IN THE HIGH COURT OF JUDICATURE FOR RAJASTHAN BENCH AT JAIPUR

****

DB Income Tax Appeal No.341/2011
Commissioner of Income Tax, Jaipur-II, Jaipur
Vs.
M/s. Modern Insulators Ltd.

Date of Order :- 09/09/2014

HON'BLE MR. JUSTICE AJAY RASTOGI.
HON'BLE MR. JUSTICE J.K. RANKA.

Mr. Vikram Pagariya, ACIT, Circle 6, Jaipur, present in person, on behalf of the appellant.

By the Court : (Per Hon'ble Ranka, J.)

1. This appeal under Section 260A of the Income Tax Act (for short, 'IT Act') is directed against the order of the Income Tax Appellate Tribunal (for short, 'ITAT') and is relevant for the assessment year 2007-08.

2. 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 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 & 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 non-resident agents and

in view of the circular of the Central Board of Direct Taxes, bearing No.786 dated. 07/02/2000, it was not required to deduct tax at source on the said commission payments, however, the Assessing Officer (for short, 'AO') was of the view that in view of the latest Circular No.7 dated. 22/10/2009, 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 Govt. treasury account under Section 195 of the IT Act, therefore, the AO was of the view that the entire amount is disallowable under the provisions of Section 40(a)(ia) of the IT Act and accordingly a show cause notice was issued to this effect and dissatisfied with the reply of the assessee, the AO disallowed the entire amount by invoking provisions of Section 40(a)(ia). The AO also disallowed the payments to M/s Alavabond Ltd, London and M/s. Trafalghar Trading FZC. As per AO the assessee was unable to justify the business expediency in payment of the said amount to the aforesaid companies and therefore, the AO 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 & Jacob S.A. De C.V. is concerned,

the AO was satisfied and allowed the commission payment but since TDS was not deducted, disallowed the entire claim u/s 40 (a)(ia) of the Act.

3. Dissatisfied with the disallowance us/ 40(a)(ia) and on account of business expediency, the matter was carried in appeal before the Commissioner of Income Tax (Appeals) (for short, “CIT(A)”), who was satisfied with the explanation offered by the assessee and the CIT(A) 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 the circular No.786 dated 07/02/2000, 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 u/s 195 of the Act and accordingly he was of the view that provisions of Section 40(a) (ia) cannot be invoked and are inapplicable and thus deleted the entire disallowance. The CIT(A) also discussed the grounds relating to business expediency and rejected the finding of the AO.

4. Dissatisfied with the deletion of the disallowance under Section 40(a) (ia), the revenue carried the matter in appeal before the ITAT. However, before the ITAT, 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 business expediency of the payments, the revenue was

satisfied and no ground was raised before the ITAT. The ITAT also, after analyzing the material on record and the circular of the Board dated 07/02/2000 came to the conclusion that the said circular was in force and was not withdrawn and the Circular No.7 dated 22/10/2009 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 GE Technological Centre (P) Ltd. Vs. CIT, reported in (2010) 327 ITR 456, Authority for Advance Ruling in the case of SPAHI Projects (P) Ltd.., in Re (2009) 315 ITR 374 (AAR) & Delhi High Court in the case of Asia Satellite Telecommunications Ltd. Vs. DIT (2011) 332 ITR 340 and also after analyzing the two circulars, upheld the order passed by the CIT(A) and thus dismissed the appeal of the revenue which is assailed before us by the revenue.

5. Learned Officer, appearing on behalf of the revenue, contended that the circular No.7 dt.22/10/2009, which was brought in by the Central Board of Direct Taxes on 22/10/2009, was applicable in the facts of the present assessee because the assessment was made by the AO on 31/12/2009 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 AO was well within the provisions of law to disallow the entire amount under Section 40(a) (ia) of the IT Act. He also contended that the assessee was unable to prove business expediency of making huge payment of approximately about Rs.6 crores. He thus contended that the provisions of Section 40(a) (ia) and interpretation of Circulars is required to be seen and therefore, substantial question of law arise out of the order of the Tribunal.

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

7. Section 40(a) (ia) of the IT 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 IT 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 foreign agents/non-residents. The relevant provision for disallowance, if any, would have been 40(a)(i) and not 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. Para No.2 of the Circular No.786 dt.07/02/2000 provides as under:-

> *"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 C.B.D.T Circular No.23 dated 23rd July, 1969, is drawn, where the taxability of "Foreign Agents of Indian Exporters" was considered alongwith 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 no 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.213 still prevails. No tax is therefore deductible under section 195 and consequently, the expenditure on export commission and other related charges payable to a nonresident 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. "*

8. From perusal of relevant Para 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 IT Act. The circular No.7 dt. 22/10/2009, in our view, cannot be considered retrospectively to make it applicable for payments made before that date. The ITAT 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 non-resident is a business profit. As per DTAA between India and UK and DTAA between India and UAE, it is mentioned in Article 7 of both the DTAAs 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. The Circular No.786 dt. 07/02/2000 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 dt.22/10/2009, which came into force from 22/10/2009, 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.

9. Though the ld. 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 ITAT 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 ITAT. Be that as it may, even otherwise it is a finding of fact arrived at by the CIT(A) after elaborate discussion that rate of commission was same for all the foreign agents and when AO has been satisfied about other payments nothing was brought on record by the AO to justify about disallowance of commission payment to these two foreign agents, merely because amount is more, that by itself does not justify disallowance and AO has to bring on record something more to disallow any payment, there is also a finding of fact appreciated by the CIT(A) 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 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 ITAT so as to call for interference of this Court.

11. Consequently, the appeal, being devoid of any merit, is hereby dismissed in limine.

[J.K. RANKA],J. **[AJAY RASTOGI],J.**

Raghu/p.9/

Certificate:All corrections made in the judgment/order have been incorporated in the judgment/order being e-mailed.

Raghu, Sr. PA.