

## TAX FLASH NEWS

### No disallowance under Section 40(a)(i) of the Income-tax Act if the taxpayer has not deducted tax at source based on 'nil' withholding certificate obtained from the tax officer

#### Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Carl Zeiss India (P) Ltd.<sup>1</sup> held that no disallowance under Section 40(a)(i) of the Income-tax Act, 1961 (the Act) shall be made in case of non-deduction of tax at source on payment made to a non-resident if the taxpayer has made such a payment on the basis of 'nil' withholding certificate under Section 195(2) of the Act.

#### Facts of the case

- The taxpayer, a company incorporated in Singapore, is a 100 per cent subsidiary of Carl Zeiss, AG Germany. The Carl Zeiss group manufactures and sells optical products. It was engaged mainly as a front office for the Carl Zeiss group in India. The branch office of the taxpayer in India facilitates the sale of the group's products in India, apart from providing it sales support in India.
- During the year under consideration, the taxpayer had made payment for reimbursement of the expenditure in respect of the services rendered by the head office through three senior management officials. The payment was made under the cost sharing arrangements and claimed as reimbursement to the head office.
- The taxpayer had obtained a nil withholding tax certificate from the tax officer before remitting the amount to its head office.
- During the the assessment proceedings, the Assessing Officer (AO) noted that the taxpayer had claimed INR11.25 million under the head office cost of senior management.
- The AO held that the services provided by the head office through three senior management officials fall within the category of Fee for Technical Services (FTS) under Section 9(1)(vii) of the Act as well as the India-Singapore tax treaty. It was held that since the taxpayer did not deduct tax at source, the said payment was disallowed under Section 40(a)(i) of the Act and added to the total income.
- The AO also made the disallowance in respect of the expenditure on account of advertisement and sales promotion. The expenditure on account of printing, reimbursement, sales promotion, stall charges were covered under Section 194C of the Act, and the expenditure on account of training charges were covered under Section 194J of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)]:
  - deleted the addition made by the AO in respect of one senior management personnel;
  - confirmed the addition made by the AO in respect of other personnel holding that the payment was in the nature of FTS; and
  - held that the AO failed to establish the fact that payments made by the Indian branch towards advertisement and sales promotion expenditure, qualified as payments covered under Section 194C/194J of the Act and, therefore, the provisions of withholding tax were not attracted to such payments. Accordingly, the CIT(A) had deleted the disallowance made by the AO.

<sup>1</sup> DCIT v. Carl Zeiss India (P)Ltd. (IT(IT)A No.1251(B)/2014) – Taxsutra.com

## Tribunal's ruling

### Head office expenditure

- The taxpayer had remitted the amount to the non-resident after obtaining a certificate from the tax officer under Section 195(2) of the Act. The AO while granting the certificate under Section 195(2) had duly recorded the fact that the payment in question is in respect of availing the services of Carl Zeiss Pte. Ltd., Singapore under the agreement for providing certain managerial and human resources to the Indian branch.
- The tax officer noted that the payment was in connection with salaries and other cost of managerial and HR officials charged to the Indian branch which includes the cost of the MD, Chief Officer, HR & Quality and web administrator for IT application specialists.
- Thus, after considering the submissions of the taxpayer that the services provided by the non-resident from Singapore does not fall within the definition of FTS under Article 12 of the India-Singapore tax treaty, the tax officer issued a 'nil' withholding certificate for making remittance.
- The provisions of Section 40(a)(i) of the Act can be invoked only when there is a failure on the part of the taxpayer to comply with the provisions of Chapter-XVIIIB of the Act. The payment in question was to a non-resident company and therefore, the provisions for deduction of tax as provided under Section 195 of the Act are relevant.
- The taxpayer had already made an application under Section 195(2) of the Act for seeking permission from the authority concerned to remit the said payment to the non-resident without a deduction of tax at source and the AO concerned had determined the tax deductible at source as nil and allowed the taxpayer to remit the said amount without deduction of tax at source.
- Once the taxpayer had complied with the provisions of Section 195 of the Act and had obtained a certificate from the AO in accordance with the requirement of Section 195(2) then, the taxpayer cannot be penalised by invoking the provisions of Section 40(a)(i) of the Act during assessment.
- Accordingly, without going into the issue of the nature of payment - whether FTS or not, it was held that once the taxpayer had complied with the provisions of Section 195 by obtaining the certificate under Section 195(2) of the Act, no disallowance can be made under Section 40(a)(i) of the Act with respect to the said amount paid to the non-resident.

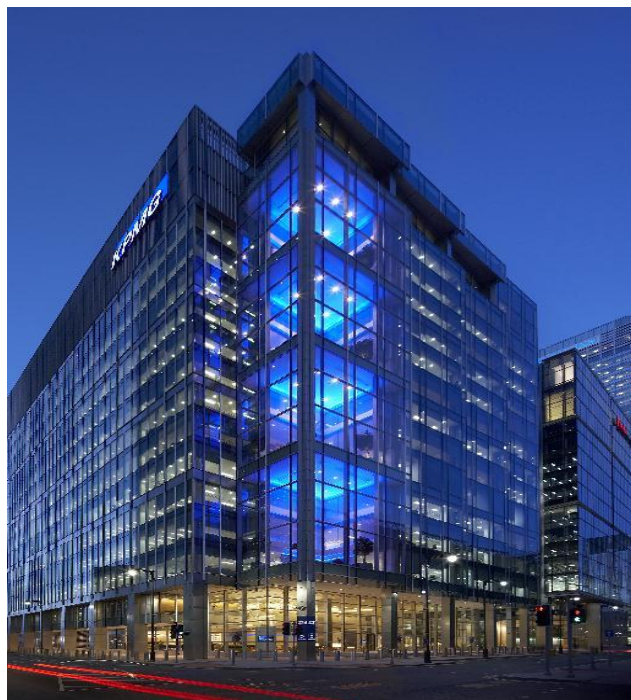
### Advertisement and sales promotion expenditure

- After going through the details, the Tribunal held that the advertisement and sales promotion expenditure did not fall within the scope of Section 194C or 194J of the Act. Accordingly, the decision of the CIT(A) was upheld by the Tribunal.

### Our comments

This is a welcome decision of the Bangalore Tribunal where it has been held that once a taxpayer has complied with the provisions of Section 195 by obtaining a certificate from the AO, a disallowance cannot be made under Section 40(a)(i) of the Act.

This decision is consistent with the decision of the Mumbai Tribunal in the case of Mangalore Refinery and Petrochemicals Ltd<sup>2</sup> where the Tribunal held that in respect of payments made without a deduction of tax at source after moving an application under Section 195(2) of the Act and on issuance of a certificate of no objection by the AO, the taxpayer should not be treated as an assessee in default under Section 201 of the Act.



<sup>2</sup> Mangalore Refinery and Petrochemicals Ltd v. CIT [2008] 113 ITD 85 (Mum)

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