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Amount paid to a non-resident 'net of taxes' to be grossed up at the 'rates in force'

In brief

In a recent case of Bosch Ltd[1] (the assessee), the Bangalore Tribunal held that repair services encompassing technical assistance towards preventive maintenance would be taxable as fees for technical services (FTS) whereas 'mere' repair services were held to be taxable as business income. Further, where payments are made to a non-resident 'net of taxes', tax would be required to be 'grossed up' under the provisions of section 195A of the Income tax Act, 1961 ('the Act') at the 'rates in force'. In this case, while the withholding tax rate under section 206AA of the Act was applied at 20% as the non-resident company did not have a permanent account number (PAN) in India, it was held that grossing up is not required at this rate but at the 'rates in force' according to section 195A of the Act.

Facts

- The assessee is a manufacturing company using both imported and indigenous plant and machinery. It entered into the following two contracts with foreign suppliers of plant and machinery, who were residents of Germany (German company or non-resident company):

[1] Bosch Ltd *v.* ITO [2012] 28 taxmann.com 228 (Bang-Tribunal)

- Contract for repairs

- Preventive annual maintenance contract (AMC)

- The assessee made payments to the German company for the repairs conducted under the above contracts which were carried out in the country. The payments were required to be made to the German company 'net of taxes'.

- The assessee was of the opinion that payments to the German company did not constitute as FTS in terms of the provisions of section 9(1)(vii) of the Act or under Article 12(4) of the India-German Double Tax Avoidance Agreement ('tax treaty').

- The assessee however, exercising abundant caution, withheld tax before making payments to the German company under section 195 of the Act. The tax was withheld at the rate of 20% under section 206AA of the Act since the German company did not have a tax PAN. The assessee also obtained a certificate in Form 15CB[2] from its auditor at the time of making the remittance to the German company. The rate of withholding tax as per the certificate was 20% as per section 206AA of the Act.

- During the course of assessment proceedings, the AO held that the assessee was required to withhold tax under section 195 of the Act for both the contracts i.e. the repairs contract and the preventive maintenance contract. The payments were chargeable to tax as FTS in terms of Explanation 2 to section 9(1)(vii) of the Act.

- The assessee appealed before the CIT(A) denying its liability to withhold tax under section 195 of the Act.

[2] Certificate for information relating to remittance of payment to a non-resident

- The CIT(A) held the following:

  - The payments made by the assessee to the German company for the repairs contract and for the preventive maintenance contract constituted FTS in terms of Explanation to section 9(2) of the Act. These were chargeable to tax in India.

  - As the assessee was liable to withhold tax at 20%, the grossing up of tax under section 195A of the Act was also to be done at 20% and not at the rates prescribed under the Act or the tax treaty.

Issues before the Tribunal

- Whether payments made to non-resident company for repairs contract and for preventive maintenance contract were to be treated as payment towards FTS in terms of Explanation 2 of section 9(1)(vii) of the Act.

- In the absence of the non-resident company having a PE in India, whether income was taxable in the hands of the non-resident company as business income.

- Whether withholding tax was to be grossed up under section 195A of the Act as per the 'rates in force' (i.e. under the Act or the tax treaty) or as per the rate (i.e. at the rate of 20%) provided by section 206AA of the Act.

Assessee's contentions

- The assessee contended that it was necessary to determine the nature of services before concluding the payment to be treated as FTS. The services rendered by the German company under both the contracts were in the nature of repairs and not technical, consultancy or managerial services. In this regard,

the purchase order, invoices, etc. provided the details of the services rendered by the German company to the effect that they were in the nature of repairs and not in the nature of technical, consultancy or managerial services.

- The assessee relied on the decision of the Hyderabad Bench of the Tribunal in the case of BHEL-GE-Gas Turbine Servicing (P) Ltd[3] where it was held that 'repairs' could not be considered as technical services even if specific and technical expertise was required to render the services.

- It was also contended that payments made to the non-resident for the services were in the nature of business income and as the non-resident did not have a PE in India, the payments were not chargeable to tax in India under section 195 of the Act.

- It was further contended that the provisions of section 206AA of the Act will be applicable in the circumstances where the non-residents are required to obtain a PAN but had not acquired it. The assessee submitted that as per section 139A(8)(d) of the Act, read with Rule 114C(b) of the Income tax Rules, 1962 (the Rules), non-residents were not required to apply for and obtain PAN under section 139A of the Act.

Revenue's contentions

- The payments relating to repairs of plant and machinery made to the non-resident company were taxable as FTS in terms of Explanation 2 of section 9(1)(vii).

- It was also contended that payments made to non-residents were treated as FTS pursuant to a certificate in Form 15CB and tax was withheld at the rate of 20%. This certificate was issued by the assessee's auditors and therefore, binding on the assessee.

- The provisions of section 206AA of the Act have an overriding effect on all other provisions of the Act. Therefore, a recipient whose income is chargeable to tax in India has to obtain and furnish the PAN to the deductor. In the absence of a PAN, tax will be required to be withheld at a higher rate of tax (i.e. at 20%).

Tribunal ruling

Plant and machinery-repair contracts

- The assessee entered into a contract with the German company for repairing machinery. The repairs were carried out outside India. The Tribunal observed that for an income to be taxable in India it has to accrue or arise in India under section 9 of the Act. On perusing the copies of the purchase order and invoices, it was clear that the services rendered were in the nature of 'repairs' only and no technical, consultation and managerial services were rendered by the non-resident company to the assessee. The Tribunal distinguished between the definitions of 'repairs' and 'services'. The term 'repair', as defined by Cambridge Dictionary, means 'to put something, damaged, broken or not working correctly back into condition and make it work'. The term 'services' denotes 'an activity to help achieve something or result in something useful or purposeful'. Consequently, machinery was repaired but not modified.

- The Tribunal also relied on the ruling in the case of Lufthansa Cargo India Pvt. Ltd[4] where it was held that payments made for repairs of machinery were not FTS but was business income which was not taxable in the absence of PE.

[3] BHEL-GE-GAS-Turbine Servicing (P) Ltd *v.* ADIT [TS-576-ITAT-2012(Hyd)]

[4] Lufthansa Cargo India Pvt Ltd *v.* DCIT [2005] 92 TTJ 837 (Delhi)

Therefore, the assessee was not required to withhold tax under section 195 of the Act on payments made to the German company towards repairs of machinery.

- Further, it held that the certificate in Form 15CB was given by the assessee's auditors. The opinion and view of the auditors and was not binding on the assessee.

- The Tribunal held that since the repairs were not taxable as FTS in terms of Explanation 2 to section 9(1)(vii) of the Act and as business income in the absence of PE in India. Hence, there was no liability to withhold tax under section 195 of the Act. In the absence of liability to withhold tax, the issue of grossing up of tax was not relevant.

Plant and machinery - preventive AMC

- The services rendered by the non-resident company under the preventive AMC included services such as assistance in analysing and solving technical problems, locating and mending the disfunctions by providing telephonic advice and assistance. Therefore, the services were held to be not in the nature of 'mere repairs' but towards preventive maintenance and were in the nature of FTS in terms of Explanation 2 to section 9(1)(vii) of the Act. Accordingly, the assessee was liable to withhold tax under section 195 of the Act.

- Since the services were in the nature of FTS, it was important to analyse the applicability of section 206AA of the Act. The provisions of section 206AA of the Act overrides the other provisions of the Act and the non-resident would be subject to a higher rate of withholding tax (i.e. at the rate of 20%) where he was required to obtain and furnish a PAN but had failed to do so.

- The assessee was required to make payment to the non-resident 'net of tax'. Once the liability to withhold tax was established, it was necessary to consider the issue of grossing up of tax under section 195A of the Act. Tax was required to be withheld at the 'rates in force' i.e. rates of withholding tax under the Act or tax treaty whichever is beneficial to the assessee as per section 195A of the Act. Therefore, the Tribunal held that the grossing up of the tax would be required to be done at the 'rates in force' and not at 20% under section 206AA of the Act which is applicable only where PAN is not furnished.

Conclusion

The Tribunal has differentiated between ordinary repair services and preventive maintenance services. The ordinary repair services, which does not require technical assistance, would be taxed as business income of the non-resident and were distinguished from the preventive maintenance services. The preventive maintenance services would be taxable as FTS. Importantly, wherever payment is made 'net of taxes' to a non-resident, the income would be increased at the 'rates in force' for that financial year and not at the rate at which tax has been withheld by the tax payer.

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