IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 20.01.2016

CORAM:

THE HONOURABLE **MR.JUSTICE M.JAICHANDREN**
AND
THE HONOURABLE **MRS.JUSTICE S.VIMALA**

Tax Case Appeal No.484 of 2015

The Commissioner of Income Tax,
Chennai ... Appellant

vs.

M/s. Farida Leather Company,
No.29A, Perianna Maistry Street,
Periamet, Chennai – 600 003 ... Respondent

Tax Case Appeal filed under Section 260A of the Income Tax Act, 1961, as against the order of the Income Tax Appellate Tribunal, Madras 'B' Bench, dated 10.04.2014 passed in I.T.A.No.85/Mds/2014.

For Appellant : Mr. J.Narayanasamy

For Respondent : Mr. T.N.Seetharaman

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**J U D G M E N T**

This Tax Case Appeal has been filed by the Revenue, as against the order of the Income Tax Appellate Tribunal, Madras 'B' Bench, Chennai, dated 10.04.2014, made in I.T.A.No.85/Mds/2014.

Brief facts:-

2. The assessee is a firm, engaged in leather business, under the name and style of M/s.Farida Leather Company. The said company filed the return of income for the assessment year 2010-11, on 04.10.2010, admitting a total income of Rs.15,02,222/-. The return of income was processed and later scrutiny assessment was made and during completion of assessment, the Assessing Officer disallowed a deduction of Rs.52,17,014/-, being the commission paid to foreign agents, under Section 40 (a) (i) of the Income Tax Act, 1961 (hereinafter referred to as "the Act").

2.1. Aggrieved over the order passed by the Assessing Officer, the assessee filed an appeal before the Commissioner of Income Tax (Appeals) (CIT (A)).

2.2. The CIT (A) allowed the appeal by the assessee and deleted disallowance made by the Assessing Officer on the ground that: (a) the agents abroad were non-residents operating outside India; (b) the commission paid relates to services provided outside India; (c) the agents did not have any permanent establishment in India; and (d) the amounts were remitted directly outside India. The CIT (A) also relied on the decision of the Apex Court, reported

in **(2010) 327 ITR 456 (G.E India Technology Cen. P. Ltd., v. CIT)** and held that the commission payments made to the non-residents cannot be treated as income deemed to accrue in India and Section 195 of the Act has no application in such cases. The further findings are that: (a) the non-grant of 'nil deduction certificate' would not entitle the Assessing Officer to proceed for 'non-deduction of tax at source', while making payments; (b) the Assessing Officer had to establish that the payee had tax liability in respect of the income embedded in the impugned payment; (c) the non-resident agents were only procuring orders for the assessee and were not providing any technical services and therefore, the commission payment does not fall under the category of 'fee for technical services' and Explanation 2 to Section 9 (1) (vii) of the Act cannot be invoked. Thereby, the CIT (A) deleted the disallowance of monies paid to foreign agents made by the Assessing Officer, by invoking Section 40 (a) (i) of the Act.

2.3. Aggrieved over the order of the CIT (A), the Revenue has filed an appeal to the Tribunal and the Tribunal allowed the assessee's appeal, following the earlier orders of the Tribunal. The Tribunal held that no disallowance of expenditure of commission paid by the assessee can be made on the ground of non-deduction

of tax at source, while making payments by invoking provisions of Section 40 (a) (i) of the Act.

2.4. Aggrieved over the order of the Income Tax Appellate Tribunal, the Revenue has preferred this Appeal, raising the following substantial questions of law:-

> "1. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that no disallowance can be made as per Section 40 (a) (i) of the Act with respect to payment of commission to non-resident foreign agents without deduction of tax at source?
>
> 2. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the disallowance cannot be made by following the decision reported in **G.E India Technology Cen. P. Ltd., v. CIT (2010) 327 I.T.R. 456 (SC),** inspite of insertion of Explanation 4 to Section 9 (1) (i) and Explanation 2 to Section 195 (1) of the Act, which was introduced by Finance Act, 2012, w.e.f. 01.04.1962 to overcome the said judgment?
>
> 3. Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that the income of the payee, the foreign agent, is not taxable in India inspite of insertion of

Explanation below Section 9 (2) of the Act, which was introduced by Finance Act, 2010, w.e.f. 01.06.1976?

4. Whether on the facts and in the circumstances of the case, the income of foreign agent is not taxable in India, as fee for technical services under Section 9 (1) (vii) of the Act and consequently, the tax need not be deducted at source while paying the foreign agents?"

3. It is not in dispute that the assessee / company, engaged in the business of manufacturing and export of leather goods, availed the services of certain non-resident foreign agents for the purpose of procuring export orders and the assessee was paying commission for them. It is equally not disputed that even though they are rendering services to the assessee (Indian company), these services are rendered totally outside the country.

4. Under such circumstances, whether the commission payment made to such agents are liable to be taxed in India, is the main issue to be decided in this appeal.

5. The main contention of the learned counsel for the assessee / respondent is that the agency commission / sales commission paid by the assessee to non-resident agents, for the services rendered by them, outside India, in procuring export orders for the assessee, would not attract or partake the character of "fees for technical services" as explained in the context of 9 (1) (vii) of the Act and therefore, there is no scope for the application of the provisions of Section 195 of the Act (Tax Deducted at Source). It is also contended that as the non-resident agents have neither business connection in India nor they have permanent establishment in India, they are liable to be taxed in India.

5.1. Yet another contention of the learned counsel for the assessee is that: (a) the assessee paid the amount by way of commission to foreign agents for the services rendered outside India; (b) the Tax Deduction at Source (TDS) is required to be made on all payments to non-residents, only if such payments are liable to be taxed in India. (c) following the decision of this Court, reported in **The Commissioner of Income Tax v. Faizan Shoes Private Limited 2014 (8) TMI 170**, the assessee is not liable to deduct tax at source, when the non-resident agent provides services outside India on payment of commission.

5.2. The contention of the Revenue is that such services are attracted by Explanation (2) to Section 9 (1) (vii) of the Act and therefore TDS certificate is essential.

6. Whether this contention is correct, is the issue to be decided.

7. In order to appreciate this contention, it is necessary to consider the relevant provisions of the Act:-

(i) Section 40 (a) (i) of the Act :-

"Section 40 - Amounts not deductible:

Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession", –

(a) in the case of any assessee –

(i) 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 XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139:

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:

(ia) thirty per cent of any sum payable to a resident, on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139.

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 subsection (1) of section 139 thirty per cent of, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso."

(ii) Explanation 2 to Section 195 (1) of the Act :-

"Section 195 - Other sums: (1) Any person responsible for paying to a non-resident not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the

time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force :

Provided that in the case of interest payable by the Government or a public sector bank within the meaning of clause (23D) of section 10 or a public financial institution within the meaning of that clause, deduction of tax shall be made only at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode :

Provided further that no such deduction shall be made in respect of any dividends referred to in section 115-O.

[Explanation 1] : .....

[Explanation 2.- For the removal of doubts, it is hereby clarified that the obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident person has--

(i) a residence or place of business or business connection in India; or

(ii) any other presence in any manner whatsoever in India."

(iii) Explanation 4 to Section 9 (1) (i) of the Act:-

"Section 9 - Income deemed to accrue or arise in India -

(1) The following incomes shall be deemed to accrue or arise in India : (i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

.....

Explanation 4.- For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included ''by means of", "in consequence of" or "by reason of".”

7.1. Section 40 of the Act spells out what amounts are not deductable from the income charged to tax under the profits and gains of business or profession.

7.2. Section 40 (a) (i) of the Act deals with interest and other sums payable outside India. The provisions of this sub-clause made applicable to interest have been extended to payment of royalty,

technical fees and any other sum chargeable under this Act. The section provides that the sums covered by the sub-clause, which are chargeable under the Act and are payable outside India, shall not be allowed as an expenditure to the assessee, unless tax is paid thereon or is deducted therefrom under Chapter XVII-B of the Act.

7.3. Section 195 (1) of the Act deals with deduction of tax from payment to non-residents and foreign companies. Section 195 (1) of the Act comes into play at a stage where the payer, who is enjoined to deduct the tax, either credit such income to the account of the payee or make payment thereof, whether in cash / cheque / draft or any other mode. The taxability of such amount in the hands of the payee or occasioning of the taxable event is alien for the purpose of Section 195 (1) of the Act.

7.4. Section 195 (2) is an enabling provision, enabling an assessee to file an application before the Assessing Officer to determine the appropriate proportion of the sum chargeable and upon such determination, the tax has to be deducted under Section 195 (1) of the Act. The payment is made credited to the account of the payee.

8. The question now is, whether the assessee ought to have

deducted tax at source as contemplated under Section 195 of the Act, when the assessee paid commission to foreign agent.

9. This question has been answered by the Hon 'ble Supreme Court, in the case of **G.E.India Technology Centre Pvt. Ltd. v. CIT (2010) 327 I.T.R. 456**, in which, it is very categorically held that the tax deducted at source obligations under Section 195 (1) of the Act arises, only if the payment is chargeable to tax in the hands of the non-resident recipient.

9.1. Therefore, merely because a person has not deducted tax at source or a remittance abroad, it cannot be inferred that the person making the remittance, namely, the assessee, in the instant case, has committed a default in discharging his tax withholding obligations because such obligations come into existence only when the recipient has a tax liability in India.

9.2. The underlying principle is that, the tax withholding liability of the payer is inherently a vicarious liability on behalf of the receipient and therefore, when the recipient / foreign agent does not have the primary liability to be taxed in respect of income embedded in the receipt, the vicarious liability of the payer to deduct tax does not arise. This vicarious tax withholding liability

cannot be invoked, unless primary tax liability of the recipent / foreign agent is established. In this case, the primary tax liability of the foreign agent is not established. Therefore, the vicarious liability on the part of the assessee to deduct the tax at source does not exist.

10. Further, just because, the payer / assessee has not obtained a specified declaration from the Revenue Authorities to the effect that the recipent is not liable to be taxed in India, in respect of the income embedded in the particular payment, the Assessing Officer cannot proceed on the basis that the payer has an obligation to deduct tax at source. He still has to demonstrate and establish that the payee has a tax liability in respect of the income embedded in the impugned payment.

11. In the instant case, it is seen, admittedly that the non-resident agents were only procuring orders abroad and following up payments with buyers. No other services are rendered other than the above. Sourcing orders abroad, for which payments have been made directly to the non-residents abroad, does not involve any technical knowledge or assistance in technical operations or other

support in respect of any other technical matters. It also does not require any contribution of technical knowledge, experience, expertise, skill or technical know-how of the processes involved or consist in the development and transfer of a technical plan or design. The parties merely source the prospective buyers for effecting sales by the assessee, and is analogous to a land or a house / real estate agent / broker, who will be involved in merely identifying the right property for the prospective buyer / seller and once he completes the deal, he gets the commission. Thus, by no stretch of imagination, it cannot be said that the transaction partakes the character of "fees for technical services" as explained in the context of Section 9 (1) (vii) of the Act.

12. As the non-residents were not providing any technical services to the assessee, as held above and as held by the Commissioner of Income Tax (Appeals), the commission payment made to them does not fall into the category of "fees of technical services" and therefore, explanation (2) to Section 9 (1) (vii) of the Act, as invoked by the Assessing Officer, has no application to the facts of the assessee's case.

13. In this case, the commission payments to the non-resident agents are not taxable in India, as the agents are remaining outside, services are rendered abroad and payments are also made abroad.

14. The contention of the learned counsel for the Revenue is that the Tribunal ought not to have relied upon the decision reported in **G.E.India Technology's case, cited supra,** in view of insertion of Explanation 4 to Section 9 (1) (i) of the Act with corresponding introduction of Explanation 2 to Section 195 (1) of the Act, both by the Finance Act, 2012, with retrospective effect from 01.04.1962.

15. The issue raised in this case has been the subject matter of the decision, in the recent case, reported in **(2014) 369 I.T.R. 96 (Mad) (Commissioner of Income Tax v. Kikani Exports Pvt. Ltd.)** wherein the contention of the Revenue has been rejected and assessee has been upheld and the relevant observation reads as under:-

> "... the services rendered by the non-resident agent could at best be called as a service for completion

of the export commitment and would not fall within the definition of "fees for technical services" and, therefore, section 9 was not applicable and, consequently, section 195 did not come into play. Therefore, the disallowance made by the Assessing Officer towards export commission paid by the assessee to the non-resident was rightly deleted."

16. When the transaction does not atract the provisions of Section 9 of the Act, then there is no question of applying Explanation 4 to Section 9 of the Act. Therefore, the Revenue has no case and the Tax Case Appeal is liable to be dismissed.

17. In the result, this Tax Case Appeal is dismissed. The order passed by the Income Tax Appellate Tribunal is confirmed.

(M.J.J.) (S.V.J.)
20.01.2016

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**M.JAICHANDREN, J.**
**and**
**S.VIMALA, J.**

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To
1. Income Tax Appellate Tribunal, Madras 'B' Bench, Chennai

T.C.A.No.484 of 2015

20.01.2016