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Commission paid for procuring export orders not taxable in India despite withdrawal of Circulars

In brief

Recently, in the case of Gujarat Reclaim and Rubber Products Ltd[1] (the assessee), the Mumbai Income-tax Appellate Tribunal (the Tribunal) held that the payment of commission to non-resident agents on procurement of export orders is not taxable in India. Such payment is made for services rendered and utilised outside India and does not warrant disallowance under section 40(a)(i) of the Income-tax Act, 1961 (the Act) on account of non deduction of tax at source. The Tribunal similarly held that ocean freight expenses paid to foreign shipping lines through their Indian shipping agents are not subject to Indian withholding tax and therefore no disallowance under section 40(a)(ia) ought to have been made. The case pertained to assessment year (AY) 2007-08 and 2008-2009.

Facts

- The assessee, a company incorporated in India, made commission payments without deduction of tax at source under section 195 of the Act to non-resident agents for marketing and distribution of various grades of reclaim rubber in foreign countries.

- With respect to AY 2007-08 and AY 2008-09, the assessing officer (AO), among other additions, invoked the provisions of section 40(a)(i) of the Act and disallowed the payments. The Commissioner of Income-tax (Appeals) (CIT(A)) confirmed the addition made by the AO in AY 2007-08 and deleted the addition in AY 2008-09.

[1] Gujarat Reclaim & Rubber Products Ltd v. CIT [TS-153-ITAT-2013(Mum)]

- The AO also disallowed ocean freight expenses paid by the assessee to foreign shipping company/their Indian shipping agents on the basis that no tax was deducted under sections 194C/195 of the Act.

Issue before the Tribunal

Among other issues, the key issue raised for consideration was whether tax at source is required to be deducted under section 195 of the Act on payment of commission to non-resident agents for procuring export orders.

Another important issue was whether section 40(a)(ia) or sections 194C/195 of the Act applied to ocean freight expenses paid to foreign shipping company/their Indian shipping agents.

Assessee's contentions

- The non-residents agents rendered services in foreign countries and the commission was paid to them outside India, in foreign currency. The agents did not have any business connection or place of business in India.

- The assessee reserved the right of execution and cancellation of orders procured by the agent.

- CBDT Circular Nos 23 and 786 which determined the taxability of export commissions, though now withdrawn through CBDT Circular No 7 (dated 22 October 2009), are applicable for AY 2007-08 and AY 2008-09.

- To support its contentions, the assessee relied on the judgements of the Bombay High Court in the case of BASF (India) Ltd[2] and the Unit Trust of India[3], the order of the Mumbai Tribunal in the case of Armayesh Global[4], and the judgement of the Delhi High Court in the case of EON Technologies[5].

- In respect of ocean freight expenses, section 172 of the Act was a self-contained code which governed taxability of freight in the hands of the foreign shipping company. Therefore, as per Circular No.723, neither section 194C nor section 195 of the Act applied. Reliance was also placed on the Coordinate Bench decision[6] on this point.

Revenue's contentions

- The beneficiary erstwhile CBDT circulars being withdrawn, the AO has rightly disallowed the amounts under section 40(a)(ia) of the Act.

Tribunal ruling

- As far as taxability of export commission was concerned, the ITAT relied on the order of the CIT(A) for AY 2008-09 wherein it was observed that the non-resident agents procured orders and rendered services outside India, the payments for which were made in foreign currency outside India. The non-resident commission agents did not have a permanent establishment (PE) in India.

- The commission income of the agents do not directly or indirectly accrue or arise in India and is not chargeable under the provisions of the Act in the absence of a business connection in India. It was observed by the CIT(A) that the provisions of section 9(1) are not applicable in this scenario and the Explanation to section 9(2) (inserted by the Finance Act, 2010 with retrospective effect from 1 June 1976) is not applicable to sub clause (i) of section 9(1) of the Act.

[2] BASF (India) Ltd. v. W.Hasan, CIT [280 ITR 136]

[3] Unit Trust of India v. ITO [249 ITR 612]
[4] Armayesh Global v. ACIT [50 SOT 564]
[5] CIT v. EON Technologies [203 Taxman 266]
[6] ITO v. Freight Systems India Pvt Ltd [6 SOT 473]

- In the erstwhile Circular No 23, it was clarified that the payment made to non-resident agents is not liable to tax in India based on the provisions of the Act. The CIT(A) observed that in the absence of any relevant changes in the provisions of the Act, the withdrawal of the circular will not make the payments to non-resident agents taxable in India. Moreover, since the circular was withdrawn in 2009 by Circular No 7, it will be applicable for the relevant years under consideration.

- Relying on the decision of the Delhi High Court in the case of EON Technologies (above) and the Coordinate Bench decision in the case of Armayesh Global (above), the Tribunal held that the income of non-resident agents does not accrue or arise or deemed to accrue or arise in India. In the absence of PE in India, the income of the agents cannot be subjected to tax in India. Hence, the assessee was not liable to deduct tax on payments made to the agents.

  In respect of the ocean freight expenses, the Tribunal agreed with the assessee's contention regarding non applicability of Indian withholding tax and relied on two more decisions[7] and the fact that the Revenue had not even contested the CIT(A)'s decision for AY 2008-09 on the same point.

Conclusion

The payment of commission to non-resident agents outside India shall not be liable to tax under section 195 of the Act despite withdrawal of the erstwhile circulars as the corresponding provisions of the relevant sections of the Act remain unchanged. Similarly, ocean freight expenses paid to non-resident shipping companies/their Indian shipping agents cannot be disallowed under section 40(a)(ia), since the payment is governed by section 172, which is a self-contained code.

This decision adds to the list of the favourable cases wherein it has been held that withholding tax provisions do not apply in case of export commission as well as ocean freight payments.

[7] Subhash Chand Gupta v. ITO [ITA No.898, 899 and 731/JP/2010, Jaipur dated 23.09.2011] and Hindustan M-1 Swaco Ltd, Bharuch v. ITO [ITA No.1004/Ahd/2010 dated 7th September, 2012]

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