

Tribunal holds that refuge under contractual format cannot be taken to avoid rigor of withholding tax, when nature of services suggest otherwise

February 10, 2018

In brief

In a recent ruling¹, the Ahmedabad bench of the Income-tax Appellate Tribunal (Tribunal) observed that it was not the medium of contract but the nature of services that determines whether or not the services tantamount to technical or professional services.

Accordingly, the Tribunal held that the information technology infrastructure and support services (IT infrastructure and support services) rendered under an annual maintenance contract were to be treated as “fees for technical services” (FTS) under the provisions of the Income-tax Act, 1961 (the Act).

In detail

Facts

- The taxpayer¹ was an Indian company engaged in the business of manufacturing rail vehicles and coaches.
- During financial years 2007-08 to 2013-14, the taxpayer had made contractual payments to an Indian vendor company pursuant to an agreement.
- As per the agreement, the payments were in connection with rendering support services in connection with desktop, help desk, call centre, data centre, network and application management owned by the taxpayer.
- During a survey, the Revenue found that taxes were withheld on payments to the vendor company under section 194C of the Act at a rate of 2%,² instead of 10%, as applicable for FTS under section 194J.³ Therefore, the Revenue initiated proceedings under section 201 of the Act for non-compliance with the withholding tax provisions.
- Aggrieved by the order of the tax officer (TO), the taxpayer appealed before the Commissioner of Income-tax (Appeals)

[CIT(A)]. The CIT(A) upheld the view of the TO holding that the services of technical nature dominate the contract as the same were provided by qualified software professionals. Aggrieved, the taxpayer appealed before the Tribunal.

Issue before the Tribunal

Whether the lower authorities were justified in treating the payments for IT infrastructure and support services as payment for technical services.

Taxpayer's contentions

- The IT infrastructure and support services provided

¹ TS-622-ITAT-2017 (Ahd)

² Clause (ii) of sub section (1) of section 194C of the Income-tax Act, 1961

³ Clause (b) of sub section (1) of section 194J of the Income-tax Act, 1961

by the vendor could not be characterised as FTS. As the taxpayer was outsourcing all its IT related services to the vendor on contractual basis, withholding tax would be attracted at 2% and not 10% as FTS.

- Reliance was placed on the decision of Mumbai Tribunal,⁴ wherein it was held that the mere use of technology would not make any service managerial, technical or consultancy in nature.
- Further, reliance was also placed on another Mumbai Tribunal decision,⁵ wherein the payment for composite services comprising of providing varied skilled personnel, back office support, software, hardware and other infrastructure was treated subject to withholding under section 194C of the Act.
- The definition for “FTS” specifically excludes “construction, assembly, mining or like project” and the services provided by the vendor are in the nature of annual maintenance contracts, which fall within the category of “like project” mentioned in the exception.
- FTS was not attracted in the instant case, as the vendor had received his impugned payment under a contractual obligation, which nowhere involved any managerial, technical or consultancy services.
- As per section 201(1A) of the Act, interest can be levied only in consequence of an order under section 201(1) of the Act. The lower authorities cannot impose interest under section 201(1A) for the years where order under section 201(1) is not passed.

Revenue’s contention

The TO opined that the payments were made in lieu of services received of technical nature and the services amounted to a full spectrum of services in nature of technical, managerial and consultancy and were liable for withholding tax at higher rate of 10% under section 194J of the Act.

Tribunal’s decision

- It was not the medium of contract or payment but the nature of services rendered by the payee, which was the crucial factor in determining whether the services amounted to technical or professional services.
- The taxpayer could not succeed in treating its payments under section 194C of the Act by taking recourse to a written contract document.
- The Tribunal noted that during the course of hearing, the taxpayer did not countermand the joint press release issued by the overseas group companies of the taxpayer and the vendor, whereby it was announced that the vendor company shall provide an entire range of IT transformation program to the taxpayer.
- The Tribunal relied on the decision of the Delhi High Court⁶ and rejected the taxpayer’s contention that the services in question fell within the ambit of exclusion clause of the definition of FTS.
- The Tribunal further distinguished the decision of Mumbai Tribunal⁷ relied upon by the taxpayer, as the same pertained to only provision of technical service without involvement of any element of human service.

- The Tribunal observed that the vendor company rendered IT related integrated service activities, which were in the nature of “FTS.”
- A mere contractual arrangement could not camouflage the nature of services rendered and be used as a shield to avoid deduction of taxes at higher rates. Consequently, the taxpayer was held to be a “taxpayer-in-default” for not withholding tax at a higher rate of 10%.
- Further, the Tribunal ruled that levy of interest under section 201(1A) was without prejudice to the 201(1) order. Therefore, interest under section 201(1A) could be levied even when no order under section 201(1) had been passed by the Revenue.

The takeaways

- The Tribunal decision focuses on the concept of substance over form, whereby, the nature of work performed or service rendered needs to be analysed in depth. A mere nomenclature or an alternative arrangement for payment cannot be used as a colourable device for deducting taxes at a lower rate.
- In light of this ruling, one has to relook at the annual maintenance contracts where taxes are withheld at the rate of 2% under section 194C, especially in cases where taxes were withheld relying on the Circular 715 dated 08 August, 1995, without considering the nature of services involved.

Let’s talk

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

⁴ [2016] 159 ITD 743 (Mumbai - Trib.)

⁵ [2014] 147 ITD 696 (Mumbai - Trib.)

⁶ [2012] 340 ITR 507 (Delhi)

⁷ [2016] 159 ITD 743 (Mumbai - Trib.)

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Hyderabad

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

Gurgaon

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

Bengaluru

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

Kolkata

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

Pune

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

Chennai

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

Mumbai

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

For more information

Contact us at
pwctr.knowledgemanagement@in.pwc.com

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR (Gurgaon), Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

©2018 PwC. All rights reserved

Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2018 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.