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Huzaima & Ikram
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This issue contains:

Kind regards

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<u>Budget 2012-13</u>
Re-telling the story of "failures"

by

Huzaima Bukhari & Dr. Ikramul Haq

Release of *Economic Survey* on May 31, 2012—a day before announcement of budget for fiscal year 2012-13—was not a mere ritual but re-telling the story of failures. Missing revenue targets by 31 billion or more, failure to keep fiscal deficit within the projected limit, fast depletion of foreign reserves, widening of current account gap, slow growth rate, acute shortage of energy in coming days and insurmountable inflation-everything portraying a bleak economic scenario.

The most popular and well-informed TV channel of Pakistan (Geo), showed copy of Economic Survey in its evening news bulletin on 30 May 2012, reporting that "all the growth targets of agriculture, industry and services sectors have been missed". The economic growth remained at 3.7% despite a set target of 4.2%. The biggest admission of failure in the budget paper is that half of the industrial capacity remains idle, primarily due to the energy crisis. The trade deficit of the country surged exponentially, the survey conceded. It says imports have escalated to $37 billion against the total exports of $19 billion. The economic managers confessed that they have failed to manage subsidies, resulting into a higher budget deficit. The Survey states that excluding Rs. 391 billion circular debt payments, budget deficit has crossed 4.3% of gross domestic product (GDP) and the revised target will be difficult to achieve. Total public debt surged to Rs. 12.1 trillion, or 58.2% of GDP, a net increase of Rs. 1.3 trillion. Foreign investment plunged by over 75%.

Last year, Dr. Abdul Hafeez Shaikh, in his budget speech, while admitting that Pakistan was facing very difficult conditions, emphasised the need to stabilise the economy but ironically, the jargon and story for this year remained the same. The process of recovery failed miserably. As the bleak scenario persists, the Governor State Bank warned that "Pakistan may have to return to the IMF for financial assistance this year amid an unstable macroeconomic situation. We see reserves going down quite aggressively".

Seven objectives that budget 2011-12 entailed were: (1) reduction in fiscal deficit through revenue generation and expenditure control; (2) lowering of inflation; (3) self-reliance through better domestic resource mobilization; (4) rapid poverty alleviation; (5) improving efficiency of public sector; (6) employment generation and (7) make the country fertile for investment. None of these was attained. In almost all areas, the situation turned from bad to worse.

The Finance Minister very aptly observed in his last year's budget speech, "I would like to place the budget in the perspective of economic management. In today's world, economic management of a modern internationally open economy is a continuous year-long task. The budget is but one important instrument of economic management. However, the importance of this once a year ritual should not be overly exaggerated. There are important linkages between the budget and other instruments of government policies, including monetary; trade; pricing of agriculture, electricity, gas and petroleum products as well as various economic packages. We need to sharpen our understanding of the government's role and its interventions and make them more effective. Ultimately results depend on the impact of a combination of these policies. This is what economic management is all about".

Where has been economic management since 3 June 2011? The story is both sordid and painful. For example take the implementation of tax measures, announced by Mr. Hafeez Shaikh. Massive corruption in customs duties bypassed all past records—the mystery of missing containers is still daunting. The apex court asked National Accountability Bureau (NAB) to initiate investigation and punish the culprits. The response was as expected, "there is no incriminate evidence". It is simply shocking. Reduction in duty on import of crude palm oil from Rs. 9,000 per metric ton to Rs. 8,000 per metric ton did not bring down the price of vegetable oil, widely consumed in cooking by poorer lot of this country, despite big claims. Many made billions in this reduction by increasing the prices. Amnesty for stock exchanges and evaders of taxes bypassing the Parliament was what our Minister called good economic management.

There was incentive of 5% concessionary rate of import duty to encourage use of renewable energy resources, but progress remained negligible. Energy crisis has become so acute that it has led to violent public protests. To encourage enhanced equity financing, and to provide relief to new corporate industrial undertakings, established on or after 1st July 2011, with 100% equity financing, a tax credit equal to 100% of tax payable was announced but nobody opted to invest. Foreign direct investment drained all together.

The Finance Minister emphasised that structural reforms were a key to sound economic management. Last year's budget sought austerity, efficiency and self-reliant economy. After one year, all these dreams remain a distant reality. The convicted Prime Minister made mockery of it during his visit to United Kingdom in May 2012. According to news reports, 70-member entourage stayed at the Churchill Hotel in London with a fleet of thirty limousines hired and the five day trip cost the nnational eexchequer around $1,000,000.

The fact is that the ruling elite-comprising politicians, military complex, absentee landlords and rich businessmen-kept on plundering and wasting the national wealth besides successfully avoided paying personal taxes. It is openly admitted by technocrats like Abdul Hafeez Shaikh, who has failed to bring any meaningful structural change in the existing system.

Resultantly, neither fiscal deficit has receded-rather increased to a dangerous level-nor growth target is achieved.

In all the budgets by PPP-once known to be a progressive party—not a single progressive tax has been imposed. On the contrary, various amnesty schemes have been introduced aimed at whitening money plundered by the ruling elite and unscrupulous businessmen. No effort whatsoever has been made to correct the imbalance between direct and indirect taxes in Pakistan to give relief to the poor. The rich are not paying income tax on their colossal incomes and wealth—amazingly, total number of people showing income more than one million rupees is below 500,000!

Tax-to-GDP ratio of Pakistan is one of the lowest in the world—below 10% for the last five years. Last year, the Member Inland Revenue claimed that FBR would collect revised target of Rs. 1588 billion giving tax-to-GDP ratio of 9.1%. The actual collection was Rs.1530 billion causing a further decline in tax-to-GDP ratio—it went to 8.2%. The original revenue target was Rs. 1680 billion. This year's story is not different. Target of Rs. 1952 billion will be missed by billions—the ffigure-fudging continues as actual collection is much less if undisputed refunds are subtracted and advance payments are excluded.

What makes things even more painful is the fact that 75% collection by FBR constitutes indirect taxes—the burden of which is more on the poor and almost negligible on the rich. The revenue target of current fiscal year of Rs.1952 billion, even if achieved through highhandedness and jugglery of figures will remain below the 10% of total GDP. Due to corruption and inefficiencies, FBR is facing revenue shortfall of billions of rupees each year. Last year FBR was to collect Rs. 1680 billion. Later, the target was revised downwards to Rs. 1588 billion, yet FBR missed it by Rs. 30 billion. This year's target of Rs. 1952 billion, tacitly reduced to Rs. 1920 billion, confirms window dressing to maneuver over all fiscal deficit that is much higher than is projected in the *Economic Survey 2012*.

The real revenue potential of the country is not less than Rs. 6 trillion provided taxes are levied on the rich and properly enforced. Since the rich do not pay personal taxes and are guilty of illegally remitting untaxed money abroad, Pakistan has become indebted to the extent that now 70% of tax revenues are going towards debt servicing alone—in budget 2011-12, the allocation for debt servicing was Rs. 1.07 trillion against revenue target of Rs. 1.952 trillion. This year it has to be increased by 25%. In a nutshell, the government in is fifth and last budget had nothing to be proud of, except admitting failures on all fronts.

"FED on cement cut by just Rs 100 a ton"

The government, despite strong resistance put up by the Federal Board of Revenue (FBR), has decided to cut federal excise duty (FED) on cement from Rs 500 per ton to Rs 400 per ton, reflecting a decrease of Rs 100 a ton in budget (2012-2013). Sources told here on Wednesday that the FBR has strongly opposed the proposal of the Pakistan Cement Manufacturers Association (PCMA) for reduction in the rate of the FED from existing Rs 500 PMT to Rs 250 PMT.

An impression was created that the FBR would reduce FED on cement by as much as Rs 250 per ton in budget (2012-2013). However, the finalised reduction was just Rs 100 a ton. In the prevuious budget, the government had reduced FED on cement from Rs 700 per metric ton to Rs 500 per metric ton. The FBR argued that the cement industry failed to pass on the benefit of FED reduction to the consumers. Contrary to this, the price of cement has been increased despite decrease in the FED in 2011-2012. There is, therefore, no justification to further reduce the duty by Rs 200 per ton.

According to sources, the opening up of trade with India would benefit cement industry the most, as there is a huge demand for cement in India. This, the sources said, would enable the plants to utilise their full capacity. The rate of customs duty on two fuel inputs of the cement industry - shredded rubber and tyre-derived fuel - is also being reduced in budget (2012-2013). The FBR argued that as the government had decided to phase out the FED regime over the next couple of fiscal years, it would be appropriate to reduce the FED by just Rs 100 a ton in the budget (2012-2013). – *Courtesy Business Recorder*

FED on 10 items to be abolished

The government has decided to abolish federal excise duty (FED) on 10 items - cosmetics, filter rods, lubricating oil in packs; base lube oil, lubricating oil manufactured from reclaimed oil, lubricating oil in bulk, lubricating oil manufactured from sludge and lubricating oil manufactured from sediment. Sources told here on Wednesday that the FED would be totally abolished on cosmetics and filter rods besides other items.

The withdrawal of the FED on cosmetics would also require amendment in the agreement signed between the FBR and the cosmetic manufacturers of Swat, who were annually paying a fixed amount of the FED. The cosmetic manufacturers of Swat are also part of the PM relief package for the war-affected areas. Cosmetics are still subjected to sales tax on the basis of printed retail price under Third Schedule of the Sales Tax Act, 1990. Despite proposed abolition of the FED on cosmetics, the sales tax would be charged on the basis of printed retail price. Under the government policy to avoid multiplicity of taxes, the FBR has proposed abolition of the FED on cosmetics.

In the last budget, the FED on filter rods was fixed at 20% of additional value, instead of Rs 1 per filter rod. The FBR has now proposed to abolish the FED on filter rods giving a major tax relief to the two multinational cigarette manufacturing companies. The higher rates of the sales tax and the federal excise duty has been charged on the finished product ie cigarettes. When the tax department is charging sales tax and federal excise duty on the cigarette, there is no need for imposition of the FED on filter roads. Secondly, the presence of smuggled filter rods in the market also creates disadvantage for the local manufacturers. Thus, it has been proposed to totally abolish the FED on the filter rods.

The FBR will also abolish the FED on five different kinds of oils covering lubricating oil in packs; Base Lube Oil, lubricating oil manufactured from reclaimed oil or sludge or sediment, lubricating oil in bulk, lubricating oil manufactured from sludge and lubricating oil manufactured from sediment. The proposed withdrawal of excise duty on various kinds of oils would cause revenue loss in billions. However, abolition of duty would provide a major relief to the business community as well as general masses in budget.

In this connection, the Finance Bill (2012-13) would introduce amendment in Table-I (excisable goods) of the First Schedule of the Federal Excise Act 2005 to reduce the number of excisable commodities in coming budget. Except such 5-6 kinds of oils, the excise duty would be retained in the remaining items mentioned in the Table-I of the First Schedule of the Federal Excise Act 2005.

In budget (2011-12), the excise duty was abolished on solvent oil, other, other fuel oil, mineral greases, transformer oil, other mineral oils excluding sewing machine oil, waste oil, carbon black oil (carbon black feed stock) including residue carbon oil, greases, organic composite solvents and thinners, viscose staple fiber, motor cars and other motor vehicles. The policy of abolition of the

FED on oils would continue in coming budget (2012-13). Keeping in view this policy, the FED on the remaining oils would be abolished from next fiscal.

Under the government plan to phase out the FED regime, out of 46 items subjected to the FED, the FBR had abolished the FED on 15 items in last budget. In budget (2012-13), the number of items would be further reduced from 31 items to 21. The gradual phasing out of the excise duty would continue in the next two budgets for complete abolition of the excise regime in future. – *Courtesy Business Recorder*

Greenhouse machinery: ST exemption likely to curb misuse of zero-rating facility

The government has decided to give sales tax exemption on sprinklers, drip equipment, spray pumps and nozzles and import and supply of polyethylene and polypropylene used in the manufacture of mono filament yarn and net cloth in budget (2012-13).

Sources told here on Wednesday that the sales tax zero-rating facility is available under the relevant notifications to sprinklers, drip equipment, spray pumps and nozzles. The import and supply of polyethylene and polypropylene for manufacture of mono filament yarn and net cloth is also zero-rated.

The FBR has found that the sales tax zero-rating facility has been grossly misused by unscrupulous elements by claiming illegal refunds of sales tax. The FBR has strongly proposed that these items may be exempted from sales tax to check illegal refunds. Background of the issue revealed that zero-rating on green house machinery was introduced in 2009 with the objective to promote newly introduced green house farming in Pakistan.

However, it was observed that a large number of refund claimants were out to avail the facility and reportedly billions of rupees of refunds were availed by the unscrupulous elements. The government to curb the abuse of this facility is likely to change the facility of zero-rating with the exemption. The proposed change on one hand will result in reducing abnormal sales tax refunds and on the other the sector will benefit as the exemption will remain intact, sources added. – *Courtesy Business Recorder*

Edible oil: Finance Bill may not include FBR proposal for FED hike

Finance Bill (2012-13) may not incorporate a major budgetary proposal of the Federal Board of Revenue (FBR) that seeks to increase the rate of Federal Excise Duty in value addition mode from Rs 1 per kg to Rs 4 per kg on the import of edible oil in budget (2012-13).

It is learnt here on Thursday that the policy makes have accepted a proposal of the FBR on sales tax zero-rating facility on cotton seed oil from next fiscal (2012-13). This proposal would remain intact and would be made part of the Finance Bill (2012-13). The FBR had proposed that the FED is being charged on edible oil at import stage at the rate of Rs 1 per kg which has been proposed to be enhanced to Rs 4 per kg.

This Rs 1 per kg is being collected in lieu of value addition at manufacturing stage, whereas the actual value addition of ghee and cooking oil sector is over and above Rs 4/kg, reflecting an increase of Rs 3 per kg. However, this proposal of the FBR has not been accepted by the policymakers and Finance Bill (2012-13) may not include this proposal of the FBR to increase the rate of Federal Excise Duty (FED) from Rs 1 per kg to Rs 4 per kg on the import of edible oil. Due to its impact on the prices of the ghee and cooking oil, the proposal has not been made part of the Finance Bill, sources said.

The government has agreed to a proposal of the FBR that the cotton seed oil may also be zero-rated to ensure due amount of collection from oil/ghee sector. Presently the cotton seed has been zero-rated whereas cotton seed oil has been totally exempted from sales tax. Under the current status of sales tax exemption, the solvent extractors have not been required to issue any sales tax invoice to the ghee and cooking oil mills. In the absence of the sales tax invoices, the tax department cannot ascertain the actual production of oil and ghee mills. This also resulted into misuse of imported oil, which is sold in the open market, substituted by the production of oil/ghee from locally produced oil. The FBR has proposed that cotton seed oil may also be zero-rated to ensure due amount of collection from oil/ghee sector.

Meanwhile, industry sources said that the edible oil-cum-Manufacturing of Vegetable Ghee/Cooking Oil sector of Pakistan is heavily burdened by duty/tax structure. Further enhancement of FED rate in value addition mode from Re 1 to Rs 4/kg will have an impact of Rs 5-6/kg. Likewise proposal of replacing SRO 191 from 3 percent additional sales tax will jack up the price of product by at-least Rs 5.50/kg. Therefore, the accumulative effect translates into Rs 12/Kg rise in prices for end consumers with immediate effect.

Currently the C&F price of palm oil in the international market hovers around US $1070 per Metric Ton, thus exchange rate of US $ (Pak Rs 93) means Rs 99,510/ Metric Ton. Custom duty, Sales Tax, WHT, FED, warehousing surcharge and other levies totals to Rs 23,000/Metric Ton approximately, which means Rs 23/kg.

Other inputs used in the value addition such as electricity, gas, tin plate, chemicals, transport etc are all sales tax paid commodities/inputs. Hence further imposition of Rs 12/kg in addition to existing taxes will fetch to government total of Rs 40/kg on vegetable ghee/cooking oil.

Although the steps will fetch additional Rs 22 Billion to the National Exchequer, but the burden shall be borne by 160 million population, 70% of which spends 60% of their income on foods items and 30% of total population is living below poverty line. Various NGOs and manufacturing sector has widely condemned new tax/revised structure levied on this food item and desires the removal of proposed unjust levy, sources added. – *Courtesy Business Recorder*

GST on nearly 100 raw materials to be reduced

The federal government has decided to reduce the higher rate of 20-22 percent sales tax on nearly 100 raw materials and inputs to standard rate of 16 percent in budget (2012-13). Sources told here on Wednesday that it is the major relief to be announced for the business and trade on budget day ie Friday (June 1, 2012).

The higher rates of sales tax of 19.5 percent, 20 percent and 22 percent have been imposed at import stage for certain sectors/goods. Sales tax collected at import stage on account of higher rates is subsequently adjusted/refunded without any revenue gain. It is, therefore, proposed that the higher rate of sales tax 22% and 19.5% at import stage may be replaced with the standard rate of 16 percent.

In this connection, the government is planning to introduce amendments in the SRO644(I)/2007 to reduce higher rate of 20-22 percent sales tax on nearly 100 raw materials and inputs in budget (2012-13). SRO644(I)/2007 had imposed higher rates of sales tax on certain inputs. The FBR has proposed 16 percent sales tax on the higher rates of sales tax of 20-22 percent on the import of items mentioned in the SRO644(I)/2007.

The amendment to SRO644(I)/2007 would provide a big relief to the manufactures and industrial units from next fiscal year. Resultantly, the higher rate of 20 percent and 17 percent as per SRO644(I)/2007 would be reduced in coming budget. Around 70 raw materials attracting higher rate of 20 percent sales tax and around 10 items having sales tax rate of 17.5 percent may benefit from lower rate of sales tax under proposed amendments to the SRO644(I)/2007 at the import stage and local supplies, they added. – *Courtesy Business Recorder*

Supply of waste paper to be GST-free

The government has decided to give sales tax exemption on the local supply of waste paper in budget (2012-13). Sources told here on Thursday that the local waste paper has been collected in the unorganised /unregistered sector and sold to waste paper dealers who are also unregistered with the sales tax department.

The registered paper manufacturers buy waste paper from dealers but claim input tax based on fake and flying invoices. Under current circumstances, such input is adjusted against output tax by paper manufacturers. The Federal Board of Revenue has proposed that local supply of waste paper may be exempted to avoid loss of revenue through illegal input tax adjustment.

The government has also decided to announce sales tax exemption on re-meltable scrap in the coming budget (2012-13). At present, the re-meltable scrap is zero-rated. The re-meltable scrap was zero-rated with the objective to collect sales tax effectively from steel melters/re-rollerrs through electricity bills. Zero rating on re-meltable scrap is being misused by some steel melters by charging sales tax only on processing. The misuse can be effectively controlled if re-meltable scrap is exempted. It is, therefore, proposed that zero-rating on re-meltable scrap may be substituted with sales tax exemption. – *Courtesy Business Recorder*

FED on international air travel may be increased

The government is likely to increase federal excise duty (FED) on the international air travel (club, business and first classes) from existing Rs 4,340 per ticket (Saarc, the Middle East/Saudi Arabia) and Rs 5,840 per ticket (Europe, USA the Far East/China, etc) to a standard rate of Rs 6,840 for all countries in the upcoming budget (2012-13).

Sources told here on Wednesday the FBR has decided to revise procedure for collection of FED on the international air travel in budget (2012-13). In this connection, Finance Bill (2012-13) is expected to amend the Federal Excise Act 2005 to bring changes in the FED collection procedure on the international air travel. Under the new regime, the FED on international air travel would be charged irrespective of the destination or embarking country for all categories of economy and economy plus classes, club, business and first class.

According to sources, the FED is chargeable on foreign travel to and from Pakistan. The Board of Airlines Representatives in Pakistan (BARIP) in its budget proposals has asked the FBR to make certain amendments in the existing FED structure in line with the international best practices. The BARIP has explained that the international civil aviation laws object to taxation on travel not including embarkation from the country. The BARIP has also proposed that the law be amended so that it is responsibility of the uplifting carrier of the embarking passenger from Pakistan and not the issuing carrier to pay tax/duty. This will help in the correct collection of FED on all the embarking passengers.

Taking into account the observations of the BARIP, the FBR has proposed that FED may be collected only on embarkation of passengers from Pakistan. Under the services of providing international air travel facilities, rate of excise duty has been specified for passengers embarking for different international destinations. For passengers embarking to or from SAARC region, UAE (Middle East), Saudi Arabia, Africa and Afghanistan, the applicable rate of excise duty is Rs 3,340 for economy and economy plus classes and Rs 4,340 for club, business and first class.

For passengers embarking to or from Europe, Far East, China, USA, Canada, Australia, South America, others, the rate of excise duty is Rs 4,340 for economy and economy plus classes and Rs 5,840 for club, business and first class. Under the proposed FED structure on the international air travel, the FBR has proposed a uniform rate of the FED for all passengers embarking from any country whether Saarc region, UAE (Middle East), Saudi Arabia, Africa and Afghanistan, Europe, Far East, China, USA, Canada, Australia, South America and others. The existing two different FED structures for Saarc, Middle East/Saudi Arabia/Africa etc and Europe, USA/Far East/Australia etc) would be unified into a single standard rate of the FED.

As per proposed FED structure, the rate of the excise duty would remain 16 percent plus Rs 60 per ticket within the territorial jurisdiction of Pakistan. The FED on domestic air ticket would not be changed in the budget. In case of international air travel, Rs 3840 would be charged as the FED for the economy and economy plus class. The existing rate of duty of Rs 3340-Rs 4340 (economy and economy plus) would be merged into a single rate of Rs 3840 per ticket.

For the international air travel, the FBR would now charge Rs 6840 as the FED per ticket for passengers travelling through club, business and first classes. As per existing structure of the FED, the FBR charge Rs 4,340 for club, business and first classes for passengers embarking to or from SAARC region, UAE (Middle East), Saudi Arabia, Africa and Afghanistan and Rs 5,840 (club, business and first classes) for passengers embarking to or from Europe, Far East, China, USA, Canada, Australia, South America and others. If the Cabinet gives approval of the proposal, only a single rate of Rs 3840 would be charged as the FED for the economy and economy plus class and Rs 6840 as the FED per ticket for club, business and first class passengers, sources added. *– Courtesy Business Recorder*

Businessmen slam amended SRO

The business community has criticised the amendment made by the Federal Board of Revenue in SRO 647 (i)/2007 through another SRO 564 (i)/2012 dated 26-05-2012, just a few days before the announcement of the Federal Budget 2012/13, a statement said on Wednesday.

Mian Anjum Nisar, chairman of Pakistan Industrial and Traders Association Front (PIAF) and the former president of the Lahore Chamber of Commerce and Industry (LCCI), said that this amendment will create further financial burden and liquidity problem for the organised sector in the country, it said.

They said that at a time when the business community faces a number of challenges, including prolonged energy crisis, deteriorating law and order situation, high input cost and struggling for its survival, instead of providing some relief, the revenue body is engaged in creating more hurdles for the businessmen, the statement said.

They said that the funds of the taxpayers would be blocked due to unrealistic tax policies of the revenue department and the business community, to meet its working capital requirement, injects further debt from the financial institution, which ultimately increases the cost of doing business in the country.

There is no such type of tax culture existed in the world, which blocked the funds of the taxpayers, they said, adding that the business community is expecting certain tax relief in the Federal Budget 2012/13,but this amendment is against the expectation, which creates frustration between the taxpayers before the announcement of the forthcoming budget.

They demanded the Federal Board of Revenue to withdraw the abovementioned amendment immediately. – *Courtesy The News*

Member NFC from Sindh terms RGST unconstitutional

Dr Kaiser Bengali, who represents Sindh at the National Finance Commission, said on Wednesday that the reformed general sales tax (RGST) is unconstitutional and it should be replaced with sales tax without the input/output adjustment and refund process.

“RGST is an integrated tax, including goods and services. Whereas sales tax on goods is a federal tax and sales tax on services is a provincial tax,” said Dr. Bengali, who is also member of the National Economic Council and former Advisor for Planning and Development to the Chief Minister Sindh. “Therefore, RGST is unconstitutional,” he added. He said that under the IMF programme of November 2008 the main focus was on the RGST, which was not truly adopted due to hassles. “It created problems especially after Sindh started collected sales tax on services in which issues of refunds raised between the province and the federal government,” he added.

As reported, Pakistan again is going for the IMF loan programme this year due to balance of payment crisis, he said, adding that the donor agency would ask the government to implement reform programme, which were missed in the previous loan condition.

He also feared that meeting such IMF conditions the federal government would ask the provinces to surrender the rights of tax collection. He called for simplification of tax regime and respects the constitution. He proposed replacing RGST with sales tax, without the input/output adjustment and refund process. “The tax rate on goods should be reduced to 3-5 percent, chargeable at every stage. The tax rate on services should be fixed at 10-15 percent. Sales tax on goods should be collected by the Federal Board of Revenue (FBR) and sales tax on services should be collected by provinces or delegated by any province to FBR,” he said.

Dr. Bengali, also a prominent economist, proposed restructuring of RGST, as an alternative in case RGST is not possible to abolish, such that the VAT mode regime is applicable to goods only. “Provinces can collect sales tax on services on a non-refund basis,” he said. “In other words, while FBR collects RGST on all goods and allows input/output adjustment and refunds on all goods transactions, provinces collect sales tax on services without making any refunds,” he explained. He said that integrity of RGST had already been compromised by the special dispensation granted to the textile industry and which effectively placed the industry out of RGST net. Dr. Bengali said that such measures would reduce the revenue collection for some time but it would increase industrial activities by reducing cost of doing business, which would resultantly raise revenue and expand the tax base in the medium term.

Presently the country’s tax system is raising revenues for the government expenditure but is failing to serve the purpose of economic growth. “Pakistan’s GDP growth is stagnant to around five percent for the last many years,” he added.

About taxation on equity markets, he said that imposing capital gains tax on stock markets was a correct decision. He, however, said no exemption should be allowed. Dr. Bengali said that property transactions on higher rates did not yield any revenue for exchequer. He proposed introduction of CGT for property/land transactions.

To curb under invoicing in the import trade, he suggested that introduction of ‘right of first purchase’ to enable any private party to purchase an imported consignment. “The measure will curb under-invoicing and reduce profitability in import trading relative to that of manufacturing,” he added.

He also suggested reintroduction of wealth tax with expanded base. To a query on agriculture tax, he said that to impose tax there was need to amend the constitution. – *Courtesy The News*

2012 PTR 1176 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
MUMBAI "L" BENCH, MUMBAI

B.R. Mittal, Judicial Member and J. Sudhakar Reddy, Accountant Member

FACTS/HELD

1. **Despite retrospective law through Finance Act 2012, "royalty" is not taxable as DTAA prevails**
2. The assessee, a Mauritius company, made payment to Panamsat, USA, for hire of a "transponder satellite". The AO held that the said hire charges constituted "royalty" and that the assessee ought to have deducted TDS u/s 195 and that as it had not done so, the amount was to be disallowed u/s 40(a)(ia). Before the Tribunal, the department argued that though as per Asia Satellite 332 ITR 340 (Del), the hire charges were not assessable as "royalty", this verdict was no longer good law in view of the amendment to s. 9(1)(vi) by the Finance Act 2012 w.r.e.f. 1.4.1976 to provide that such hire charges shall be assessable as "royalty". HELD by the Tribunal:

    (i) In Asia Satellite 332 ITR 340 (Del) it was held that in order to constitute "royalty", the payer must have the right to control the equipment. A payment for a standard service would not constitute "royalty" merely because equipment was used to render that service. A similar view was taken in Skycell Communications 251 ITR 53 (Mad). In De Beers (Kar) &Guy Carpenter (Del) it was held that to "make available" technical knowledge, mere provisions of service was not enough and the payer had to be enabled to perform services himself. **The department's argument that the amendments by the Finance Act, 2012 changes the position is not acceptable because there is no change in the DTAA** between India and USA and the DTAA prevails where it is favourable to the assessee;

    (ii) Even otherwise as the payment is made from **one non-resident to another non-resident outside India** on the basis of contract executed outside India, **s. 195 will not apply** as held in Vodafone International Holdings B.V. 341 ITR 1 (SC). As s. 195 did not apply, no disallowance can be made u/s 40(a)(i);

(iii) Further, as prior to the insertion of s. 40(a)(ia) in AY 2004-05, payments to a resident did not require TDS, under the **non-discrimination clause** in the DTAA, the disallowance u/s 40(a)(i) in the case of non-residents cannot be made as held in Herbalife International 101 ITD 450 (Del), Central Bank of India & Millennium Infocom Technologies 21 SOT 152 (Del).

Appeal allowed.

I.T.A.No. 3326/Mum/2006 (Assessment Year : 2002-03).

Heard on: 1st May, 2012.

Decided on: 28th May, 2012.

Present at hearing: Arvind V. Sonde, for Appellant. Mahesh Kumar, for Respondent.

JUDGMENT

Per B.R. Mittal:– (Judicial Member)

This appeal filed by the assessee is directed against the order of learned CIT(A) dated 1.3.2006 for A.Y. 2002-03.

2. Ground No. 1&2 is on the issue as to whether the assessee has a PE in India.

3. The arguments of the assessee as well as revenue on the issue are identical to the arguments advanced for the A.Y.2001-02. Consistent with the view taken by us in that assessment year, we hold that the assessee has no PE in India. The Indian Representative cannot be considered as dependent agent of the assessee. We further held alternatively that even if it is to be held that there is a PE, we have to conclude that the Indian agent was remunerated at ALP and hence no further attribution of profits can be made. Hence we uphold contentions of the assessee and allow these grounds.

4. All the other grounds are on applicability of TDS provisions u/s. 195 and consequently issue of disallowance u/s. 40(a)(i) of the Act. As we have held that there is no PE, the question of a claim being made and disallowing such a claim for expenditure u/s. 40(a)(i) does not arise. In any event as we have heard the matter at length we consider the issue on merits and dispose of the issues.

5. Ground No. 3 is disallowance made u/s. 40(a)(i) on payment for hiring charges for transponder, paid to PanAmSat Limited on the ground

that no tax has been deducted at source by the assessee, u/s. 195 of the Act.

6. The Assessing Officer discussed this issue at paragraph 5.6.2 of his order. He held that the payments made were for hire of transponder and hence is in the nature of 'Royalty' and hence income received by "PanAmSat Limited" and "Advanced Satellite" is taxable in India as per DTAA between India and the country of residence of PanAmSat Limited and Advanced Satellite i.e. U.S.A. and U.K. respectively.

7. On appeal, the first appellate authority observed that in the case of PanAmSat Limited, Indo-US tax treaty is applicable. He negatived the contentions of the assessee.

8. Learned counsel for the assessee contended that learned CIT(A) followed the order of the ITAT Delhi Bench in the case of *Asia Satellite Telecommunications Co. Ltd. vs. DCIT* (85 ITD 478) and that this decision has been reversed by Hon'ble Delhi High Court in the case of *Asia Satellite Telecommunications Co. Ltd.* (332 ITR 340) and hence learned CIT(A)'s order has to be reversed.

9. The other contentions of the learned counsel can be summarized as follows:–

(a) The payment by the assessee to PanAmSat Limited was in respect of facility which is provided to anyone willing to pay and not in respect of any technology which is "made available" and thus do not fall under Article 12 of the India USA/UK DTAA.

(b) Since PanAmSat Limited does not have a PE in India, the above payments are covered under Article-7 of the DTAA and hence cannot be taxed in India.

(c) The payment has been made by a non-resident to another nonresident, outside India and hence not taxable in India. Reliance was placed on Vodafone International Holdings B.V. [341 ITR 1(SC)]

(d) He relied on 'non-discrimination' article in Indo-US DTAA and submitted that no disallowance can be made in the case of the non-resident assessee u/s. 40(a)(i), as under similar circumstances 40(a)(i) cannot be invoked in the case where similar payment are made to a resident of India. He relied on the following case laws:-

- *Harballife International India Pvt. Ltd. vs. ACIT*, 101 ITD 450 (Del)
- ITA No. 4155/Mum/03 and others, "F" Bench, "*Central bank of India vs. DCIT*" order dated 24.9.2010

10. On the other hand learned Departmental Representative relied solely on the proposed amendment to the Finance Bill, 2012 which are

retrospective w.e.f. 1.6.1976. He argued that by the said amendment royalty includes and as always included consideration for transfer/use of any right, property or information,

(i) The possession or control of such right, property or information is with the payer or not.

(ii) Such right, property or information is used directly by the payer or not.

(iii) To location of such right, property or information is in India or not.

11. Learned Departmental Representative submits that the Judgement of Hon'ble Delhi High Court in the case of "*Asia Satellite Telecommunication Co. Ltd.*" [332 ITR 340(Del)] will not survive in view of the amendments and that in terms of Explanation 9(1) of the Act, the source rule will apply and non-existence of a PE, is not relevant. He contended that in the decision of ITAT in "PanAmSat Limited", it was held that the term "royalty" in Article 12 of Indo-US DTAA, there was a 'comma' after the world "secret formula or process" and it was only "secret process" which would qualify as royalty and not what was provided by the assessee and therefore payment made to "PanAmSat Limited" will not be held as royalty as there is no "secrete process".

12. He pointed out that Special Bench in the case of "New Sky Satellite" (121 ITD 1)(SB), reversed this proposition and it was held that, provision of a transponder through which telecasting companies are able to uplink the desired images/data and de-link the same in the desired areas is a "**process**". To constitute '**royalty**' it is not necessary that the '**process**' be a "**secrete process**". Hence he submits that the fact that there is a coma after the words "**secrete formula or process**" in the DTAA does not mean that different interpretation has to be given to the DTAA, as compared to the Act. Thus he contends that the payment for use of process is assessable as royalty both under the Act and DTAA.

He submitted that the AR is making fresh argument that the payment is not borne by the PE. He argued that this should not be entertained. He relied on the AAR ruling in DHV Consultants B.V. in RE 227 ITR 97 (AAR) and argued that the expression "**borne by**" means "**deductable**" or "**liable to be deducted**" Alternatively he submitted that the payment to PanAmSat Limited is taxable as "**Fee for technical services**". On discrimination clause, he submitted that the provisions of the Act have to be considered and implemented.

13. In reply learned counsel for the assessee submits that the proposed amendment to the Finance Bill, 2012 will have no bearing on the case as there is no change in the relevant DTAA and the beneficial provisions of DTAA will be applicable in terms of section 90(2) of the Act. On the argument that under provisions of Income tax Act, source rule is attracted, it was submitted that "PanAmSat Limited" is resident of USA

and application of source rule is to be examined under the DTAA between India and USA and that clause (a) and clause (b) of Article 12.7 of the said DTAA is mutually exclusive. He submitted that if income arise in USA in accordance with clause (a), then in respect of such income, clause (b) is irrelevant and it is not permissible to look into it. He argued that the payment received by PanAmSat Limited from a non-resident arises in USA. With regard to the argument on FTS, he submitted that "fee for included services", should relate to the services performed in India. He argued that the word "perform" is equivalent to "render" and that a service could be performed or rendered in a place which is different from the place where it is utilized. For the proposition he relied on the prima facie view expressed by ITAT in the case of "*PanAmSat Limited*" (103 TTJ 861). He relied on the Delhi High Court decision in the case of *Asia Satellite Telecommunication Co. Ltd.* (supra) and submitted that both Delhi and Bombay Bench have followed this decision in the case of *T.V. Today Network Ltd.*, ITA No. 2376/Del/2010 and in the case of "Times Global Broadcasting Co.Ltd." in ITA No. 5868/Mum/2010 order dated 13.1.2012. He repeated his contention that a standard facility or services was provided by PanAmSat Limited, to all those who are willing to pay for the same and hence it is not consideration for the use of any process. Reliance was placed on the decision of Hon'ble Madras High Court in the case of *Skycell Communications Ltd. vs. Deputy Commissioner of Income-tax* (251 ITR 53) for the proposition that the payment is not in consideration for making available technical services. Reliance was placed on the following case laws:–

- *Raymond Ltd. vs. Deputy Commissioner of Income-tax* (86 ITD 791)(Mum).
- *Dy.CIT vs. Boston Consulting Group Pte Ltd.* (94 ITD 31)(Mum)

14. Rival contentions heard. On careful consideration of the facts and circumstances of the case and the papers on record and case law cited, we hold as follows:–

The issue stands covered in favour of the assessee and against the revenue by the decision of Hon'ble Delhi High Court in the case of *Asia Satellite Communication Co. Ltd. vs. DIT* (332 ITR 340), where it is held as follows:–

> *"Held,_ (i) that under the agreement with television channels, the role attributed to the assessee was as follows : (i) programmes were uplinked by the television channels (admittedly not from India) ; (ii) after receipt of the programmes at the satellite (at locations not situated in Indian airspace), these were amplified through complicated process ; and (iii) the programmes so amplified were relayed in the footprint area including India where the cable operators caught the waves and passed them over to the Indian population. The first two steps were not*

carried out in India. Merely because the footprint area included India and the programmers by ultimate consumers/viewers watched the programmes in India, even when they were uplinked and relayed outside India, that would not mean that the assessee was carrying out its business operations in India. The expressions "operations" and "carried out in India" occurring in Explanation 1(a) to section 9(1)(i) signify that it was necessary to establish that any part of the assessee's operations were carried out in India. No machinery or computer was installed by the assessee in India through which the programmes reached India. The process of amplifying and relaying the programmes was performed in the satellite which was not situated in Indian airspace. Even the tracking, telemetry and control operations were performed outside India in Hong Kong. There was no contract or agreement between the assessee either with the cable operators or viewers for reception of signals in India. Thus, section 9(1)(i) was not attracted.

(ii) That the process of transmission of television programmes started with television channels (customers of the assessee) uplinking the signals containing the television programmes ; thereafter the satellite received the signals and after amplifying and changing their frequency relayed it down in India and other countries where the cable operators caught the signals and distributed them to the public. Any person who had a dish antenna, could also catch the signals relayed from these satellites. The role of the assessee was that of receiving the signals, amplifying them and after changing the frequency relaying them on the earth. For this service, the television channels made payment to the assessee. The assessee was the operator of the satellites and was in control of the satellite. It had not leased out the equipment to the customers. The assessee had merely given access to a broadband width available in a transponder which can be utilized for the purpose of transmitting the signals of the customer. A satellite is not a mere carrier, nor is the transponder something which is distinct and separable from the satellite as such. The transponder in fact cannot function without the continuous support of various systems and components of the satellite. Consequently, it is entirely wrong to assume that a transponder is a self-contained operating unit, the control and constructive possession of which is or can be handed over by the satellite operator to its customers. The terms "lease of transponder capacity", "lessor", "lessee" and "rental" used in the agreement would not be the determinative factors. There was no use of "process" by the television channels. Moreover, no such purported use had taken place in India. The telecast companies/customers were situated outside India and so

was the assessee. The agreements under which the services were provided by the assessee to its customers were executed abroad. The transponder was in orbit. Merely because it had its footprint on various continents that would not mean that the process had taken place in India.

ISRO Satellite Centre [ISAC], In re [2008] 307 ITR 59 (AAR), Ishikawajima-Harima Heavy Industries Ltd. v. DIT [2007] 288 ITR 408 (SC) and Lakshmi Audio Visual Inc. v. Asst. CCT [2001] 124 STC 426 (Karn) applied.

(iii) That the money received from the cable operators by the telecast operators was treated as income by these telecast operators which had accrued in India and they had offered and paid tax. Thus, the income generated in India had been duly subjected to tax in India. The payment made by the telecast operators situated abroad to the assessee which was also a non-resident did not represent income by way of royalty as defined in Explanation 2 to section 9(1)(vi) of the Act. Article 12 of the model double taxation avoidance agreement framed by the Organisation of Economic Co-operation and Development contains a definition of "royalty" which is in all material respects virtually the same as the definition of "royalty" contained in clause (iii) of Explanation 2 to section 9(1)(vi) of the Act. The commentary issued by the OECD can be relied upon.

(iv) That the Tribunal rightly admitted the additional ground on the question of applicability of section 9(1)(vii) on the ground that it was purely legal and did not require consideration of any fresh facts, as all necessary facts for adjudication whether the amount received was chargeable to tax under section 9(1)(vii) were available on record. However, no arguments having been advanced by the Department on this ground, it had to be presumed that the case was not sought to be covered under this provision."

15. Coming to argument of learned Departmental Representative that this is a process Hon'ble Madras High Court in the case of Skycell Communications Ltd. v. Deputy Commissioner of Income-tax held as follows:–

"Merely collection of fees for use of standard facility provided to all those willing to pay for it does not amount to fees having been received for technical services".

At page 58 (b) &(c) it is held as follows:–

"Satellite television has become ubiquitous, and is spreading its area and coverage, and covers millions of homes. When a person receives such transmission of television signals through the cable provided by the cable operator, it cannot be said that the home

owner who has such a cable con- nection is receiving a technical service for which he is required to deduct tax at source on the payments made to the cable operator.

Installation and operation of sophisticated equipments with a view to earn income by allowing customers to avail of the benefit of the user of such equipment does not result in the provision of technical service to the customer for a fee.

When a person decides to subscribe to a cellular telephone service in order to have the facility of being able to communicate with others, he does not contract to receive a technical service. What he does agree to is to pay for the use of the airtime for which he pays a charge. The fact that the telephone service provider has installed sophisticated technical equipment in the exchange to ensure connectivity to its subscriber, does not on that score, make it provision of a technical service to the subscriber. The subscriber is not concerned with the complexity of the equipment installed in the exchange, or the location of the base station. All that he wants is the facility of using the telephone when he wishes to, and being able to get connected to the person at the number to which he desires to be connected. What applies to cellular mobile telephone is also applicable in fixed telephone service. Neither service can be regarded as "technical ser- vice" for the purpose of section 194J of the Act".

16. Moreover a mere rendering of service cannot be considered as making available FTS. Recently Hon'ble Karnataka High Court in the case of *CIT vs. DE BEERS India Minerals Pvt. Ltd.,* upheld the proposition laid down by the Mumbai Bench of the Tribunal in the case of *Raymonds ltd.* (86 TTJ 791). Similarly Hon'ble Delhi High Court in the case of *DIT vs. Guy Carpenter & Co. Ltd.,* held that to make available technical knowledge, mere provisions of service is not enough and payer must be enabled to perform services himself. Thus, the issue in question is covered in favour of the assessee by the above decisions.

17. Coming to the argument of learned Departmental Representative that the amendment to the Finance Act, 2012 changes the position, we find that there is no change in the DTAA between India and USA. Thus, the amendments have no affect on our decision.

Even otherwise as the payment is made from one non-resident to another non-resident outside India on the basis of contract executed outside India, section 195 will not apply to such cases as held by Hon'ble Supreme Court in the case of *Vodafone International Holdings B.V.* (WP No. 1942 of 2007) 341 ITR 1 (SC). Thus on this ground also no disallowance can be made u/s. 40(a)(i) of the Act.

Even under the non-discrimination clause the disallowance cannot be made. In the case of Herbelife International India (P) ltd., it is held as follows:–

"Held : The provisions of s. 40(a)(i) as it existed prior to its amendment by Finance Act, 2003, w.e.f. 1st April, 2004 provided for disallowance of payment made to a nonresident only where tax is not deducted at source on such payment at source. A similar payment to a resident does not result in disallowance in the event of non-deduction of tax at source. Thus, a nonresident left with a choice of dealing with a resident or a non-resident in business would opt to deal with a resident rather than a non-resident owing to the provisions of s. 40(a)(i). To this extent the non-resident is discriminated. Article 26(3) of In do-US DTAA seeks to provide against such discrimination and says that deduction should be allowed on the same condition as if the payment is made to a resident. Thus this clause in DTAA neutralizes the rigour of the provisions of s. 40(a)(i). By virtue of the provisions of s. 90(2) the law which is beneficial to the assessee to whom the DTAA applies, should be followed. Therefore, in view of art. 26(3) of Indo-US DTAA, the AO cannot seek to invoke the provisions of s. 40(a)(i) to disallow the claim of the assessee for deduction even on the assumption that the sum in question is chargeable to tax in India."

Similar is the view taken in Central Bank of India (supra), wherein it is held as follows:–

> *"The dispute was regarding disallowance of deduction claimed by the assessee on account of payments made to Master Card and VISA cards. The said payments were made by it for the services rendered by the foreign non- residents and disallowance had been made under section 40(a)(i) on the ground that no tax had been deducted at source. The assessee's case was that the said payments were not taxable in the hands of the payees-nonresidents as they did not have any permanent establishment in India. Alternatively, it was argued that even if the amounts were taxable in the name of the non-residents, the deduction claimed on account of payments could not be disallowed in case of the assessee in view of the article 26(3) of the Indo-US Double Taxation Avoidance Agreement. On perusal of said article, it became apparent that the said article protects the interests of the non—residents vis-a-vis residents. The article provides that payments made to the non-resident would be deductible under the same conditions as the payments were made to a resident. The exceptions provided in the article 26(3) were not applicable to case of the assessee as paragraph 8 of the article*

> *12 would not apply to the assessee, as there was no relationship between the assessee and the payee-concerns. As per the provisions of section 40(a)(i) applicable to the relevant year no disallowance could be made in respect of payments made to the residents on the ground of non-deduction of lax at source. Therefore, in view of the provisions of article 26(3), no disallowance could be made in case of payments to the non-residents also even if the amount was found taxable in India in their hands. Thus, the order of Commissioner (Appeals) confirming the disallowance could not be upheld. Accordingly, the order of the Commissioner (Appeals) was to be set aside and the claim of the assessee was to be allowed."*

> *The Delhi Bench of the Tribunal in Millennium Infocom Technologies Ltd. v/s ACIT, [2008] 21 SOT 152 (Del.), has also taken a similar view.*

> *The learned Departmental Representative could not bring on record any contrary decision. Under these circumstances, we follow the decisions of co-ordinate bench of the Tribunal and dismiss this ground of the Revenue.*

18. Thus on this ground also, no disallowance can be made. Thus for all these reasons we allow this ground of the assessee and hold that the assessee need not deduct tax at source u/s. 195 and consequently there can be no disallowance u/s. 40(a)(i) of the Act.

19. Ground No. 4 is against the disallowance made u/s. 40(a)(i) on payments made to Advanced Satellite.

20. Advanced Satellite is taxed resident of UK and does not have PE in India. Like under Indo-US DTAA, even under Indo-UK DTAA, the term FTS has been narrowly defined. The arguments of the assessee are similar to the arguments raised in Ground No. 3 on the issue of payments made to PanAmSat Limited.

21. The learned Departmental Representative on the other hand argued that the payments made to Advanced Satellite are not similar to payments for transponder and that it is a payment for equipment and technical fees. He referred to Agreement dated 11.4.2000 between Advanced Satellite and the assessee at paper book 43 to 62. The other arguments were the same as in the case of PanAmSat Limited.

22. In reply, learned counsel submits that, if the contention of learned Departmental Representative is that the nature of services provided by PanAmSat Limited is different from the nature of services provided by Advanced Satellite then in such a case, amendment will not have any bearing on the payments to Advanced Satellite. He referred to the Agreement and submitted that conceptually nature of services is the same in both the cases. He pointed out that the Agreement for the use of facilities which are standard facilities i.e. reception and transmission of

signals wherein programme is delivered by the assessee to the Advanced Satellite on video tape for transmission via a circuit. It was submitted that technical staff and equipments used to provide technical services are belonging to or hired by or under the control of Advanced Satellite. It was submitted that the application of source rule is to be examined under Indo-UK DTAA Article 13.7.

23. On the other issues similar arguments were advanced by learned AR as in the case of payments made to PanAmSat Limited. Referring to Article 13.7 of Indo-UK DTAA, he submitted that the payment has been made by the appellant who is a non-resident to another non-resident and accordingly royalty did not arise in India, in terms of the said Article. He reiterated his contention that the burden of the payment is not borne by PE in India. He clarified that payments to Advanced Satellite and Advanced Broadcast are two separate payments which are evidenced by two separate invoiced and hence there is no ambiguity.

24. After hearing rival contentions, we are of the considered opinion that the conclusion drawn by us in the case of PanAmSat Limited squarely cover the issue on hand. As there is no change in the DTAA between India and UK, we have to hold that no disallowance can be made u/s. 40(a)(i). No disallowance can be made in view of the nondiscrimination clause also. Thus for the very same reasons on which ground No. 3 has been allowed, we allow ground No. 4.

25. Ground No. 5 is on the disallowance u/s. 40(a)(i) on payments made to LMB(Mauritius) Ltd. which is a resident of Mauritius. The assessee submits that the payment in question is for outright purchase of programmes and hence it should be considered as business receipts of the foreign company. Referring to the Agreement, specific reference is made to clause 2(ii), 2(iv), 3&4. It is submitted that these clauses deal with the sale and delivery of programmes to the assessee, which are existing as on the date of the Agreement and also which are to be developed over a period of six years. The assessee, has right to sublicense to the third party, promote and amend programmes without approval of the LMB(Mauritius) and hence it is claimed that this is a sale. It is further submitted that after delivering the programmes there is no liability of BIHL to return back or restrict the rebroadcast of programmes on termination. Further clause 9.2, 10,12 &15 are relied upon to argue that it is a outright sale of programme for Asian and Indian territories which is perpetual in nature. On the issue of charges, it is submitted that these are levied on annual basis, only because the contract is ongoing contract. He submitted that under Article 12 of Indo-US DTAA, if payment is made for use of programmes, then it will fall within definition of 'royalty' and as in the case of the assessee, it was purchase of programmes, section 9(1)(vii) cannot be attracted. Reliance was placed on the Judgement of B. Suresh (313 ITR 149), *Commissioner of Income-tax vs. D. C. M. Ltd.* (336 ITR 599) and *Far Video Films* (15 SOT 385)(Mum).

26. The learned counsel for the assessee further argued that without prejudice, if payment is categorized as royalty, then it does not accrue in India as it is not incurred in relation to PE in India and such royalty is not required to be borne by PE in India. He pointed out that Mauritius Company does not have PE in India. Reliance was placed on the decision of Sat Satellite (Singapore) Pte Ltd (132 TTJ 459).

27. Learned Departmental Representative on the other hand contended that this is not a case of outright purchase of programmes, but a payment for use of broadcasting rights. He contended that Hon'ble Supreme Court Judgement in the case of B. Suresh (supra) pertains to provisions of section 80HHC and hence cannot be relied upon. He argued that Mauritius Company has not produced tax residency certificate and hence the benefit of treaty cannot be given.

28. In the reply learned counsel for the assessee submitted that tax residency certificate is filed as additional evidence and is at page 175 of assessee's paper book-2. It was stated that tax residency certificate was not available earlier and it was subsequently obtained and hence it should be admitted as additional evidence. It was reiterated that this is a case of purchase of films.

29. After hearing rival contentions, we find that the issue as to whether it is a sale of a programme as contended by the assessee or a payment for grant of broadcasting right as contended by revenue, is to be judged based on the Agreement between the parties which is at page 119 to 126 of the assessee's paper book. Perusal of this Agreement demonstrates that LMB (Mauritius) Ltd. is called the "seller" and B4U International is called the "buyer". At page 119 the Agreement reads as follows:–

"(A) The Seller is the sole and exclusive owner of Indian Film and Music based "programming content" ("said Programmes") details of which are set out in Schedule A to this Agreement.

(B) The Buyer is desirous of obtaining broadcasting rights of the said Programmes on B4U Music for the territory of the India Sub Continent and or other Asian countries, the Middle East wherever relevant (the "Territory") for the purpose of exploiting such rights through the broadcasting operations of its subsidiaries, associates operating in the Territory.

(C) The Buyer has approached the Seller for the grant of such Buyer rights ("License") of the said Programmes, for the Territory.

(D) This Agreement sets out the terms agreed by both parties for the grant of the License of the said Programme.

2.1 In consideration of the undertakings of the Buyer in this Agreement and subject to and conditional on the full and timely *warranties and undertakings in this Agreement the Seller grants to the Buyer:*

(i) The License to all commercial & non-commercial "Broadcasting Rights" of the said Programmes, either by Satellite, Cable or DTH during the Contracted Period in the Territory.

(ii) The License includes the right to package the Channels on the relevant platforms and to do all that is necessary to that end including but not limited to entering into contracts/deals with third parties such as service providers, platform owners and other channel owners.

(iii) The License includes the right to sub-license the said Programme Rights to any third party without the approval of the Seller.

(iv) It includes the right to promote and advertise the Programme and to edit it as suitable for telecast for the Territory.

3. SELLER'S OBLIGATIONS

The Seller agree and covenant with the Buyer that:–

a. The Seller shall affect delivery of the Programmes listed in Schedule A (Schedule A is not exhaustive as it only contains Programmes which are already produced or is under production and does not include Programmes what are likely to be produced in the near future).

b. The Seller shall also deliver free of charge such available publicity material such as promos, photo sets, posters, trailers, extracts etc and other materials in respect of the said Programmes.

c. The Seller shall, deliver on loan to the Buyer specified play out center good Digi-Betacam copies of all Programmes at least 48 hours in advance of the scheduled broadcast of the Programme.

4. BUYER'S OBLIGATIONS

The Buyer agree and covenant with the Seller that:–

b. In consideration of the License granted hereunder by the Seller, the Buyer shall pay to the Seller the Programming Charges as set out in Paragraph 5.1 and payment shall be made in accordance to the terms and conditions provided in Paragraph 6.

10. The Buyer shall have the right to take all necessary steps (including registration of copyright where the Buyer shall deem necessary) to have the copyright in the Programme and the

Delivery Material and the rights granted to the Buyer under this agreement protected throughout the Territory."

30. Hon'ble Supreme Court in the case of B. Suresh (supra) has considered a case where the assessee has bought rights of various decoders, recorded movies on beta-cam tapes and transferred them as telecasting rights to Star TV for five years and claimed for deduction u/s. 80HHC of the Income Tax Act, 1961. Hon'ble Supreme Court held that telecasting rights fell in the category of articles of trade and commerce and hence within category of "merchandise" and the transfer of the said rights by way of lease fell within the meaning of "sale" and attract 80HHC. Mumbai Bench of the Tribunal in the case of *Far Video Films (P) Ltd vs. ACIT Circle 1(6)* (15 SOT 385) was considering a case where the assessee company was engaged in the business of producing TV commercials, as per specifications of clients located abroad. The assessee claimed deduction u/s. 80HHC on the basis that it was an exporter of films. The Assessing Officer disallowed the claim on the ground that the exhibition and telecast rights were intangible and could not be termed as goods and merchandise in respect of export of advertisement films. Commissioner (Appeals) held that the assessee was rendering only job work services and no goods were sold. On appeal, the Tribunal held that the transaction was that of 'sale'. Thus proposition laid down in these case laws, when applied to the facts of the case, we have to hold that there is a sale of programmes, section 195 cannot be invoked in case of purchases. In the result, question of applying 40(a)(i) does not arise. Even otherwise, this ground has to be allowed for the same reasons as allowing the ground on payments made to "PanAmSat" as this is a payment by a non-resident to another non-resident and as nondiscrimination clause also applies. Thus this ground of the assessee is allowed.

31. Ground No. 6 is on the issue of disallowance u/s. 40(a)(i) on purchase of films from LMB Isle of Man.

32. Learned counsel for the assessee submitted that there is no tax treaty with Isle of Man and hence provisions of section 9 of the Income Tax Act governed taxability of the payments. He contended that Explanation 2 to section 9(1)(vi) defines the term "royalty" and that the amount paid for "Cinematographic films" do not fall within the definition. He submitted that Cinematographic films, should be treated as "business profit" of seller of the films, as they are not covered under the definition of 'royalty' and as LMB Isle of Man has no business operations in India nor business connection, profit from sale of films cannot be taxed in India. Thus he argues that section 40(a)(i) cannot be invoked. It is argued that alternatively if the payment is considered as for royalty, then it is related to business of broadcasting carried outside India and hence not covered by section 9(1)(vi). Reliance was also placed on the decision of Supreme Court in the case of Vodafone International Holdings B.V. and argued

that the payment of a non-resident to another non-resident does not attract T.D.S. provisions.

33. Learned Departmental Representative argued that the payments made for Cinematographic films is covered by clause (v) of Explanation 2 to section 9(1)(vi). He referred to the Agreement between the assessee and LMB Isle of Man which is at page 238 to 246 of the assessee's paper book and submitted that it was a case of obtaining broadcasting right of films on B4U Movies on the territory of Indian sub-continent and other Asian countries and hence not sale of films.

34. Learned counsel for the assessee replied that the assessee is carrying on its broadcasting business outside India and this is a case of purchase of Cinematographic films for LMB Holdings for Television broadcasting and hence 40(a)(i) does not apply.

35. After hearing rival contentions, we hold as follows:–

Explanation 2 to section 9(1)(vi) defines the term "royalty". In subclause (v) reads as follows:–

> *"The transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting,* ***but not including consideration for the sale, distribution or exhibition of Cinematographic films.****"*

Thus, consideration paid for sale distribution or exhibition of Cinematographic films, does not fall within term Royalty in view of Explanation 2 sub-clause (v) to section 9(1)(vi) of the Act. Perusal of the Agreement dated 1.9.2000 between LMB Holdings Isle of Man and the assessee, demonstrate that the assessee is a buyer and LMB Holdings is a seller. At paragraph 2.1, 3&4 & 10 reads as follows:–

"2.1 In consideration of the undertakings of the Buyer in this Agreement and subject to and conditional on the full and timely warranties and undertakings in this Agreement the Seller grants to the Buyer:

(v) The License to all commercial & non-commercial "Broadcasting Rights" of the said Programmes, either by Satellite, Cable or DTH during the Contracted Period in the Territory.

(vi) The License includes the right to package the Channels on the relevant platforms and to do all that is necessary to that end including but not limited to entering into contracts/deals with third parties such as service providers, platform owners and other channel owners.

(vii) The License includes the right to sub-license the said Programme Rights to any third party without the approval of the Seller.

(viii) It includes the right to promote and advertise the Programme and to edit it as suitable for telecast for the Territory.

3. SELLER'S OBLIGATIONS

The Seller agree and covenant with the Buyer that:

d. The Seller shall affect delivery of the Programmes listed in Schedule A (Schedule A is not exhaustive as it only contains Programmes which are already produced or is under production and does not include Programmes what are likely to be produced in the near future).

e. The Seller shall also deliver free of charge such available publicity material such as promos, photo sets, posters, trailers, extracts etc and other materials in respect of the said Programmes.

f. The Seller shall, deliver on loan to the Buyer specified play out center good Digi-Betacam copies of all Programmes at least 48 hours in advance of the scheduled broadcast of the Programme.

4. BUYER'S OBLIGATIONS

The Buyer agree and covenant with the Seller that:

b. In consideration of the License granted hereunder by the Seller, the Buyer shall pay to the Seller the Programming Charges as set out in Paragraph 5.1 and payment shall be made in accordance to the terms and conditions provided in Paragraph 6.

10. The Buyer shall have the right to take all necessary steps (including registration of copyright where the Buyer shall deem necessary) to have the copyright in the Programme and the Delivery Material and the rights granted to the Buyer under this agreement protected throughout the Territory."

36. As the conditions are same as in the case of purchase of programmes from LMB Mauritius in our opinion propositions followed by us applies to this issue also. Thus the amount in question is not liable to tax in India and consequently the question of deduction of tax u/s. 195 does not arise. Thus there is no liability on behalf of the assessee for deduction of tax at source.

37. In the result, appeal of the assessee is allowed.

Order has been pronounced on 28th Day of May, 2012.
