

MVDCO ADVISORY SERVICES

CHARTERED ACCOUNTANTS

News Letter

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INCOME TAX

Worldwide Township Projects – Delhi High Court

Re: Scope of Section 269SS - Penalty is not leviable if liabilities are recorded by book entries.

The Company had purchased land worth Rs. 14 crores. The purchase price was paid by third party PACL. Journal entries were passed in the books of the Company reflecting PACL as creditor. The AO held that the assessee had taken loan from PACL in violation of Section 269SS since the same was otherwise than Account Payee cheque or Account Payee draft. On appeal, Tribunal deleted the penalty. On further appeal by the Revenue, the High Court held:

Section 269SS applies to a transaction where loan or deposit is accepted by an assessee otherwise than by Account Payee cheque or draft. The scope of this section is clearly restricted to the transactions involving acceptance of money. It does not intend to cover the transactions where a liability or a debt is created on account of book entry. The objective of this section is to prevent transactions in cash.

PACL had made payment to the land owner through normal banking channel on behalf of the assessee. This payment was recorded by the assessee in the books by crediting the account of PACL. There was no transaction in cash/currency other than through banking channel and therefore no infringement of Section 269SS. The levy of penalty was invalid.

Exxon Mobil Gas – Delhi Tribunal

Re: To compute Operating Profit under TNMM for determining PLI of comparable Company, non-operating income and non-operating expenses should be excluded.

The assessee Indian Company was engaged in the business of conducting marketing survey and performing related advisory services to its global AEs. The Company had adopted TNMM as the most appropriate method and Operating Profit (OP) to Total Cost (TC) as Profit Level Indicators (PLI) and selected a few Companies as comparables.

In respect of one of the Companies, the profit margin was 37% whereas if one excludes 'other income', the profit margin was only 7%. The question was whether the other income should be included while computing the operating profit or not.

The Delhi Tribunal held that:

The major component of other income of the comparable Company was "interest income". To determine Profit under TNMM, the items of non-operating income should be excluded. If the non-operating income is excluded, the non-operating expenses should also be excluded. The

Tribunal therefore remanded the matter back to the TPO for correct determination of Operating Profit after excluding both the non-operating income and non-operating expenses.

Three Star Granites – Cochin Tribunal

Re: No disallowance u/s. 40(a)(ia) can be made in case of short deduction of tax

In respect of certain payments made by the assessee Company, it had deducted tax @ 2% under section 194C instead of 10% under section 194I. The question was whether such expenses – fully or proportionately - can be disallowed where the tax was not deducted at source as per the prescribed rates under the Act?

The Cochin Tribunal held that:

Section 40(a)(ia) does not envisage a situation where there was short deduction of tax at source. Therefore, when the genuineness of the entire expenditure was not doubted by the AO, in absence of specific disallowance provision in the section, the same cannot be disallowed.

Birla Corporation – Jabalpur Tribunal

Re: Payment made towards construction, assembly and installation activity

Payment was made for the services rendered which were in the nature of construction, assembly and installation services. The question arose whether this payment will be taxable under Article 12 on Fees for Technical Services or will be taxable as business income under Article 7 if an Installation Permanent Establishment (PE) is created under Article 5 of the DTAA?

The Tribunal observed as follows:

The DTAA has general provision in Article 12 dealing with rendering of technical services and specific provision in Article 5 dealing with rendering of technical services in the nature of construction, assembly, installation and supervisory services in connection therewith. To this extent, there is clearly an overlap between Article 5 and Article 12. Whenever there is such overlap, specific provision will prevail over general provision. Therefore the taxability has to be determined based on the provisions of specific Article 5 and not general provision 12. If one has to proceed on the basis that even when the project fails the Installation PE test, the taxability must be held as FTS at least, the PE provisions will be rendered totally meaningless.

Accordingly, the Tribunal held that though construction, installation and assembly activities are de facto in the nature of technical services, the consideration thereof will not be assessable under Article 12 but will only be assessable under Article 7 on business income if an Installation PE is created under Article 5.

Compiled by: CA Malay Damania, Partner

VAT

I Recent Judgements

1. Contracts for repairs to building – DDQ

The Hon. Commissioner - Maharashtra State – in the case of Painterior (India) has held that under composition scheme, contracts for repairs to building are not construction contracts and hence not eligible to lower tax @ 5% but liable to tax @ 8%.

2. 'F' forms:

'F' forms covering transactions of 2 months held allowable (Castrol India Ltd. – West Bengal)

3. Rate of tax on tools - Mumbai High Court:

Tools made of "iron & steel" held to be declared goods, covered by sub-entry (ix) of entry (iv) of section 14 of the Central Salestax Act, 1956 – liable to 4% (currently 5%) (Commission of Salestax Maharashtra State v/s. Jhalani Tools (India) Ltd).

4. Purchase of machinery (against 'C' form to be utilized in execution of works contracts):

The Hon. Calcutta High Court has ruled that the Petitioner (Joyrath Projects . Ltd.) has validly purchased machinery against 'C' form, to be utilized in execution of works contracts since the C.S.T. registration certificate indicates the nature of business as "works contracts" as well as certain machines.

5. Hon. Supreme Court

In the case of Nokia India P. Ltd., has held that Battery Charger sold along with the cell phone is not part of cell phone but is an accessory and liable to VAT @ 12.5% & not eligible to concessional rate of 4% (this matter originated in Punjab State)

II Goods & Service tax (GST)

There are strong indications that GST Bill will be introduced in the forthcoming session of parliament. This indication flows from the fact that the Central Govt. has introduced the Constitutional Amendment Bill as a step towards introduction of GST Bill

III Salestax department news:

Recently Maharashtra ST dept. has kept on their website “List of Dealers entitled to refund” as earlier Return – not - filer dealers have filed returns for F.Y. 2009-10 & 2010-11. The dealer whose name appears in the list is not required to file refund application in Form No. 501. Let’s keep our fingers crossed till such refund is actually granted.

Compiled by: CA Rajeev Varaiya, Partner

COMPARABLE UNCONTROLLED PRICE METHOD (CUP)

INTRODUCTION:

Section 92 of the Income Tax Act, 1961 lays down that any income arising from an international transaction shall be computed having regard to arm's length price (ALP).

Further Section 92C states that the arm's length price in relation to an international transaction or specified domestic transaction (SDT) shall be determined by any of the following methods prescribed, being the most appropriate method, having regard to the nature of transaction or class of transaction or class of associated persons (related party/parties) or functions performed by such persons or such other relevant factors as the Board may prescribe.

One of the methods prescribed u/s 92C is the **Comparable Uncontrolled Price Method (CUP)**.

Transaction:

Section 92F (v) defines "Transaction" as below:

Transaction includes an arrangement, understanding or action in concert whether or not such arrangement, understanding or action is formal or in writing; or is intended to be enforceable by legal proceedings.

Hence transaction covers not only transaction entered into by virtue of a written agreement but it also covers transaction entered into by means of an oral communication.

"Controlled transaction" is a transaction between enterprises which are associated or related to each other, i.e. transactions between related parties are controlled transactions, whether resident or on-resident.

"Uncontrolled transaction" is a transaction between enterprises other than related parties, whether resident or on-resident.

CUP Method:

The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. If there is any difference between the two prices, this may indicate that the conditions of the commercial and financial relations of the associated enterprises are not arm's length, and that the price in the uncontrolled transaction may need to be substituted for the price in the controlled transaction.

Comparability:

An uncontrolled transaction is comparable to a controlled transaction (i.e. it is a comparable uncontrolled transaction) for the purposes of the CUP method if one of the two conditions is met:

- a) None of the differences, if any, between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market or,
- b) Reasonably accurate adjustments can be made to eliminate the material effects of such differences.

CUP method is the most direct method and when uncontrolled transactions are identified, this is the most preferred method over other methods for determining ALP.

Methods of CUP:

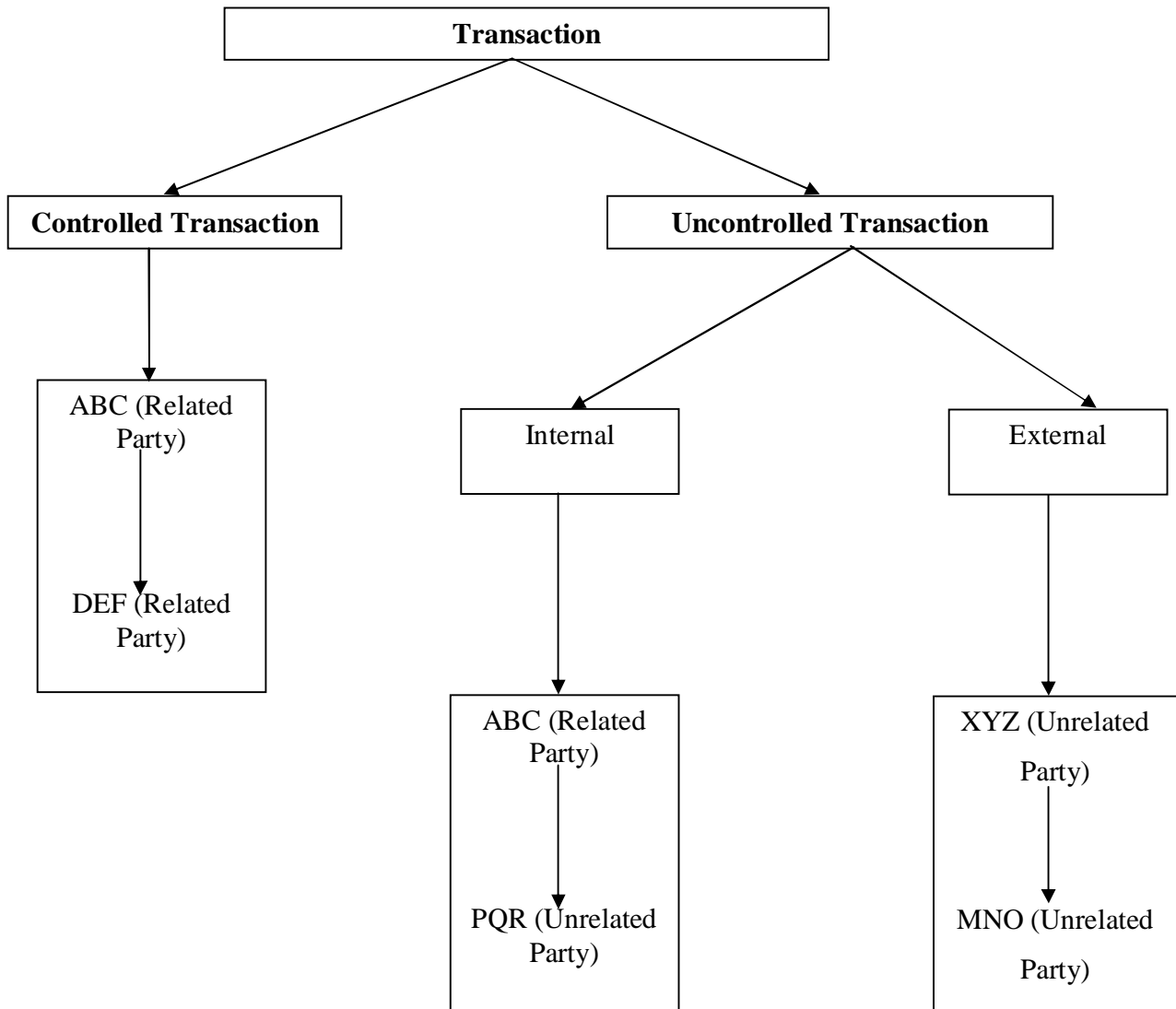
CUP can be either –

- a) Internal CUP or
- b) External CUP.

Internal CUP is available when the taxpayer enters into a similar transaction with a related party and also with a non-related party. Internal CUP is available when the taxpayer buys or sells same goods from/to a related party and also from/to a non-related party in the same/similar quantity at the same terms and conditions. Internal CUP is the best method to benchmark a transaction entered into with a related party as all the available information is readily available with precision and adjustments if required to be made to the terms and conditions of the transactions can be easily made with accurateness.

External CUP is available when the transactions entered into by the taxpayer with a related party are the same as the transactions entered into by any other enterprise with a non-related party. It is difficult to get the price details of the same/similar transaction entered into by any other enterprise with a non-related party and hence the applicability of external CUP becomes difficult.

Following chart explains the methods of CUP:



Computation of arm's length price:

Rule 10B(a) of the Income Tax Rules, 1962 prescribes the following steps for computing arm's length price under CUP method:

- a) The price charged or paid for property transferred or services provided in a comparable uncontrolled transaction, or a number of such transactions, is identified;
- b) Such price is adjusted to account for differences, if any, between the international transaction or SDT and the comparable uncontrolled transactions or between the enterprises entering into such transactions, which could materially affect the price in the open market;
- c) The adjusted price arrived at under point no. b above is taken to be an ALP in respect of the property transferred or services provided in the international transaction or SDT.

Factors affecting applicability of CUP method:

Following are a few factors affecting the applicability of CUP method:

- a) Characteristics of property or services like:
 - ✓ In the case of tangible property - physical features of the property, its quality and reliability and the availability and volume of supply.
 - ✓ In the case of provision of services – the nature and extent of the services.
 - ✓ In the case of intangible property – licensing or sale, patent, trademark or know-how etc.
- b) Geographical market.
- c) Foreign currency risks etc.

CUP VIS-A-VIS OTHER METHODS:

As part of the process of selecting the most appropriate transfer pricing method and applying it, the comparability analysis always aims at finding the most reliable comparables. Thus, where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated. When performing comparability analysis, due care should be given to:

- a) the determination of the available sources of information on external comparables, taking into account their relative reliability
- b) Identification of potential comparables, determining the key characteristics to be met by any uncontrolled transaction in order to be regarded a potential comparable, and
- c) The selection of the most appropriate method, determining the relevant financial indicator.

The scope of the adjustments has to be widened. All the submissions regarding the disparity between the two transactions should be considered and suitable adjustment is to be made before finalizing the ALP under the CUP method.

Steps (a) to (c) should be repeatedly carried out until a satisfactory conclusion is reached. The available sources of information for examination may influence the selection of the transfer pricing method. In case the tax payer is not able to find information on comparable transactions and make reasonably accurate adjustment, the taxpayer might have to select another transfer pricing method and repeat the process of comparability analysis. A relatively better methods - other less direct methods, can throw a fair degree of accuracy when comparing the transaction with associated enterprise with that of the unrelated parties to achieve comparability.

The CUP method can be applied when the comparable transaction is identical or nearly similar to the controlled transaction. There should not be such material differences as cannot be reasonably adjusted. The CUP can be applied when an adjustment can be easily made. For example, if controlled and uncontrolled sales are similar except for the fact that the controlled sale price is a CIF price and uncontrolled sales are made at the FOB factory. The difference in terms of transportation and insurance are generally definite and reasonably certain adjustment can be made to apply a CUP, as comparable.

Also, the CUP method loses its reliability if a reasonably accurate adjustment cannot be made, due to the non- availability of data from the independent enterprises or the open market / commodity market for the above mentioned items.

ILLUSTRATIONS WITH CASE LAWS:

In case of *Bharti Airtel Limited*, the Delhi ITAT held that under CUP method, difference in geographical location of market, not sufficient reason to reject a comparable, unless resulting in different market conditions; TPO, while rejecting assessee's comparables, should have demonstrated that market conditions were so different that uncontrolled transactions ceased to be comparable with transactions with AE; Assessee's sale of carriage and termination of voice traffic services is a business to business service performed in India and differences in market conditions in countries of origin of call, has no impact on the determination of price for Indian segment;

In case of *Noble Resources & Trading India Pvt. Ltd.*, the Delhi ITAT held that internal CUP more appropriate for assessee's trading transactions, provided complete data of such comparable uncontrolled transactions is available; In case complete details not available to establish ALP under CUP, Revenue at liberty to discard the CUP method and resort to any other suitable method; Under CUP, quotations or prices as per publications cannot be considered as external

CUPs; Directs assessee to submit details of actual uncontrolled transactions to establish ALP under CUP method.

In case of *Dufon Laboratories*, Mumbai ITAT held that turnover, quality, geographical differences etc to be considered while identifying comparables for determining ALP.

CONCLUSION:

The CUP method is the most direct and preferred method for determining ALP under Transfer Pricing Law. But getting price for the same product from external sources becomes practically difficult as an apple to apple comparison is not always available.

To conclude though CUP method is the preferable method for determining ALP from both taxpayer's and tax officer's perspective, in practice it is the most difficult to apply due to the comparability factors and preciseness in the products being compared.

References:

- i. OECD – Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration
- ii. Income Tax Act, 1961
- iii. Article published by Dr. R. Kanthakrishnan & M.S. Vasani

Compiled by: CA Chandra Shekhar Sah

APPLICABILITY OF SERVICE TAX IN CONSTRUCTION INDUSTRY

Services provided by Developer/Contractors

1. Services by way of Construction and Sale of flats/units in a complex.
2. Services by way of Works Contracts
3. Services by way of maintenance of a Complex/Building

Entries of Declared List governing Construction/Builders Services

1. As per section 66E (b) Construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, **except where the entire consideration is received after issuance of completion-certificate by the competent authority;**
2. As per section 66E (h) Service portion in the execution of a works contract;

EXEMPTIONS PROVIDED TO BUILDER/CONTRACTOR UNDER NOTIFICATION NO. 25/2012 DATED 20.06.2012

Services provided to Government/ Local Authority/ Governmental Authority (Entry No 12)

Services by way of Construction, completion, Fitting out, repair, maintenance, renovation, alteration in respect of:

- ✓ Civil Structure for Non-Commercial Purpose.
- ✓ Historical Monument etc.
- ✓ Structure for use as clinical, educational, or cultural establishment
- ✓ Canal, Dam Etc.
- ✓ Pipeline, Conduit Etc.
- ✓ Residential Complex for self of employees of above

Services provided to any Person (Entry No 13) (For use of general public)

Services by way of Construction, Completion, Fitting out, repair, maintenance, renovation, alteration in respect of

- ✓ Road, Bridge, Tunnel etc.
- ✓ Civil Structure under Jawaharlal Nehru National Urban Mission or Rajiv Awaas Yojana

- ✓ A building owned by entity registered under Section 12AA of Income Tax Act, 1961
- ✓ A pollution Control plant
- ✓ Structure for burial, funeral etc.

Services provided to any person by way of construction, erection, commissioning or installation pertaining to Infrastructure project etc. (Entry No 14):

- ✓ Airport, port & railways (including monorail & metro)
- ✓ Single residential unit otherwise as a part of residential complex
- ✓ Low-cost houses up to a carpet area of 60 sq metres.
- ✓ Post-harvest storage infrastructure for agriculture produce
- ✓ Mechanised food grain handling system, machinery, or equipments for units processing agricultural produce.

Services of Works Contract provided by a Sub-Contractor to another contractor providing Works Contract services which are Exempt from Service Tax [Entry No 29 (h)]

Charges collected by Builders and rate of Service Tax applicable on said charges

Construction of a complex, building, civil structure or a part thereof, intended for a sale to a buyer, wholly or partly except where entire consideration is received after issuance of completion certificate by the competent authority,

Situation 1

For residential unit having carpet area upto 2000 square feet and where the amount charged is less than rupees one crore Abatement of 75 %

Situation 2

For other than (i) above Abatement of 70%

CONDITIONS: Applicable on Situation 1 & 2

1. Value of Land included in Gross Amount Charged
2. CENVAT Credit in respect of INPUTS NOT AVAILED

Situation 3

For original Works Contract (All new constructions)

Situation 4

In this situation full amount collected by builder shall be liable to service tax

SR.No	Charges	Situation	Rate of Service tax
1.	Basic Charges	1	3.09%
		2	3.708%
2.	Preferential Location Charges	4	12.36%
3.	Club Charges <ul style="list-style-type: none"> • Towards cost of construction • For membership of club • other services 	1	3.09%
		2	3.708%
		4	12.36%
		4	12.36%
6.	Administrative Charges for registration	4	12.36%
7.	Interest Free Maintenance Security (IFMS) <ul style="list-style-type: none"> ✓ Refundable ✓ Non Refundable 		Non Taxable.
		4	Taxable @12.36%
8.	Firefighting Equipment Installation charges	1	3.09%
		2	3.708%
		3	4.944%
9.	Power Backup Charges (Towards cost of installation of DG Sets and substations)	1	3.09%/
		2	3.708%
		3	4.944%
10.	Administrative/Transfer Charges (In case of sale of flat by original buyer, builder charge said charged for modifying its records i.e. entering the name of new buyer in its records)	4	12.36%

Maintenance Services provided by a Developer/Builder/Society

Apart from construction Services developers/Builders also provide the services of maintenance of buildings/complexes constructed by it. For providing such services developer charges maintenance charges from the occupants of flats/offices. The nature of charges collected by builders and Rate of Tax applicable on the same has been summarized as under:

Charges	Description	Taxability
Maintenance Charges	Towards maintenance of building/complex	12.36%
Electricity Charges	For supplying electricity in flats/shops (Charged on actual basis)	Non Taxable
Common Area Electricity Charges	Towards cost of electricity consumed in Common Area	12.36%

CASE STUDIES

Case Study-1

ABC Ltd has entered into a contract for construction of road meant for general public. ABC Ltd sub contracts the aforesaid work to three contractors namely:

- ✓ DEF Ltd , the work of site formation for construction of road
- ✓ XYZ Ltd , laying the surface of road
- ✓ GHI Ltd, other physical activities in respect of such roads.

What will be the Service tax implication on the aforesaid transactions?

Services provided by way of construction of road meant for use by general public is Exempted from payment of Service Tax. Thus, any service which is used in the construction of said road shall be exempted from Service Tax as per Entry 13(a) of Notification no. 25/2012 dated 20.06.2012. Accordingly, all the aforesaid services in respect of roads are not liable to Service Tax. Further, as far as laying of surface is concerned same is also covered under definition of Works Contract under Section 65B (54) of Finance Act, 1994. Since, main Contractor enjoys exemption, the sub contractor also continue to enjoy the exemption in respect of Works Contract Services - Entry 29(h) of Notification no. 25/2012 dated 20.06.2012

Case Study-2

M/s ABC Pvt Ltd is engaged in construction of hospitals and educational institutes. Whether M/s ABC Pvt Ltd. is required to pay Service Tax on the same?

If M/s ABC Ltd is constructing such structures for the government, a local authority or a governmental authority, in that case M/s ABC is not required to pay Service Tax on the same as per Entry 12 (a) of Notification No 25/2012. However, if such structure are built for persons other than government, a local authority, governmental authority, M/s ABC Ltd is required to pay Service Tax on the same.

Case Study-3

M/s XYZ Pvt Ltd is engaged in maintenance & Repair of Ports. Whether M/s ABC Pvt Ltd. is liable to pay Service Tax on the same?

Yes, M/s XYZ Pvt Ltd is required to pay Service Tax on the same as vide Entry No 14 of Notification No 25/2012 dated 20.06.2012, exemption has been provided only to services in respect of Construction of Ports.

VALUATION ASPECTS IN RELATION TO CONSTRUCTION SERVICES

Valuation in respect of Works Contract Services

SERVICE TAX (DETERMINATION OF VALUE), RULES, 2006:

RULE 2A, Determination of value of service portion in the execution of a works contract :

Clause(i): Taxable Value shall be Gross Amount Charged [excluding VAT/Sales Tax paid / payable on transfer of property in goods involved in execution of works contract] for the works contract service less the value of transfer of property in goods involved in the execution of the said works contract.

As per said Rule labour charges, amount paid to sub-contractors, charges for planning, designing etc, cost of consumables, cost of establishment of the contractor, and other similar expenses in relation to supply of labour are required to be included in the Gross Amount Charged.

Clause(ii) In case the value cannot be determined under clause (i) above, then taxable value shall be determined as follows:

Sr. No.	PURPOSE OF WORK CONTRACT	PROPORTION OF THE TOTAL AMOUNT ON WHICH SERVICE TAX IS PAYABLE
1.	For execution of original works a) All new constructions; b) All types of additions and alterations to abandoned or damaged structures on land that are required to make them workable; c) Erection, commissioning or installation of plant, machinery or equipment or structures, whether prefabricated or otherwise.	40%
2.	Works contracts, including maintenance, repair, completion and finishing services for example glazing, plastering, floor and wall tiling, installation of electric fittings of an immovable property.	60%
3.	Maintenance or repair or reconditioning or restoration or servicing of any goods	70%

Valuation in respect of Builders' Services

- **LABOUR CONTRACTS** for Construction of a complex, building, civil structure or a part thereof

$$\text{Value of Service} = \frac{\text{Gross Amount Charged}}{\text{(Rate of Service Tax: 12.36%)}}$$

Case Study- 4

What are the options available to a Builder for discharging its Service Tax Liability?

In addition to discharging Service Tax liability after availing abatement as per Notification No 26/2012 dated 20.06.2012, the builder can also discharge its Service Tax Liability as per Rule 2A of Service Tax (Determination of Value), Rules, 2006 provided builder has entered into a separate agreement with the allottee for the sale of land. The same has been explained with the help of following illustration.

A builder XYZ Ltd. constructed and sold the building. Costs incurred by him for constructing the building & other relevant details are as under:

Sr.No	Particulars	Amount(Rs.)
1.	Total Gross Amount Charged	10,00,000
2.	Cost of Land	5,00,000
3.	Value of Material used	2,20,000
4.	Cost of Labour Services	40,000
5.	CENVAT Credit on Inputs	12,000
6.	CENVAT Credit on Inputs services	4120
7.	CENVAT Credit on Capital Goods	2000

PARTICULARS	Valuation Methods		
	Option A	Option B	Option C
Relevant Notification/provision	No. 26/2012	Separate Land Agreement is required to be made	
		Rule 2A (i)	Rule 2A (ii)
Gross Amount Charged	Rs. 10,00,000	Rs. 10,00,000	Rs. 10,00,000
Less :- Exemption of 75%	(Rs. 7,50,000)	NIL	NIL
Less :- Exemption of 60%			(Rs. 6,00,000)
Less :- Cost of Land	NIL	(Rs. 5,00,000)	NIL
Less :- Value of Material	NIL	(Rs. 2,20,000)	NIL
Taxable Value	Rs. 2,50,000	Rs. 2,80,000	Rs. 4,00,000
Service Tax thereon (12.36%)	Rs. 30,900	Rs. 34,608	Rs.49,440
Less :- CENVAT Credit on Inputs*	NIL	NIL	NIL
Less:-CENVAT Credit on Input Services	4120	4120	4120
Less :- CENVAT Credit on Capital Goods	2000	2000	2000
Service Tax to be paid in cash	Rs. 24,780	Rs. 28,488	Rs. 43,220

***As per CENVAT Credit Rules 2004 provider of taxable service shall not take CENVAT credit of duties and cess paid on any inputs, used in or in relation to the said works contract.**

Compiled by: Vikram Singh, Article