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Subsequent amendments in TDS law doesn't alter liability for amounts already credited

In brief

In a recent ruling, the Bangalore Income-tax Appellate Tribunal (Tribunal) in the case of Wifi Networks Pvt. Ltd.¹, held that as the provisions of section 194J of the Income-tax Act, 1961 (the Act) did not cover 'royalties' or 'non-compete fees' for the year under consideration, the assessee had no obligation to deduct tax at source. The Tribunal held that tax was to be deducted considering the provisions applicable as on the date of credit or payment, whichever is earlier. Once the liability is triggered, any subsequent amendment will not alter the liability.

Facts

- Wifi Networks Pvt. Ltd. (the assessee) was a company engaged in the business of software development in the telecom sector. The share capital of the assessee was held by its managing director, Mr. G N Mohan Raju (Mr. Raju) and his relatives/friends.
- Widescreen Holdings Pvt Ltd (WHPL) entered into an oral agreement on February 01, 2006, with Mr. Raju, his relatives and the assessee to acquire 51% of the assessee's capital. The oral agreement was later converted to a written agreement on September 12, 2006.

¹ Wifi Networks Pvt. Ltd. vs. The Deputy Commissioner Income Tax, Circle 18(1), Bangalore [TS-282-ITAT-2013(Bang)]

- The agreement provided that if Mr. Raju or his group started any new business in the fields of telecommunication, digital media and convergence, he should offer 74% of the economic interest in such business to the assessee and WHPL. Only in a case where the assessee and WHPL refused such an offer, would Mr. Raju be free to carry on with his competing business independently.
- The assessee was required to pay a lump sum amount of Rs. 5 crore to Mr. Raju as a consideration for the first right of refusal. Based on the agreement, payments were made over a period of time to Mr. Raju.
- Revenue carried out a survey under section 133A of the Act. The assessing officer (AO) held that the payment made by the assessee was a royalty and therefore held the assessee to be an 'assessee in default' for not deducting tax at source.
- The assessee filed an appeal before the CIT (Appeals) and submitted that:
 - the payment was made for first right of refusal and was a one-time payment for an outright purchase of a capital asset; and
 - the payment in consideration was not a royalty under the various clauses of Explanation 2 to section 9(1)(vi)
- CIT (Appeals) upheld the observations of the AO of treating the payment as a royalty, and held that taxes were to be deducted on such payments.

Issues before the Tribunal

Whether there was an obligation on the part of the assessee to deduct tax at source under section 194J when it made a payment of Rs. 5 crore to Mr. Raju.

Assessee's contentions

- The assessee contended that the provisions of section 194J of the Act, as it

stood, prior to its amendment by the Finance Act, 2006 w.e.f. July 13, 2006 did not include royalty or payment covered by the provisions of section 28(va) of the Act.

- It was further argued that the assessment orders wherein the receipts received by Mr. Raju had been taxed as a "non-compete fee" had been challenged by Mr. Raju on the ground that they were capital in nature.
- Liability to deduct tax at source under section 194J on any sum payable by way of royalty or non-compete fee falling under section 28(va) of the Act arose at the time of credit or at the time of making payment, whichever was earlier.
- The assessee had credited the sums payable to Mr. Raju in its books of account on the date of the oral agreement i.e. February 01, 2006. As on the date of credit in books of accounts, the provisions of section 194J were not applicable in respect of payments, even if they were to be assumed to be a "royalty" or "non-compete fee".

Revenue's contentions

- The Ld. DR relied upon the following observations from the order of CIT (Appeals) –
 - Mr. Raju had knowledge of process related to technology in the field of networking. By agreeing to give the right of first refusal, Mr. Raju had parted with his right related to the knowledge of the process;
 - By giving the right of first refusal, Mr. Raju had parted with his commercial and scientific knowledge, experience and skill in the field of networking in favour of the assessee;
- The payment should be treated as a royalty and tax should be deducted thereon.

Tribunal Ruling

- The Tribunal observed the fact that Revenue had not disputed that there was an oral agreement as on February 01, 2006 whereby the assessee had agreed to pay Rs. 5 crore to Mr. Raju. The payments made by the assessee supported the existence of an oral agreement.
- The assessee has credited the amount in its books of account as on the date of the oral agreement.
- It was held that the liability to deduct tax at source under section 194J of the Act would have to be tested as on the date of credit of the amount or payment, whichever was earlier. In this case, as the date of credit preceded the date of payment, tax was to be withheld on the date of credit in the books of account. Considering the facts of the case, Tribunal held that the law as it stood as on February 01, 2006 was to be seen for the purpose of deducting tax.
- It was also observed by the Tribunal that neither royalties nor non-compete fees were covered by the provision of section 194J of the Act prior to July 13, 2006.
- In view of the above, the Tribunal held that the assessee had no obligation to

deduct tax at source under section 194J of the Act. It further held that the fact that payments were made by the assessee after July 13, 2006 cannot create any obligation on the assessee under section 194J of the Act.

- Accordingly, it held that the orders passed by the revenue authorities treating the assessee as “assessee in default” and levying interest under section 201(1A) of the Act were unsustainable and accordingly cancelled them.

Conclusion and PwC Observations

- Tax is to be deducted considering the provisions applicable as on the date of credit or payment, whichever is earlier. Any subsequent amendment shall not have any impact on the determination of liability to deduct tax.
- The Tribunal in the aforementioned judgment refrained from commenting on whether the payment under consideration would qualify as payment of “royalty” or “non-compete fees”.
- Post the amendment of section 194J, any similar transaction would have to be evaluated from the perspective of tax deduction at source.

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