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Domestic law prevails if no provision exists for a particular head of income under the tax treaty

In brief

In a recent ruling in the case of TVS Electronics Ltd[1] (the assessee), the Income-tax Appellate Tribunal (the Tribunal) held that merely because the India-Mauritius Double Taxation Avoidance Agreement (the tax treaty) is silent on taxability of a particular type of income, it cannot be construed that such income will automatically be taxable as business income in the hands of the recipient. The India-Mauritius tax treaty does not have a clause on taxability of fees for technical services (FTS). In such a situation, the Tribunal held that one has to consider and apply the provisions of the Income-tax Act, 1961 (the Act).

The Tribunal also ruled that annual maintenance charges received in advance are not taxable in the year of receipt.

Facts

- The assessee is a company engaged in manufacturing and sale of computer peripherals.
- The assessee made payment to Rosewell Group Services Ltd. (Rosewell), a Mauritius based company, for conducting market survey for preparation of project report called 'Opportunities in Asia for Electronics'.

[1] DCIT *v.* TVS Electronics Ltd. [TS-421-ITAT-2012 (Chny)]

- The assessing officer (AO) disallowed under section 40(a)(i) of the Act, the payment made by the assessee, on the ground that the payment made to Rosewell was towards FTS falling within the ambit of section 9(1)(vii) of the Act, on which tax was required to be withheld, which the assessee failed to withhold.

- The AO placed reliance on Explanation 2 to section 9(1)(vii) of the Act and by relying on the decision of the Supreme Court in the case of Transmission Corporation of AP Ltd[2] held that the assessee had violated section 195 of the Act. Accordingly, the payment made to Rosewell was disallowed under section 40(a)(i) of the Act.

- Aggrieved by the same, the assessee filed an appeal before Commissioner of Income Tax (Appeals) (CIT(A)).

Proceedings before the CIT(A)

- The assessee disputed the disallowance made by the AO on the following two grounds -

  - in absence of any specific clause on FTS under the India-Mauritius tax treaty, the payment made to Rosewell can only be considered as business income, which is taxable only in Mauritius, in the absence of any permanent establishment (PE) in India;

  - just because technical services were required for gathering such commercial information, that would not make such commercial information itself a technical service.

- The CIT(A) deleted the disallowance on the grounds that –

  - the services were rendered outside India;

  - in absence of any PE of Rosewell in India, the said amount was not taxable in India;

- The CIT(A), therefore, concluded that the sssessee was not liable to withhold tax under section 195 of the Act.

- Aggrieved by the order of the CIT(A), the Department went in appeal before the Tribunal.

Issue before the Tribunal

Whether the assessee was required to withhold tax under section 195 of the Act from the payments made by it to Rosewell and accordingly, whether section 40(a)(i) of the Act is attracted or not?

Revenue's contentions

- None of the agreements placed by the assessee before the CIT(A) were ever made available by the assessee before the AO.

- The provisions of India-Mauritius tax treaty were not brought to the notice of the AO and the CIT(A) had also not obtained remand report from the AO in relation to the same.

- The services rendered by the Mauritius company were nothing but technical in nature falling within the ambit of section 9(1)(vii) of the Act.

- Assessee was obliged to withhold tax irrespective of the *situs* of receipt of the money or rendering of the service.

[2] Transmission Corporation of AP Ltd *v.* CIT [1999] 239 ITR 587 (SC)

- Explanation added to section 9 of the Act by the Finance Act, 2007 with retrospective effect from 1 June 1976 states that it is not necessary that a non-resident should have a permanent business establishment or business connection in India, insofar as fees received for technical services are concerned.

- The assessee was in default for not withholding tax and attracted the rigours of section 40(a)(i) of the Act.

Assessee's contentions

- In the absence of a clause on 'fees for technical services' in the Indo-Mauritius tax treaty, the assessee contended that FTS could only be considered as business income in the hands of the recipient, which is not taxable in India in the absence of any PE in India.

- Provisions of the tax treaty prevailed over the Act, and therefore, the assessee had every liberty to take advantage of the provisions of the tax treaty.

- Assessee was under a *bona fide* belief that in view of the provisions of the tax treaty, it was not required to withhold any tax on the payments made to Rosewell.

- The assessee supported the stand of the CIT(A) by placing reliance on the decision of Chennai Special Bench in the case of Prasad Production Ltd.[3]

Tribunal Ruling

- Payment made by the assessee to Rosewell for 'market survey' definitely involved exercise of technical knowledge and skill by the persons who did the survey and by virtue of Explanation 2 to section 9(1)(vii) of the Act, the payment made by the assessee for services rendered was nothing but FTS.

- Only for a reason that the Indo-Mauritius tax treaty is silent on taxability of income as FTS, it cannot be construed that such income will automatically be taxable as business income in the hands of the recipient.

- When the tax treaty is slient on an aspect, the provisions of the Act have to be considered and applied.

  Since this aspect was not analysed by the lower authorities, the Tribunal remanded the matter to the AO for fresh consideration in accordance with law.

PwC Observations

- The ruling in TVS Electronics Ltd.'s case will have an adverse impact on service providers of those countries which do not have FTS clause in their respective tax treaties entered into with India. For example, Mauritius, Malasiya, Sri Lanka, etc. do not have an FTS clause in their tax treaties with India. Services of the service providers of those countries may be made liable to tax in India as per Indian Tax Laws.

- The view taken by the Tribunal is, however, contrary to the view taken by the Bangalore Tribunal in the case of Spice Telecom[4] wherein it has been held that in absence of FTS clause in the Indo-Mauritius tax treaty, payments made, even if assumed to be FTS, will be governed by clause 7 of the said tax treaty dealing with business income.

- The view adopted by the Tribunal in TVS Electronics Ltd.'s case also deviates from the ruling of the Supreme Court in the case of Azadi Bachao Andolan[5] in

[3] ITO *v.* Prasad Production Ltd. [2010] 125 ITD 263 (TChennai)(SB)

[4] Spice Telecom *v.* ITO [2008] 113 TTJ 502 (Bang)

[5] UOI *v.* Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

which it has been held that the provisions of the tax treaty will prevail over the provisions of domestic law.

- The better view, is the view adopted by the Bangalore Tribunal in the case of Spice Telecom (above).

Other issue before the Tribunal

The other issue before the Tribunal was as regards taxability of pro rata revenue from annual maintenance contracts (AMCs) received in advance i.e. for the period falling beyond the previous year.

Tribunal Ruling

- The Tribunal dismissed the appeal of the Department and held that the amount received by the assessee at the point of time it entered into an AMC was nothing but an advance, which on the progress of each day got converted into revenue. This view was fortified by the fact that the clients of the assessee could at any point cancel the contract and get a refund for the unexpired period.
- Income was accruing on a day-to-day basis based on the progress of time and it did not accrue on the day of entering into the contract.
- Principle of matching concept of income and expenses comes to the aid of the assessee in such a situation.
- The assessee was justified in its claim that income relatable to the unexpired period of AMC could be considered only in the subsequent year and not in the relevant previous year.

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Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	**Bangalore** 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	**Bhubaneswar** IDCOL House, Sardar Patel Bhawan Block III, Ground Floor, Unit 2 Bhubaneswar 751009 Phone +91-674 253 2279 / 2296	**Chennai** PwC Center, 2nd Floor 32, Khader Nawaz Khan Road Nungambakkam Chennai 600 006 Phone +91-44 4228 5000	**Hyderabad** #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600
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