

Routing expenditure as reimbursement cannot absolve withholding tax liability

November 8, 2017

In brief

The Bangalore Bench of the Income-tax Appellate Tribunal (Tribunal) upheld disallowance under section 40(a)(ia) of the Income-tax Act, 1961 (the Act) on account of failure to withhold tax on management charges paid as reimbursement to holding company. The Tribunal held that the mode of payment would not change the obligation to withhold tax at source, if the nature of payment attracted withholding tax provisions.

In detail

Facts of the case

- The present case¹ was on an appeal filed by the Revenue against the taxpayer, which was a resident company.
- The taxpayer made certain payments towards management charges as reimbursement to its holding company without withholding tax.
- The Tax Officer (TO) disallowed the amount of reimbursement towards management charges to the holding company under section 40(a)(ia) of the Act, as no tax was withheld under section 194J of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] deleted the addition made by the TO, holding that the payment was in the nature of

reimbursement of expenses incurred by the holding company on behalf of the taxpayer and withholding tax was not applicable on the same.

Issue before the Tribunal

Whether management charges paid as reimbursement by the taxpayer to its holding company was disallowable under section 40(a)(ia) of the Act on account of non-withholding of taxes under section 194J of the Act?

Revenue's contention

- The Revenue contended that withholding tax was applicable on payment towards management charges to holding company under section 194J of the Act.
- Merely because the payment was routed through the holding company, taxpayer would

not be relieved from the liability to withhold tax at source.

Taxpayer's contention

The order of the Tribunal was an *ex-parte* order, no one appeared on behalf of the taxpayer.

Tribunal's decision

- The Tribunal observed that the payment was towards management charges to the holding company.
- Even if the said payment was on account of reimbursement of expenses incurred by the holding company, the provisions of section 194J of the Act could not be circumvented by the *modus operandi* of payment routed through a holding company.
- If the nature of payment attracted withholding tax provisions, the mode of

¹ I.T. A. No. 984/Bang/ 2017

payment would not change the obligation to withhold tax at source.

The takeaways

- It is not clear if the holding company had withheld tax when making the payment in

the first instance, and the subsequent claim was only a cost to cost reimbursement.

- On facts, this ruling emphasises that withholding tax obligations are with reference to nature of payment

and not manner of routing payments.

Let's talk

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

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