
(2014) 09 RAJ CK 0121

In the Rajasthan High Court

Case No : Income Tax Appeal No. 341 of 2011

Commissioner of Income Tax

APPELLANT

Vs

Modern Insulators Ltd.

RESPONDENT

Date of Decision : 09-09-2014

Acts Referred:

Income Tax Act, 1961 — Section 195, 260A, 40(a)(i), 40(a)(ia), 5(2)

Citation : (2014) 272 CTR 156 : (2014) 369 ITR 138

Hon'ble Judges : J.K. Ranka, J;Ajay Rastogi, J

Bench : Division Bench

Judgement

J.K. Ranka, J.—This appeal under section 260A of the Income-tax Act (for short, "the IT Act") is directed against the order of the Income-tax Appellate Tribunal (for short, "the ITAT") and is relevant for the assessment year 2007-08. Brief facts necessary for disposal of this appeal are that the respondent is engaged in the business of manufacturing of insulators and bushings and is a limited company incorporated under the Companies Act. The short controversy relates to the payment of commission made by the respondent-company to (1) M/s. Alavabond Ltd., London, amounting to Rs. 3,17,93,218; (2) M/s. Jacob and Jacob S.A. De C.V., amounting to Rs. 32,75,683; (3) M/s. Trafalghar Trading FZC, Sharjah (UAE) amounting to Rs. 2,53,89,798 and liability to deduct TDS thereon. While the claim of the respondent-assessee is that it relates to payments of commission to the non-resident agents and in view of the circular of the Central Board of Direct Taxes, bearing No. 786, dated February 7, 2000 See [2000] 241 ITR (St.) 132, it was not required to deduct tax at source on the said commission payments, however, the Assessing Officer (for short, "the AO") was of the view that in view of the latest Circular No. 7, dated October 22, 2009 See [2009] 318 ITR (St.) 1, which came to be issued by the Central Board of Direct Taxes before completion of the assessment, therefore, the said circular is applicable and in the light of the said circular, the assessee was liable to deduct tax at source on payments made to the non-residents, referred to above, and since the assessee failed to deduct tax at source and to pay in the Government treasury account

under section 195 of the Income-tax Act, therefore, the Assessing Officer was of the view that the entire amount is disallowable under the provisions of section 40(a)(ia) of the Income-tax Act and, accordingly, a show-cause notice was issued to this effect and dissatisfied with the reply of the assessee, the Assessing Officer disallowed the entire amount by invoking the provisions of section 40(a)(ia). The Assessing Officer also disallowed the payments to M/s. Alavabond Ltd., London, and M/s. Trafalghar Trading FZC. As per the Assessing Officer, the assessee was unable to justify the business expediency in payment of the said amount to the aforesaid companies and, therefore, the Assessing Officer disallowed the amount paid to the said companies but since the disallowance was being made under section 40(a)(ia), no separate addition was made. In so far as payment made of commission to M/s. Jacob and Jacob S.A. De C.V. is concerned, the Assessing Officer was satisfied and allowed the commission payment but since TDS was not deducted, disallowed the entire claim under section 40(a)(ia) of the Act.

2. Dissatisfied with the disallowance under section 40(a)(ia) and on account of business expediency, the matter was carried in appeal before the Commissioner of Income-tax (Appeals) (for short, "the CIT(A)"), who was satisfied with the explanation offered by the assessee and the Commissioner of Income-tax (Appeals) not only deleted disallowance of commission by holding that the assessee has been able to justify the payments on account of business expediency to the agents aforesaid but also held that in view of Circular No. 786, dated February 7, 2000 See [2000] 241 ITR (St.) 132, which was in force during the previous year relevant to the year under appeal, there was no liability of the assessee to deduct tax at source under section 195 of the Act and, accordingly, he was of the view that the provisions of section 40(a)(ia) cannot be invoked and are inapplicable and thus deleted the entire disallowance. The Commissioner of Income-tax (Appeals) also discussed the grounds relating to the business expediency and rejected the finding of the Assessing Officer.

3. Dissatisfied with the deletion of the disallowance under section 40(a)(ia), the Revenue carried the matter in appeal before the Income-tax Appellate Tribunal. However, before the Income-tax Appellate Tribunal, the ground raised by the Revenue, pertained to challenging the order under section 40(a)(ia) only and in so far as the ground relating to the business expediency of the payments, the Revenue was satisfied and no ground was raised before the Income-tax Appellate Tribunal. The Income-tax Appellate Tribunal also, after analysing the material on record and the circular of the Board dated February 7, 2000, came to the conclusion that the said circular was in force and was not withdrawn and Circular No. 7, dated October 22, 2009, cannot be said to be retrospective in nature and, thus, while relying upon the judgment of the hon'ble apex court in the case of G.E. India Technology Centre Private Ltd. Vs. Commissioner of Income Tax and Another, , the Authority for Advance Rulings in the case of SPAHI Projects P. Ltd., In re [2009] 315 ITR 374 (AAR) and the Delhi High Court in the case of Asia Satellite Telecommunications Co. Ltd. Vs. Director of Income Tax, and also after analysing the two circulars, upheld the order passed by the Commissioner of

Income-tax (Appeals) and, thus, dismissed the appeal of the Revenue which is assailed before us by the Revenue.

4. Learned officer, appearing on behalf of the Revenue, contended that Circular No. 7, dated October 22, 2009, which was brought in by the Central Board of Direct Taxes on October 22, 2009, was applicable in the facts of the present assessee because the assessment was made by the Assessing Officer on December 31, 2009, by which time the circular came into force and, according to him, it was applicable to all pending assessments as the said circular came into force immediately. He further contended that there was liability to deduct tax at source by the assessee of the commission payments to the foreign agents under section 195 and since tax was required to be deducted at source and was not deducted, the Assessing Officer was well within the provisions of law to disallow the entire amount under section 40(a)(ia) of the Income-tax Act. He also contended that the assessee was unable to prove the business expediency of making huge payment of approximately about Rs. 6 crores. He, thus, contended that the provisions of section 40(a)(ia) and the interpretation of circulars is required to be seen and, therefore, substantial question of law arises out of the order of the Tribunal.

5. We have considered the arguments advanced by the learned officer appearing on behalf of the appellant-Revenue and have also perused the impugned order and other orders.

6. Section 40(a)(ia) of the Income-tax Act provides that the amount can be disallowed under the provisions of section 40(a)(ia), if the assessee has not deducted tax at source under Chapter XVII-B of the Income-tax Act. However, we notice that under section 40(a)(ia), in so far as the payment is concerned, it is restricted to payment made to a resident and it nowhere specifies as to amount of commission having been paid to the foreign agents/non-residents. The relevant provision for disallowance, if any, would have been section 40(a)(i) and not section 40(a)(ia). Liability for deduction of TDS under section 195 arises for payment made to a non-resident, not being a company or to a foreign company any interest or royalty, i.e., fees for technical services or any other sum chargeable under the provisions of the Act and it is a finding of fact by the lower authorities that all the three foreign agents are not assessed to tax in India and none of them has any office in India. Paragraph 2 of Circular No. 786, dated February 7, 2000, provides as under (page 133 of 241 ITR (St.)):

"2. The deduction of tax at source under section 195 would arise if the payment of commission to the non-resident agent is chargeable to tax in India. In this regard attention to CBDT Circular No. 23, dated July 23, 1969, is drawn, where the taxability of "foreign agents of Indian exporters" was considered along with certain other specific situations. It had been clarified then that where the non-resident agent operates outside the country, no part of his income arises in India. Further, since the payment is usually remitted directly abroad it cannot be held to have been received by or on behalf of the agent in India. Such payments

were, therefore, held to be not taxable in India. The relevant sections, namely, section 5(2) and section 9 of the Income-tax Act, 1961, not having undergone any change in this regard, the clarification in Circular No. 23 still prevails. No tax is, therefore, deductible under section 195 and, consequently, the expenditure on export commission and other related charges payable to a non-resident for services rendered outside India becomes allowable expenditure. On being appraised for this position, the Comptroller and Auditor-General have agreed to drop the objection referred to above."

7. From a perusal of relevant paragraph 2 of the aforesaid circular, it clearly specifies that the question of deduction of tax at source under section 195 would arise only if the payment of commission to a non-resident is chargeable to tax in India the fact that the said payment was remitted directly abroad and it cannot be held to have been received on or on behalf of the agent in India. It is a finding by the two appellate authorities that the commission paid abroad is not chargeable to tax in India under the Income-tax Act. Circular No. 7, dated October 22, 2009, in our view, cannot be considered retrospectively to make it applicable for payments made before that date. The Income-tax Appellate Tribunal has also held that the above non-residents/foreign agents have provided services for earning commission and the services have been rendered outside India, the commission so earned by the non-resident is a business profit. As per the DTAA between India and the UK and the DTAA between India and the UAE, it is mentioned in article 7 of both the DTAA's that the business profit can be taxed in other contracting State in case the enterprise of a Contracting State is having a permanent establishment in other contracting State and it has never been a case admittedly of the Revenue that the aforesaid non-resident companies/entities are having their permanent establishment in India. Circular No. 786, dated February 7, 2000, governs the case of the respondent-assessee as the year involved is the assessment year 2007-08 and, in our view, the Circular No. 7, dated October 22, 2009, which came into force from October 22, 2009, cannot be said to be applicable in the facts of the instant case or can be said to be retrospective in nature or even clarificatory in nature.

8. Though the learned officer argued that huge payments to the tune of about Rs. 6 crores were made to the aforesaid agents and no business expediency was proved/established by the assessee, we notice that even the question of law is framed to the above effect but we are surprised that before the Income-tax Appellate Tribunal when the Revenue did not raise/challenge the said issue, then on what basis substantial question of law can be said to be raised. This shows the lackadaisical approach of the Revenue officers. Thus, the said question does not arise out of the order of Income-tax Appellate Tribunal. Be that as it may, even otherwise it is a finding of fact arrived at by the Commissioner of Income-tax (Appeals) after elaborate discussion that the rate of commission was the same for all the foreign agents and when the Assessing Officer has been satisfied about other payments nothing was brought on record by the Assessing Officer to justify about the disallowance of commission payment to these two foreign

agents, merely because the amount is more, that by itself does not justify disallowance and the Assessing Officer has to bring on record something more to disallow any payment, there is also a finding of fact appreciated by the Commissioner of Income-tax (Appeals) that the assessee had to establish in foreign markets which are highly competitive, therefore, services of these foreign agents/companies was taken by the assessee. Payment of such nature is to be judged from the angle of a businessman/assessee and the Revenue officers should normally not interfere unless cogent/valid reasons are available to disallow. Thus, in our view, no substantial question can be said to emerge and we find no perversity or illegality in the order of the Income-tax Appellate Tribunal so as to call for interference of this court. Consequently, the appeal, being devoid of any merit, is hereby dismissed in limine.