held that Article 12 is not applicable. Paragraph 3 of Article 7 is the edifice

which is to be examined to answer the substantial question No.3 mentioned above. A careful examination of the said paragraph shows that to determine the profits of a PE, the assessee is to be allowed deductions "in accordance with and subject to limitations of the law" relating to tax in the contracting State, i.e., in the present case Income Tax Act in India. It further stipulates that expenses incurred for the purpose of the business of a PE would include executive and general administrative expenses so incurred regardless whether they have incurred in any contracting State, i.e., India/Australia or elsewhere. However, the material words in paragraph 3 of Article 7 are "the assessee shall be allowed as deduction, in accordance with and subject to limitation of the law relating to tax (i.e., the Income Tax Act, 1961) in the contracting State (i.e., India) in which the permanent establishment is situated". What is stipulated and stated in paragraph 3 of Article 7 is that the expenses incurred by the assessee can be claimed as a deduction but only in accordance with and subject to limitation stipulated in the Act. The provisions of the Act, therefore, relating to deduction of expenditure, become applicable for computing business profits under Article 7(3). The limitations and conditions stated and stipulated in the Act with regard to deductions accordingly get attracted and retain their supremacy and are not obliterated/diluted in view of paragraph 3 of Article 7. In other words, paragraph 3 of Article 7 gives paramouncy and accepts that the deductions can be only claimed in accordance with and subject to limitations of the Act and not otherwise.

13. The net effect of the aforesaid conclusion is that to compute business profits under Article 7(3) of the DTAA, we have to examine whether a particular expense/expenses can be allowed as a deduction from the income earned in accordance with and is subject to the limitations relating to the deduction available to the assessee under the Act. This necessarily requires examination and consideration of the provisions of the Act to find out whether for computing taxable income, an expense can be claimed as a deduction under the Act. If deduction can be claimed under the Act, then the said deduction is permissible and has to be allowed but if an expense cannot be claimed as a deduction because of the stipulations in the Act in respect of the earned income, then the said expenditure is not to be allowed as a deduction/expense.

14. Second part of paragraph 3 to Article 7 protects and states that the assessee is entitled to claim deduction of expenses both in India as well as administrative and general expenses whether they are incurred in the contracting State in which the PE is situated or outside the said contracting State. However, the first part and the second part of paragraph 3 of Article 7 have to be read harmoniously giving full effect to the two parts, as if there is no conflict between them. The first part, as noticed above, is a part which states when deduction of an expense can be allowed, i.e., deduction should be in accordance with and subject to the

limitation of law of the contracting State where PE is situated. This condition must be satisfied before the advantage or benefit of second part of paragraph 3 can be taken by the assessee, i.e., the expenses of which deduction can be claimed are not restricted to merely expenses in the contracting State but also executive and general administrative expenses which were incurred outside the contracting State. To this extent paragraph 3 of Article 7 will override and will have primacy over any stipulation in the Act, if any, that executive and general administrative expenses outside India cannot be taken into consideration.

15. In view of the reasoning given above, it is not possible to agree with the conclusion and the findings recorded by the tribunal that once Article 7 applies, Section 44D read with Section 115A is not applicable. The tribunal has overlooked and not given due credence and importance to paragraph 3 of Article 7 of the DTAA. The said paragraph as noticed above, states that the provisions relating to the tax enactment on the question of deduction of expenditure are fully protected; are to be enforced and are applicable. Deduction can only be claimed in accordance with and subject to the limitations of the Act in the contracting State, i.e., India or Australia, as the case may be. In this manner, Paragraph 3 of Article 7 has given primacy to the provisions stipulated in the domestic tax legislation while computing business income under Article 7(3) in case the assessee has a PE in the non-resident country.

16. In view of the aforesaid reasoning, we have to examine the provisions of the Act to find out whether the assessee is entitled to deduction of expenses and if so, to what extent or there is any prohibition or bar for claiming a deduction under the Act. This "question" is in built or a part of question No.3.

17. Business income in India is taxable under Chapter IV-D "profits and gains of business or profession". Sections 28 to 44DB are under the said heading. Each Section and provision of the said part has to be considered and examined to find out whether a particular deduction or expenditure can be claimed when income is taxable under the head "income from business". Section 44D has been quoted. The said Section begins with a non-obstante or overriding expression and states that Sections 28 to 44C would not be applicable and deductions under the said Sections cannot be allowed and are not admissible in case an assessee is a foreign company and has earned income by way of "royalty" or "fee from technical services" from Indian Government or Indian concern. For the purpose of Section 44D, the expression "fee for technical services" and "royalty" have the same meaning as defined in Explanation 2 to clause (vii) and (vi) of sub-section 1 of Section 9 of the Act. The term "foreign company" has also been defined in clause (b) to the Explanation to Section 44D to mean a company, which is not a domestic company as per Section 80B of the Act. It is not in dispute before us that the assessee was a foreign company.

18. The next question, which arises for consideration is whether the income earned by the assessee is "fee for technical services" within the meaning of Explanation 2 to clause (vii) of sub-section 1 of Section 9.

19. The tribunal in their findings recorded in paragraph 4.3 has held that the contracts are inclusive contracts of technical nature as well as of drilling etc. It has been further observed that it cannot be said that the activities of the assessee were of purely technical nature.

20. In paragraph 4, the tribunal has extracted a portion of the agreement between the assessee and RPIL and RITS. The said portion reads as under:–

> "The evaluation of the resources will begin with a geological mapping, drilling and editing programme and be followed by iron ore quality testing and resource modeling.
>
> Specifically, the objectives of the pre-feasibility phase 2 programme are to:
>
> - Improve the knowledge of the ore body and ore characteristics by a bulk sampling and drilling programme;
> - Investigate preliminary metallurgical and treatment characteristics, define options and estimate costs;
> - Investigate infrastructure requirements and existing capacities, define option and estimate costs;
> - Carry out a preliminary environmental assessment;
> - Identify major issues which might prevent the project proceeding;
> - Identify major options for further study;
> - Prepare the Phase 2 Pre-feasibility study report encapsulating all of the above listed elements, including preliminary mining plan, flow sheets, and costs, and indicative financial analysis."

21. Immediately after extracting the portion of the one of the contracts, the tribunal in paragraph 4.1 has observed as under:–

> "4.1 A reading of portion extracted above shows that the primary objective is technical work for the evaluation of iron ore resources and the corresponding feasibility study for transportation of ore by rail and the development and handling of ship loading capacities as the specified process. The evaluation of the resources was to begin with geological mapping, drilling and editing programme, to be followed by iron ore quality testing of the resources modeling. Thus, this is not a case where a simple technical or consultancy service is provided, but it includes specific activities which are required to be done on site, i.e., by various activities such as the geological mapping,

> drilling, testing or quality, quantifying the possible quantity and resources, examining the environmental hazards. For the performance of the contract, it is noticed, the assessee has obtained necessary permission from the RBI, which is the sanctioning authority for opening a project office in India. It is an accepted fact that the asssessee has opened its project office in India and has entered into a contract to do business in line with the permission granted by RBI. It is also an accepted fact that he assessee does have a permanent establishment (PE) in India."

22. The tribunal has not specifically examined Explanation 2 to Section 9(1) (vii) and whether or not the said explanation is applicable and the income earned by the assessee is covered by the said explanation. The expression "fees for technical services" has been defined in Explanation 2 to Section 9(1)(vii) to mean any consideration including lumpsum payment for rendering managerial, technical or consulting services and includes provisions of service of technical or other personnel. Section 44D read with Explanation 2 to Section 9(1)(vii) envisages different and separate treatment for taxation purposes of income regarded as "fee for technical services" as noticed above.

23. The tribunal has also erred in holding that the extracted portion of the agreement establishes and shows that the consideration received was for a composite contract. Further, even in a case of a composite contract for supply of goods/equipment/machinery and for providing technical services, bifurcation, if already made in the contract, has to be considered and accordingly the income has to be taxed. In absence of bifurcation, an estimated allocation is justified and has to be made for the purpose of tax.

24. The payment in the present case is for furnishing of evaluation report. The fee paid is for the said purpose. To collect and collate the information and furnish evaluation report, the assessee was required and it was necessary to undertake certain tests, mapping and studies. Drilling for tests as to evaluate is to gain information and knowledge. The payment which is received is for furnishing of information and not "business" income or composite income including "business" income as held by the tribunal. The assessee may be carrying on manufacturing or trading activities but can enter into a contract to furnish technical information for a fee to a third party. Technical information which is furnished may be a result of the knowledge, experience and expertise gained by the assessee as a result of business or trading activity; or tests, mapping etc. may be required for furnishing the said information, but this is immaterial. The fee received from the third party in such cases is fee for technical services, if it satisfies and is covered by the Explanation 2 to Section 9(1)(vii). The payment made is to acquire technical information. Therefore it is "fee for technical services". It will be

immaterial whether the assessee had acquired and gained the said technical information because of business or trading activity or after conducting tests, mapping etc. The nature and character of the information furnished and for which the fee or consideration is paid is the relevant criteria for deciding whether or not Explanation 2 to Section 9(1)(vii) is applicable. In the present case, as per the clauses quoted above, the fee was paid to acquire technical and managerial information.

25. At this stage, it will be appropriate to notice and decide the contention of the assessee that Explanation 2 to Section 9(1)(vii) is not applicable in view of the exclusion i.e., the expression " fee for the technical services, but does not include consideration for any construction, assembly, mining or like project undertaken by the assessee". The aforesaid exclusion states that the consideration received by an assessee for construction, assembly, mining or like project has to be excluded and is not fee for technical services. The use of the word "project" in the expression is relevant and significant. Construction, assembly or mining projects are normally and in common parlance not regarded as services relating to fee for technical services. Explanation 2 to Section 9(1)(vii) makes and draws a distinction between income earned by way of fee for technical services, which have been defined to mean any managerial, technical or consultancy services, including provision on services of technical and other personnel, in contradistinction to income earned from manufacturing or trade activity. The legislature by the said expression has clarified and as a matter of abundant caution stated that construction, assembly or like project undertaken by the recipient should not be regarded and treated as consideration for fee for technical services. The reasoning and justification is obvious; construction, assembly or mining activities may not strictly fall within and be regarded as the manufacturing, or trading activity, when interpreted in a narrow manner. The intention of the legislature is that the narrow interpretation is not warranted. The aforesaid expression, therefore, is merely clarificatory and declaratory of what is fairly obvious and clear. It removes doubts and ensures that any debate on this score is avoided. It does not seek to curtail the scope and ambit of managerial, technical or consultancy services which are taxable as fee for technical services. Use of the word "project" in the said expression requires and mandates that there should be construction project, assembly project or a mining project or a like project undertaken by the recipient and the consideration paid should be on the said account. It is apparent and the clauses of the agreement do not disclose that the assessee had undertaken any mining project or a construction project. There is no such finding recorded by the tribunal also.

26. Learned counsel for the petitioner assessee had relied upon decision of the Supreme Court in *Union of India and Another vs. A. Sanyasi Rao and Others*, (1996) 219 ITR 330 and has submitted that

Section 44D is a draconian provision and should be read down as an option available to an assessee and is not a mandatory provision. It is submitted that taxation on gross income basis is unconscionable.

27. Constitutional validity of the said provision is not challenged before us and cannot be examined in an appeal under Section 260A of the Act. We have to decide the appeal on the basis that this Section is constitutionally valid, though courts can read down a section while interpreting a provision in case of ambiguity/doubt to ensure that the provision does not fall foul of the constitutional limits. It may be relevant to note that taxation of non-resident on gross receipt basis was one of the contentions or defences raised by the Revenue in A. *Sanyasi Rao* case (supra) to defend the presumptive provision under challenge in the said case. The Supreme Court dealt with the said defence, observing as under:–

> "Counsel for the Revenue brought to our notice sections 44B, 44BB, 44BBA and 44D and contended that there are other similar provisions in the Act. We should state that they relate to non-residents carrying on business in India and are not much relevant in construing sections 44AC and 206C of the Act."

28. It is clear from the aforesaid quote that the Supreme Court had drawn a distinction between not resident assessees and assessees who are resident in India, as far as taxation on gross receipt basis is concerned. It may be also noted that the rate of tax under Section 44D is 20%, whereas rate of tax at the normal rates in the years in question was much higher. In some cases, Section 44D may work to the advantage of an assessee and to the disadvantage of the Revenue and in other cases to the advantage of the Revenue and to the disadvantage of the assessee. This contention is rejected.

29. In view of the aforesaid findings, the questions of law mentioned above are answered as under:

(1) Question No. 1 is answered in negative and it is held that Article 12 of the DTAA is not applicable.

(2) Question No. 2 is also answered in negative and it is held that Article 7 of the DTAA applies but on interpretation of the said Article, specially paragraph 3, we have to examine the provisions of the Indian Income Tax Act to find out whether or not deduction of expenses is permitted or allowed.

(3) Question No. 3 is answered in negative and it is held that Section 44D is applicable as the income earned by the assessee is taxable as "fee for technical services".

The appeals are accordingly disposed of. No costs.

2012 PTR 82 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
DELHI "F" BENCH, DELHI

Rajpal Yadav, Judicial Member and K.D. Ranjan, Accountant Member

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FACTS/HELD

1. **Long-term & short-term gains from PMS transactions taxable as business profits**
2. The assessee offered LTCG & STCG on sale of shares which had arisen through a Portfolio Management Scheme of Kotak and Reliance. The investments were shown under the head "investments" in the accounts and were made out of surplus funds. Delivery of the shares was taken. The AO & CIT (A) held that as the transactions by the PMS manager werefrequent and the holding period was short, the LTCG & STCG were assessable as business profits. On appeal by the assessee, HELD dismissing the appeal:

    In a Portfolio Management Scheme, the choice of securities and its period of holding is left to the portfolio manager and the assessee has no control. Only the portfolio manager can deal with the Demat account of the assessee. While, at the time of depositing the amount, the assessee will make entry in his books of account as investment in PMS, he is not aware of the transactions in the shares being entered into by the portfolio manager on his behalf as his agent. Since the assessee comes to know about the purchase and sale of shares under PMS after the expiry of the quarter, the accounting treatment in the books of the assessee in respect of shares purchased/sold by the portfolio manager under PMS cannot be entered in the books of the assessee. It is at the end of the year the shares available in the DEMAT account can be entered. **Therefore, at the time of deposit of amount, the intention of the assessee was to maximize the profit. As the purchase and sale of shares under PMS is not in the control of the assessee at all, it cannot be said**

that the assessee had invested money under PMS with intention to hold shares as investment. The portfolio manager carried out trading in shares on behalf of his clients to maximize the profits. Therefore, it cannot be said that shares were held by the assessee as investment. The fact that the transactions were frequent and its volume was high indicated that the portfolio manager had done trading on behalf of the assessee. The fact that the shares remaining at the end of the year were shown under the head 'investment' makes no difference. **Even the LTCG is assessable as business profits and s. 10(38) exemption is not available**. The fact that the AO took a contrary view in the preceding year is irrelevant. There is no difference between similar transactions carried out by an individual in shares and the transactions carried out by portfolio manager. There is, however, a difference between investment in a mutual fund and PMS.

Appeal dismissed.

I.T. Appeal No. 1368 (Del) of 2010 Assessment Year : 2006-07.

Decided on: 16th December, 2011.

Present at hearing: Rakesh Nanda, C.A., for Appellant. B. Kishore, Sr. D. R., for Respondent.

JUDGMENT

Per K.D. Ranjan:– (Accountant Member)

This appeal by the assessee for assessment year 2006-07 arises out of order of the ld. CIT (Appeals)-XXIV, New Delhi.

2. The grounds of appeal raised by the assessee are as follows:–

"1. The order passed by the ld. CIT (Appeals), New Delhi under section 250(6) dismissing the appeal against the assessment order passed under section 143(3) of the Income-tax Act, 1961 by the ld. ACIT assessing the total income for assessment year 2006-07 at Rs.3,37,26,993/- and raising the demand of Rs.16,36,716/- is bad in law and needs to be quashed;

2. That ld. CIT (Appeals), New Delhi has erred in facts and law in holding transactions relating to sale / purchase of equity shares under Portfolio Management Scheme as an adventure in the nature of trade and not as a sale of investments;

3. That ld. CIT (Appeals), New Delhi has erred in facts and law in holding the Long Term and Short Term gains / losses on sale of *equity shares under Portfolio Management Scheme as business income and not under the head Capital Gains;*

4. *That ld. CIT (Appeals), New Delhi has erred in facts and law in holding the charging of tax on the gains / losses on sale of equity shares under Portfolio Management Scheme as business income and not under the head Capital Gains;*
5. *That ld. CIT (Appeals), New Delhi has erred in facts and law in holding that the exemption under section 10(38) on long term capital gains on sale of Equity shares under Portfolio Management Scheme is not allowable;*
6. *That ld. CIT (Appeals), New Delhi has erred in facts and law in holding that tax at concessional rate of 10 per cent under section 111-A on short term capital gain on sale of Equity shares under Portfolio Management Scheme is not applicable;*
7. *That ld. CIT (Appeals), New Delhi has erred in facts and law in holding the initiation of penalty under section 271(1)(c) and alleged furnishing of inaccurate particulars of income and thereby concealing income;*
8. *That ld. CIT (Appeals), New Delhi has erred in facts and law in holding the charging of interest under section 234-B of Rs.3,45,345/- and 234-D of Rs.13,200/-."*

3. The first issue for consideration relates to confirming the stand of the assessing officer that the transactions involving sale and purchase of shares under Portfolio Management Scheme [PMS] are adventure in the nature of trade and not a sale of investments. The facts of the case stated in brief are that the assessee had shown short term capital gain of Rs.35,02,080/- and short term capital gain of Rs.22,17,955.06 on sale of shares. During the course of assessment proceedings it was noticed by the AO that the assessee had made numerous purchase and sale of shares during the relevant previous year. On a query raised by the assessing officer it was submitted by the assessee that the assessee was engaged in the business of providing technical, marketing and maintenance services for earth-movers tyres and trading in tyres. The substantial part of its income was generated out of above business of the assessee. The assessee had invested the surplus funds generated out of profits of its above business in mutual funds and shares either directly or through Portfolio Management Scheme of Kotak and Reliance etc. and such investments have been clearly shown under the head investments on the assets side. The surplus funds in the past were invested in the fixed deposits with the banks and the same have been partly invested in mutual funds. Therefore, the intention of the assessee was to earn dividend from such investments. The investments in mutual funds were held by the assessee as investments and not stock-in-trade.

4. This contention of the assessee was turned down by the assessing officer relying on CBDT Circular No. 4 dated 15/06/2007 and decision of Authority for Advance Ruling reported in 288 ITR 641. He noted that the assessee has purchased and sold shares with the motive of earning profit. The holding period of shares during the relevant previous year ranged from two days to a few months at the most. It was evident that the object of the investment in these shares was not to derive income by way of dividend, but to earn profit through sale as in almost all the transactions the share bought were sold in short period of time. The assessing officer thereafter examined the nature of Portfolio Management Scheme and duties of portfolio manager. He noted that portfolio manager proceeds systematically to manage on an 0ngoing basis the collection of securities in his custody in tune with market variations to optimize in the return of process. He carries out regular follow-up trading operations, selling securities on hand and/or buying new items of security based on the sentiments and movement of the stock market. In fact he makes sizeable profits through these supplementary follow-up operations. He chooses to buy securities when the market is bearish and sells or off-loads those securities when market is bullish. This enables him to secure considerable trading profits which results in the value addition to his holdings. The ld. assessing officer in view of these facts came to the conclusion that the transactions were not of investment but an adventure in the nature of trade. The shares were purchased with the sole intention of selling them and not to holding them as investment. The assessing officer, therefore, treated the profits arising on purchase and sale of shares under PMS as business income. The assessing officer also held that it was not possible for an investor to have two portfolios i.e. trading as well as investment. Once the nature of income has been determined as income from trading, then there was no rational justification for treating income from shares held for more than 365 days as long term capital gains. The assessing officer, therefore, did not allow the benefit of long term capital gains in respect of shares or units of mutual funds held for more than one year.

5. On appeal before the ld. CIT (Appeals) it was submitted that the transaction of purchase and sale of equity shares under PMS were delivery based meaning thereby the delivery was taken on purchase and similarly delivery was given on sale of shares and the same were duly reflected in the statement of DEMAT account with National Securities Depository Ltd. It was submitted that since the assessee had taken and given delivery of shares, the same could not be treated as trading activities. The ld. CIT (Appeals) noted that the assessee in the relevant year was a debt free entity except car loan. The assessee was carrying on business of providing technical, marketing and maintenance services for earth movers, earth mover tyres and trading in tyres since 1987. The assessee had purchased and sold shares of various companies in hundreds of transactions during the assessment year under

consideration. The brokers M/s. Kotak Securities Ltd., Reliance Capital and Fortis had charged fee in lieu of transactions carried on behalf of the assessee. The assessee had also paid share transaction tax on trading of shares. The assessee had not claimed fee paid to brokers and share transaction tax etc. as business expenditure as it appears that the same have been debited in the assessee's account by the broker/service provider. The result thereof has been shown as sale consideration. All transactions of purchases and sale of shares were undertaken by the assessee through professional portfolio managers under PMS. The investment in equity shares was started in assessment year 2005-06, which was accepted under scrutiny and assessment year 2006-07 was the second year of trading. The investment in mutual fund had been considered as capital investment and income derived there-from has been assessed as capital gain during the previous years as well as during relevant year. Only the nature of income derived from sale / purchase of equity shares has been disputed by the assessing officer.

6. As regards the claim of the assessee that income derived from share trading has been assessed as capital gains in the preceding year, ld CIT(A) had held that merely because the tax authorities had assessed it as capital gain in preceding year would not in any way operate as resjudicata to preclude from holding the same as business income in subsequent year. He placed reliance on the decision of Hon'ble Supreme Court in the case of *New Jahangir Vakil Mills vs. CIT* 49 ITR 138 (SC); *Raja Bahadur Vishwaria Singh vs. CIT* 41 ITR 685 (SDC); and *Dalhausi Investment Trust Co. Ltd. vs. CIT* 68 ITR 486. He also observed that the transactions dealing in shares is a mixed question of law & facts and the legal effect of fact on which the assessee could be treated as a dealer or as investor is a question of law. He placed reliance on several decisions in support of the contention. The ld. CIT (Appeals) further observed that when what is done is not merely a realization or a change of investment, but an act done in what is truly the carrying on of a business, the amount recovered as appreciation will be assessable as business profit as held in the case of Rajabahadur Vishweshara Singh (supra). In such a situation what is to be found out for such determination is whether at the time of purchasing a particular lot the assessee had an intention to sell it subsequently at profit or only to make an investment. The presence of commercial motive is a primary legal requisite. This commercial motive is established by the fact that the assessee's focus has not been on earning the dividend on the investments; rather reaping the profits out of volatility of the market. Purchase and sale as a business deal is another requisite. An intention to make profit normally inspires trade and commerce. Similarly, habitual dealing is ordinarily indicative of trade and commerce. Also the magnitude and frequency and the ratio of sales to purchase and total holding is evidenced from which the authorities can come to the conclusion as to the true nature of assessee's activities in such situation. The ld. CIT (Appeals) examined the facts of the assessee's

case in the light of decision of Hon'ble Supreme Court and observed that from the details of purchase and sale of shares enumerated in annexure to assessment order and details submitted before him, the assessee at the time of purchasing the shares had an intention to sell them subsequently at a profit. This commercial motive is established by the fact that the assessee sold bought and sold shares after holding them for a small period. Therefore, the initial investment was utilized for purchase and sale of shares in such a way which resulted in profit derived from business and profession. Such an intention was clearly discernible from the facts of the case.

7. Regarding the contention of the assessee that actual delivery was given at the time of purchase and sale and, therefore, the transactions were in the nature of investments. In this regard the ld. CIT (Appeals) observed that the assessee acquired shares and sold. They were not held as property which yielded to its owner an income or personal enjoyment merely by virtue of its ownership as the fee paid to the broker was more than the return on the property excluding return on account of trading of the property. Therefore, the shares were acquired with the object of a deal. A large number of shares were sold in short period. All these facts clearly showed that the assessee was engaged in dealing in shares. As regards the frequency of number of similar transactions, the ld. CIT (Appeals) observed that the assessee has entered into numerous and frequent transactions on regular basis to carry out his trading venture in shares. The ld. CIT (Appeals) therefore, came to the conclusion that the assessee was carrying on dealing in shares in a systematic and organized manner. Therefore, the conclusion of the assessing officer that income from sale of shares claimed as investment was to be assessed under the head 'Income from business or profession'.

8. Before us the ld. AR of the assessee submitted that the assessee is engaged in the business of providing technical, marketing and maintenance services for earth-movers and also deals in trading of tires. Substantial part of income is generated out of the above business of the assessee. The assessee had invested surplus funds in units or mutual fund and in shares through Portfolio Management Scheme [PMS]. The assessee is not dealing in shares as business income. The investments in the year under considerations were made as in the last year. The transactions of purchase and sale of equity shares under PMS were delivery based. The delivery of scrips was taken on purchase of shares. Similarly delivery of scrips was given on sale of shares and are duly reflected in the statement of DEMAT account with National Securities Depository Ltd. The assessee has treated delivery based transactions as investment and, therefore, profits on sale of shares will be in the nature of capital gains / short term capital gains depending upon the period of holding of such shares. The ld. AR of the assessee placed reliance on the decision of Hon'ble Bombay High Court in the case of *Gopal Purohit vs.*

JCIT [2010] 188 Taxman 140 (Bom). The ld. AR of the assessee further submitted that merely because of volume of transactions is high will not decide the nature of transactions. The assessee had invested in shares in surplus fund and, therefore, the profit arising on sale of shares will be in the nature of capital gains. On the other hand, the ld. Sr. DR submitted that the shares purchased through PMS, no discretion is left with the assessee. It is the PMS Manager, who decides as to when the shares are to be sold. The PMS is structured in such a way so that maximum earning is made. Shares are not held as investment, but stock-in-trade. The portfolio manager is agent of the assessee. Therefore, the shares held by the assessee are stock-in-trade and the profit arising on sale of shares would be in the nature of business income and not as short term / long term capital gains.

9. We have heard both the parties and gone through the material available on record. The assessee apart from investment in mutual funds deposited money with three different Portfolio Management Schemes. Under PMS as per SEBI the term 'Portfolio' means a collection of securities owned by an investor. It represents the total holding of the securities belonging to any person. 'Portfolio Manager' means any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client [whether as a discretionary Portfolio Manager or otherwise] the management or administration of a portfolio securities or the funds of the client as the case may be. From the definition of 'Portfolio Manager' it is clear that portfolio manager acts like an agent who buys and sells shares on behalf of the Individual. The portfolio manager devotes sufficient time in reshuffling the shares on hand in line with changing dynamics of the market. It prevents holding of dormant or stocks of depreciating value. The PMS provides the skill and expertise to steer through the complex volatile and dynamic conditions of the market. A portfolio manager proceeds systematically to manage on an ongoing basis the collection of securities in his custody in tune with market variations to optimize his returns in the process. He carries out regular follow-up trading operations, selling securities on hand and or buying new items of securities based on the sentiments and movement of stock market. He chooses to buy securities when market is bullish and sells those securities when it turns bullish. This enables him to secure considerable profits as a result of value addition to his holding.

10. Under PMS a person deposits the money under the contract for a period normally not less one year. After depositing the money the investment in securities is left to the choice of the portfolio manager. The assessee has no control either on selecting the securities or the period of holding. The portfolio manager normally gives the account quarterly on the basis of which the investor comes to know about the profit earned and the securities in which the transactions were done by the portfolio manager on behalf of the assessee. The shares purchased and sold are

credited and debited to the DEMAT account of the party, which remains in the control of portfolio manager. It is the portfolio manager who can only deal with the DEMAT account of a particular person. At the time of depositing the amount the assessee will definitely make entry in his books of account as investment in PMS. But he is not aware of the transactions in the shares being entered into by the portfolio manager on his behalf as his agent. The portfolio manager charges his fee for the services rendered and other expenses incurred on the same lines as is done in a case where the agent charges from the his principal. Since the assessee comes to know about the purchase and sale of shares under PMS after the expiry of a period of three months, the accounting treatment in the books of the assessee in respect of shares purchased/sold by the portfolio manager under PMS cannot be entered in the books of the assessee. It is at the end of the year the shares available in the DEMAT account can be entered. Therefore, at the time of deposit of amount, the intention of the assessee was to maximize the profit. The purchase and sale of shares under PMS was not in the control of the assessee at all. Therefore, it cannot be said that the assessee had invested money under PMS with intention to hold shares as investment. The portfolio manager has carried out trading in shares on behalf of his clients to maximize the profits. Therefore, it cannot be said that shares were held by the assessee as investment.

11. We may also like to mention that there is difference in investment in mutual fund and PMS. In case of mutual fund the investor is allotted units for the amount invested by him in the mutual fund. The mutual fund manager purchases and sells shares frequently and makes profit/loss. The profit/loss so earned/incurred, increases/decreases the net asset value of the units. The units are also tradable depending upon the lock in period and terms of the fund. However, in the case of PMS the amount is invested under the scheme. No units or instruments are issued, which can be traded. The portfolio manager undertakes trading in shares to maximize the profits on behalf of the investor. Therefore, the investment in PMS cannot be equated with that of investment in units of mutual fund.

12. Further, in case of an assessee, who purchases shares from the market and sells frequently after getting them routed through the DEMAT account. Such transactions will be in the nature of trading activity and the resultant profit will be assessed as business profits. Merely because the shares are credited to DEMAT account at the time of purchase and debited at the time of sale would not make the transactions in the nature of investment. What is important is the intention at the time of purchase, frequency of transactions and volume of the transactions even if he has employed his own funds.

13. The assessee had made investment under PMS. The profit has not arisen directly from the deposits made, but from the securities

purchased from such deposits, which were traded by the portfolio manager on behalf of the assessee. The quantity of share traded is huge as is evident from the list appended with the assessment order. The shares have been traded frequently with a motive to maximize profit and not with a view to hold them as investment. The volume of the transaction is very high. All these facts indicate that the portfolio manager had in fact done trading on behalf of the assessee. There is no difference between similar transactions carried out by an individual in shares and the transactions carried out by portfolio manager. Such transactions can be compared with trading in commodities or real estate. If an assessee gives money to a property dealer with the instructions to purchase, get possession and sale at a reasonable profit keeping in view the market conditions. The property dealer acting as an agent enters into series of transactions of purchase and sale earns profit in some of the transactions and incurs loss in some of them. The property dealer after charging his commission and expenses will handover the amount together profit to the principal. Can the profit earned or loss incurred on such transactions be treated as capital gain or loss. The answer is no. Therefore, in our considered opinion, the profits arising on purchase and sale of shares are in the nature of business and not as investment. Merely because the purchase and sale of shares had occurred through DEMAT account on delivery based; it would not change the nature of the transaction. Since the portfolio manager in the capacity of an agent has traded in shares on behalf of the assessee, the profits arising therefrom will be in the nature of business profits. Further simply because the assessee has treated the deposits made under PMS as investments and balance shares lying in DEMAT account as on the last day of the accounting year under the head 'investment' would not change the character of trading done by the portfolio manager on behalf of the assessee. The shares purchased and sold during the year have not been recorded in the books of accounts as investment nor it is feasible to record as the details were not available with the assessee and the assessee has no control or say as to when and the type of shares or the period of holding of the shares. Therefore, in our considered opinion, the transactions are in the nature of business. The decision relied upon by the assessee in the case of Gopal Purohit (supra) is not applicable to the facts of the assessee's case.

14. It is also a settled law that the principle of res-judicata is not applicable to income tax proceedings. Hence, the assessing officer was not debarred in taking a different view if the earlier view was not in accordance with law. It is also a settled law that the mistake committed earlier should not be perpetuated. Hon'ble Supreme Court in the case of *Distributor (Baroda) p. Ltd vs. Union of India* 155 ITR 120 (SC) has held mistake committed earlier should be rectified. It should not be perpetuated. Hon'ble Supreme Court summarized their views at page 124 in following words:–

> *".....To perpetuate an error is no heroism. To rectify it is the compulsion of the judicial conscience. In this, we derive comfort and strength from the wise and inspiring words of justice Bronson in Pierce vs. Delameter (A.M.Y. at page 18): "a judge ought to be wise enough to know that he is fallible and, therefore, ever ready to learn: great and honest enough to discard all mere pride of opinion and follow truth wherever it may lead : and courageous enough to acknowledge his errors".*

In view of decision of Hon'ble Supreme Court we dismiss the contention of the assessee that in assessment year 2005-06 the similar transactions were treated as capital gains on the ground that the view taken earlier was not in accordance with the law. Profit arising from a trading transaction cannot be treated as capital gain. Accordingly in view of the above discussion, we do not find any infirmity in the order of the ld. CIT (Appeals) holding that the profit arising on sale/purchase through PMS as business income and is accordingly upheld.

15. The next issue for consideration relates to disallowing the exemption of section 10(38) on long term capital gains on sale of equity shares under portfolio management scheme. Since we have held that the shares were traded by the portfolio manager as an agent on behalf of the assessee and, therefore, the profits arising are in the nature of business profits. Therefore, provisions of section 10(38) of the Act will not apply in case of profits arising on trading activity though the shares were held by the assessee for more than a period of 12 months. Accordingly we do not find any infirmity in the order of the ld. CIT (Appeals) confirming the disallowance under section 10(38) of the Act.

16. The next issue for consideration relates to rejecting the concession rate of 10 per cent under section 111-A on short term capital gains on sale of equity shares under portfolio management scheme. Since we have held the profits on purchase and sale of shares as business income, provisions of section 111-A of the Act are not applicable. We, therefore, uphold the order of the ld. CIT (Appeals).

17. The last issue for consideration relates to charging of interest under section 234-B and 234-D of the Act. Charging of interest under sections 234-B and 234-D is mandatory and consequential to the additions made. We, therefore, direct the assessing officer to charge interest, if any, after giving effect to this order.

18. In the result, the appeal filed by the assessee is dismissed.

The order pronounced in the open court on : **16th December, 2011**.

2012 PTR 92 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
BANGALORE "A" BENCH, BANGALORE

N. Barathvaja Sankar, Vice President, G.C. Gupta Vice President, and P. Madhavi Devi, Judicial Member

FACTS/HELD

1. **S. 72: Gains arising from "business assets" not eligible for set-off against B/fd business loss**
2. The assessee sold land & building used for business purposes. Though the gain was offered as capital gains, the assessee claimed, relying on **Cocanada Radhaswami** Bank Ltd 57 ITR 306 (SC) and other judgements, that as the assets were "business assets", the gains there from were eligible for set-off against the brought forward business loss u/s 72. The issue was referred to a Special Bench. HELD by the Special Bench against the assessee:

   S. 72 (1) allows brought forward business loss to be set-off against the "*profits & gains of any business or profession*" of the subsequent year. The expression "*profits & gains of business*" means **income earned out of business carried on by the assessee and not just income connected in some way to the business or profession carried on by the assessee**. The land & building were fixed & capital assets used by the assessee for its business purposes. The gains arising there from were assessable as capital gains and were **not eligible for set-off** against the brought forward business loss u/s 72 (**Express Newspapers** 53 ITR 250 (SC) followed; **Cocanada Radhaswami** Bank 55 ITR 17(SC) distinguished; **Steelcon Industries reversed**)

Order accordingly.

I.T.A. No.546(Bang.)/2008 (Assessment Year : 2003 -2004).

Heard on: 17th October, 2011.

Decided on: 9th December, 2011.

Present at hearing: S. Ramasubramanian, CA, for Appellant. G.V.Gopala Rao, CIT-I, for Respondent.

JUDGMENT

Per P. Madhavi Devi:– (Judicial Member)

The present Special Bench has been constituted u/s 255(3) of the IT Act, 1961. The Special Bench was constituted under the following circumstances.

2. The assessee company which is engaged in the business of manufacture/production of Iron and Steel has filed its return of income for the relevant assessment year on 14-10-2003, declaring an income of Rs.98,27,270/- under the head 'capital gains'. The return was processed u/s 143(1) on 20-01-2004 and a refund of Rs.4,77,163/- was issued. Subsequently, the AO noticed that the assessee had set off the long term capital gains of Rs.43,36,640/- against the brought forward business loss and depreciation contrary to the provisions of Sec.72 of the IT Act. In view of the same, the AO believed that the income chargeable to tax has escaped assessment within the meaning of Sec.147 and issued notice u/s 148 on 8-07-2005. In response to notice u/s 148, the assessee filed its return of income on 17-04-2006 as returned in the original return of income. The assessee also requested the AO to furnish a copy of the reasons recorded for re-opening of the assessment. The AO furnished the reasons recorded for reopening of the assessment to the assessee. In the proceedings u/s 143(3) read with Sec.148 of the IT Act, the AO held that the brought forward business loss and unabsorbed depreciation cannot be set off against the income from capital gains. He observed that the assessee has sold the land situated at Tumkur road along with the building and bore well which were all used for the business. Taking note of the decision of the Hon'ble Apex Court in the case of *M/s Killick Nixon & Co., vs. CIT* reported in 66 ITR 714(SC), wherein it was held that only income which is earned by carrying on business is entitled to be set off, he held that the carry forward business loss cannot be set off against the income from capital gains, as it is against the provisions of law. He also observed that the assessee has admitted the profit and sale of land etc. as long term capital gains and offered to tax at the rate of 20%. He accordingly, computed the income of the assessee.

3. Aggrieved, the assessee preferred an appeal before the CIT(A) who confirmed the order of the AO and the assessee came in appeal before the Tribunal.

3.1 Before the Tribunal, the assessee has raised various grounds relating to validity of the assessment u/s147 of the Act and also with regard to disallowance of the set of carry forward business loss and depreciation against the long term capital gains arising from the sale of land and buildings used for the purpose of business. The Division Bench of this Tribunal vide its reference dated 11-12-2008 have decided the first four grounds of appeal and also the additional ground of appeal raised by the assessee and with regard to ground no.5 & 6 a reference was made to the Hon'ble President for the constitution of a Special Bench of the

Tribunal. The reasons for the reference was that the asseseee has relied upon the decision of the Bangalore Bench of the Tribunal in a reported case of *M/s Steelcon Industries (P) Ltd., vs. IT*O dated 27-12-2004 in ITA No.571(Bang.)1989 for the assessment year 1985-86, wherein the issue was decided in favour of the assessee holding that the carry forward loss can be set off against the income from capital gains. For coming to this conclusion, the Tribunal has followed the decisions of the Hon'ble Supreme Court in the case of CIT vs. Cocanada Radhaswami Bank (1965) 55 ITR 17(SC) and *CIT vs. Chugandas & Co.*,(1965) 55 ITR 17(SC). The Division Bench however, noticed that there is another judgment of the Hon'ble Supreme Court in the case of *CIT vs. Express Newspapers Ltd.*,53 ITR 250(SC) wherein it was held that the capital gains are connected with the capital assets of the business and therefore, it cannot make them the profit of the business and cannot be set off against the carry forward business loss. Having observed that the Bench of the Tribunal at Bangalore in the case of *M/s Steelcon Industries Ltd.,* (supra) has not considered the decision of the Hon'ble Supreme Court in the case of Express Newspapers Ltd., cited supra, the Division Bench felt that the decision of the Tribunal in the case of *M/s Steelcon Industries Pvt.Ltd.,* requires re-consideration by a Special Bench constituting of three Members for a decision. Thus, they referred the grounds of appeal nos.5 & 6 to the Special Bench. The Hon'ble President of ITAT after considering the reference in detail u/s 255(3) made by the Division Bench of this Tribunal (vide order dated 11-12-2008 constituted a Special Bench) for disposal of the ground nos.5 & 6. We accordingly, proceed to decide the appeal.

4. Ground no.5 & 6 raised by the assessee in the appeal are as under;

> *"Ground no.5: That the learned CIT(A) erred in law and on facts that the appellant is not entitled to set off carry forward business loss of Rs.39,99,652/- against the long term capital gain arising on sale of land used for the purpose business".*
>
> *Ground no.6: That the authorities below ought to have appreciated that there is no cessation of business and the appellant is entitled to set off the carry forward business loss".*

5. The learned counsel for the assessee Shri S.Ramasubramanian, submitted that during the previous year relevant to the assessment year 2003-04, the assessee sold the land, building and bore well of the assessee used for its business purposes for a consideration of Rs.1,55,00,000/-. He submitted that the assessee had claimed depreciation in the earlier years on the building and the bore well. According to him, the factory building and plant & machinery stood on the same land and since these assets were connected to the business of the assessee, the gain from sale of these assets has been rightly set off against the carried forward business loss from the earlier years. According to him, the long term capital gains on transfer of business assets had the character of business income and

therefore, business loss brought forward from earlier years can be set off against such income though, it was not computed under the head " profits and gains of business or profession". In support of his contention, he placed reliance upon the following decisions;

1. *United Commercial Bank Ltd.,* 32 ITR 688
2. *Chugandas & Co.*, 55 ITR 17
3. *Cocanada Radhaswami Bank Ltd.*, 57 ITR 306

6. He also drew our attention to the rationale laid down by the Hon'ble Apex Court's decision to the effect that though the income was computed under the different heads of income, but when it has the character of business income, the brought forward business loss can be set of against such income. He submitted that the decision of the Hon'ble Supreme Court in the case of *CIT vs. Express Newspapers Ltd.,* cited supra, was considered by the subsequent bench of the Supreme Court in the case of CIT vs. Cocanada Radhaswami Bank Ltd., cited supra and after taking into consideration of the same, it has been held that the break up of income under different head is only for the purpose of computation of total income and it does not cease to be income from the business.

7. Another argument put forth by the learned counsel for the assessee is that Sec.72 of the Act permits the carry forward of unabsorbed loss and clause-(i) thereof permits set off of such loss from the income, if any, of any business of the assessee. Therefore, according to him, it is enough, if such profits and gains have a nexus with business. He also submitted that whenever legislature wanted to refer to a particular head, it specifically stated so. He drew our attention to the reference to the head 'profits and gains of business or profession" in the explanation (baa) to sec.80HHC, wherein while defining the profits of business it is provided that it means the profits of business as computed under the head 'profits and gains of business or profession". He submitted that the similar expression is used in clause-(d) of the Explanation to sec.80HHE. Thus, according to him, since sec.72 does not state that the loss can be set off only from income computed under the head "profits and gains of business or profession", it can be set off against the profits and gains of business or profession even if it is computed under any other head of income.

8. The other argument raised by the assessee is that the lower authorities have rejected the claim of the assessee mainly on the ground that the assessee has not carried on the business during the previous year ending 31-03-2002 and therefore, the decisions of the Hon'ble Supreme Court in the cases of United Commercial Bank and Cocanada Radhaswami Bank Ltd (cited supra) and that of Bangalore Bench in the case of *M/s Steelcon's* case are not applicable. He submitted that this finding of the lower authorities is incorrect because, the AO himself has

determined the loss of Rs.9,67,922/- under the head 'profits and gains from business or profession' and this is a pointer to the fact that the asseseee had carried on the business during the year ending 31-03-2003. He thereafter, drew our attention to the details of turnover effected by the asseseee during various financial years till 31-03-2009 to demonstrate that during the financial year 2003-04 the turnover was Rs.33,09,862/- for the assessment year 2007-08 it was Rs.8,02,775/- for assessment year 2008-09 it was Rs.86,40,160/-. He submitted that there was no turnover during the financial years : 2000-01,2001-02 and 2002-03 and that this only shows that there was a temporary lull in the business of the asseseee and it does not amount to closure of the business. For this proposition, the assessee placed reliance upon the following decisions;

1. *CEPT vs. Srilakshmi Mills Ltd.,* 20 ITR 451 (SC)
2. *CIT vs. Vikram Cotton Mills Ltd.,* (1988) 169 ITR 597(SC)
3. *M/s Lakshmi Narayan Board Mills Pvt.Ltd., vs. CIT* (1994) 205 ITR 88(Cal.)
4. *M/s Karsondas Ranchhoddass vs. CIT* (1972) 83 ITR 1(Bom)
5. *L.VE Vairavan Chettiar vs. CIT* (1969) 72 ITR 114(Mad.)
6. *M/s Emdee Exports vs. Eleventh Income Tax Officer* (1985) 13 ITD 8(Bang.)

8.1. The learned counsel for the assessee therefore, prayed that the grounds of the appeal of the assessee before the Special Bench may be allowed.

9. The learned DR on the other hand, supported the orders of the authorities below and submitted that the assets sold by the assessee are in fact capital assets and therefore, the assessee by itself offered the income from the sale of these assets under the head "capital gains and has also paid taxes at the rate at which capital gains are taxed. He submitted that any gain or loss on the sale of a capital asset cannot be referred to as business income and it cannot be set off against the brought forward loss of earlier years. He drew our attention to the provision of Sec.72 of IT Act to demonstrate that it is only business income against which the brought forward loss can be set off. He strongly relied upon the judgment of the Hon'ble Supreme Court in the case of M/s Express Newspapers Ltd., (cited supra) and submitted that the findings of the Hon'ble Supreme Court should be considered in the light of the facts and circumstances before the Hon'ble Court. He also submitted that in both the cases i.e *M/s United Commercial Bank Ltd.,* and *M/s Cocanada Radhaswami Bank Ltd.,* the capital gains were on account of sale of securities and the Hon'ble Supreme Court has taken note of the fact that these securities were in fact trading assets of the assessee's therein and therefore, though the income was to be taxed under the head" Income from securities" it does not lose the character of business income

and therefore, brought forward loss of earlier years can be set off against such income. He submitted that in the case before us, assets were fixed assets as shown in the balance sheet of the assessee and were undoubtedly capital assets. He submitted that the assessee even claimed depreciation on the building and bore well in the earlier years. He submitted that merely because, there is a nexus between the business carried on by the assessee and the assets sold, the gains on the sale of such assets cannot get the character of business income. Thus, according to him, the findings of lower authorities are to be upheld.

10. Having heard both the parties and having considered the rival contentions and the material on record, we find that the only question before us for consideration is whether the brought forward loss from the earlier years can be set off against the income from "capital gains" u/s 72 of the IT Act. For the purpose of ready reference, the relevant portion of sec.72 is reproduced here under;

> *" 72 (1) Where for any assessment year, the net result of the computation under the head "Profits and gains of business or profession" is loss to the assessee, not being loss sustained in a speculation business, and such loss cannot be or is not wholly set off against income under any head of income in accordance with the provisions of sec.71, so much of the loss as has not been so set off or .. where he has no income under any other head, the whole loss shall, subject to the other provisions of this Chapter, be carried forward to the following assessment year, and –*
>
> *(i) it shall be set off against the profits and gains, if any , of any business or profession carried on by him and assessable for that assessment year;….*

Much stress has been laid by both the parties on the term "profits and gains if any, of any business or profession" mentioned in subclause – (i) of sub-sec.(1) of sec.72 of the IT Act. What are the profits and gains of business or profession?. Whether it should be the income earned out of the business carried on by the assessee or it may be the income in any way connected to the business or profession carried on by the assessee?. The answer to this question entirely depends on the interpretation to be given to the term "of any business or profession carried on by the assessee and assessable for that assessment year" for determination of the issue. It is not in dispute that the land, building and bore well sold by the assessee were used by the assessee for its business purposes. It is also not disputed that these assets were fixed assets of the assessee. The only argument of the assessee has been that they have direct nexus with the business carried on by the assessee and therefore, are business assets and any gains from the sale of such assets would also have the character of business income. We are unable to agree with this contention of the assessee that the assets sold by the assessee were business assets. Undisputedly, they were capital assets and the capital receipts are not taxable nor are the capital payments deductible from the income of the assessee. The capital is to be used for the purpose of carrying on the business of the assessee and it shall remain in the business of the assesee till it is either converted into stock-in-trade or is disposed off. The income earned by the assessee by carrying on the business by use of the stock in trade only is the business income of the assessee. Likewise, any expenditure incurred by the assessee for carrying on of business and for earning the income from such business or profession is only allowable as deduction. After taking into account the receipts and payments for carrying on the business of the assessee only the profit or gain or loss from the business is computed. If the profit or loss relate to the same assessment year from one source then it can be set off from another source under the same head of income u/s 70 Act, and it can be set off against the income from any other head of income u/s 71 of the Act. Sec.72 of the Act however, permits the carry forward business loss to subsequent assessment years and allows it to be set off against profit & gains, if any, of any business or profession carried on by the assessee and assessable for the relevant assessment year. Thus, it is clear that it is only the business loss that can be carried forward u/s 72 of the Act and it can also be set off only against the business income of the assessee, be it from the same business or from any other business. In the cases relied upon by the learned counsel for the assessee, the Hon'ble Supreme Court was dealing with the cases of the assessee's whose business was dealing in securities also and it was thus held that these securities were trading assets and therefore, the income therefrom though to be computed under the head "income from securities" does not lose the character of "business income". But in the case of *M/s Express Newspapers Ltd.*, cited supra, the facts of the case are little different and after taking into consideration the facts of the case therein, the Hon'ble Supreme Court has held that the capital gains on sale of capital assets is not to be set off against the brought forward loss of earlier years. In our opinion, the decision of the Hon'ble Supreme Court in the case of *M/s Express Newspapers Ltd.,* is fairly applicable to the facts of the case before us. The Coordinate Bench of the Tribunal in the case of *M/s Steelcon Industries Pvt.Ltd.,* cited supra, has misplaced its reliance upon the decision of the Apex Court in the cases of *M/s United Commercial Bank Ltd.,* and *M/s Cocanada Radhaswami Bank Ltd.,* In view of the same, we are inclined to reject the grounds of appeal nos.5 & 6 raised by the assessee. Thus, the reference is answered in favour of revenue.

11. The case is now to be posted before the Division Bench to give effect to the order of the special Bench and also to give effect to the order of the Division Bench on the grounds of appeal nos. 1 to 4 decided by it while making the reference to the Hon'ble President for the Constitution of a Special Bench.

2012 PTR 99 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "L" BENCH, MUMBAI

B.R. Mittal, Judicial Member and Pramod Kumar, Accountant Member

FACTS/HELD

1. **Onus on AO to show foreign co has a PE in India. Under India-France DTAA, even dependent agent is not PE in absence of finding that transactions are not at ALP**
2. The assessee, a French company, engaged in the operation of ships in international traffic, claimed that it did not have a PE in India and that no part of its income was chargeable to tax in India. The AO & DRP held that *as the assessee had an agent in India which concluded contracts, obtained clearances and did the other work, there was a PE in India under Articles 5(5) & 5(6) of the DTAA*. On appeal by the assessee, HELD allowing the appeal:
   (i) **In order to constitute a PE under Article 5(1) & 5(2), three criteria are required to be satisfied viz; physical criterion (existence), functionality criterion (carrying out of business through that place of physical location) & subjective criterion (right to use that place)**. There must exist a physical "location", the enterprise must have the "right" to use that place and the enterprise must "carry on" business through that place. An "agency" PE will not satisfy this condition because the enterprise will not have the "right" to use the place of the agent. **Under Article 5(6) of the India-French DTAA (*which is at variance with the UN & OECD Model Conventions*), even a wholly dependent agent is to be treated as an independent agent unless if it is shown that the transactions between him and the enterprise are not at arms' length**. The Department's argument that as the AO had not examined whether the transactions were done in arm's length conditions, the matter should be restored to him is not acceptable because the **onus was on the Revenue to demonstrate**

that the assessee had a PE. The onus is greater where the very foundation of DAPE rested on the negative finding that the transactions between the agent and the enterprise were not made under at arms length conditions. **A negative finding about transactions with the dependent agent not being at ALP is sine qua non for existence of a DAPE under the India-France DTAA**. The AO could not be granted a fresh inning for making roving and fishing enquiries whether the transactions were at arm's length conditions or not (Airlines Rotables 44 SOT 368 followed);

(ii) (*Observed, on a conceptual note, taking note of revenue's plea but without deciding*) If as a result of a DAPE, no additional profits, other than the agent's remuneration in the source country – which is taxable in the source state anyway de hors the existence of PE, become taxable in the source state, the very approach to the DAPE profit attribution seems incongruous. Further, before accepting the DAPE profit neutrality theory, as per Morgan Stanley 292 ITR 416 (SC), the arm's length remuneration paid to the PE must take into account 'all the risks of the foreign enterprise as assumed by the PE'. **In an agency PE situation, a DAPE assumes the entrepreneurship risk in respect of which the agent can never be compensated because even as DAPE inherently assumes the entrepreneurship risk, an agent cannot assume that entrepreneurship risk.** To this extent, there may be a **subtle line of demarcation between a dependent agent and a dependent agency PE**. The tax neutrality theory, on account of existence of DAPE, may not be wholly unqualified at least on a conceptual note.

Appeal partly allowed.

ITA No. 9001/Mum/10 Assessment year: 2006-07.

Heard on: 15th December, 2011.

Decided on: 11th January, 2012.

Present at hearing: F.V. Irani, for Appellant. Malthi Sridharan, for Respondent.

JUDGMENT

Per Pramod Kumar:– (Accountant Member)

1. By way of this appeal, the assessee- appellant has called into question correctness of the order dated 27th October 2010, in the matter of assessment under section 143(3) r.w.s. 144C of the Income Tax Act, 1961, for the assessment year 2006-07.

2. The core issue that we are really required to adjudicate in this appeal is whether or not, on the facts and circumstances of this case, the assessee can be said to have a permanent establishment (PE)[1] in India, and, if it is held that the assessee indeed has a permanent establishment in India how much profits can be taxed as being attributable to such a permanent establishment. We will take up these issues first. These issues are raised by way of grounds of appeal numbers 3 and 4, which are reproduced below for ready reference:

> **<u>3. Existence of a Permanent Establishment</u>**
>
> **3.1 The learned ADIT erred in holding that the appellant's case f alls under Article 5(1) of the DTAA as the business was carried out through agents's fixed place in India wherein the agent was to maintain office f or the principal, duly equipped.**
>
> **3.2 The learned ADIT erred in holding that the appellant's case is also covered under Article 5(5) of the DTAA**
>
> **<u>4. Computation of income</u>**
>
> **4.1 The learned ADIT erred in denying the applicability of provisions of Section 44B of the Act, with respect to freight earnings of Rs 23,66,57,986**
>
> **4.2 Having denied the applicability of section 44B of the Act, the learned ADIT erred in estimating the income at 10% of freight earnings of Rs 23,66,57,986 in accordance with the provisions of Rule 10 of the Income Tax Rules 1962.**

3. The assessee before us is a foreign company incorporated in, and tax resident of, the Republic of France. The assessee claims to be engaged in the business of operations of ships in international traffic. Independent of its claim that, in terms of the distributive rule embedded in Article 9 of Indo French DTAA, entire profits of such business cannot be taxed in the source country i.e. India, the assessee has also contended that since the assessee does not have any PE in India, its business profits cannot be taxed in India at all. It is contended that in terms of the provisions of

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[1] In terms of the provisions of India France Double Taxation Avoidance Agreement (209 ITR Stat 130) – hereinafter referred to as 'Indo French DTAA'

Article 7 of the Indo French DTAA, unless the assessee has a PE in India, no part of the business profits of the assessee can be taxed in India at all. It was contended that the assessee does not have a PE in India. The Assessing Officer did not approve assessee's claim of non- taxability in India, in terms of Article 9 of Indo French DTAA, but right now we are not really concerned with application of Article 9. Suffice to say, having rejected the main contention of the assessee regarding applicability of Article 9, the Assessing Officer proceeded to deal with the alternative claim of assessee's non- taxability under Article 7, and rejected the same as well. The reasoning which prevailed on the Assessing Officer was this. The Assessing Officer noted that "the business of the assessee was carried out from a fixed place through an agent in India wherein the agent was to maintain the, for the principal i.e. the assessee". A reference was made to Hon'ble Andhra Pradesh High[1] Court's judgment in the case of *CIT vs. Vishakhapatnam Port Trust* wherein it was held that PE connotes a virtual projection of the foreign enterprise itself into the territory of taxing state in a substantial and enduring form. A reference was made to paragraph 38 of the OECD Model Convention Commentary. It was in this light that the Assessing Officer gave the following finding of fact:

> **"Delmas had Barwil as its agents which are doing the agency work in most of the Indian ports. The agents are responsible f or concluding contracts on behalf of the assessee in the f orm of all the clearances from the Government departments. They are doing all the functions such as brokering and contracting with the parties f or loading of cargo, dealing with labour f or loading, unloading, collecting the freight on behalf of the assessee and maintaining and operating bank account f or the assessee"**

4. The Assessing Officer further added that "**the above stated f actual position brings out that the assessee's case f alls under Article 5(1) of the DTAA when business of the assessee is carried out through a fixed place through an agent in India wherein the agent was to maintain the office f or the principal duly equipped**" and that "**it is an admitted position in this case that all the work of the assessee is carried out by its agent, namely Barwil**". In this view of the matter, and relying upon a coordinate bench's unreported decision in the case of *ACIT vs. DHL Operations BV*,[2] the Assessing Officer held that the assessee had a permanent establishment in India. Having held that the assessee had a PE in India, and in the absence of details so as to enable him to compute profits of the PE, the Assessing

[1] 144 ITR 146

[2] ITA No. 7987 and 7988/Bom/92

Officer proceeded to adopt total income of the assessee at 10% of gross receipts. Aggrieved by the stand so taken by the Assessing Officer, assessee raised objection to the same before the Dispute Resolution Panel, but without any success. The DRP rejected the objection by observing as follows:

> **The objection of the assessee is not tenable. Article 9 of the DTAA presupposes the existence of a PE and thus allows exemption of profits from operations of ships in international traffic. The assessee's agent in India, who is issuing the bill of lading, has the authority to conclude contracts which are legally binding on the assessee. The business of operations of ships of the assessee is being carried out through the office of the agent in India. In view of this, the assessee does have a permanent establishment in India. The Assessing Officer's action is accordingly confirmed. The ground of objection is dismissed.**

5. The assessee is aggrieved and is in appeal before us.

6. When this called out for hearing and it was noticed that it is admittedly a case of dependent agent permanent establishment (DAPE), it was put, as a proposition, to the parties that in view of Hon'ble jurisdictional High Court's judgment in the case of *Set Satellite (Singapore) Pte Ltd vs. DDIT*[1], the controversy regarding existence of permanent establishment could perhaps be a wholly academic issue inasmuch as once the agent is paid an arm's length remuneration for the services rendered, as is not even in dispute in the present case, no further profit can be attributed to the PE. In other words, the proposition was that, as the law stands now, existence of a DAPE is tax neutral except in a situation in which agent is not paid an arm's length remuneration for services rendered, and since it is nobody's case that agent has not been paid arm's remuneration, nothing turns on existence of PE because, even if there is a PE, no further profits can be attributed to the DAPE. While learned representatives did not dispute this legal position, both the parties objected to the matter being decided on this short ground. While learned counsel for the assessee was of the view that since Hon'ble Supreme Court is right now hearing revenue's appeal against the said jurisdictional High Court decision, and assessee's interest can be adversely affected in the eventuality of the said judgment being reversed, learned Departmental Representative was of the view that since Circular No. 23[2], which was foundation of Set Satellite judgment (supra) by Hon'ble Supreme Court, now stands withdrawn, the said judgment ceases to hold good in law. She also submitted that if DAPE profit neutrality

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[1] 307 ITR 205

[2] dated 23rd July 1969 issued by the Central Board of Direct Taxes

theory is to be accepted as such, the very existence of DAPE is meaningless. We were thus urged to adjudicate the matter on merits in entirety, and not to simply go by DAPE profit neutrality theory. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

7. There are two issues that we need to deal with – first, existence of assessee's PE in India, and, second- quantification of the profits which can be said to be attributed to assessee's PE in India. Let us deal with the first issue first, but before we address ourselves to the question as to whether or not the assessee can be said to have a permanent establishment in India, on the facts of this case, it will be useful to take a look at the relevant provision in the Indo French DTAA, which is reproduced below for ready reference:

<u>Article 5 – Permanent Establishment</u>

1. For the purposes of this Convention, the term permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term permanent establishment includes especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;

(g) a warehouse in relation to a person providing storage facilities for others;

(h) a premises used as a sales outlet;

(i) an installation or structure used for the exploration of natural resources provided that the activities continue for more than 183 days.

(3 and 4 ……….not relevant for our purposes)

5. Notwithstanding the provisions of paragraphs 1 and 2 where a person other than an agent of an independent status to whom paragraph 6 applies is acting in one of the Contracting States on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State, if:

(a) he has and habitually exercises in that Contracting State an authority to conclude contracts on behalf of the enterprise, unless, his activities are limited to the purchase of goods or merchandise for the enterprise ; or

(b) he has no such authority, but habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise.

6. An enterprise of one of the Contracting States shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other Contracting State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph if it is shown that the transactions between the agent and the enterprise were not made under at arm's length conditions.

(7 ……….not relevant for our purposes)

8. A plain reading of the above provisions indicates that the provisions of Article 5(5) read with article 5(6), which deal with the agency situations, are concerned, these provisions specifically override the provisions of Article 5(1) and 5(2), inasmuch as if a foreign enterprise is carrying on business in the other contracting state through an agent, the provisions of Article 5(1) and 5(2) do not come into play. That is, however, an academic aspect, because, the very business model of business of a foreign enterprise being carried out through an agency is such that it does not ordinarily admit the possibility of a fixed base PE under article 5(1) and 5(2). As observed by a coordinate bench in the case of *Airline Rotables Ltd vs. DDIT*[1], in order that there exists a fixed base PE, under article 5(1) and 5(2), "**there are three criteria embedded in this definition—physical criterion i.e., existence of physical location, subjective criterion i.e., right to use that place, and functionality criterion i.e., carrying out of business through that place**" and that "**It is only when these three conditions are satisfied, a PE under the basic rule can be said to have come into existence**". The very business model of the agency PE is such that the subjective criterion, i.e. "right to use that place", can never be satisfied inasmuch as while it is a *sine qua non* for existence of a fixed base PE that "the place of business should also be at the disposal of the foreign enterprise and it must be used for the business of foreign enterprise as well", that "a place of business should be at the disposal of the foreign enterprise for the purpose of its own business activities, and that such

[1] 44 SOT 368

"place has to be owned, rented or otherwise at the disposal of the assessee, and a mere occasional factual use of place does not suffice", as against the business agency model wherein business of the foreign enterprise is carried on by the agent and the foreign principal does not have the powers, as a matter of right, to use the said place for carrying on its business. The use of physical location is, in this business model, always by the agent – though for furtherance of business interests of the principal. Clearly, therefore, the subjective criterion for existence of PE is not satisfied, and, therefore, PE under the basic rule cannot be said to have come into existence. On the facts of this case, therefore, the assessee cannot be said to have a PE under the basic rule, as the assessee is doing business through agent and even though business of the assessee is carried out from the premises owned by the agent, it is not even revenue's case that the foreign enterprise has, its disposal and as a matter of right, agent's premises for carrying out business of the foreign enterprise. A Special Bench of this Tribunal in the case of *Motorola Inc.*[1] upheld this school of thought, and has, *inter alia*, observed as follows:

> **"..........The OECD Commentary on Double Taxation Conventions refers to a fixed place as a link between the place of business and a specific geographical point. It has to have certain degree of permanence. It is emphasized that to constitute a 'fixed place of business', the foreign enterprise must have at its disposal certain premises or part thereof. Philip Baker, in his commentary on Double Taxation Conventions (Third Edition), states that the fixed place is very much that of a physical location, i.e., one must be able to pinpoint to a physical location at the disposal of the enterprise through which the business is carried on. On the other hand, possession of a mailing address in a State without an office, telephone listing or bank account-has been held not to constitute a PE. Further, the fixed place of business need not be owned or leased by the enterprise provided it is at the disposal of the enterprise in the sense of having some right to use the premises for the purposes of its business and not solely for the purpose of project undertaken on behalf of the owner of the premises...."**

9. Let us now deal with the scope of dependent agent permanent establishment (DAPE) as set out in Article 5(5) and Article 5(6) of the Indo French DTAA. Article 5(5) provides the situations in which business being carried on through a dependent agent results in creation of PE in the source state. The provisions of Article 5(6) are, however, slightly at variance with standard tax treaty provisions, and need to be analysed in

[1] 95 ITD SB 269

some detail . The significant feature of Article 5(6) of Indo French DTAA, which is somewhat unique in the sense that this provision is in clear deviation from the standard UN and OECD Model conventions, is that even when an agent is wholly or almost wholly dependent on the foreign enterprise, he will still be treated as an independent agent unless additional condition of the transactions being not an arm's length conditions is fulfilled. It is so for the reason that Article 5(6) provides that even when an agent is wholly or almost wholly dependent on the principal, i.e. foreign enterprise, "**he will not be considered an agent of an independent status within the meaning of this paragraph *if it is shown that the transactions between the agent and the enterprise were not made under at arms length conditions***" (*emphasis by underlining supplied by us*). In other words, as long as it is not shown that the transactions between the agent and the principal are not made under arm's length conditions, the agent is treated to be an independent agent. The implication of the agent being treated as an independent agent is that the provisions of dependent agent PE, as set out in Article 5(5), can never come into play in the cases in which the business is carried out by the foreign enterprise through an independent agent, because Article 5(5), which overrides the provisions of Article 5(1) and 5(2), specifically provides that "**where a person *other than an agent of an independent status to whom paragraph 6 applies*** (*emphasis by underlining supplied by us*) **is acting in one of the Contracting States on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State**" subject to fulfilment of certain other conditions which are admittedly fulfilled in the present case. Therefore, as long as the agent is of independent status, the provisions of Article 5(5) cannot be invoked. It is also important to bear in mind that since provisions of Article 5(5) override the provisions of Article 5(1) and 5(2), no permanent establishment under article 5(1) and (2) can be said to come into existence, so far agency situations are concerned, until the conditions of Article 5(5) are also satisfied. Learned Departmental Representative fairly does not dispute, and rightly so, that the permanent establishment in the present case will be governed by Article 5(5) read with Article 5(6). Learned Departmental Representative's only objection is that since an important aspect, i.e. aspect relating to the transactions having been done in arm's length conditions, has not been examined by the Assessing Officer, the matter should be restored to the file of the Assessing Officer for specific adjudication on the transactions between principal and agent having been done in arm's length conditions. We are unable to see any merits in this plea. As held by a coordinate bench of this Tribunal, in the case of *Airlines Rotables Ltd vs. DDIT*[1], "**It is a settled position of law,**

[1] 44 SOT 368

as noted by the Special Bench of this Tribunal in the case of *Motorola Inc.*[1], that the onus is on the Revenue to demonstrate that a PE of the foreign enterprise exists in India". In the present case, i.e. in the case of DAPE in accordance with provisions of Indo French DTAA, the onus is even greater inasmuch the very foundation of DAPE rests on a negative finding with respect to the wholly dependent or almost wholly dependent agent i.e. "***if it is shown that the transactions between the agent and the enterprise were not made under at arms length conditions***". Unless this negative finding is on record, it cannot be inferred that the agent is not of an independent status. No such finding was given by the Assessing Officer, or even by the Dispute Resolution Panel. Even in the proceedings before us, no material has been brought on record which at least *prima facie* demonstrates, or even indicates, that the transactions between the principal and agent are not under arm's length conditions. Once this onus is not discharged by the revenue authorities at any of these stages, and in accordance with the law laid down by Special Bench decision in the case of *Motorola Inc*[2], we have to hold that the assessee did not have any PE in India. We are not inclined to grant a fresh inning to the Assessing Officer for making roving and fishing enquiries on the aspect of transactions not having been done in arm's length conditions – particularly as there is nothing on record to even remotely suggest a *prima facie* case in this regard. A negative finding in this regard is a sine qua non for making out a case for existence of DAPE in the context of Indo French DTAA, and this finding being absent, we have to hold that the stand of the Assessing Officer, with regard to existence of PE, is not sustainable in law. As regards reference to Hon'ble Visakhapatnam Port Trust's case[2], the observations made therein donot apply in this context as it was not dealing with Dependent Agency Permanent Establishment (DAPE) which is now the case before us. As we have seen earlier, the provisions of DAPE override the provisions regarding fixed place PE, and, therefore, any observations made in the context of fixed place PE donot apply to the DAPE situations. As regards the reference to the OECD Model Convention commentaries or other standard literature in the context of DAPE, it cannot be of any help in interpretation of DAPE provisions in Indo French DTAA because of a somewhat peculiar provision in Article 5(5) read with Article 5(6), which is not part of OECD or UN Model Convention, and which provides that "**However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph if it is shown that the transactions between the agent and the enterprise were not made under at arm's length conditions.**". We have also noted that the DRP has held

[1] 95 ITD SB 269
[2] supra

that there is a PE on the short ground that assessee's claim for applicability of Article 9 presupposes existence of a PE, but it is difficult to comprehend as to how existence of a PE can be inferred merely because the assessee has made a particular claim, which is rejected anyway. The onus of establishing that there is a PE, as we have noted earlier in the discussions, is on the revenue authorities and there is no room for inferences being drawn up in this respect merely because the assessee has made a particular claim. Similarly, reference to agent's authority to conclude contracts, as has been made by the DRP, is not decisive test either because even when agent has the authority to conclude contracts, it is still to be established that the agent is not an independent agent. That exercise is not even conducted in this case. The Assessing Officer's reliance on OECD Commentary, therefore, is of no avail either. In view of these discussions, as also bearing in mind entirety of the case, we set aside and vacate the Assessing Officer's findings with regard to existence of assessee's PE in India. We may, at the cost of repetition, clarify that these conclusions are arrived at in the light of the factual position that there are no findings by the Assessing Officer, or the Dispute Resolution Panel, to the effect that the transactions between the agent and the assessee are not at an arm's length price, and that, in view of the provisions of Article 5(6) of Indo French DTAA, such a finding by the revenue is a *sine qua* non for existence of DAPE. To this extent, our decision is confined to the facts of this case for the particular assessment year before us.

10. There are some interesting issues with respect to PE profit attribution, raised by the learned Departmental Representative, that we may briefly touch upon, even though, having held that the DAPE did not exist on the facts of this case, it is not really necessary to deal with, on merits, the fine points regarding profit attribution in the case of DAPEs. On a conceptual note, PE, whether a fixed base PE, DAPE or any other type of PE, provides for threshold limits to trigger taxation in the source state, but then if as a result of a DAPE, no additional profits, other than agent's remuneration in the source country – which is taxable in the source state anyway *de hors* the existence of PE, become taxable in the source state, the very approach to the DAPE profit attribution may indeed seem clearly incongruous. Similarly, before accepting DAPE profit neutrality theory, we will still have to deal with learned Departmental Representative's plea that as per the law laid down by Hon'ble Supreme Court in the case of DIT vs. Morgan Stanley & Co Inc.[1] , the arm's length remuneration paid to the PE must take into account 'all the risks of the foreign enterprise as assumed by the PE', but then in an agency PE situation, unlike a service PE situation which was the case before the Hon'ble Supreme Court, a DAPE assumes the entrepreneurship risk in respect of which agent can never be compensated because even as DAPE

[1] 237 ITR 889

inherently assumes the entrepreneurship risk, an agent cannot assume that entrepreneurship risk. To this extent, there may clearly be a subtle line of demarcation between the dependent agent and the dependent agency permanent establishment. The tax neutrality theory, on account of existence of DAPE, may not indeed be wholly unqualified- at least on a conceptual note. However, given the findings in the present case, we need not deal with this matter on merits or give any judicial findings in respect of the same. We leave it at that.

11. Ground Nos. 3 and 4 are thus allowed in the terms indicated above.

12. Let us now deal with the other grounds of appeal.

13. It is a case of reopened assessment. While the assessee has, in the first ground of appeal, taken up a specific grievance against reopening of the assessment, learned counsel for the assessee did not press this ground of appeal. We, accordingly, dismiss the first ground of appeal as not pressed.

14. Ground No. 1 is dismissed as not pressed.

15. In ground nos. 2, the assessee has raised the following grievance:

> **Relief under Article 9 of the Double Taxation Avoidance Agreement between India and France DTAA**
>
> **2.1 The learned ADIT erred in holding that the appellant's income is taxable in India.**
>
> **2.2 The learned ADIT erred in rejecting the appellant's claim f or relief under Article 9 of the DTAA in respect of freight earnings of Rs 23,66,57,986.**
>
> **2.3 The learned ADIT erred in denying the relief on the basis that the appellant has f ailed to provide complete and sufficient documentary evidence, to link and establish voyage wise, that the feeder vessels were actually loading the cargo into mother vessels.**

16. Learned counsel fairly states that the issue is covered against the assessee by a coordinate bench's decision in assessee's own case for the assessment year 2001-02[1] inasmuch as the provisions of Article 9 of India France Double Taxation Avoidance Agreement are held to not applicable to the income in question, but he hastens to add that Hon'ble Bombay High Court has admitted appeal against the said order, that this statement should not be construed as assessee's conceding the issue and that the assessee would like to keep the issue alive before higher judicial forums. Learned Departmental Representative does not oppose these submissions either. While the issue is thus covered against the assessee so far as this forum is concerned, the assessee is at liberty to, if so

[1] reported as DDIT vs. Delmas , France 27 SOT 441

advised, take up the issue before Hon'ble Courts above. With these observations, we reject the second ground of appeal as well.

17. Ground No. 2 is thus dismissed.

18. Ground No. 3 and 4, as discussed earlier in this order, are allowed in the terms indicated therein.

19. In ground no. 5, the assessee has raised grievance against levy of interest under section 234 B. Learned representatives, however, fairly agree that the issue is covered, in favour of the assessee, by Hon'ble jurisdictional High Court's judgment in the case of *DIT vs. NGC Netwrok Asia LLC*[1]. Respectfully following Hon'ble jurisdictional High Court in the said case, we uphold the grievance of the assessee and direct the Assessing Officer to grant necessary relief.

20. Ground No. 5 is thus allowed in the terms indicated above.

21. In the result, the appeal is partly allowed in the terms indicated above. Pronounced in the open court today on 11th day of January, 2012.

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[1] 313 ITR 187