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News Alert
2 May 2014



The method of settlement is of no consequence for the purpose of deduction of tax at source where the payee is a non-resident

In brief

Recently, in the case of Right Tunnelling Co. Ltd.¹, the Delhi Bench of the Income-tax Appellate Tribunal (Tribunal) held that adjusting the expenditure payable to a non-resident against the receipt due from such a non-resident amounted to constructive payment for the purpose of applicability of the provisions of section 195 of the Income-tax Act, 1961 (the Act) and therefore this expenditure was liable for deduction of tax at source (TDS), and consequentially it was liable to be disallowed under section 40(a)(i) of the Act.

Facts

- The taxpayer, a tax resident of Thailand, was engaged in the execution of hydroelectric power project of National Thermal Power Corporation (NTPC) as a sub-contractor of Italian Thailand Development Company Limited, Thailand (ITDL).
- A contract was entered into between the taxpayer and ITDL to this effect which, *inter alia*, included a variation clause. This variation clause permitted ITDL to modify the terms and conditions of the contract at its discretion, the value of which would be determined by ITDL after consultation with the taxpayer.

¹ Right Tunnelling Co. Ltd. v. ADIT [TS-220-ITAT-2014(DEL)]

- ITDL also provided its own machinery to the taxpayer on a chargeable basis for executing the project.
- The taxpayer debited such expenditure in its profit and loss account and claimed it as payment of machinery hire charges to ITDL in its return of income.
- With respect to the settlement of accounts, the taxpayer was required to submit a monthly statement to ITDL for the contract dues and the payments were obtained after adjustment of the machinery hire charges.
- During the course of the assessment proceedings, the Tax Officer (TO) noticed that the taxpayer failed to deduct tax at source under section 195 of the Act on the payment of machinery hire charges to ITDL, and consequently, made a disallowance under section 40(a)(i) of the Act.
- The taxpayer appealed before the Commissioner of Income-tax (Appeals) [CIT(A)], wherein it was held that method of settlement in the books of accounts was of no consequence for the purpose of deduction of tax at source under section 195(1) of the Act, if the payee was a non-resident.
- Aggrieved by this order, the taxpayer filed an appeal before the Tribunal.

Issue before the Tribunal

- Did the adjustment of the hire charges against the contract dues received/receivable from ITDL amount to actual payment attracting the provisions of section 195 of the Act, and the resulting disallowance under section 40(a)(i) of the Act?

Taxpayer's contentions

- The taxpayer was not responsible for paying the hire charges to ITDL as the arrangement was that ITDL recovered the hire charges from the contract dues.
- The adjustment was only a variation in the contract entered into between ITDL and the taxpayer, which was termed as hire charges.
- The language and intent of the Act did not take into account a situation where actual payment was not stipulated, but only adjustment on account was envisaged. Furthermore, the term *payment* could not be equated with adjustment of accounts.
- Relying on the Delhi High Court's decision in Career Launcher India Limited², the taxpayer contended that on a holistic appraisal of the agreement between the taxpayer and ITDL, there was no payment of hire charges.
- Reliance was also placed on the Delhi High Court's decision in the case of NIIT Limited³. Furthermore, the taxpayer distinguished its facts from the Andhra Pradesh High Court's decision in the case of KanchanGanga Sea Foods⁴.

Revenue department's contentions

- The machinery was given to the taxpayer on hire, and the taxpayer had incurred the hire charges.
- The taxpayer had accounted for this expenditure as hire charges in its books of accounts and claimed it as expenditure in its return of income.

² CIT v. Career Launcher India Limited, reported in [2012] 250 CTR 240 (Del)

³ CIT v. NIIT Limited [2009] 318 ITR 289 (Del)

⁴ KanchanGanga Sea Foods Limited v. CIT [2004] 265 ITR 644 (AP)

Tribunal's ruling

- On the facts of the case, the Tribunal observed that ITDL had provided certain machinery on hire to the taxpayer and the invoices raised by ITDL had described these services as *equipment rental*.
- The Tribunal held that the mere fact that certain terms and conditions had been agreed between the taxpayer and ITDL did not itself lead to a conclusion that there was no hirer and hiree relationship between them.
- The Tribunal also held that the method of settlement of accounts was of no consequence; even a credit entry in the books of accounts attracted the provisions of section 195 of the Act.
- The Delhi High Court's decisions in the case of Career Launcher India Limited² and NIIT Limited³, relied upon by the taxpayer, were distinguished on facts.
- Additionally, the Tribunal upheld the following findings of the CIT(A):
 - The taxpayer's contention that only a book entry was made for the hire charges by the taxpayer, and there was no actual payment to ITDL either by cash or by cheque or by any other mode, was not acceptable.
 - Adjustment of the taxpayer's dues against hire charges by ITDL at regular intervals amounted to constructive payment for the purpose of the term *payment thereof* under section 195(1) of the Act.
 - The taxpayer's reliance on section 191 of the Act was misplaced. Section 191 of the Act was an additional safety net to take care of situations in which taxes may not be collected. However, in those cases where there were express provisions for TDS, it was the payer's obligation to comply. Thus, section 191 of the Act was applicable to the payees in certain situations, but it did not help the taxpayer in the present case.

- Based on the above, the Tribunal held that since the taxpayer had failed to deduct tax at source on the payment of hire charges to ITDL under section 195, the TO has rightly disallowed the expenditure under section 40(a)(i) of the Act.

PwC Comments

- This decision affirms the principle that the method of settlement of accounts is of no consequence for the purpose of deduction of tax under section 195(1) of the Act, in the event that the payee is a non-resident.
- Furthermore, one may also want to consider the judicial precedents laid down by the Supreme Court in the case of J B Boda & Company Private Limited⁵ and the Mumbai Tribunal in the case of Raymond Limited⁶, wherein it was held that an adjustment of the amount payable to the non-resident, or the deduction thereof by the non-resident from the amounts due to the resident payer (of the income), would be considered as any other mode. Such an adjustment or deduction is also equivalent to actual payment. Commercial transactions very often take place in this manner and the provisions of section 195 of the Act cannot be sought to be defeated by contending that an adjustment or deduction of the amounts payable to the non-resident cannot be considered as actual payment.

⁵ J B Boda & Company Private Limited v. CBDT 223 ITR 271 (SC)

⁶ Raymond Limited v. DCIT [2003] 86 ITD 791 (Mum)

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