

Liability to withhold tax on royalty paid to an Italian resident shall arise at the point of its payment rather than at the time of its recording in the books of accounts of the Indian taxpayer

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In brief

In a recent judgement¹, the Ahmedabad Bench of the Income-tax Appellate Tribunal (Tribunal) has analysed the India-Italy Double Taxation Avoidance Agreement (tax treaty) and held that the liability to withhold tax on royalty shall arise at the time of actual payment and not at the time of recording the entry in the books of accounts of the Indian taxpayer. The Tribunal has further held that the aforesaid position will not change even though the taxpayer has withheld tax as per the beneficial rate provided under the Income-tax Act, 1961 (Act).

In detail

Facts

- The taxpayer was an Indian company. The taxpayer was liable to make a royalty payment to an Italian resident on account of technical know-how.
- The liability was recorded in the books of accounts of the taxpayer during the financial year under consideration; however, it was only paid in the immediately subsequent financial year. The tax on such payment was withheld and deposited with the government at the time of making the payment to the Italian resident.
- The Revenue raised a demand for interest under section 201(1A) of the Act on the taxpayer by treating the due date for depositing tax as seven days from the end of the month in which the amount was credited in the books of accounts.
- Further, the Commissioner of Income-tax (Appeals) [CIT(A)] rejected the appeal on the basis that the provisions of the tax treaty are not relevant in determining the withholding tax liability of the taxpayer. Furthermore, the Act specifically casts an obligation on the taxpayer to withhold tax at the time of credit of liability in the books of accounts or its actual payment, whichever was earlier. Accordingly, it was held that the taxpayer delayed in withholding tax and the levy of interest was justified.
- Aggrieved by the order of the CIT(A), the taxpayer filed an appeal before the Tribunal.

Issue before the Tribunal

Whether the liability on the taxpayer to withhold tax was

¹ TS-134-ITAT-2017(Ahd)

triggered at the time of actual payment to the Italian resident or when such liability was recorded in the books of accounts of the taxpayer.

Taxpayer's contention

As per Article 13 of the tax treaty, royalty income becomes liable to tax in India only when the payments are actually made and not when the taxpayer credits such amount in its books of accounts. Accordingly, the liability to withhold tax under section 195 of the Act arose only at the time of payment to the non-resident i.e. when the amounts were taxable in the hands of the non-resident as per the tax treaty.

Revenue's contentions

- The Revenue contended that the taxpayer was liable to withhold tax on the payments made by it to the Italian resident at the time of credit of such liability in the books of accounts or its actual payment, whichever was earlier in accordance with the provisions of the Act.
- As the taxpayer applied the beneficial withholding tax rate as prescribed in the Act, the taxpayer could not take

recourse to the tax treaty to determine the point of deducting tax on royalty payment made to the Italian resident.

Tribunal's ruling

- The liability to withhold tax under section 195 of the Act is a vicarious liability and such liability on the taxpayer is dependent upon the fact whether such income was taxable in the hands of the non-resident. Reliance was placed on the decision of the Supreme Court² in this regard.
- That income was taxable in the hands of the non-resident in the year in which the payment was made by the taxpayer. Consequently, the liability of the taxpayer to withhold tax under section 195 of the Act on royalty payment arises in the year in which such payment was made and not in the year in which the amount was credited in the books of accounts of the taxpayer. Reliance was placed on a decision rendered by the Tribunal³ in this regard.

- The taxpayer was correct in applying the beneficial withholding tax rate of 10% as prescribed in the Act. However, adoption of the beneficial withholding tax rate under the Act would not imply that the taxpayer was liable to withhold tax on the royalty income in the year in which such income was credited in its books of accounts as prescribed in the Act.

The takeaways

This is an important decision for resident taxpayers liable for withholding tax on payments of royalties and fees for technical services made to non-residents, which are taxable on a payment basis under the respective tax treaties. This principle may even be applied to payments other than royalties and fees for technical services, which are taxable on a payment basis under the respective tax treaties.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

² [2010] 327 ITR 456 (SC)

³ [2005] 96 TTJ 765 (Mumbai)

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