

Advance payments for work, even without contractual arrangement, liable to withholding tax

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In brief

Recently, the Delhi bench of the Income-tax Appellate Tribunal¹ (Tribunal) held that the taxpayer (formed for organising an international sports event) was liable to withhold tax under section 194C of Income-tax Act, 1961 (Act) on amount tendered as advances to various public sector undertakings (PSUs) to conduct infrastructure work for the winter games. The Tribunal rejected the taxpayer's plea that it was merely a pass-through entity that had received grants/ sponsorships for organising the winter games and that it did not enter into any contract with the parties to whom payments were made. The Tribunal further clarified that merely because the taxpayer was provided grants for onward distribution to the parties carrying out the construction work did not exclude it from the liability of withholding tax under section 194C of the Act.

In detail

Facts

- The taxpayer was a body registered under The Societies Registration Act, 1860 and was an implementing agency that organised an international sports event. The taxpayer was involved in the development of infrastructure facilities, ancillary sports facilities and other infrastructure for the games and its activities were funded through grants and sponsorships.
- The taxpayer made payments for the following:
 - development of infrastructure facilities to certain PSUs;
 - construction and installation of water storage, installation of ski lift and comprehensive maintenance wherein the agreement was with two foreign companies and an Indian company under a consortium arrangement.
- The taxpayer disbursed grants as advances to PSUs who were appointed as executing agencies to get the work done through contractors. There were no contracts entered into by the taxpayer with these PSU's/ contractors.
- With respect to purchase of equipments, the taxpayer entered into a consortium arrangement. However, the payments were made directly to the foreign companies.
- Additionally, the taxpayer made payment to the State Trading Corporation (STC) for facilitating import of certain goods and clearance thereof including installation, commissioning, handling, etc.
- The tax officer (TO) and Commissioner of Income-tax (Appeals) held that the taxpayer had withheld less/ not withheld tax on aforesaid payments made for purchase of goods (including incidental jobs) and for development of infrastructure facilities.

Issues before the Tribunal

Whether the taxpayer was liable to withhold tax on payments made to the

¹ ITA Nos. 798 & 799/Del/2013 and 1576/Del/2015

following:

- PSUs for carrying out work with respect to the winter games;
- Foreign entities for import of goods under the consortium arrangement; and
- STC for facilitation of import of goods including incidental jobs.

Taxpayer's contention

With respect to (w.r.t.) development of infrastructure facilities

- The taxpayer was merely a pass-through entity that received grants for organising the winter games. The taxpayer further made grants to the PSUs who had to get the work done by engaging sub-contractors.
- There was no contract between the taxpayer and the PSUs/ subcontractors.
- The payments made by PSU's to sub-contractors was subjected to withholding tax.
- The PSUs/ subcontractors did not raise any bills on the taxpayer.
- The grants paid were already included in the income of PSUs who had paid tax thereon.

W.r.t. import of goods and incidental jobs

- If payment was for purchase of goods from foreign companies, then no withholding tax was required either under section 195 or section 194C of the Act. Under the consortium arrangement, the parties had demarcated their duties; they were responsible for the work carried out by them, and each party was paid separately. Further, the property in the goods were passed outside

India as was evident from the fact that customs duty was paid by taxpayer and it became owner of goods prior to its shipment in India. Hence, there was no income arising to the recipient in India.

- Regarding payment to STC, it was contended that it was a contract for sale of goods and hence no tax was required to be withheld.

Revenue's contention

W.r.t. development of infrastructure facilities

- Taxpayer got the work executed and made payments. Therefore, section 194C of the Act clearly applied.
- If PSU's withheld tax on payment for contracts executed by the sub-contractors, it could not absolve the taxpayer from its withholding tax liability.

W.r.t. import of goods and incidental jobs

- Payment to foreign parties towards import of goods was made to an association of person (AOP) for the complete work and not only for the sale of goods. Thus, it was subject to withholding tax.
- On payment to STC, withholding tax was to be applied as STC acted as an agent of the taxpayer and incurred certain costs on its behalf which amounted to carrying of work.

Tribunal's ruling

W.r.t. development of infrastructure facilities

The Tribunal paraphrased the provisions of section 194C of the Act and evaluated its applicability to the taxpayer as follows:

- The taxpayer was a specified person being a society registered under Societies

Registration Act 1860, therefore the liability for withholding tax rested on the taxpayer.

- All parties to whom payments were made were residents and receipt by them was subject to withholding tax.
- Payment had been made as advance/ against letters issued by taxpayer for carrying on certain work by the parties.
- The taxpayer was an implementing agency; its function was to collect grants and disburse to executing agencies who got the work done through sub-contractors.
- The Tribunal observed that although the contractor may be identified and engaged by the executing agencies/ PSU's, the implementation and utilisation was sole responsibility of taxpayer. Therefore, it was clear that taxpayer was the person responsible for payments of sums to the PSUs.
- Based on the above observation, the Tribunal held that the contract was between the recipient of income and the taxpayer. Thus, the taxpayer was responsible for withholding tax under section 194C of the Act.
- The Tribunal held that merely because the taxpayer was provided grant for onward distribution to PSUs, the taxpayer was not absolved from the liability for withholding tax under section 194C of the Act.
- Furthermore, the fact that the recipient of income had onward distributed the work to sub-contractor and withheld tax on such payment was not a reason for non-withholding of tax by the taxpayer.
- Thus, the Tribunal held that

payment made by taxpayer to PSUs was subject to withholding tax under section 194C of the Act.

- However, considering the taxpayer's argument that tax had already been paid on such grants by the recipient PSU's, following the decision of the Delhi High Court², the Tribunal set aside the matter to the TO with a direction to collate prescribed details and:
 - if found appropriate, not treat the taxpayer as 'taxpayer-in-default'.
 - compute appropriate interest under section 201(1A) of the Act.

W.r.t. import of goods and incidental jobs

- Considering the facts stated by taxpayer and consortium agreement, the Tribunal observed that all members were independently responsible for executing work, payments were

being made to each of them directly and common management was only for administration convenience.

Accordingly, none of the conditions regarding constituting an AOP mentioned in Circular No. 7 of 2016, were fulfilled. Hence, the payments made to foreign companies was chargeable to tax in their own hands.

- On facts, it was observed that goods were shipped from outside India as also title to goods was passed outside India. Hence, the Tribunal held that no income had accrued to the foreign companies in India. Therefore, section 195 of the Act was not applicable.
- In relation to payment made to STC, the Tribunal set aside the matter to the TO to examine the invoices with a direction that tax was to be withheld on payment for facilitation of work for import of goods excluding the value of

material (if charged separately on invoice).

The takeaways

- The Tribunal has considered the overall essence of the transaction while holding that the taxpayer was liable to withhold tax under section 194C of the Act, even in a case where no contract existed between the payer and the payee.
- The ruling has also reaffirmed the position that no AOP is constituted if all members of consortium are responsible for their work; payments are made directly to these parties, each party is individually charged to tax on their profit, and common management is only for administration convenience.

Let's talk

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

² CIT v. Ansal Landmark Township Limited [2015] 377 ITR 635 (Delhi)

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 Greaves 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
pwctrs.knowledgemanagement@in.pwc.com

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