

# Applicability of withholding tax depends on nature of underlying transaction – reimbursement mechanisms through agents to be ignored

February 17, 2015

## In brief

The Mumbai bench of the Income-tax Appellate Tribunal (ITAT), in the case of Kodak India Private Limited (the taxpayer), has observed that supplying raw materials, providing interest-free finance, and directing assembly of its cameras following its specifications constituted a works contract and accordingly, attracts Withholding Tax (WHT) under section 194C of the Income-tax Act, 1961 (the Act).

It held that if this *modus operandi* was allowed, then each and every payment which otherwise attracted WHT could be given a colour of reimbursement by making the payment through intermediary, and consequently circumvent the TDS provisions.

## In detail

### Facts

- The taxpayer<sup>1</sup> is a Company engaged in manufacture and sale of cameras.
- A survey under section 133A was conducted at the taxpayer's premises. On the basis of information collected during the survey, the Tax Officer (TO) found that the taxpayer had made certain payments to Powercell Batteries India Limited (PBI) for supply of batteries to Hical Magnetic Private Limited (HMP) towards the cost of assembling the cameras. These payments were made

under agreements between the taxpayer and PBI/ HMP through which the taxpayer was getting cameras manufactured/ assembled under its brand name, "Kodak". In addition, there was a tripartite agreement between the taxpayer, HMP and the suppliers for supply of camera parts, viz. moulds, to HMP.

- While the taxpayer contended that the agreements with PBI and HMP were a contract for sale of goods on which sales tax/ VAT was charged, the TO was of the view that they were contract manufacturing/ job work agreements, and that the payments were liable to WHT under section 194C.

On appeal, the Commissioner of Income-tax (Appeals) (CIT(A)) allowed the taxpayer's appeal.

- Separately, the TO observed that the taxpayer had paid commission to a Customs House Agent (CHA) and that no WHT was done on the gross payments as these were paid in advance to the agents towards reimbursement of freight charges, delivery order charges, post handling charges etc.
- The TO noted from the sample bills that the payments included

<sup>1</sup> DCIT v. Kodak India Private Limited [TS-31-ITAT-2015(Mumbai-Tribunal)]

- payment for transportation, crane hiring, administration charges, handling charges paid to the Airport Authority of India, and that the composite bill was raised in the taxpayer's name. The TO was of the view that each of these payments individually attracted WHT under sections 194I (Rent), 194J (Professional fees), 194H (Commission) and 194C (Works contract) of the Act.
- On appeal, the CIT(A) held that no WHT was required to be made as these items were mere reimbursement of expenses. The Revenue authorities disagreed with the CIT(A)'s order on all issues.

### **Issues before the Tribunal**

- Did the arrangements between the taxpayer and PBI, and the taxpayer and HMP amount to a works contract, thus giving rise to a WHT obligation under section 194C of the Act?
- Did payments made by the taxpayer to the CHA towards reimbursement of expenses attract WHT?

### **Taxpayer's contentions**

#### **Payments to PBI and HMP**

- The arrangement was only a contract for sale of goods on which sales tax/ VAT was levied.
- Payments to PBI and HMP did not result in works contracts, and were contracts of sale. Reliance was placed on the judgement of the jurisdictional High Court in the case of CIT v. Glenmark Pharmaceuticals Limited<sup>2</sup>.
- The tripartite agreement between the taxpayer, HMP and the supplier was only a tooling agreement and not an agreement for supply of raw

material between the parties. The agreement was only with regard to the tools/ moulds (used for manufacturing of camera parts) given to the suppliers of the camera parts to maintain the specifications and secrecy of the moulds.

- HMP purchased raw material on its own account and on its own cost and then manufactured the camera.

#### **Payments to CHA**

The payment was intended to reimburse the agent for expenses incurred by him for payments to be made to third parties and other charges. It was not therefore liable to WHT. Reliance was placed on the decision of the jurisdictional High Court in the case of **CIT v. Siemens Aktiengesellschaft**<sup>3</sup> as well as on the decision of the Punjab & Haryana High Court in the case of **S.S. & Co. Octroi Contractors v. State of Punjab**<sup>4</sup>, in which it was held that amounts paid towards reimbursement of expenses would not be subject to WHT.

#### **Revenue's contentions**

#### **Payments to PBI**

- According to the agreement between the taxpayer and PBI, the camera was manufactured by PBI following the specifications provided by the taxpayer.
- The branding of "Kodak" on the batteries was also as stated in the specifications, making the agreement a contract of work.

#### **Payments to HMP**

- According to the agreement between the taxpayer and HMP, the camera was assembled by HMP following

the specifications provided by the taxpayer.

- The raw material for assembling the camera by HMP was supplied under the tripartite agreement and, therefore, it was a job work contract attracting WHT provisions under section 194C of the Act.

#### **Payments to CHA**

- When the payment was otherwise subject to WHT provisions of the Act, making the payment through an agent did not alter the WHT liability.
- Merely because the taxpayer had not made a direct payment to the vendor and routed it through the CHA agent, did not absolve him from his WHT obligations.

### **Tribunal's Ruling**

#### **Payments to PBI**

- The supply of batteries was predominantly a sale, and the agreement was therefore a contract for sale, following the Glenmark Pharmaceuticals ruling<sup>2</sup>, in which it was held that the fact that the specifications were provided by the assessee to the manufacturer/ supplier made no difference to the legal position. The agreement was on a principal-to-principal basis.
- The manufacturer had its own establishment where the product was manufactured. The material required in the manufacture of the article or thing was obtained by the manufacturer from a person other than the taxpayer. The ownership of the articles changed hands upon delivery of the products delivered. Therefore, the agreement was not a contract for carrying out of work within the meaning of section 194C of the Act.

<sup>2</sup> CIT v. Glenmark Pharmaceuticals Limited [2010] 324 ITR 199 (Bombay)

<sup>3</sup> CIT v. Siemens Aktiengesellschaft [2010] 310 ITR 320 (Bombay)

<sup>4</sup> S.S. & Co. Octroi Contractors v. State of Punjab [2004] 268 ITR 398 (Punjab & Haryana)

### Payments to HMP

- The process of getting the camera manufactured involved arrangement for raw materials under the tripartite agreement as well as the provision of financial assistance to HMP by the taxpayer.
- Under the product pricing arrangement, the taxpayer had to provide the working capital, in the absence of which the cost of working capital would be reimbursed at INR 4.89 per camera. HMP did not have financial risk and working capital risk as it was provided by the taxpayer. Even the procurement of raw material was arranged by the taxpayer under the tripartite agreement.
- In addition, the taxpayer paid in advance the entire cost of working capital and compensation, with the margin on cost of raw material and labour at INR 8.04 per camera to HMP, and this was nothing but job work charges. The price arrangement as agreed between the parties clearly showed that it was job work of assembling of cameras by HMP.
- The nomenclature of the agreement became irrelevant when the intention of the parties presented a different picture as per the various terms and conditions of the agreement.
- Accordingly, the arrangement related to supply of raw material and getting job work done. Therefore, the contract

was in the nature of a works contract and liable to WHT under section 194C of the Act.

### Payments to CHA

- The nature of the underlying transactions attracted WHT, viz. Rent, Professional fees, Commission etc.. If the payment were made directly, the taxpayer ought to have deducted tax at source.
- These payments were not subjected to WHT either by the taxpayer or by the agent. If this *modus operandi* was allowed, then each and every payment which otherwise attracted WHT could be given a colour of reimbursement by making the payment through an intermediary, and could consequently circumvent the WHT provisions.
- The fact was that the payment was made for and on behalf of the taxpayer by the agent, and therefore should be considered as payment made by the taxpayer to the third party for the purpose of WHT provisions, under chapter XVII of the Act. The decisions relied upon by the taxpayer, viz. CIT v. Siemens Aktiengesellschaft<sup>3</sup> as well as S.S. & Co. Octroi Contractors v. State of Punjab & others<sup>4</sup> did not apply to the facts of this case.
- Accordingly, it was held that WHT provisions would apply even on reimbursements routed through the CHA, since the real nature of the transaction attracted WHT

provisions. The CIT(A)'s order was set aside and the TO's order was restored.

### Conclusion

The payments for batteries and assembly of cameras are fact specific, and reliance placed on other precedents cannot help where facts could be distinguished.

WHT obligations in case of CHA had been a matter of dispute at various levels. However, with this ruling, the ITAT has looked at the real nature of the transaction before characterising the payment as a reimbursement of expenses.

### The takeaways

An obligation to deduct tax at source has to be discharged by the taxpayer or intermediary. Characterising or structuring transactions as reimbursements would be disregarded where the underlying liability to deduct tax exists.

### Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

#### Tax & Regulatory Services – Direct taxes

Shyamal Mukherjee, Gurgaon  
+91-124 330 6536  
[shyamal.mukherjee@in.pwc.com](mailto:shyamal.mukherjee@in.pwc.com)

Ketan Dalal, Mumbai  
+91-22 6689 1422  
[ketan.dalal@in.pwc.com](mailto:ketan.dalal@in.pwc.com)

Rahul Garg, Gurgaon  
+91-124 330 6515  
[rahul.garg@in.pwc.com](mailto:rahul.garg@in.pwc.com)

## ***Our Offices***

### ***Ahmedabad***

President Plaza  
1st Floor Plot No 36  
Opp Muktidham Derasar  
Thaltej Cross Road, SG Highway  
Ahmedabad, Gujarat 380054  
+91-79 3091 7000

### ***Bangalore***

6th Floor  
Millenia Tower 'D'  
1 & 2, Murphy Road, Ulsoor,  
Bangalore 560 008  
Phone +91-80 4079 7000

### ***Chennai***

8th Floor  
Prestige Palladium Bayan  
129-140 Greams Road  
Chennai 600 006  
+91 44 4228 5000

### ***Hyderabad***

Plot no. 77/A, 8-2-624/A/1, 4th  
Floor, Road No. 10, Banjara Hills,  
Hyderabad – 500034,  
Andhra Pradesh  
Phone +91-40 44246000

### ***Kolkata***

56 & 57, Block DN.  
Ground Floor, A- Wing  
Sector - V, Salt Lake  
Kolkata - 700 091, West Bengal  
+91-033 2357 9101/  
4400 1111

### ***Mumbai***

PwC House  
Plot No. 18A,  
Guru Nanak Road (Station Road),  
Bandra (West), Mumbai - 400 050  
+91-22 6689 1000

### ***Gurgaon***

Building No. 10, Tower - C  
17th & 18th Floor,  
DLF Cyber City, Gurgaon  
Haryana -122002  
+91-124 330 6000

### ***Pune***

7th Floor, Tower A - Wing 1,  
Business Bay, Airport Road,  
Yerwada, Pune – 411 006+91-20  
4100 4444

### ***For more information***

Contact us at  
[pwctr.knowledgemanagement@in.pwc.com](mailto:pwctr.knowledgemanagement@in.pwc.com)

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