

Delhi HC's Ruling on applicability of Withholding Tax Provisions to Non-Residents only if Non Resident recipient has taxable income in India



Background

As per the current Indian tax provisions, every payer is required to withhold taxes in respect of payments made to non residents/foreign companies for sums chargeable to tax in India.

However, the Karnataka High Court in the case of Samsung Electronics and Others¹ (based on its interpretation of the decision of Supreme Court in the case of Transmission Corporation of A.P. Ltd.²) created uncertainty on this matter by stating that unless an order is obtained from the tax authorities for withholding tax at a lower or nil rate, a taxpayer would need to withhold taxes on all payments at the applicable withholding tax rates, even if the income may not be taxable in the hands of non-resident. The Karnataka High Court held that Supreme Court (SC) in the case of Transmission Corporation of A.P. Ltd. had declared the legal position with respect to withholding tax on payments made to non-residents and the law declared by the SC is binding on all the High Courts in India.

The decision of Karnataka High Court was viewed by most professionals as impractical, creating lot of difficulties and hassles while making payments to non residents.

In the recent case of Van Oord ACZ

India (P) Ltd.³, the Delhi High Court has not followed the decision of Karnataka High Court and has held that the obligation to withhold taxes arises in India only if the payment is chargeable to tax in India.

Key Facts of the Case

- ◆ The tax payer Van Oord ACZ India (P) Ltd., an Indian company remitted mobilization & demobilization charges of INR 86.5 million (for the dredging project under consideration for the relevant fiscal year) by way of reimbursement to its parent company- Van Oord ACZ Marine Contractors BV (hereinafter referred to as VOAMC), a company based in Netherlands.
- ◆ The tax payer applied to the tax officer u/s 195 (2) for a Nil withholding in respect of reimbursement of various costs required to be paid to VOAMC, on the ground that the amount represented pure reimbursement of expenses and thus, there was no income liable to tax in India in the hands of VOAMC.
- ◆ The tax officer held that the reimbursement of costs to VOAMC were liable to tax in India and determined 11% of the reimbursement amount as the profit arising to VOAMC in India and

¹ ITA No. 2808 of 2005

² 239 ITR 387 (SC)

³ ITA No. 439 of 2008. Order passed on 15th March 2010

directed the taxpayer to withhold taxes on the said basis. The taxpayer, in accordance with the aforesaid order, withheld taxes in respect of mobilization and demobilization charges of INR 69.8 million (instead of INR 86.5 million) reimbursed to VOAMC.

- ◆ In the tax return filed by the taxpayer in India, it declared a loss of INR 19.5 million after claiming certain deductions including the deduction for the aforesaid mobilization and demobilization cost of INR 86.5 million. In the course of tax assessment of the taxpayer, the tax authorities disallowed the expenses on the ground that the taxpayer had defaulted in withholding taxes under section 195 while making payment to VOAMC.

Relevant Issues before the High Court

- ◆ *Whether the taxpayer was liable to withhold taxes at source under Section 195(1) of the Act in respect of the mobilization and demobilization costs reimbursed by the appellant to VOAMC?*
- ◆ *Whether in terms of the provisions of Section 195 of the Act, the payer is obliged to withhold taxes in respect of any sum paid to a non-resident and the payee is not required to determine whether the said sum is chargeable to tax or not under the provisions of the Act?*

Contentions of the Indian Tax Authorities:

- ◆ Based on interpretation of provisions of section 195 of ITA, the taxpayer is under an obligation to withhold taxes if the payments are to be made to a non resident. An application should be made to tax authorities if the taxpayer feels that no such deduction is required or deduction is required at a lower rate. In the absence of any certificate obtained from concerned tax authorities, it is obligatory for the taxpayer to withhold the taxes. Reliance was placed in this regard on the decision of Supreme Court in the case of Transmission Corporation of A.P. Ltd.
- ◆ The taxpayer was under a default for not withholding taxes on dismissal of nil withholding tax certificate by tax authorities and it was of no consequence as to whether or not the non resident was liable to pay tax on payments received from India.

Contentions of the Taxpayer:

- ◆ The intention of the law is not to fasten liability on the remitter to withhold taxes even if payment is not chargeable to tax in India and then subject the non resident to the rigorous process of filing return of income in India to seek refund of taxes withheld and assessment on the basis of such return.
- ◆ The taxpayer relied on the decision of Supreme Court in the case of Transmission Corporation of A.P. Ltd. and Ors to contend that it was categorically laid down by the Supreme Court that the obligation to withhold taxes is triggered only when the payment made to non resident is chargeable to tax in India in the hands of non resident recipient. Reliance was also placed on similar other favourable Indian rulings.
- ◆ The order passed by tax officer under section 195(2) was only tentative determination directing the remitter to withhold taxes in accordance with such order. In the instant case, the Revenue had itself held that VOAMC did not have any Permanent Establishment (PE) in India and therefore, was not liable to tax in India. Even the taxes withheld on reimbursement of mobilization and demobilization charges were refunded to VOAMC. As such, the effect of order under section 195(2) had been washed off.
- ◆ In view of Non Discrimination clause under Article 24 of India-Netherlands tax treaty, there could not be disallowance under section 40(a)(i).

Ruling of High Court

- ◆ The Delhi High Court observed that while rendering the decision in case of Transmission Corporation of A.P. Ltd. and Ors, the Supreme Court was not confronted with the situation where the amount was not chargeable to tax in India. The case dealt with a situation where part of the payment to non resident was chargeable to tax in India. From certain observations of Supreme Court, it is clear that liability to withhold tax arises only when the payment is chargeable to tax in India. One has to cull out the ratio of the judgment viz what it decides and not logically follows from it.
- ◆ The Delhi High Court also commented on the decision of Karnataka High Court in case of Samsung Electronics Company Ltd. The Delhi High Court held that the same was given in a different context

wherein the taxability of payment itself was concerned. In the instant case, the tax authorities itself had confirmed that the amounts received by VOAMC were not taxable in India and as such, there was no question of withholding taxes in India.

- ◆ Section 195 deals with withholding of taxes at source by the tax payer if the payments are to be made to a non-resident and this obligation to withhold taxes arises only when the payment is chargeable under the provisions of the Income Tax.
- ◆ In the instant case, the tax authorities had processed the tax return of VOAMC under section 143(a)(i) and even refunded the taxes to VOAMC. The tax return filed was accepted as it by the authorities without any disputes. Accordingly, the plea of VOAMC that it is not liable to pay any tax in India had been accepted by the income tax authorities. As a consequence, the taxpayer was not liable to withhold taxes in respect of the mobilization and demobilization costs reimbursed by the taxpayer to VOAMC. Subsequently, in case, the assessment proceedings in case of VOAMC are reopened and the final view is taken that VOAMC is assessable to tax in India, then the taxpayer would also be treated as taxpayer ‘in default’ which would attract the consequence provided under section 40(a)(i). However, the position as of today, that is VOAMC is not liable to pay any taxes in India and therefore, there is no obligation on the taxpayer to withhold taxes in respect of payments made to VOAMC.

Our Comments:

The decision of Delhi High Court has been welcomed by the taxpayers. It has brought respite to the payers by clearly laying down that the obligation to withhold taxes arises only when the payments are taxable in India. The Indian companies could now be absolved from the liability of procuring withholding tax order from the Indian tax authorities in cases where the overseas payments are not taxable in India. Similar positions have been recently held by the Authority for Advance Ruling in following cases:

- ◆ Laird Technologies India Pvt. Ltd. (2010-TIOL-06-ARA-IT)
- ◆ Federation of Indian Chambers of Commerce & Industry (2010-TIOL-ARA-IT)
- ◆ ABB Limited (2010-TIOL-16-ARA-IT)

The decision of Karnataka High Court in case of Samsung Electronics has reached the Supreme Court level and Supreme Court’s decision is awaited in this matter. In view of two different rulings by two different High Courts (Karnataka and Delhi), the decision by Supreme Court would set to rest the controversy in respect of withholding tax compliances to be done by an Indian payer in respect of overseas remittances. Till then, taxpayers would have to observe their withholding compliances in respect of overseas payments, with care ■

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Sudit K Parekh & Co
Chartered Accountants

2nd Floor, Ballard House
Adi Marzban Path
Ballard Estate
Mumbai 400 001
Tel +91 22 66178000
Fax: +91 22 66178002
E-mail: admin@skparekh.com

Offices also at Bangalore,
Delhi, Hyderabad and Pune.

For further queries
e-mail - maulik.doshi@skparekh.com