INTERNATIONAL TAX: Where assessee, engaged in business of manufacturing of PP bags, made payments to non-resident as commission for procuring sales order outside India, such payment would not be taxable in India

[2019] 106 taxmann.com 145 (Jaipur - Trib.)

IN THE ITAT JAIPUR BENCH 'A'

Satyam Polyplast

v.

Deputy Commissioner of Income-tax, Circle-4, Jaipur*

RAMESH C. SHARMA, ACCOUNTANT MEMBER
AND VIJAY PAL RAO, JUDICIAL MEMBER
IT APPEAL NO. 158 (JP.) OF 2019
[ASSESSMENT YEAR 2015-16]
MAY 14, 2019

Section 9, read with section 40(a)(i), of the Income-tax Act, 1961 - Income - Deemed to accrue or arise in India (Royalties/Fees for technical services - Commission) - Assessment year 2015-16 - Assessee firm, engaged in business of manufacturing of PP bags, paid certain amount of sum as commission to a non-resident for procuring sale orders outside India - Assessing Officer was of view that payment made by assessee was in nature of fees for technical services (FTS) and assessee was liable to deduct TDS on same, accordingly, he made disallowance by invoking provisions of section 40(a)(i) - Whether commission paid to non-resident outside India for services rendered outside India would not be deemed to accrue or arise in India and, consequently, same was not chargeable to tax in India - Whether, therefore, assessee was not liable to deduct TDS on impugned payment and, consequently, disallowance made by Assessing Officer under section 40(a)(i) was to be deleted - Held, yes [Para 5] [In favour of assessee]

FACTS

- The assessee was a partnership firm engaged in the business of manufacturing of PP Bags. The assessee had paid commission of certain amount to various non-resident entities without deducting TDS. The assessee submitted that it was engaged in the business of export of its final products and for this purpose, the assessee had tie up with non-resident persons for procuring the sales orders on behalf of the assessee. After exporting the goods and receiving the payment in foreign currency, the assessee paid commission to such non-resident persons for services rendered outside India. Thus, the assessee contended that the payment made by the assessee to non-resident was not liable to tax in India and, therefore, the assessee was under no obligation to deduct TDS.
- The Assessing Officer did not accept this contention of the assessee and referred to the *Explanation* II of section 195(1) inserted by the Finance Act, 2012 on the point that where the non-resident person had place of business or business connection in India the provisions of section 195(1) were applicable. He, accordingly, held that the

provisions of section 195(1) were applicable where the payment was made to non-resident without deduction of TDS and, consequently, the provisions of section 40(*a*)(*i*) were attracted. The Assessing Officer then proceeded to hold that the payment in question was fee for Technical Services (FTS) as the assessee had made this payment for rendering managerial or consultancy services by the non-resident persons. The Assessing Officer accordingly made disallowance under section 40(*a*)(*i*).

- On appeal, the Commissioner (Appeals) also upheld the order passed by the Assessing Officer.
- In instant appeal, the assessee contended that the payment of commission to non-resident was not liable to tax in India when the non-resident had no PE in India.

HELD

- The assessee has paid commission to non-resident persons against the service of procuring orders for the assessee. The Assessing Officer disallowed the said amount under section 40(a)(i) on the ground that the assessee has not deducted the tax at source as required under section 195(1). The Assessing Officer has given much emphasis to *Explanation* II to section 195(1). The Assessing Officer also held that the payment in question is fee for technical services (FTS) because the non-residents have rendered the service of managerial in the nature which falls in the ambit of definition of fee for technical services (FTS) under section 9a(1)(vii). It is pertinent to note that the provisions of section 40(a)(i) can be applied only with respect to sum payable or paid to a non-resident towards interest, royalty or fee for technical services (FTS) or other sum chargeable under the Act which is payable to non-resident. [Para 5]
- The payment in question is commission and *prima facie* not royalty or fee for technical services (FTS). The Assessing Officer though observed that the payment in the nature of FTS, however, the Assessing Officer has not examined or not given the finding as to how the payment in question is FTS and what is the nature of service rendered by the non-resident. Even otherwise the issue of FTS has to be considered in light of definition provided in respect the DTAA. It is found that the Commissioner (Appeals) for the assessment year 2013-14 has clearly given a finding that the payment in question is not fee for technical services but it is a regular payment to the non-resident in the nature of ordinary course of business. Even otherwise the Commissioner (Appeals) has upheld the order of the Assessing Officer only on the ground that as per the *Explanation* II of section 195(1), the assessee was under obligation to deduct the tax at source for making the payment of commission to non-resident. Therefore, the Commissioner (Appeals) has accepted the nature of payment as commission and not fee for technical service. [Para 5]
- Once the payment in question is commission then the provisions of section 40(a)(i) are applicable only if such sum is chargeable to tax under the Act. As per provisions of section 5(2), the total income of non-resident includes all income from whatsoever sources derived which is received or deemed to be received in India accrues or arises or is deemed to accrue or arise to him in India during such year. Therefore, the commission paid to non-resident outside India for the services rendered outside India will not fall in the category of the income received or deemed to be received in India as well as accrues or arises or is deemed to accrue or arise in India. Thus, the said

amount paid to non-resident does not fall in the scope of total income of non-resident and, consequently, it is not chargeable to tax in India under the provisions of the Act. Even otherwise the said income in the hands of non-resident has to be considered in the light of the provisions of DTAA between India and the Country of the non-resident. In the absence of PE of the non-resident in India such business income is not chargeable to tax in India. Accordingly, in the facts and circumstances of the case when the amount paid by the assessee is not chargeable to tax in India then the assessee is not liable to deduct TDS and consequently, the provisions of section 40(a)(i) cannot be invoked for making the disallowance. In the facts and circumstances of the case the disallowance made by the Assessing Officer under section 40(a)(i) is deleted. [Para 5]

CASES REFERRED TO

CIT v. *EON Technologies (P.) Ltd.*[2012] 343 ITR 366 [2011] 203 Taxman 266/15 taxmann.com 391 (Delhi) (para 3), *Armayesh Global* v. *Asstt. CIT* [2012] 51 SOT 564/21 taxmann.com 130 (Mum. - Trib.) (para 3), *CIT* v. *Fluidtherm Technology (P.) Ltd.* [2015] 57 taxmann.com 87/231 Taxman 259 (Mad.) (para 3), *CIT* v. *Faizan Shoes (P.) Ltd.* [2014] 367 ITR 155/226 Taxman 115/48 taxmann.com 48 (Mad.) (para 3), *CIT* v. *Gujarat Reclaim Rubber Products (P.) Ltd.* [2017] 79 taxmann.com 352/[2016] 383 ITR 236 (Bom.) (para 3), *CIT* v. *Toshiku Ltd.* [1980] 125 ITR 525 (SC) (para 3), *ITO* v. *Excel Chemical India Ltd.* [2016] 72 taxmann.com 284 (And.) (para 3) and *Asstt. CIT* v. *Pahilajrai Jai Kishan* [2016] 66 taxman.com 30/157 ITD 1187 (Mum. - Trib.) (para 3).

V.K. Jain, (C.A.) *for the Appellant.* **K.C. Meena**, (ACIT) *for the Respondent.*

ORDER

Vijay Pal Rao, Judicial Member - This appeal by the assessee is directed against the order dated 27.12.2018 of the ld. CIT(A), Ajmer for the assessment year 2015-16. The solitary ground raised by the assessee in this appeal is as under:—

"1. The Learned CIT(A) erred in sustaining addition of Rs. 38,92,787/- being disallowance of commission paid to non residents U/s 40(a)(ia). Therefore being no liability to deduct tax at source disallowance made is illegal and addition of Rs. 38,92,787/- made deserves to be deleted."

2. The assessee is partnership firm and engaged in the business of manufacturing of PP Bags. During the assessment proceedings, the AO noted that the assessee has paid commission of Rs. 38,92,787/- to various nonresident entities without making TDS. Accordingly, the AO has proposed to make disallowance of the said commission by invoking the provisions of Section 40(a)(i) r.w.s. 195 of the Act. In response the assessee submitted that the assessee engaged in the business of export of its final products and for this purpose, the assessee has tie up with non-resident persons for procuring the sales orders on behalf of the assessee. After exporting the goods and receiving the payment in foreign currency, the assessee paid commission to such non-resident persons for services rendered outside India. Thus the assessee contended that the payment made by the assessee to non-resident is not liable to tax in India and therefore, the assessee was under no obligation to deduct TDS and consequently the provisions of Section 40(a)(i)of the Act cannot be invoked. The AO did not accept this contention of the assessee and referred to the *Explanation* II of Section 195 (1) of the Act inserted by Finance Act, 2012 on the point that whether the non-resident person has placed of business or business connection in India the provisions of Section 195(1) are applicable. The AO accordingly, held that the provisions of Section 195(1) are applicable in all the cases whether the payment is made to non-resident without deduction of TDS and consequently the provisions of Section 40(a)(i)are attracted. The AO then proceeded to hold

that the payment in question is Fee for Technical Services (FTS) as the assessee has made this payment for rendering managerial or consultancy services by the non-resident persons. The AO accordingly disallowed the said amount of Rs. 38,92,787/- U/s 40(a)(i)of the Act. The assessee challenged the action of the AO before the ld. CIT(A) but could not succeed. The ld. CIT(A) was of the view that there is no finding by any authority that the said payment was not chargeable to tax under Income Tax Act.

3. Before us, the ld. AR of the assessee has reiterated its contention as raised before the authorities below and submitted that the payment of commission to non-resident is not chargeable to tax in India and consequently the assessee was not liable to deduct tax on such amount. Therefore, the provisions of Section 40(a)(i) of the Act cannot be invoked in the case of the assessee. He has relied upon a series of decisions and submitted that the courts have consistently held that the payment of commission to non-resident is not liable to tax in India when the non-resident has no P.E. in India. He has referred to the order of the ld. CIT(A) for the assessment year 2013-14 and submitted that the ld. CIT(A) has deleted an identical disallowance made by the AO by following decision of Hon'ble Delhi High Court in case of *CIT* v. *EON Technologies (P.) Ltd.* [2012] 343 ITR 366/[2011] 203 Taxman 266/15 taxmann.com 391 as well as the decision of Mumbai Benches of the Tribunal in case of *Armayesh Global* v. *Asstt. CIT* [2012] 51 SOT 564/21 taxmann.com 130. The ld. AR has also relied upon the following decisions:—

CIT v. *Fluidtherm Technology (P.) Ltd.* [2015] 57 taxmann.com 87/231 Taxman 259 (Mad.).

CIT v. *Faizan Shoes (P) Ltd.* [2014] 367 ITR 155/226 Taxman 115/48 taxmann.com 48 (Mad.).

CIT v. *Gujarat Reclaim Rubber Products (P.) Ltd.* [2017] 79 taxmann.com 352/[2016] 383 ITR 236 (Bom.)

CIT v. *Toshoku Ltd.* [1980] 125 ITR 525(SC)

CIT v. *Sea Resources Ltd.* (Bombay High Court) (*Sic*)

ITO v. *Excel Chemical India Ltd.* [2016] 72 taxmann.com 284 (Ahd.).

Asstt. CIT v. *Pahilajrai Jaikishan* [2016] 66 taxmann.com 30/157 ITD 1187 (Mum. - Trib.).

4. On the other hand, the ld. DR has submitted that as per provisions of Section 195 of the Act the assessee is under obligation to deduct tax at source for making the payment to non-resident. In case the assessee was having the belief that the amount in question is not chargeable to tax in India then the assessee would have applied for such exemption U/s 195(2) of the Act. In the absence of such finding the assessee has defaulted in making deducting of TDS and consequently the provisions of Section 40(a)(i)of the Act are attracted in this case. He has relied upon the orders of the authorities below.

5. We have considered the rival submissions as well as the relevant material on record. The assessee has paid commission to non-resident persons against the service of procuring orders for the assessee. The details of the commission paid by the assessee are as under:—

Sl. No.	*Name of Agent*	*Address*	*Commission*
1.	Mr. Claudio Haberl A/c	AV. Sesquicentenario 4540 CP1613, Buenos Aires, Argentina	22,06,46,7.00
2.	Md. Habibur Rahman	Kalibarl, Azizabad, Patharghata Barguna	3,31,442.00
3.	Nadia Anwar hasan Ali	AL-Shekh, Othman, Snafer Building Yemen	4,68,120.00
4.	Reinhard Bosse	UND Geschaftskunden Ag, Bahnhofstrabe 17,49525 Lengerich, Germany	7,10,060.00
5.	Shamlan Naseer Ali	Doha, Qatar, YEMEN	1,76,698.00

Total	38,92,787.00

The AO has disallowed the said amount U/s 40(a)(i)on the ground that the assessee has not deducted the tax at source as required U/s 195(1) of the Act. The AO has given much emphasis to explanation-II to Section 195(1) of the Act. The AO also held that the payment in question is Fee for Technical Services (FTS) because the non-residents have rendered the service of managerial in the nature which falls in the ambit of definition of Fee for Technical Services U/s 9a(1)(vii) of the Act. It is pertinent to note that the provisions of Section 40(a)(i) can be applied only respect of sum payable or paid to a non-resident towards interest, royalty or Fee for Technical Services (FTS) or other sum chargeable under this Act which is payable to non-resident. For ready reference we quote the provisions of Section 40(a)(i) of the act as under:—

'chargeable under the head "Profits and gains of business or profession",—

(*a*) in the case of any assessee—

[42][(*i*)[4344]any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid [45][on or before the due date specified in sub-section (1) of section 139] :

[46][Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.]

Explanation.—For the purposes of this sub-clause,—

(A) "royalty" shall have the same meaning as in *Explanation* 2 to clause (vi) of sub-section (1) of section 9;

(B) "fees for technical services" shall have the same meaning as in *Explanation* 2 to clause (vii) of sub-section (1) of section 9;'

The payment in question is commission and prima facie not royalty or Fee for Technical Services (FTS). The AO though observed that the payment in the nature of FTS, however the AO has not examined or not given the finding as to how the payment in question is FTS and what is the nature of service rendered by the non-resident. Even otherwise the issue of FTS has to be considered in light of definition provided in respect the DTAA. We find that the ld. CIT(A) for the assessment year 2013-14 has clearly given a finding that the payment in question is not fee for technical services but it is a regular payment to the non-resident in the nature of ordinary course of business. Even otherwise the ld. CIT(A) has upheld the order of the AO only on the ground that as per the explanation-II of Section 195(1) of the Act the assessee was under obligation to deduct the tax at source for making the payment of commission to non-resident. Therefore, the ld. CIT(A) has accepted the nature of payment as commission and not fee for technical service. The relevant finding of the ld. CIT(A) in para 4.3 as under:—

"4.3 I have gone through the assessment order, statement of facts, grounds of appeal and written submissions carefully. It is seen that the AO after discussing the provisions of Section 195,

including the *Explanation* 2, has concluded that the appellant was required to deduct the tax at source while making the payment of above referred expenses even, to the non-resident persons, whether or not the non-resident person had a residence or place of business or business connection in India or any other presence in any manner whatsoever in India. The explanation 2 has been inserted by the Finance Act of 2012 with retrospective effect from 01.04.1962. I am of the considered view that the argument of the appellant that since the non-resident persons whom the payments were made did not have place of business or business connection in India, therefore, the appellant was not required to deduct tax at source on the above referred payments, is not correct. Regarding the second argument of the appellant that the income of the recipients of the above referred expenses was not "sum chargeable under the provisions of income Tax Act, 1961 therefore the provisions of Section 195(1) are not applicable to these payments" the A/R of the appellant was specifically requested to clarify whether any ruling was obtained from the Authority for Advance Ruling u/s 245(2), regarding non taxability of the income of the recipient in India under the Income Tax Act. The A/R submitted that no such ruling was obtained from AAR by the recipients of the above referred expenses. There is no other evidence on record to show that the sum received by the non-residents in the form of selling commission (Rs. 38,92,787/-) was not chargeable to tax under the Income Tax Act. There is no order or finding by any Income Tax Authority that the above referred sum of Rs. 38,92,787/- was not chargeable to tax under I. T. Act, 1961. Therefore, I am of the considered view that the appellant was required to deduct tax at source while making payment of selling commission (Rs. 38,92,787/-) to non-resident, whether or not the non-resident had a residence or place of business or business connection in India. The decision relied upon by the appellant are applicable only when there is evidence on record to show that the sum paid by the assessee was not chargeable to tax under the Income Tax Act. Therefore, disallowance of Rs. 38,92,787/- made by the AO is hereby confirmed."

Once the payment in question is commission then the provisions of Section 40 (a)(i) of the Act are applicable only if such sum is chargeable to tax under this Act. As per provisions of Section 5(2) of the Act the total income of non-resident includes all income from whatsoever sources derived which is received or deemed to be received in India accrues or arises or is deemed to accrue or arise to him in India during such year. For ready reference we quote to Section 5(2) reproduced as under:—

5(2) Subject to[11] the provisions of this Act, the total income[12] of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(*a*) is received[14] or is deemed to be received in India in such year by or on behalf of such person ; or

(*b*) accrues or arises[14] or is [14]deemed to accrue or arise to him in India during such *year.*

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received[14] in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued[15] or arisen[15] or is deemed to have accrued[15] or arisen[15] to him shall not again be so included on the basis that it is received or deemed to be received by him in India.

Therefore, commission paid to non-resident outside India for the services rendered outside India will not fall in the category of the income received for deemed or received in India as well as accrues or arises or is deemed to accrue or arise in India. Thus, the said amount paid to non-resident

does not fall in the scope of total income of non-resident and consequently it is not chargeable to tax in India under the provisions of the Act. Even otherwise the said income in the hands of non-resident has to be considered in the light of the provisions of DTAA between India and the Country of the non-resident. In the absence of P.E. of the non-resident in India such business income is not chargeable to tax in India. Accordingly, in the facts and circumstances of the case when the amount paid by the assessee is not chargeable to tax in India then the assessee is not liable to deduct TDS and consequently the provisions of Section 40(a)(i) of the Act cannot be invoked for making the disallowance. In the facts and circumstances of the case the disallowance made by the AO U/s 40(a)(i) of the Act is deleted. In the result, the appeal filed by the assessee is allowed.

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*In favour of assessee.