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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
1 (SB)
\+ **ITA No. 180/2014**

THE COMMISSIONER OF INCOME TAX-II ..... Appellant
Through: None.

versus

MITUSUBISHI CORPORATION INDIA P. LTD. ...Respondent
Through: None.

CORAM:
JUSTICE S. MURALIDHAR
JUSTICE PRATHIBA M. SINGH

O R D E R

% 17.11.2017

In view of the difference of opinion between us on the questions framed in the appeal, as expressed in our individual opinions placed on file, the matter is placed before the Hon'ble Acting Chief Justice for appropriate orders.

S. MURALIDHAR, J.

PRATHIBA M. SINGH, J.

NOVEMBER 17, 2017
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* **IN THE HIGH COURT OF DELHI AT NEW DELH**

\+ **ITA 180/2014**

Reserved on: 11th September, 2017
Date of decision: 17th November,2017

THE COMMISSIONER OF INCOME TAX-II ..... Appellant
Through: Mr. Raghvendra Singh, Mr. Rahul Chaudhary and Mr.Ashok Manchanda, Senior Standing counsel.

versus

MITSUBISHI CORPORATION INDIA PVT. LTD ..... Respondent

Through: Mr. M. S. Syali, Senior Advocate with Mr. Mayank Nagi, Mr. Tarun Singh and Mr. Shubham Gupta, Advocates.

CORAM: JUSTICE S.MURALIDHAR
JUSTICE PRATHIBA M. SINGH

JUDGMENT

Prathiba M. Singh, J.:

1.The present appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') challenges the order dated 23rd August, 2013 passed by the Income Tax Appellate Tribunal ('ITAT') in ITA No.5147/Del/2010 for the Assessment Year ('AY') 2006-07.

2. This Court on 29th April, 2014, framed the following questions of law.

> *"(i) Whether the ITAT fell into error in holding that Section 40(a)(i) of the Income Tax Act, 1961*

cannot be applied in view of the provisions of the Double Tax Avoidance Agreement between the Indian and Japan and India and the US?
(ii) Whether the ITAT fell in error in reversing the findings of the DRP with respect to the existence of the PEs in India?"

3. The Assessee, Mitsubishi Corporation India Private Limited (*hereafter 'MI'*) was incorporated in India on 22nd May, 1996. It is engaged in the development of international trade and is also procuring raw materials and marketing finished products in India, through various Indian joint ventures of Mitsubishi Corporation, Japan (*hereafter 'MC'*). The return of income for AY 2006-07 was filed by the Assessee on 29th November, 2006 declaring a total income of Rs.6,39,59,620/- and the same was assessed under the provisions of Section 143 (3) read with Section 144C of the Act.

4. The Assessing Officer ('AO') passed a draft assessment order under Section 144C of the Act on 31st December, 2009 and made, amongst others, an addition of Rs.97,89,54,176/-. The Assessee filed its objections before the Dispute Resolution Panel ('DRP') on 2nd February, 2010. The DRP on 30th September, 2010 directed the AO to complete the assessment as per the draft order.

5. The final assessment order dated 25th October, 2010 was passed by the AO under Section 143(3)/144C of the Act and the addition of Rs. 97,89,54,176/- was confirmed under Section 40 (a) (i) of the Act and added to the total income of the Assessee. An addition of Rs. 155,27,14,989/- was

also made on account of difference of Arm's Length Price determination by the TPO which is however, not the subject matter of the present Appeal.

6. Aggrieved by the final order of the AO, the Assessee filed an appeal before the ITAT. The ITAT allowed the Assessee's appeal on 23rd August, 2013 insofar as it related to the deductions under Section 40 (a) (i) and sent the matter back to the AO/TPO for determination of comparables and consequently the Arm's length price for the international transactions with the AEs. The said order insofar as it relates to the deduction under Section 40 (a) (i) is challenged by the Revenue in the present appeal.

7. The question that arises in the present case is whether MI was liable to deduct TDS for the payments made by it in respect of transactions with companies of the Mitsubishi Group including MC, MC Metal Services Asia, Thailand (*hereafter 'MC Thailand'*), Metal One Asia Pvt. Ltd., Singapore (*hereafter 'MO Singapore'*), and Metal One Corporation, Japan (*hereafter 'Metal One'*). The seven specific transactions that the Court is concerned with in the present matter are -

S. No.	**Name of the Group Company**	**Country**	**Disallowance u/s 40(a)(i) - Rs.**
1	Mitsubishi Corporation	Japan	5,01,55,844
2	MC Metal Services Asia	Thailand	24,09,32,203
3	Metal One Asia P. Ltd.	Singapore	10,06,99,115
4	Metal One Corporation	Japan	57,91,87,712
5	Mc.Tubular Inc.	USA	11,60,956

6	Petro Diamond Corporation	Japan	16,34,096
7	Miteni	Japan	51,84,250

Order of the Assessing Officer ('AO')

8. The final assessment order dated 25th October, 2010 passed by the AO, captures in detail the business operations of MC. According to the AO, a survey operation was conducted on the Liaison Office ('LO') of MC, which resulted in MC finally conceding that it is liable to pay tax in India. The AO records that MC has worldwide operations and operates through a network of LOs and segmental units called divisions. According to the AO, there is an overlap between the functions of MI and the LOs of MC. The AO discussed the complete structure of MC and also notes that the various groups created in India and the divisions created thereunder including the Business Initiative Group, Energy Group, Chemical and Business Group, Metal Business Group, Living Essential Business Group, Machinery Group, are shared between the LOs and MI. The AO analyzed in detail the manner in which MC conducted its activities in various countries. The AO finally relies upon the letter dated 10th March, 2006 given by MC to the department, which stated that MC admitted that it would have no objection to pay tax in India by applying the gross profit rate of 2.75% for computing the profitability in respect of the Indian transactions of MC. This letter, as per the AO, meant that MC admitted to the existence of its Permanent Establishment ('PE') in India. The AO, thus, concludes that since MC is taxable in India and this position is not contested by it, the provisions relating to TDS i.e. Section 195 of the Act, consequently, apply to MC.

9. Insofar as Metal One is concerned, the AO analyzed the management plan of Metal One as available on its website and came to the conclusion that the functioning of Metal One is identical to that of MC. Metal One also has an LO in India which functions in the same manner as its other LOs, which undertake core activities. So according to the AO, the fact that Metal One may be trading through an entity based in Singapore or Thailand, does not make any difference, insofar as deduction of TDS is concerned. According to the AO, the transactions are not exempt from the purview of Section 195 of the Act, as payment to a non-resident is included therein. If the non-resident has a PE in India, then there is no doubt that TDS has to be deducted. In the case of MC Thailand and MO Singapore, since they have a business connection in India through the LO of Metal One, TDS was liable to be deducted. The AO then discusses that the role of the Assessee is that of a service provider between the customer in India and the vendor located outside India. Hence, the Assessee's functions are in the nature of a service provider, as per the AO.

10. Insofar as the Double Taxation Avoidance Agreement (*hereafter 'DTAA'*) between India and Japan is concerned, the AO concluded that the non-discrimination clause does not come to the assistance of the Assessee as MI is, admittedly, a resident company. In any event, according to the AO, since the recipient non-resident companies are chargeable to tax in India – in the case of MC it has a PE in India and in the case of Metal One it has a close business connection - thus the Assessee was bound to deduct TDS under Section 195 of the Act and by not doing so its expenses towards purchase payments made to these entities were not liable to deduction under

Section 40 (a) (i) of the Act. The AO relies upon the judgment of the Supreme Court in ***Transmission Corporation of AP Ltd. v. CIT, (1999) 239 ITR 587 (SC)*** *(hereafter 'Transmission Corporation'*) to hold that *'any other sum chargeable under the provisions of this Act'* as appearing in Section 195 would not include cases where any sum payable to the non-resident is a trading receipt which may or may not include `pure income'. The observation of the Supreme Court that *'the language of Section 195(1) for deduction of income tax by the payee is clear and unambiguous and casts an obligation to deduct appropriate tax at the rates in force'* clearly imposed an obligation upon the Assessee to deduct tax. The AO also relied upon the judgment of the Karnataka High Court in ***Commissioner of Income Tax, International Taxation and the Income Tax Officer TDS-I v. Samsung Electronics Co. Ltd., India Software Operations [2010] 320 ITR 209 (Kar)*** *(hereafter 'Samsung Electronics')* to support this view. The AO then concluded as under:

> *"4.21 In light of the unambiguous legal position as emanates from the discussion made above under the observations of Hon'ble Apex Court and Hon'ble Karnataka High Court, the assessee was clearly under obligation to comply with the provisions of Sec.195 of the I. T. Act and to deduct tax at source on the payments made to non-residents as discussed above. As a result of this default of the assessee, the payments made to non-residents as above, are clearly disallowable u/s 40(a)(i) of the Income Tax Act, 1961 and I hold accordingly.*
>
> *4.22 To sum up the above discussion, the payments made to non-residents are disallowable on the following grounds:*

1. The non-resident entities to whom payments have been made by the assessee are chargeable to tax in India in the light of their business model and presence in India under the provisions of Income Tax Act, 1961 and well as under the provisions of relevant DTAA as they have a PEs as well as business connection in India.

2. The purchases in the instant case are purchases simplicitor as the nonresident entities are trading houses whose work is to liaison with the seller and purchaser and to make the deal happen. The assessee is not an end user of the purchases but is a mediator between the seller and the end user. The argument that the purchases are not taxable in India is therefore misplaced and out of context.

3. The 'non-discrimination' clause under the DTAA cannot be invoked by resident assessee. In any case there is no discrimination under the prevailing provisions of law as discussed above.

4. An obligation is cast upon the assessee under section 195 of the Income Tax Act, 1961 to comply with the provisions of, the said section and to withhold tax at source failing which other provisions of Act including Sec. 40(a)(i) and Sec. 201 thereof apply to the facts of the assessee's case."

Order of the Income Tax Appellate Tribunal

11. The ITAT describes MC's activities as that of a general trading company known in Japanese language as `Sogo Shosha'. The ITAT recognized the nature of services provided by the Assessee to MC. The ITAT after considering the arguments made by both parties held that the transaction

with Mc.Tubular Inc. USA was covered under the India-US DTAA as discussed in ***Herbalife International Pvt. Ltd. V. ACIT 101 ITD 450 (Del)*** (*hereafter 'Herbalife ITAT*'). The ITAT thereafter sets out the relevant provisions of the India-Japan DTAA that are in *pari materia* with the non-discriminatory clause in the Indo-US DTAA and thus holds that the ***Herbalife ITAT (supra)*** judgment of the Tribunal applies squarely to the India-Japan DTAA. On the basis of ***Herbalife ITAT (supra)*** judgment, the ITAT deleted the disallowance of purchases in respect of some companies, namely, MC, Mc.Tubular Inc, U.S.A., Petro Diamond Corporation. Japan, Miteni, Japan and Metal One.

12. The ITAT thereafter looked at the transactions in respect of MC Thailand and MO Singapore. Relying upon the decision of the Tribunal in ITA No.5377/Del/2011 (***Metal One Corporation v. DCIT*** (*hereafter 'Metal One DCIT'*)) for AY 2008-09, the ITAT holds that since Metal One has no PE in India, payments to it are not taxable in India and hence the provisions of Section 195 of the Act are not attracted. Consequently, according to the ITAT, the disallowance under Section 40 (a) (ia) is bad in law.

13. Thus, the ITAT set aside the order of the AO and deleted the additions so made by him. However, in respect of the addition made by the AO in respect of the Arm's length pricing, the ITAT remanded the matter to the AO for fresh adjudication on the issue of the determination of comparables and to conduct a fresh TP study and file additional evidences/comparables before the AO/TPO for consideration.

Decision in Herbalife International India Pvt. Ltd.

14. The decision in ***Herbalife ITAT (supra)*** was appealed to this Court and in its decision dated 13th May 2016 in ***CIT v. Herbalife International Pvt. Ltd. [2016] 384 ITR 276*** (*hereafter 'Herbalife'*), this Court analyzed the provisions relating to non-discrimination, namely Article 26 (3) of the DTAA between India and U.S.A. After analyzing the extant provisions of the Act as applicable, read with the provisions of the DTAA, it was held that in the AY in question i.e. 2001-02, Section 40 (a) (i) did not provide for deduction of TDS where the payment was made in India to a resident. In view thereof, this Court held that a non-resident would have to be subjected to the same conditions as a resident and held that *'the lack of parity in allowing all the payment as deduction'* brings about discrimination. The Court held that while payments to non-residents require deduction of TDS, payment to residents were neither subject to deduction of TDS nor the consequences of disallowance of the payment as deduction under Section 40 (a) (i). After noting this statutory position, the Court applied the principle laid down in ***Union of India v. Azadi Bachao Andolan (2004) 10 SCC 1*** (*hereafter 'Azadi Bachao Andolan'*), wherein the Supreme Court, after taking note of decisions given by various High Courts, held:

> *"…28. A survey of the aforesaid cases makes it clear that the judicial consensus in India has been that Section 90 is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement. When that happens, the provisions of such an agreement, with respect to cases to which where they apply, would*

> *operate even if inconsistent with the provisions of the Income Tax Act. We approve of the reasoning in the decisions which we have noticed. If it was not the intention of the Legislature to make a departure from the general principle of chargeability to tax under Section 4 and the general principle of ascertainment of total income under Section 5 of the Act, then there was no purpose in making those sections 'subject to the provisions of the Act'. The very object of grafting the said two sections with the said clause is to enable the Central Government to issue a notification under Section 90 towards implementation of the terms of the DTACs which would automatically override the provisions of the Income tax Act in the matter of ascertainment of chargeability to income tax and ascertainment of total income, to the extent of inconsistency with the terms of the DTAC…*"

15. In view of this legal position, this Court held that the conditions of deduction of TDS being discriminatory, the disallowance of the expenses towards purchases made on the ground of non-deduction of TDS was not sustainable.

Amendments to the Finance Act,

16. The ***Herbalife (supra)*** decision was rendered in the context of AY 2001-02 and the present case relates to AY 2006-07. There have since been amendments to the Act. The Finance Act, 2004, that came into operation with effect from 1st April, 2005, substituted/added sub-clauses (i), (ia) and (ib) to Section 40 (a) of the Act. Section 195 of the Act was also amended by the Finance Act, 2012, by adding Explanation 2 w.r.e.f. 1st April, 1962. The amended provisions as applicable to the AY in issue, read as under:

*"**Section 40** - Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—*

(a) in the case of any assessee —

*(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services **or other sum chargeable under this Act**, which is payable,—*

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

***on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted** or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139:*

***Provided** that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.*

Explanation.—For the purposes of this sub-clause,—

(A) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;

(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;

(ia) any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply

of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :

Provided *that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, thirty per cent of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid:*

Provided further *that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.*

Explanation.—For the purposes of this sub-clause,—

(i) "commission or brokerage" shall have the same meaning as in clause (i) of the Explanation to section 194H;

(ii) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;

(iii) "professional services" shall have the same meaning as in clause (a) of the Explanation to section 194J;

(iv) "work" shall have the same meaning as in Explanation III to section 194C;

(v) "rent" shall have the same meaning as in clause (i) to the Explanation to section 194-I;

(vi) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;

(ib) any consideration paid or payable to a non-resident for a specified service on which equalisation levy is deductible under the provisions of Chapter VIII of the Finance Act, 2016, and such levy has not been deducted or after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :
***Provided** that where in respect of any such consideration, the equalisation levy has been deducted in any subsequent year or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such levy has been paid…."*

17. Section 195 (1) along with its newly added explanation as applicable to the AY in question reads as under:

***"Section 195**(1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force:*
***Provided** that in the case of interest payable by the Government or a public sector bank within the meaning of clause (23D) of section 10 or a public financial institution within the meaning of that clause, deduction of tax shall be made only at the time of*

payment thereof in cash or by the issue of a cheque or draft or by any other mode:
Provided further *that no such deduction shall be made in respect of any dividends referred to in section 115-O.*
.....
Explanation 2.—For the removal of doubts, it is hereby clarified that the obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident person has—
(i) a residence or place of business or business connection in India; or
(ii) any other presence in any manner whatsoever in India."

The effect of these amendments would be discussed later.

Submissions of the Appellant-Revenue

18. Mr. Raghavendra Singh, learned Senior Standing Counsel appearing on behalf of the Revenue, submits that the ITAT went drastically wrong in applying the decision of ***Herbalife ITAT (supra)***. He submitted that the amended statutory position has not been considered by the ITAT and thus the ITAT erred in holding that the provisions continue to be discriminatory. He relies on the following four tables to submit that the factual position since the decision in ***Herbalife (supra)*** having changed, the discrimination has been done away with:

Position Prior to 1.4.1989:

	Any payer to any resident payee	**Any payer to a non-resident payee**
Payable Outside India	40(a)(i)	40(a)(i)
Payable in India	N.A.	N.A.

Position as amended by Finance Act, 1988 (Applicable in CIT v. Herbalife, [2016] 384 ITR 276 (Del) which dealt with AY 2001-02):

	Any payer to any resident payee	**Any payer to a non-resident payee**
Payable Outside India	40(a)(i)	40(a)(i)
Payable in India	N.A.	N.A.

Position as amended by Finance Act, 2003:

	Any payer to any resident payee	**Any payer to a non-resident payee**
Payable Outside India	40(a)(i)(A)	40(a)(i)(A)
Payable in India	N.A.	40(a)(i)(B)

Position as amended by Finance Act, 2004 (Applicable to the present case for AY 2006-07):

	Any payer to any resident payee	**Any payer to a non-resident payee**
Payable Outside India	40(a)(i)(A) & 40(a)(ia)	40(a)(i)(A)
Payable in India	40(a)(ia)	40(a)(i)(B)

19. Mr. Singh submits that the provisions of Chapter XVII-B are also not discriminatory as residents and non-residents have been placed on the same footing insofar as compliance of the requirements under Chapter XVII-B is concerned. Mr. Singh further submits that the provisions of the DTAA relating to non-discrimination do not mandate absolute parity between

residents and non-residents. In fact, the decision in ***Herbalife (supra)*** supports the position that the imposition of withholding tax on non-residents is appropriate in their case, as non-residents are beyond the jurisdiction of the taxing country. Article 24 (3) of the India-Japan DTAA requires that '*disbursements paid by a resident of a contracting state to a resident of the other contracting state shall, for the purposes of determining the taxable profits of the first mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first mentioned contracting state.'* The term '*same conditions*' would automatically bring non-residents to the same position as residents and Chapter XVII-B pertaining to TDS would squarely be applicable to non-residents.

20. Mr. Singh further submits that insofar as the entities situated in Thailand and Singapore are concerned, the basis of disallowance is Section 195 of the Act. He submits that deduction of tax is different from assessment of tax and that Chapter XVII-B stands on a completely different footing. In an assessment a full-fledged enquiry is made, but under Section 195 of the Act the deduction is at source. Even a trading receipt will attract the provisions of Section 195 of the Act. The question whether the income is taxable or not, is a question which is to be answered at a later stage. Mr. Singh's stand is that in order for an entity to be subjected to an assessment, the existence of a PE is not essential. He submits that so long as the payee is present in India and has some business connection, there is a presumption of taxability, unless the Assessee proves otherwise. Explanation 2 to Section 195 (1) of the Act, which was amended by Finance Act, 2012 with retrospective effect from 1st April, 1962, does not contradict the DTAA.

21. Mr. Singh relies upon ***Aggarwal Chamber of Commerce, Ltd v. Ganpat Rai Hira Lal [1958] 33 ITR 245(SC)*** (*hereafter 'Ganpat Rai'*), to submit that even if a payee is located in a non-taxable territory, the deduction at source ought to be made by the entity located in the taxable territory. The question as to whether the amount is taxable in the hands of the payee, which is a non-resident, is a question to be addressed at the time of his assessment and not at the time of deduction at source. Mr. Singh also relies upon ***Azadi Bachao Andolan (supra)*** to submit that if there is no conflict between the DTAA and the provisions of the Act, then Section 90 of the Act is not triggered. Since the Indo-Thai and India-Singapore DTAAs do not have any conflicting provisions, the only law occupying the field is Section 195. According to Mr. Singh, Section 90 (2) of the Act does not, in any manner, come in the way of giving effect to Section 195. This is not a case where there is a conflict or a case where the Assessee is claiming any provision which is beneficial to it, as compared to the DTAA.

22. Mr. Rahul Chaudhary, learned Senior Standing Counsel also supports the case of the Revenue and submitted that the determination is essentially provisional in nature. He relied upon ***Areva T & D SA v. Assistant Director of Income Tax [2012] 349 ITR 127 (Del)*** *(hereafter 'Areva SA')* to submit that the deduction of tax under Section 195 of the Act is not in itself final and the payee can always seek a certificate for deduction at the lower rate under Section 197 of the Act or for refund on the ground that the income is not taxable in India etc. The deduction of tax at source being a measure to safeguard the interest of the Revenue, the payee would be subjected to

scrutiny when it is assessed. That scrutiny cannot be done at this stage i.e. when the tax is to be deducted by the payer. Mr. Chaudhary also relies upon ***CIT v. Elbee Services Private Limited [2001] 247 ITR 109 (Bom)*** *(hereafter 'Elbee Services')* to submit that the orders under Section 195(2) are not conclusive and that they do not preempt the department from passing appropriate orders of assessment or even take a contrary view in the assessment proceedings. He also submitted that the non-resident payee has several options after the tax is deducted at source, under Sections 197 and 248 of the Act. The Treasury Department's Technical Explanation of the Convention and Protocol between the United States of America and the Republic of India for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income Signed at New Delhi on September 12, 1989 (*hereafter 'US technical explanation')* has been dealt with in the decision of ***Herbalife (supra)***. The US technical explanation, in fact, supports the case of the Revenue. Mr. Chaudhary specifically relied upon the following extracts from the said explanation:

> "*Section 1446 of the Code imposes on any partnership with income which is effectively connected with a U.S. trade or business the obligation to withhold tax on amounts allocable to a foreign partner. In the context of the Convention, this obligation applies with respect to an Indian resident partner's share of the partnership income attributable to a U.S. permanent establishment. There is no similar obligation with respect to the distributive shares of U.S. resident partners. It is understood, however, that this distinction is not a form of discrimination within the meaning of paragraph 2 of the Article. No distinction is made between U.S. and Indian partnership, since the law requires that partnerships of both domiciles withhold tax in respect*

> *of the partnership shares of non-U.S. partners. In distinguishing between U.S. and Indian partners, the requirement to withhold on the Indian but not the U.S. partner's share is not discriminatory taxation, but, like other withholding on non-resident aliens, is merely a reasonable method for the collection of tax from persons who are not continually present in the United States, and as to whom it may otherwise be difficult for the United States to enforce its tax jurisdiction. If tax has been overwithheld, the partner can, as in other cases of over-withholding, file for a refund.*
>
> *Paragraph 3 prohibits discrimination in the allowance of deductions. When an enterprise of a contracting State pays interest, royalties or other disbursements to a resident of the other contracting State, the first-mentioned contracting State must allow a deduction for those payments in computing the 'taxable profits of the enterprise under the same conditions as if the payment had been made to a resident of the first-mentioned Contracting State…."*

23. As per the above technical explanation, it is clear that the payee can file for refund and this method of deduction of tax is recognized within the Indo-US DTAA regime. According to Mr. Chaudhary, in the present case, trading receipts are liable to withholding tax since all the Associated Enterprises ('AE') are working together to generate business in like manner and the entire business is traceable to one source namely MC. He supports the submissions of Mr. Singh, that a person, who is a resident of India as in the case of MI, cannot invoke the non-discrimination clause under any DTAA.

Respondent-Assessee's Submissions

24. Mr. Syali, learned Senior advocate appearing for the Respondent heavily relies upon the various DTAAs to state that the said regime was more

beneficial to the Assessee and it has, therefore, opted for being governed by the same. According to Mr. Syali, the profits from the business of the payee can be taxed in India only if the payee has a PE. He specifically relies upon Article 7 of the India-Japan DTAA read with Article 5. His submission is that insofar as MC Thailand and MO Singapore are concerned, they do not have any PE in India and hence the income of the payee, corresponding to these entities, is not chargeable to tax in India. According to Mr. Syali, Section 195, therefore, does not apply and consequently, Section 40 (a) (i) also does not apply.

25. Mr. Syali submits that reliance on ***Transmission Corporation (supra)*** is misplaced. In fact, he submits that as per the tests laid down in the said case, the first question to be determined is - whether the payment made to the non-resident is chargeable to tax under the Act. Until and unless the issue of chargeability is decided, the liability to deduct tax does not exist. He further relies upon the judgment of the Supreme Court in ***GE India Technology Cen. (P.) Ltd. v. CIT*** *(hereafter 'GE India Technology')*, which confirmed this position.

26. According to Mr. Syali, the onus to establish that there is a PE of the Assessee is on the Revenue. He submits that Section 197 of the Act does not rule out the application of Section 195, inasmuch as the mere fact that the payee can obtain a certificate at a lower rate subsequently, does not by itself imply that the tax was deductible in the first place. He submits that in so far as the transactions governed by the Indo-US DTAA and Indo- Japan DTAA

are concerned, the Assessee is protected by the non-discrimination clauses in the said agreements.

27. In case of the other transactions viz., with the entities in Thailand and Singapore, the question, according to Mr. Syali, is whether the non-deduction of TDS straightway attracts the disallowance. He submits that the reliance on the decision in ***Ganpat Rai (supra)*** is misplaced as even the said decision does not uphold that chargeability is an irrelevant consideration at the time of deduction of the TDS. According to Mr. Syali, the decision in ***Ganpat Rai (supra)*** was whether the determination of income is essential while deducting the tax at source. This judgment was not in the context of any DTAA. According to him, the question that arose was whether the payer needs to consider as to what constituted the taxable income of the payee at the time of deduction of the TDS, and this question was rightly answered by the Court in the negative. He submits that the computation of income is different from its chargeability.

28. Mr. Syali fairly submits that the amount paid by the payer to the payee constitutes income, but for the purpose of determining whether TDS is to be deducted, the chargeability of the said amount to tax has to be established. He relies upon ***Prithvi Information Solutions v. ACIT [2014] 34 ITR (Trib) 429 (ITAT Hyd)*** *(hereafter 'Prithvi Information Solutions')* to submit that according to the ITAT, the judgment in ***GE India Technology (supra)*** still holds good. He urges this Court to uphold the view taken by the ITAT in ***Prithvi Information Solutions (supra)***. Mr. Syali states that MC Thailand and MO Singapore have no LO in India and the AO rightly records that if

there is no LO then the onus is higher on the Revenue for proving existence of a PE. He relies upon the observations of the ITAT to the effect that the transaction is at arm's length. Mr. Syali further relies upon ***Rajeev Sureshbhai Gajwamo v. ACIT 129 ITD 145 (Ahmd) (S.B.)*** *(hereafter 'Rajeev Sureshbhai')*.

29. Mr. Syali, thus, submits that though the wordings in the various DTAA are different, the impact of all the said DTAAs is the same. According to him, non-discrimination forms the foundation of all the DTAAs despite the clauses being different. Mr. Syali places heavy reliance on paragraph 48 of the ***Herbalife (supra)*** where he had made submissions as an intervener that the amount paid towards purchases are not covered by Section 40 (a) (ia) and thus the legal position as enunciated in ***Herbalife (supra)*** has not changed insofar as the facts of this case are concerned. Further, according to Mr. Syali, the term '*other sum chargeable*' as appearing in Section 40 (a) (i) is not contained in Section 40 (a) (ia) and this by itself establishes discrimination.

30. The final plank of Mr. Syali's submissions is that the issues that arise in this case stand concluded by the decision in ***Herbalife (supra).*** He concludes by submitting the following four propositions –

(i) that the US technical explanation was discussed by the ITAT, Pune in ***Automated Securities v. ACIT 118 TTJ 618*** *(hereafter 'Automated Securites')* and the ITAT, Ahmedabad in ***Rajeev Sureshbhai (supra),*** wherein ***Automated Securities (supra)*** was over ruled by ITAT, Ahmedabad in ***Rajeev Sureshbhai (supra)***;

(ii) the provisions requiring deduction of TDS are not determinative on the issue of discrimination and that arguments about section 195 become irrelevant except on the issue of chargeability;

(iii) the principles of Article 14 cannot be applied in the determination of issue of non-discrimination in the context of the various DTAAs;

(iv) Section 90 (2) does not refer to a situation of conflict between the DTAA and the Act but merely provides that the provisions of DTAA would prevail so long as they are more beneficial to the Assessee;

Rejoinder by the Appellant-Revenue

31. According to Mr. Singh, Section 195 is independent and stands on its own legs. Until and unless the Assessee can establish that any provision in the DTAA is more beneficial to the Assessee, chargeability cuts across all the transactions. Explanation 2 to Section 195 lessens the rigors to be established by the Revenue. He relies upon the article 23 (1) of Indo Japan DTAA to state that the laws of the Contracting State shall continue to govern the taxation of income. The question, whether the payee has a PE of its own, has to be established in the assessment proceedings of the payee and not at this stage. The ITAT observes clearly that after 1st April, 2004, there is equality between residents and non-residents. He again reiterates and derives support from Article 24 (3) of the India-Japan DTAA which clearly provides that tax is deductable on the same conditions as is deductible qua residents and thus Section 40 (i) (a) applies equally both for the residents and non-residents.

Analysis and Reasoning

32. Before proceeding with the facts, it is necessary to analyze the change in the statutory position post the amendments that have taken place by the Finance Act, 2004 w.e.f. 1st April, 2005 and the Finance Act, 2012 with retrospective effect w.e.f. 1st April, 1962.

Scheme of the Income Tax Act, 1961, after amendments

33. The scheme of the Act has undergone a substantial change subsequent to the decision in ***Herbalife (supra)***. The change arises due to the substitution and insertion of Section 40 (a) (i), Section 40 (a) (ia) and Section 40 (a) (ib), in place of the earlier Section 40 (a) (i) as also the addition of Explanation 2 to Section 195, to the Act. These provisions read with Sections 4, 5 and 9 of the Act leave no manner of doubt that tax is deductible at source, whether payments are made to residents or non-residents if the *sum is chargeable to tax under any of the provisions of the Act*. In fact as per the newly added Explanation, chargeability is no longer dependent upon the existence of a PE, a business connection or a place of business or any other presence in any manner whatsoever. The chargeability only depends on the nature of the transaction. Even if some portion is taxable, tax is to be deducted. This being the position, the submission of the Revenue that chargeability cuts across the provisions of the Act is correct. The question whether the income of the payee is finally to be considered as taxable income or not is an issue to be decided when the payee is assessed to tax and not at the stage of deduction of TDS. Thus, the obligation to deduct tax under Section 195 is inescapable insofar as the payer is concerned.

34. Deduction of tax at source is recognized as an acceptable mode of collection of tax even under the various DTAA provisions. It is a tool that can be employed to ensure that no income escapes tax, especially from such entities from whom it may be otherwise difficult to enforce tax payments. This rationale and logic finds acceptance in almost all the international jurisdictions as is evident from the U.S. Technical explanation (supra) relied upon by the Revenue as also the decision of ***Azadi Bachao Andolan (supra)***.

35. The deduction of tax at source is also an obligation which applies to all payments made inasmuch as payments, whether to a resident or a non-resident, would be included in the total income from *whatever source derived*. Section 4 (2) which is the charging section also stipulates that income tax shall be deducted at the source, in respect of income chargeable under Section 4 (1). Section 4 and Section 5 of the Act are extracted below:

> *"**Section 4** - (1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person :*
> ***Provided** that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.*
>
> *(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.*

Section 5 - *(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—*
(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
(b) accrues or arises or is deemed to accrue or arise to him in India during such year ; or
(c) accrues or arises to him outside India during such year :
Provided *that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.*

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which -
(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or
(b) accrues or arises or is deemed to accrue or arise to him in India during such year.
Explanation 1 *- Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.*
Explanation 2 *- For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the*

basis that it is received or deemed to be received by him in India."

36. Since the obligation to deduct tax at source applies equally towards payments made to residents and non-residents, especially the insertion of Explanation 2 to Section 195, the discrimination ceases to exist.

37. In ***Transmission Corporation (supra)*** it was held in no unclear terms has held that the scheme of the Act requires the payer to discharge the obligation of tax deduction at source. The relevant extract reads as under:

"…10. The scheme of Sub-sections (1), (2) and (3) of Section 195 and Section 197 leaves no doubt that the expression "any other sum chargeable under the provisions of this Act" would mean 'sum' on which Income Tax is leviable. In other words, the said sum is chargeable to tax and could be assessed to tax under the Act. Consideration would be - whether payment of sum to non-resident is chargeable to tax under the provisions of the act or not? That sum may be income or income hidden or otherwise embedded therein. If so, tax is required to be deducted on the said sum. What would be the income is to be computed on the basis of various provisions of the Act including provisions for computation of the business income, if the payment is trade receipt. However, what is to be deducted is Income Tax payable thereon at the rates in force. Under the Act, total income for the previous year would become chargeable to tax under Section 4. Sub-section (2) of Section 4 inter alia, provides that in respect of income chargeable under Sub-section (1), Income Tax shall be deducted at source where it is so deductible under any provision of the Act. If the sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted. The sum which is to

be paid may be income out of different heads of income provided under Section 14 of the Act, that is to say, income from salaries, income from house property, profits and gains of business or profession, capital gains and income from other sources. The scheme of Tax deduction at source applies not only to the amount paid which wholly bears "income" character such as salaries, dividends, interest of securities etc., but also to gross sums, the whole of which may not be income or profits of the recipient, such as payments to contractors and sub-contractors and the payment of insurance commission. It has been contended that the sum which may be required to be paid to the non-resident may only be a trading receipt, and, may contain a fraction of sum as taxable income. It is true that in some cases, a trading receipt may contain a fraction of sum as taxable income, but in other cases such as interest, commission, transfer of rights of patents, goodwill or drawings for plant and machinery and such other transactions, it may contain large sum as taxable income under the provisions of the Act. Whatever may be the position, if the income is from profits and gains of business, it would be computed under the Act as provided at the time of regular assessment. The purpose of Sub-section (1) of Section 195 is to see that the sum which is chargeable under Section 4 of the Act for levy and collection of Income Tax, the payee should deduct Income Tax thereon at the rates in force, if the amount is to be paid to a nonresident. The said provision is for tentative deduction of Income Tax thereon subject to regular assessment and by the deduction of Income Tax, rights of the parties are not, in any manner, adversely affected. Further, the rights of payee or recipient are fully safeguarded under Sections 195(2), 195(3) and 197. Only thing which is required to be done by them is to file an application for determination by the Assessing Officer that such sum would not be

chargeable to tax in the case of recipient, or for determination of appropriate proportion of such sum so chargeable, or for grant of certificate authorising recipient to receive the amount without deduction of tax, or deduction of Income Tax at any lower rates or no deduction. On such determination, tax at appropriate rate could be deducted at the source. If no such application is filed Income Tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such 'sum' to deduct tax thereon before making payment. He has to discharge the obligation of tax deduction at source…"

38. The judgment in ***Transmission Corporation (supra)*** came to be considered in ***GE India Technology (supra)*** by the Supreme Court where it was held –

"*If the contention of the Department that the moment there is remittance the obligation to deduct TAS arises is to be accepted then we are obliterating the words "chargeable under the provisions of the Act" in section 195(1). The said expression in section 195(1) shows that the remittance has got to be of a trading receipt, the whole or part of which is liable to tax in India. The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not as assessable, there is no question of TAS being deducted.*"

39. This position was also reiterated in ***Vodafone International Holdings BV v. Union of India & Anr. (2012) 6 SCC 613*** *(hereafter 'Vodafone')* wherein it was held –

"*Section 195 casts an obligation on the payer to deduct tax at source ("TAS", for short) from payments made to non-residents which payments are chargeable to tax.*

Such payment(s) must have an element of income embedded in it which is chargeable to tax in India."

40. From a conjoint reading of the ***Transmission Corporation (supra), GE India Technology (supra)***and ***Vodafone (supra)*** it can be said that-

- A sum is chargeable to tax if it can be assessed to tax under the Act and tax is leviable thereon;
- The question whether the sum can be assessed to tax is to be determined under Sections 4, 5 or 9;
- The heads of income are to be determined as per Section 14;
- A trading receipt could be chargeable to tax either as income tax from the business or income from other sources depending on the facts;
- In the case of a trading receipt even if a fraction of the sum forms part of the taxable income, it could still be included in the computation of income at the time of regular assessment;
- A trading receipt cannot be said to be completely exempt from the tax
- The deduction under Section 195 is a tentative deduction subject to regular assessment and payees are not affected adversely;

41. From the above it is clear that even if the payment is for purchase of goods it does not exempt the payer from making deduction of tax at source. Moreover, as per the facts of this case it is not a case of only purchase of goods or a trading receipt. A reading of the AO's order clearly gives the impression that the Assessee's income is for rendering of services as an intermediary between the customer and the vendor. Under the Act, in the case of a non-resident, the question whether a sum is chargeable to tax

requires determination of whether it has either a PE or a business connection in India. Owing to the nature of the activities of MC in India, as contained in the DRP's report as also the AO's order, it cannot be straightway said that the payees in this case did not have a business connection in India. The factors noted by the DRP and the AO are that –

- All the payees are connected and linked to MC;
- They are the arms of MC in different countries;
- MC's turnover includes the turnover of all its group companies including payees herein;
- MC Japan attributed the activities of all these group companies to its LO in India;
- To the extent the turnovers of the group companies are relatable to India, the existence of a PE insofar as MC is concerned stands admitted and even tax is being paid by MC;
- Some payees like Metal One also have LOs in India;
- The payees are merely different divisions of MC;
- The Assessee MI is, in fact, securing orders in India for the MC group, and all the group companies appear to be under a common control;
- MI is not the user of the products purchased but is rendering services in the nature of intermediary between the seller and the end user;
- All the payees either have a PE or a business connection in India.

42. These findings, which are part of the record in the report of the DRP as also the AO's order, have not been disturbed by the ITAT. The ITAT has merely proceeded on the basis that Metal One does not have a PE in India and hence the sums are not taxable in India. This is clearly an erroneous finding by the ITAT. The ITAT has also held that TDS was not to be deducted without considering the chargeability of the sums to tax. This approach of the ITAT is contrary to the decisions in ***Transmission Corporation (supra)*** and ***GE India Technology (supra).***

43. In this case, the Assessee is an Indian Company. The question whether there is discrimination qua the non-resident payees is an issue to be decided if and when the said non-resident payees raise issues relating to discrimination. A resident company *per se* ought not to be allowed to invoke the provisions of the DTAA, inasmuch as the resident payer would be unable to either conclusively decide at the time of deduction that the sum is not chargeable to tax or even bring all the facts relating to all the payee's businesses in India before the Court in its assessment proceedings. A resident company is fully bound by the provisions of the Act, and for the said purpose the existence of a PE of the payee is not essential. What is required to be seen is as to whether the sum is chargeable under the provisions of the Act and for the said purpose even a '*business connection*' is sufficient as per Explanation 2 to Section 9 of the Act. The said Explanation reads –

> *"**Section 9 –** ……..……..*
> ***Explanation 2** - For the removal of doubts, it is hereby declared that "business connection" shall include any*

business activity carried out through a person who, acting on behalf of the non-resident,—
(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or
(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided *that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business :*

Provided further *that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status."*

44. A reading of the Explanation reveals that `business connection' of the payee could be established in several ways and the underlying facts requiring that determination cannot be made in the payer's challenge.

45. Thus, under the applicable provisions in the AY in question, there existed a clear obligation to deduct tax at source, and both the AO and the DRP were right in holding that as per Section 195 of the Act, the Assessee was under an obligation to comply with the said provision. In so far as the judgment in ***GE India Technology (supra)*** is concerned, the transaction in the said case related to purchase of shrink wrap software wherein, the Supreme Court held that it is only if the sum is chargeable to tax in India, that the obligation to deduct tax arises. The Supreme Court further held that ***Transmission Corporation (supra)*** dealt with a case relating to a composite contract that included sums for payments of purchases as also installation and commissioning, part of which was clearly taxable in India. The Supreme Court rejected the contention of the Revenue that the moment there is a remittance, an obligation to deduct the TDS arises. This view of the Supreme Court in ***GE India Technology (supra)*** does not support the case of the Assessee inasmuch as, ***GE India Technology (supra)*** related to an AY which is prior to the insertion of Explanation 2 to Section 195 of the Act. Addition of the said explanation, in the present case, changes the nature of the payment inasmuch as it takes away the need to establish existence of a PE or a business connection in India. Thus, the legislative scheme has undergone a change post the decision in ***GE India Technology (supra)***. Even otherwise, going by the *ratio decidendi* in ***GE India Technology (supra)***, that chargeability to tax has to be read in conformity with the

charging provisions i.e. Sections 4, 5 and 9 of the Act, the analysis hereinafter makes it evident that all the payees in the present case either have a PE or a close business connection in India and thus, the obligation to deduct tax at source exists. Moreover, even the nature of the transaction, as recorded in the AO's order, suggests that it could be composite in nature i.e., purchase of goods as also providing of services as an intermediary. In such a case, the ratio in ***Transmission Corporation (supra)*** squarely applies.

Analysis of Section 40 (a) and the provisions of DTAAs

46. The decision of this Court in ***Herbalife (supra)*** was clearly rendered under the provisions as they stood in the AY 2001-02. The obligation to deduct the tax at source in the said case was found to exist only for payments made to non-residents and not to residents. Thus, this Court held that the said provisions being discriminatory, the deductions ought to be allowed for expenses made towards the payments of purchases. The Court also took note of the amendments brought in w.e.f. 1st April, 2004 by Finance Act, 2004 in paragraph 48, which reads as under:

> *"…48. Section 40 (a) (i) of the Act, as it was during the AY in question i.e. 2001-02, did not provide for deduction in the TDS where the payment was made in India. The requirement of deduction of TDS on payments made in India to residents was inserted, for the first time by way of Section 40 (a) (ia) of the Act with effect from 1st April 2005. Then again as pointed out by Mr. M.S. Syali, learned Senior Advocate for the Intervener, Section 40 (a) (ia) refers only to payments of —interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a ITA No. 7/2007 Page 27 of 35 contractor or sub-contractor‖*

etc. It does not include an amount paid towards purchases. Correspondingly, there is no requirement of TDS having to be deducted while making such payment…."

47. This observation of the Court did not take into consideration (and rightly so) the insertion of Explanation 2 to Section 195, as the amendments in Section 40 (a) did not apply to the AY in question in ***Herbalife (supra)***. The submission of the Assessee that the discrimination, qua payments made to residents and non-residents, continues until 1st April, 2015 when Section 40 (a) (ia) was amended, ignores the retrospective nature of the amendment made to Section 195 by insertion of Explanation 2. The said explanation, in categorical terms, provides that the obligation to make tax deduction at source extends and shall be deemed to have always extended to all persons, resident or non-resident, in India. Moreover, in the present case, it is not a case of mere purchase of goods but the Petitioner is also rendering other services as recorded in the AO's order, thus the transactions are composite in nature.

48. The obligation under Section 195 operates and exists independently of Section 40. The question as to whether any amount is deductible in computing the income is a question that arises at a subsequent stage. The stage of deduction of tax at source arises at the inception itself and Section 195 of the Act applies at that stage. Section 40 provides for the consequence of not deducting the tax at source. Taking Mr. Syali's arguments at its highest, it would mean that in the case of residents, it is only if the amount payable is either '*interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident*',

that the amount is not deductible while computing the income under Section 40, whereas, in the case of non-residents, if tax is not deducted at source qua '*any sum chargeable*' then the deduction under Section 40 (a) (i) is not available. In fact this goes to show that the provisions are more favourable in the case of non-residents as compared to residents. Though, the obligation to deduct TDS exists qua both residents and non-residents, the deduction under Section 40 (a) (ia) is given only qua certain payments. The mention of the various amounts in Section 40 (a) (ia) does not determine that it is only qua these amounts that TDS is deductible. The obligation to deduct tax under Section 195 exists independently of Section 40, qua all payments made both to residents and to non-residents so long as they are `chargeable to tax'. The provisions of discrimination have to result in a disadvantage to the non-resident which in this case is not found to exist. The non-resident is not subject to any disadvantage vis-à-vis the resident and in fact, a resident payee, in respect of whom tax is not deducted at source, may face a higher risk of being subjected to a more rigorous assessment at a later stage. Thus, the deduction of tax at source being a recognized mode of collection of tax qua a non-resident, and the same having been fully incorporated in the statutory scheme, the obligation to comply is mandatory. Any other interpretation would render the various amendments which have been brought into the Act wholly nugatory, especially the insertion of Explanation 2 to Section 195 of the Act.

Factual Analysis

49. Applying the above principles to the seven transactions in question, it is to be noted that arguments of counsels were primarily restricted to the first

four transactions enumerated in the table in paragraph 7 above. In any event, the analysis qua the first four transactions would also in effect provide the basis and reasoning for the remaining three transactions, as would be evident below.

Transaction with Mitsubishi Corporation, Japan

50. In relation to this transaction, the resultant disallowance was of Rs.5,01,55,844/-.The fact that MC has a PE in India is not even disputed. Thus, for all intents and purposes, MC is to be treated as a resident company for which obligation to deduct tax existed upon MI. The AO has rightly held that, after analyzing the nature of activities of MC in India and relying upon the report of DRP, MC has accepted chargeability of its income to tax in India. Thus, Section 195 applies qua MC. Insofar as the Assessee's arguments with respect to MC are concerned, the argument that non-discrimination clauses of the DTAAs continue to apply, is incorrect inasmuch as has been held above, there is no discrimination in view of the applicable statutory position. The obligation to deduct the tax applies when the payee is a resident or a non-resident so long as it is chargeable to tax. At the stage of deduction it cannot be said that the sum paid to MC is not chargeable to tax. It is settled that the deduction at source is not conclusive by itself. MC may well, as a part of its own assessment proceedings, be able to obtain deductions and benefits as permissible in law, however, for deduction of TDS, at the stage of inception, it cannot be categorically held that the payments are not liable to deduction. As held earlier, Section 195 and Section 40 operate in different spaces - the former at the stage of payment by the payer to the payee, and the latter at the stage of assessment

of the payer. Insofar as the payer is concerned, there may be interlinking of the two however, insofar as the payee is concerned i.e. MC, Section 40 is not triggered qua it at this stage.

51. The Assessee before us being MI, it had an obligation to deduct tax under Section 195 and the non-deduction attracts the consequences as contemplated under Section 40 (a) (i) and not Section 40 (a) (ia). The payer i.e. MI cannot determine that the payment to MC is not the *'sum chargeable'* under this Act. Thus, having not deducted TDS for the payments made to MC, the AO has rightly disallowed the deduction under 40 (a) (i). At this juncture, it is relevant to note that the ITAT, unfortunately, appears to confuse the two issues and has wrongly applied Section 40 (a) (ia) of the Act to the present case. The ITAT was clearly wrong in assuming that the AO examined the provisions of Section 40 (a) (ia) when clearly what the AO had applied was Section 40 (a) (i) of the Act.

52. The India-Japan DTAA, as per Article 24 (3) clearly provides as under:

> **"***Except where the provisions of article 9, paragraph 8 of article 11, or paragraph 7 of article 12 apply, interest, royalties, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first mentioned Contracting State."*

53. Under Section 195 of the Act, payments to residents and non-residents are subject to the same conditions and thus, the position that existed when

this Court rendered the judgment in ***Herbalife (supra)***, no longer applies. The discrimination has been clearly done away with. The decision in ***Herbalife (supra)*** in paragraph 48 notes that in the AY 2001-02, TDS was not to be deducted where the payment was made in India which was inserted for the first time w.e.f. 1st April, 2005. Thus, the argument of discrimination no longer survives in the context of the India-Japan DTAA. The error in the Assessee's submissions is that the services mentioned in Section 40 (a) (ia) are not an exhaustive list of the services for which tax is deductible at source. Whereas Section 195 uses the term '*any other sum chargeable under the provisions of this Act'*, Section 40 (a) (ia) prior to 1st April, 2015 mentions some services for which tax is deductible and if not deducted, the said payments shall be included in computing the income of the Assessee. It is application of a deductive logic in an indirect manner resulting in reading services mentioned in Section 40 (a) (ia) as being the only services for which tax is deductible at source qua residents. Such a reading is not supported by the plain language of Section 195 of the Act and the clarification as issued by insertion of Explanation 2 to it.

54. It could easily be concluded that insofar as the sums paid for purchases to residents are concerned, though the tax is deductible as source, if the payer does not deduct tax then the deduction under Section 40 (a) (ia) could still be available, since purchases are not mentioned in the provision. The logic is not hard to believe inasmuch as, if the payer does not deduct tax qua the purchase payments made to a payee who is a resident, then the collection of tax, if chargeable, can happen through the payee's assessment itself as the payee is subject to the jurisdiction of the authorities concerned. However,

such a luxury does not exist qua a non-resident payee who is outside the shores and from whom the collection of tax would be difficult to say the least. Thus, purchase payments made by a resident payer to a resident payee, could still be claimed as expense even if tax is not deducted at source though the obligation to deduct does exist. In any event, w.e.f. 1st April, 2015, even qua residents the expression used in Section 40 (a) (ia) is `*any sum payable*' and the listing of various services has been done away with. The intention appears to be clear that on all payments to residents and non-residents, tax ought to be deductible so long as the sum is `*chargeable under the provisions of this Act'*.

55. The argument of non-discrimination has to be considered from the point of view of whether there exists a more favourable provision in the DTAA for the non-resident. Clearly, there is none. Thus, Section 90 of the Act or the observations in ***Azadi Bachao Andolan (supra)*** do not come to the aid of the Assessee. The DTAA does not have any provision which requires non-deduction of tax at source. Article 24 (3) does not come to the aid of the Assessee as tax is deductible at source irrespective of whether the payment is made to a resident or a non-resident and thus they are being subjected to the `same conditions'.

Transaction with Metal One Corporation, Japan

56. Metal One, Japan has an LO in India which operates within the MC group. It undertakes various core activities as has been found by the AO. It is relevant at this juncture to note the specific observations in the report of the DRP that the Metals division operated by Metal One follows a very

similar chain of activity as that of MC for trading in goods. The DRP specifically notices that the turnover of all the group companies, including Metal One, is attributable to the activities of MC in India. It is considered to be turnover related to India. Thus, Metal One, clearly, has a business connection in India and under Section 9, all income arising from any business connection in India is income deemed to accrue or arise in India. Thus, at the stage of deduction of tax at source, it is not possible to hold that the payment is not a sum chargeable under the provisions of this Act. Thus, the Assessee had an obligation to deduct tax at source and the AO has rightly added the amount of payment made to Metal One, to the income of the Assessee, in the absence of such deduction.

Transactions with MC Metal Services Asia, Thailand and Metal One Asia P. Ltd., Singapore

57. The relevant extracts of the non-discrimination clauses in the Indo-Thai DTAA and the India-Singapore DTAA are extracted herein below:

> ***"Article 24 (1) of the Indo-Thai DTAA:***
> *The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.*
>
> ***Article 26 (1) of the India-Singapore DTAA:***
> *The nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in*

> *the same circumstances and under the same conditions are or may be subjected."*

58. A perusal of the DTAAs shows that the law of the Contracting State should govern taxation of income and the provisions for non-residents should not be more burdensome than those applicable to residents. Thus, the clauses under both these DTAAs primarily require the Assessee to show that there is either a contrary provision in the DTAA or a less burdensome provision in the DTAA. No submission has been made before this Court that there are any provisions in either of these DTAAs which contradict the Act or are more burdensome to the Assessee. Thus, the argument of discrimination does not apply in the case of the transactions of the Assessee with either MC Thailand or MO Singapore.

59. The payments being made to these companies are subject to the obligation under Section 195 which falls in Chapter XVII-B of the Act relating to collection and recovery of tax deduction at source. The deduction as per Explanation 2 to Section 195 has to be made irrespective of whether these entities have a residence or place of business or a business connection in India, or any other presence in any manner whatsoever. These companies are group companies of MC and their incomes are attributed to the activities of the LO of MC in India as per paragraph 5.5 of the directions of DRP which specifically notes as follows:

> *"In this connection it is noted that all the group companies of the assessee are stated to be working on same business models. They are like the arms of MC - Japan in different countries. Their accounts are consolidated with MC-Japan. Their turnover after*

netting becomes part of the turnover of the assessee. The supply from these companies follows the same pattern. While considering the taxability of MC-Japan, it is noticed that entire turnover of the MC-Japan including those of its group companies were taken into account and were attributed to the activities of the Liaison Office in India. All these companies need not establish their offices in India as MC-Japan being their flagship company undertakes necessary activities for them. As stated, the turnover of these companies were also agreed to be the part of turnover relatable to India on which permanent establishment was conceded by MC-Japan and tax was paid thereon. It is also noted that these companies form part of various divisions' viz metal division, chemical division etc and were accordingly consolidated in the global accounts of MC-Japan. Therefore, contention of the assessee that other AEs did not have their individual and separate presence in India is not very convincing."

60. This observation of the DRP led to the AO holding that Metal One, which was established as a new company in January, 2003, functions on identical lines as that of MC. Metal One, under which both MC Thailand and MO Singapore function, has an LO in India. Since the main company i.e., Metal One, is chargeable to tax in India, the fact that the transactions are routed through entities based in Thailand and Singapore does not obviate the obligation to deduct tax at source. Since both these entities have a business connection in India through the LO of Metal One, at this stage, it cannot be said that the said payments are not chargeable to tax.

Other Transactions

61. Insofar as the transactions with McTubular Inc., USA, Petro Diamond Corporation, Japan and Miteni, Japan are concerned, neither side has made

any submissions qua these companies as the transactions are of low value. In any event, all these three companies are part of MC group and are governed by the Indo-US DTAA and India-Japan DTAA provisions.

62. The payments to these companies ought to have made after deduction of tax at source. The ITAT, apart from applying the wrong provision i.e. Section 40 (a) (ia), has failed to notice the various changes in the provisions of the Act as were applicable in the judgment in ***Herbalife (supra)*** and the present case. Thus, the ITAT proceeds on the basis that if these entities do not have a PE in India, they are not chargeable to tax in India, which clearly is an incorrect finding inasmuch as even the existence of business connection is sufficient for being chargeable to tax in India. None of these entities lack a business connection with India and the observations made by the DRP and the AO clearly points to an unequivocal existence of a business connection, at least while viewed from the payer's perspective. The question as to whether all these companies would have to pay tax on these transactions is a question that needs to be determined when their respective assessments are made either through MC or the LO of Metal One in India. That is not the subject matter of the present case. From the payer's perspective, so long as the transactions are chargeable to tax, tax has to be deducted at source. The findings herein are not conclusive qua any of the companies with whom the Assessse has had transactions. Thus, the tax payable by those companies would be the subject matter of their respective assessment proceedings, which this Court is not concerned with in this case.

63. The ITAT's order is clearly not sustainable in law for the reasons aforesaid, and the same is thus, set aside. Thus, Question 1 is answered in the affirmative i.e. in favour of the Revenue and against the Assessee.

64. Question 2, however, is modified to read as under:

> Whether the ITAT was in error in reversing the findings of the DRP with respect to the existence of PEs as well as a business connection in India*?*

65. The AO had clearly come to the conclusion that the non-resident entities had a PE as well as a business connection in India. This Court holds that MC admittedly has a PE. The other entities also do have a business connection in India. The question is thus, answered in the affirmative i.e. in favour of the Revenue and against the Assessee.

66. The appeal is accordingly allowed. There will be no order as to costs.

PRATHIBA M. SINGH, J

Per Dr. S. Muralidhar, J.:

1. Having gone through the judgment of my learned colleague Prathiba M. Singh, J., I am unable to agree with the conclusions reached by her on the two questions of law framed by this Court in the present case by order dated 29th April, 2014. The said questions read as under:

> "(i) Whether the ITAT fell into error in holding that Section 40(a) (i) of the Income Tax Act, 1961 cannot be applied in view of the

provisions of the Double Tax Avoidance Agreement between the Indian and Japan and India and the US?

(ii) Whether the ITAT fell in error in reversing the findings of the DRP with respect to the existence of the PEs in India?"

Scope of the two questions

2. In the present case, the questions arise in the context of Mitsubishi Corporation India Pvt. Ltd ('MI'), the Respondent Assessee, during the Assessment Year (AY) 2006-07, failing to deduct tax at source (TDS) while making payments to a number of non-resident entities incorporated in Japan including Mitsubishi Corporation, Japan ('MC') and other group companies of MC, Metal One Corporation, Japan ('Metal One Japan'), Petro Diamond Corporation, Japan ('Petro Diamond') and Miteni, Japan ('Miteni'). It also concerns payments made to certain other non-resident entities including viz., MC Metal Services Asia, Thailand ('MC Metal Thailand'), Metal One Asia Pvt. Ltd., Singapore ('Metal One Asia'), and Mc Tubular Inc. USA ('Mc Tubular').

3. The Double Taxation Avoidance Agreements ('DTAAs') between India and Japan (the Indo-Japan DTAA) and between India and the USA (the Indo-US DTAA) both contain identically worded non-discrimination clauses that would govern the payments made to non-resident entities incorporated in those respective countries. In other words, the payments made by MI to MC, Metal One Japan, Petro Diamond and Miteni are governed by the Indo-Japan DTAA and the payment by MI to Mc Tubular is governed by the Indo-US DTAA. In these cases, as regards the tax treatment of these payments and claiming deductions thereof while computing its taxable

income, MI has opted for the more beneficial DTAA provisions. Question (i) framed by the Court therefore pertains to the above payments.

4. However, the DTAAs between India and Thailand and India and Singapore do not contain similar non-discrimination provisions. As regards the payments made to the entities in those countries, viz., MC Metal Thailand and Metal One Asia, MI claims deduction on the ground that the said payments were not chargeable to tax as the profits of those entities could not be brought to tax in India in the absence of a permanent establishment (PE) of such entities in India. The Revenue's case is that the two entities do have PEs in India. It contends that in any event Explanation 2 to Section 195 of the Income Tax Act 1961 ('Act') (as introduced by the Finance Act 2012 (FA 2012) obviates the need to first establish the existence of a PE before deducting TDS while making such payment. This is the basis of Question (ii) framed by the Court which question is relevant only for the payments by MI to the Thailand and Singapore entities.

Analysis of the relevant provisions of the Act

5. The Indo-Japan DTAA, like the Indo-US DTAA, has a non-discrimination clause in the form of Article 24 (3). It mandates *inter alia* that, for the purposes of taxation, the treatment afforded to payments made by Indian Assessees to non-resident companies incorporated in Japan, is to receive a treatment no different from payments to resident Indian entities.

6. Section 195 of the Act, which is in Chapter XXVII, requires TDS to be deducted while making payment to a non-resident entity of a sum

"chargeable" to tax under the Act. Explanation 2 inserted in Section 195 by the FA 2012 with retrospective effect from 1st April 1962 clarifies that the obligation to TDS applies irrespective of whether the non-resident entity has a permanent establishment (PE), place of business or business connection or any other presence in India.

7. The consequence for the failure to deduct TDS as mandated by Section 195 of the Act, is spelt out in Section 40 of the Act. The consequence is the denial of the said sum as a deduction from the income of the Assessee. Where the failure is to deduct TDS from any sum paid outside India or to **non-residents**, Section 40 (a) (i) of the Act applies. Where the failure is to deduct TDS from certain sums paid to **residents**, then Section 40 (a) (ia) of the Act applies. In the present case, we are concerned with AY 2006-07 and so the above provisions as they stood during AY 2006-07 are relevant.

The distinction between sub-clauses (i) and (ia) of Section 40 (a)

8. The consequence for the failure to deduct TDS in terms of Sections 40 (a) (i) and 40 (a) (ia) of the Act, as they stood during the AY 2006-07, differed in a significant way. To understand this, both provisions (as they stood during AY 2006-07) require to be set out in full. They read as under:

> "40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession"
>
> (a) in the case of any assessee
>
> (i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for

technical services or other sum chargeable under this Act, which is payable,

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under sub-section (1) of Section 200…….

Provided that where in respect of any such sum, tax has been deducted in any subsequent year or, has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under sub-section (1) of section 200, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid

Explanation….

(ia) any interest, commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVIIB and such tax has not been deducted or, after deduction, has not been paid,-

(A) in a case where the tax was deductible and was so deducted during the last month of the previous year, on or before the due date specified in sub-section (1) of section 139; or

(B) in any other case, on or before the last day of the previous year

Provided that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted–

(A) during the last month of the previous year but paid after the said due date; or

(B) during any other month of the previous year but paid after the end of the said previous year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid

Explanation…."

9. A careful comparison of the two sub-clauses i.e. (i) and (ia) of clause (a) of Section 40 of the Act, as they stood during AY 2006-07, would reveal that the expression "or other sum chargeable under the Act" occurring in sub-clause (i) is missing in sub-clause (ia). This means that while in the case of failure to deduct TDS from payments of **any** sum to non-resident entities (including payments for purchases), such sum would not be allowed as a deduction while computing the taxable income of the payer (Assessee), only certain payments to resident entities as spelt out in sub-clause (ia) would be disallowed as deductions if no TDS is deducted while making payment. Taking the example of payments for purchases, if no TDS was deducted while making payments to non-residents for purchases, then the sum paid would not be deductible while computing the taxable income of the payer. However, sums paid to residents for purchases would not suffer the same consequence of non-deductibility. This difference has since 1st April 2015 been done away with by further amending sub-clause (ia). However during the relevant AY 2006-07, this difference did exist.

Analysis of the relevant provisions of the DTAA

10. As already noted, under Article 24 (3) of the Indo-Japan DTAA the tax treatment given to payments made to non-residents which are entities incorporated in Japan has to be no different from that given to payments made to resident entities. This non-discrimination provision reads thus:

> "24 (3) Except where the provisions of article 9, paragraph 8 of article 11, or paragraph 7 of article 12 apply, interest, royalties, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first mentioned Contracting State."

11. What does the above provision actually say? It says that barring certain kinds of payments covered under Articles 9, 11 (8) or 12 (7) of the Indo-Japan DTAA, payment to non-resident entities of sums towards interest, royalties and 'other disbursements' shall be deductible for the purpose of computation of taxable profits under the 'same conditions' as if they had been made to a resident entity.

12. In the present case, the payment made by MI to the aforementioned Japanese and US entities is for purchases made from the latter. It is not a payment covered under any of the exceptions i.e. Articles 9, 11 (8) or 12 (7) of the Indo-Japan DTAA (or the corresponding provisions under the Indo US DTAA). The payment for purchases is, therefore, covered by the expression 'other disbursements' occurring in Article 24(3) of the Indo-Japan DTAA and Article 26 (3) of the Indo US DTAA.

The orders of the AO, DRP and ITAT

13. We have to now examine the orders passed by the various authorities in the present case. The AO in his draft assessment order dated 31st December 2009 went essentially by the fact that MC Japan had itself submitted to jurisdiction of the tax authorities in India and had paid tax on its income earned in India. Therefore according to the AO, Section 195 of the Act applied to the payments made to MC Japan and it was mandatory for MI to have deducted TDS from such payments. The failure to do so attracted the consequence under Section 40 (a) (i) of the Act. Since all its group entities followed the same business model, they should also be held to have a PE in India and it was incumbent on MI to deduct TDS from the payments to them as well.

14. As regards the reliance placed by MI on the DTAA, the AO held:

(i) MI being a resident could not invoke the DTAA.

(ii) In any event in view of the decision of the Supreme Court in ***Transmission Corporation of AP Ltd. v. CIT 1999 239 ITR 587 (SC)*** as followed by the Karnataka High Court in ***CIT (International Transaction) v. Samsung Electronics Co. Ltd. (2010) 320 ITR 209 (Kar)*** the chargeability to tax of the 'other receipt', for the purposes of Section 195 of the Act, was clearly established. Therefore the failure by MI to deduct TDS from the payments to the Japan and US entities would attract non-allowability of the deduction under Section 40 (a) (i) of the Act.

15. The AO also dwelt on the aspect of transfer pricing of the international transactions involving the Assessee and its Associated Enterprises. However, this is not relevant for the present appeal since that aspect of the matter was remanded to the TPO by the ITAT for a fresh determination.

16. The Dispute Resolution Panel (DRP) by its order dated 30th September 2010 rejected the Assessee's objections to the AO's draft assessment order. The DRP virtually endorsed the AO's draft order. It also rejected the contention of the Assessee based on the decision of the ITAT in ***Herbalife International (India) P. Ltd. v. ACIT [2006] 101 ITD 450 (Delhi)*** ('***Herbalife ITAT***') by referring to another decision of the Pune Bench of the ITAT in ***Automated Securities Clearance Inc. 118 TTJ 619 (Pune ITAT)*** which had declined to follow the decision in ***Herbalife ITAT***. It was further held: "……Therefore, genuine requirement and reasonableness of putting a system in place to examine payment to non-residents in special manner cannot be held to be a ground for nondiscrimination." In his final assessment order the AO reiterated his draft order in its entirety and also extracted portions of the DRP's order.

17. The Assessee's further appeal was allowed by the ITAT by relying on its decision in ***Herbalife ITAT***. As regards the payments made to the entities in Japan and the USA, the ITAT held that the said decision which interpreted Article 26 (3) of the Indo US DTAA squarely applied to the instant case. The ITAT in the impugned order noted that as a result of the decision of the Special Bench of the ITAT in ***Rajeev Sureshbhai Gajwamo v. ACIT 129***

ITD 145 (Ahmd) (SB), the decision of its Pune Bench in ***Automated Securities Clearance Inc.*** was no longer good law.

18. As regards the payments to the entities in Singapore and Thailand the ITAT noted that the AO had drawn an inference that these entities had a PE in India only because it had earlier been held that Metal One Corporation Japan had a PE in India. However, that decision of the AO had been set aside by the ITAT in its decision dated 11th May 2012 in ITA No. 5377/Del/2009. In the case of none of the entities, other than Metal One Corporation had the Department passed any orders holding that they had a PE in India. The ITAT held:

> "Thus the income of these entities are not taxed in India. Under these circumstances, we have to necessarily hold that the payments made to these entities for purchases from these entities are not taxable in India as these entities have not (been) held as having a PE in India and hence the provisions of S.195 are not attracted and consequently the disallowances made u/s 40 (a) (ia) [(*sic* 40 (a) (i)] are bad in law."

19. It requires to be noticed that against the above decision dated 11th May 2012 of the ITAT in the case of Metal One Corporation, the Revenue's appeal being ITA 113 of 2013 has been admitted by this Court and is pending consideration.

Revenue's submissions

20. In the present appeal the Revenue's submissions as regards question (i) have centred around the fact that after insertion of sub-clause (ia) in Section 40 (a) with effect from 1st April 2005, the discrimination pointed out by this Court in ***Commissioner of Income Tax v. Herbalife International Pvt. Ltd.***

[2016] 384 ITR 276 (Delhi) (‘***Herbalife HC’***) has now been done away with. It is contended that the different treatment under Section 40(a) (i) of the Act is not dependent on the fact that disbursements has been paid by an Indian enterprise to a Japanese resident, but is dependent on the fact that any payer has made a payment outside India. It is contended that Section 40(a) (i) does not use the criteria of residence of the recipient but the situs of the payment.

21. As regards question (ii), which is correctly noted as applying only in the context of the payments made to the Thailand and Singapore entities, the submission of the Revenue has focussed largely on Section 195 of the Act and the insertion therein of Explanation 2 by the FA 2012 with retrospective effect from 1st April 1962. It is submitted that there is a material difference in determining the existence of a PE for levying charge of income tax on the non-resident, and in determining the existence of a PE for ascertaining the compliance by a resident payer under Section 195. A detailed enquiry must take place in the former and not in the latter. In the latter, a detailed enquiry is possible if Sections 163, 161 and 166 are attracted. The AO, it is contended, had conducted the appropriate enquiry for applying Section 195. Reliance is placed on the decision in ***Aggarwal Chamber of Commerce v. Ganpat Rai [1958] 33 ITR 245 (SC)***.

22. Secondly, it is contended by learned counsel for the Revenue that after the insertion of Explanation 2 to Section 195 (1), the determination of the existence of a PE is not required. It is stated that while for chargeability the business connection/PE is a *sine qua non*, it is not for deductibility. The focus ought to be on "sum chargeable under the provisions of this Act" and

not on whether the recipient is a taxable unit under the Act. To the extent determination of "sum chargeable under the provisions of this Act" requires determination of the existence of PE (like in the case of business profits instead of royalty of FTS), Explanation 2 displaces such a determination for tax deduction. Section 90 (2) cannot apply to Explanation 2 because the two tests laid down in ***Union of India v. Azadi Bachao Andolan [2016] 263 ITR 706 (SC)*** are not fulfilled. The two tests are (i) that beneficial provision in the Act will not be denied to a resident of a contracting country merely because the corresponding provision in the tax treaty is less beneficial; (ii) in case of conflict between the terms of the DTAA and the IT Act, the DTAA alone would prevail. It is submitted that the DTAA contains no conflicting provision that deduction of tax at source can only be made if PE is determined. On the other hand, Article 23(1) of the DTAA states that the laws in force in either of the Contracting States shall continue to govern the taxation of income in the respective Contracting State except where express provisions to the contrary are made in this Convention.

Assessee's submissions

23. The learned counsel for the Assessee points out that as far as question (i) is concerned, all the submissions of the Revenue have been comprehensively answered against it in the decision of this Court in ***Herbalife HC***. As regards question (ii) which pertains to the applicability of Section 195 of the Act, the decision in ***Transmission Corporation*** (supra) is sought to be distinguished on facts. Reliance on the other hand is placed on the later decision of the Supreme Court in ***GE India Technology Centre Pvt. Ltd. v CIT [2010] 327 ITR 456 (SC)*** (hereafter ***GE India***).

24. As regards question (ii), it is pointed out that the AO held that Metal One Corporation, Japan had a liaison office (LO) in India which exceeded the mandate of RBI and hence its LO constituted a PE in India. This dictum was applied to MC Metal One, Thailand and Metal One Asia, Singapore on the sole allegation (without any facts) that they function on the same lines as Metal One Corporation, Japan. The AO overlooked the fact that though Metal One Corp., Japan was functioning in India through its LO, the entities of Thailand and Singapore did not even have an LO in India. There was therefore, no factual basis for the conclusion that payments to those entities had to be subject to deduction of TDS.

25. It is further submitted on behalf of the Assessee that Explanation 2 to Section 195 only lays down compliance on part of the 'payer'. It stipulates an obligation to deduct TDS even if the payer is a non-resident, provided the income is chargeable to tax in India. The said Explanation has nothing to do with the chargeability of the amount to tax which is a condition precedent for deducting TDS. It does not shift the onus from the Revenue of having to establish that the payee has a PE in India. With the ITAT having held that the said onus had not been discharged, there can be no consequence under Section 40 (a) (i) of the Act for failure to deduct TDS.

Question (i)

26. The Court first takes up question (i) which is more or less the question that arose for determination in its decision in ***Herbalife HC***. The Revenue contended that the AY in question in the said decision was AY 2001-02

whereas in the present case it is AY 2006-07. According to the Revenue, one important distinction is the insertion of sub-clause (ia) in Section 40 (a) of the Act with effect from 1st April 2005. However, as will be seen hereafter, this change was taken note of in ***Herbalife HC*** itself.

27. The material facts relevant to question (i) are as follows:

(a) The payments made by the Assessee MI to the non-resident entities were for purchases only. It was not a composite payment for purchases and services. This is clear from para 4.22 (2) of the final assessment order dated 25th October 2010 of the AO which notes:

> "4.22 (2) The purchases in the instant case are purchases simpliciter as the Non-resident entities are trading houses whose work is to liaison with the seller and purchaser and to make the deal happen. The assessee is not an end user of the purchases but is a mediator between the seller and the end user. The argument that the purchases are not taxable in India is therefore misplaced and out of context."

(b) The finding of the AO that the sum paid for purchases was taxable in India was as a result of the earlier finding that the non-resident entities to which the payments were made had PEs in India. However, the AO proceeded on the basis that the payment was only for purchases and nothing else.

(c) As far as the assessee is concerned it is asserted throughout and in particular in para 2.6 of its written submissions that: "There is no dispute that the payment made to non-resident, in the present case, is neither 'Royalty' nor 'Fee for technical services'. **It is a case of payment made for purchases from the non-resident**."

(d) Even the Revenue does not dispute that the payments were made by MI to the non-resident entities for purchases. There is nothing to the contrary stated either in the memorandum of appeal or even its written submissions.

28. The payment for purchases comes within the purview of the expression 'other disbursements' in Article 24 (3) of the Indo Japan DTAA and Article 26 (3) of the Indo US DTAA. It also comes within the purview of the expression 'other sum chargeable' in Section 40 (a) (i) of the Act. Further, the payment does not come within the purview of any of the exceptions spelt out in Article 24 (3) of the Indo Japan DTAA or Article 26 (3) of the Indo US DTAA.

29. The purport of Article 24 (3) of the Indo Japan DTAA and Article 26 (3) of the Indo US DTAA is that MI cannot be denied deduction of the sum paid to the non-resident entities in Japan and USA for purchases, if it would not be denied deduction of such sum if paid by it to a resident entity for purchases. However, in terms of Section 40 (a) (i) of the Act as it stood in AY 2006-07, MI would be denied such deduction of the sum paid to the entities in Japan and USA if it did not deduct TDS. The payments made by it to resident entities during the same period for purchases would not be denied deduction even if no TDS was deducted from such payment.

***The decision of this Court in* Herbalife**

30. The above conclusions are fully supported by the decision of this Court in ***Herbalife HC*** which upheld the decision of the ITAT in ***Herbalife ITAT*** which has been followed by the ITAT in the impugned order.

31. The expression 'other disbursements' occurring in the identically worded Article 26 (3) of the Indo-US DTAA was interpreted by the Division Bench of this Court in ***Herbalife HC***. There the sum which was not allowed by the AO to be deductible was that paid by the Indian assessee (Herbalife India –HIAI) to Herbalife USA as 'administrative fees' which the Revenue was characterizing as Fee for Technical Services (FTS). The ITAT had in ***Herbalife ITAT*** agreed with the Assessee there that the deduction could not be disallowed in terms of Article 26 (3) of the Indo-US DTAA. Agreeing with the ITAT, and dismissing the Revenue's appeal, this Court in ***Herbalife HC*** held:

> "38. The question that next arises is whether the payment by the Assessee to HIAI qualifies as 'other disbursements' for the purpose of Article 26 (3) DTAA?
>
> 39. To recapitulate, the case of the Revenue is that the expression 'other disbursements' should take colour from the context and would apply only to income which is of passive character just like interest and royalties. The Revenue invokes the doctrines of '*noscitur-a-sociis*' and '*ejusdem generis*'. It is submitted that FTS does not qualify as 'other disbursements' since it is not a passive character like royalties and interest.
>
> 40. The Court is unable to agree with the above submissions of the Revenue. In the context in which the expression 'other disbursement' occurs in Article 26 (3), it connotes something other than 'interest and royalties'. If the intention was that 'other disbursements' should also be in the nature of interest and royalties then the word 'other' should have been followed by 'such' or 'such like'. There is no warrant, therefore, to proceed on the basis that the expression 'other disbursements' should take the colour of 'interest and royalties'.
>
> 41. The expression 'other disbursements' occurring in Article 26 (3) of the DTAA is wide enough to encompass the administrative fee paid

by the Assessee to HIAI which the Revenue has chosen to characterize as FTS within the meaning of Explanation 2 to Section 9 (1) (vii) of the Act."

32. In ***Herbalife HC*** the Court was dealing with the AY 2001-02, it noted the changes that had been brought about by insertion of Section 40(a)(i) with effect from 1st April, 2005 as regards the requirements of deduction of tax at source ('TDS') for the payments made in India as well. However, discrimination did not arise as a result of non-deduction of TDS alone but regarding non-allowability of deduction for computation of income on account of failure to deduct TDS. This is evident from paragraphs 46 to 50 of this Court's decision in ***Herbalife HC***, which read as under:

"46. Section 40 is in the nature of a non-obstante provision and therefore, it overrides the other provisions as contained in Sections 30 to 38 of the Act. This means that the expenditure which is allowable under Sections 30 to 38 of the Act in computing business income would be subject to deductibility condition in Section 40 of the Act. The payment of FTS to HIAI would be allowable in terms of Section 37 (1) of the Act but before such payment can be allowed the condition imposed in Section 40 (a) (i) of the Act regarding deduction of TDS has to be complied with. In other words if no TDS is deducted from the payment of FTS made to HIAI by the Assessee, then in terms of Section 40 (a) (i) of the Act, it will not be allowed as a deduction under Section 37 (1) of the Act for computing the Assessee's income chargeable under the head 'profits and gains of business'.

47. Article 26(3) of the DTAA calls for an enquiry into whether the above condition imposed as far as the payment made to HIAI, i.e., payment made to a non-resident, is any different as far as allowability of such payment as a deduction when it is made to a resident.

48. Section 40 (a) (i) of the Act, as it was during the AY in question i.e. 2001-02, did not provide for deduction in the TDS where the

payment was made in India. The requirement of deduction of TDS on payments made in India to residents was inserted, for the first time by way of Section 40 (a) (ia) of the Act with effect from 1st April 2005. Then again as pointed out by Mr. M.S. Syali, learned Senior Advocate for the Intervener, Section 40 (a) (ia) refers only to payments of "interest, commission or brokerage, fees for professional services or fees for technical services" payable to a resident, or amounts payable to a contractor or sub-contractor etc. **It does not include an amount paid towards purchases. Correspondingly, there is no requirement of TDS having to be deducted while making such payment**.

49. However, the element of discrimination arises not only because of the above requirement of having to deduct TDS. The OECD Expert Group which brought out a document titled "Application and Interpretation of Article 24(Non-Discrimination), Public discussion Draft, May 2007 did envisage deduction of tax while making payments to non-residents. It is viewed only as additional compliance of verification requirement which would not attract the non-discrimination rule. The OECD Expert Group noted that ―the non-discrimination obligation under tax conventions is restricted in scope when compared with equal treatment or nondiscrimination clauses in an investment agreement." Specifically, in relation to withholding taxes, the Expert Group in the note by its chairman titled ―Non-Discrimination in Bilateral Tax Conventions noted as follows:

"6. The more limited non-discrimination obligations in tax conventions reflect the practical problems of cross-border taxation. For example, countries frequently collect taxes from non-residents through a system of withholding at source. Withholding is most frequently imposed on passive income, such as dividends, interest, rents, and royalties. Because the recipient may have no connection with the country of source other than the investment generating the income, withholding at the time of payment is likely to be the only realistic opportunity for the source country to collect its tax. *Withholding is often not required on payments to residents. However, the application of withholding tax systems is appropriate. Residents have*

> *substantial economic connections with their country of residence; so that country is likely to have ample opportunity to collect its tax later, when a tax return is filed. Non-residents may be beyond the collection jurisdiction of the taxing country*." (emphasis supplied)

50. While the above explanation provides the rationale for insisting on deduction of TDS from payments made to non-resident, the point here is not so much about the requirement of deduction of TDS per se but the consequence of the failure to make such deduction. As far as payment to a non-resident is concerned, Section 40 (a) (i) of the Act as it stood at the relevant time mandated that if no TDS is deducted at the time of making such payment, it will not be allowed as deduction while computing the taxable profits of the payer. No such consequence was envisaged in terms of Section 40 (a) (i) of the Act as it stood as far as payment to a resident was concerned. This, therefore, attracts the non-discrimination rule under Article 26 (3) of the DTAA."

33. In ***Herbalife HC***, this Court interpreted the expression "same conditions" occurring in Article 26 (3) of the Indo-US DTAA which incidentally is also found in Article 24(3) of the Indo-Japan DTAA. In ***Herbalife HC***, this Court noted the submissions of the parties and gave its reasoning as under:

> "51. The arguments of counsel on both sides focussed on the expression 'same conditions', in Article 26(3) of the DTAA. To recapitulate, a comparison was drawn by learned counsel for the Revenue with Article 26 (1) which speaks of preventing discrimination on the basis of nationality and which provision employs the phrase 'same circumstances'. Article 26 (2), which talks of prevention of discrimination vis-a-vis computing tax liability of PEs, employs the expression 'same activities'. The expression used in Article 26 (3) is 'same conditions'. Learned counsel for the Revenue sought to justify the difference in the treatment of payments made to non-residents by referring to Article 14 of the Constitution of India and contended that the line of enquiry envisaged examining whether

(a) the classification was based on an intelligible differentia and (b) whether the classification had a rational nexus with the object of the statute.

52. Section 40 (a) (i), in providing for disallowance of a payment made to a non-resident if TDS is not deducted, is no doubt meant to be a deterrent in order to compel the resident payer to deduct TDS while making the payment. However, that does not answer the requirement of Article 26 (3) of the DTAA that the payment to both residents and non-residents should be under the 'same conditions' not only as regards deduction of TDS but even as regards the allowability of such payment as deduction. It has to be seen that in those 'same conditions' whether the consequences are different for the failure to deduct TDS.

53. It is argued by the Revenue that since in the present case no condition of deduction of TDS was attracted, in terms of Section 40 (a) (i) of the Act as it then stood, to payments made to a resident, but only to payments made to non-residents, the two payments could not be said to be under the 'same condition'. The further submission is that if they are not made under the same condition', the non-discrimination rule under Article 26 (3) of the DTAA is not attracted.

54. In the first place it requires to be noticed that DTAA is as a result of the negotiations between the countries as to the extent to which special concessional tax provisions can be made notwithstanding that there might be a loss of revenue. In *Union of India v. Azadi Bachao Andolan* (*supra*) the Supreme Court noted that treaty negotiations are largely - a bargaining process with each side seeking concessions from the other, the final agreement will often represent a number of compromises, and it may be uncertain as to whether a full and sufficient quid pro quo is obtained by both sides. The Court acknowledged that developing countries allow 'treaty shopping' to encourage capital and technology inflows which developed countries are keen to provide to them. It was further noted that the corresponding loss of tax revenues could be insignificant compared to the other non-tax benefits to the economies of developing countries which need foreign investment. The Court felt that this was a matter

best left to the discretion of the executive as it is dependent upon several economic and political considerations.

55. Consequently, while deploying the 'nexus, test to examine the justification of a classification under a treaty like the DTAA, the line of enquiry cannot possibly be whether the classification has nexus to the object of the 'statute' for the purposes of Article 14 of the Constitution of India, but whether the classification brought about by Section 40 (a) (i) of the Act defeats the object of the DTAA.

56. The argument of the Revenue also overlooks the fact that the condition under which deductibility is disallowed in respect of payments to non-residents, is plainly different from that when made to a resident. Under Section 40 (a) (i), as it then stood, the allowability of the deduction of the payment to a non-resident mandatorily required deduction of TDS at the time of payment. On the other hand, payments to residents were neither subject to the condition of deduction of TDS nor, naturally, to the further consequence of disallowance of the payment as deduction. **The expression 'under the same conditions' in Article 26 (3) of the DTAA clarifies the nature of the receipt and conditions of its deductibility. It is relatable not merely to the compliance requirement of deduction of TDS. The lack of parity in the allowing of the payment as deduction is what brings about the discrimination**. The tested party is another resident Indian who transacts with a resident making payment and does not deduct TDS and therefore in whose case there would be no disallowance of the payment as deduction because TDS was not deducted. Therefore, **the consequence of non-deduction of TDS when the payment is to a non-resident has an adverse consequence to the payer. Since it is mandatory in terms of Section 40 (a) (i) for the payer to deduct TDS from the payment to the non-resident, the latter receives the payment net of TDS. The object of Article 26 (3) DTAA was to ensure non-discrimination in the condition of deductibility of the payment in the hands of the payer where the payee is either a resident or a non-resident. That object would get defeated as a result of the discrimination brought about qua non-resident by requiring the TDS to be**

deducted while making payment of FTS in terms of Section 40 (a) (i) of the Act." (emphasis supplied)

34. The Court in ***Herbalife HC*** thereafter noted Section 90(2) of the Act as well as the decision of the Supreme Court in ***Azadi Bachao Andolan*** and negated the Revenue's plea that "unless there are provisions similar to Section 40 (a) (i) of the Act in the DTAA, a comparison cannot be made as to which is the more beneficial provision."

35. It is significant that even while the Court was hearing the submissions in ***Herbalife HC***, it permitted the present Assessee to intervene and make submissions. These submissions were noted in paragraphs 28 to 30 of the said judgment. Therefore, even in ***Herbalife HC*** this Court was conscious of the changes brought about by introduction of Section 40 (a) (ia) in the Act with effect from 1st April, 2005. However, even after this change, the element of discrimination continued in AY 2006-07. The distinction between sub-clauses (i) and (ia) as regards the consequence of disallowance of the sum paid to a non-resident towards purchases as a deduction on account of the failure to deduct TDS, continued. That distinction was ultimately done away with only by the amendment of sub-clause (ia) by the FA 2014 with effect from 1st April, 2015.

36. Therefore, the assertion by the Revenue in para 4 of its written submissions that "discrimination as held by *CIT v. Herbal Life [2016] 384 ITR 276 (Delhi)* has been done away with" is true only after 1st April, 2015 and not during the relevant AY 2006-07. The contention about the situs of payment has been raised for the first time in this Court in the written

submissions. It was not the case of the Revenue earlier that the payments were made outside India and not in India. It was only argued that the discrimination pointed out in ***Herbalife HC*** no longer exists whereas, as demonstrated earlier, it did even during AY 2006-07.

37. The inevitable conclusion is, therefore, that the decision of this Court in ***Herbalife HC*** squarely applies and answers question (i) against the Revenue. Since Section 40 (a) (i) of the Act as it stood in AY 2006-07 continued to discriminate in the above manner and was inconsistent with Article 24 (3) of the Indo Japan DTAA or Article 26 (3) of the Indo US DTAA, the Assessee was entitled to rely on the above DTAA provisions to claim deduction of the sums paid to entities in Japan and USA.

38. For the above reasons, question (i) is answered in the negative i.e. in favour of the Assessee and against the Revenue.

Question (ii)

39. This question as noted even by the Revenue is relevant for the payments made by the Assessee for purchases made to non-resident entities incorporated in Thailand and Singapore.

40. As noticed earlier, the AO drew an inference that the above entities also had a PE in India since their business model was no different from that of Metal One Corporation Japan which was held to have a PE in India. The subsequent development was that the said decision of the AO in the case of

Metal One Corporation was set aside by the ITAT. That decision is of course the subject matter of a separate appeal pending in this Court.

41. The factual finding of the ITAT is that other than Metal One Corporation, the Department has not passed any orders holding that any of the other entities including the two in Thailand and Singapore had a PE in India. This factual finding has not been shown by the Revenue to be perverse. The Revenue has not argued before this Court that either the entity in Thailand or the one in Singapore have even an LO in India. If their profits are, therefore, not chargeable to tax in India, the question of applying Section 195 of the Act to deduct TDS from the payments made to them for purchases cannot arise. These reasons are therefore sufficient to answer question (ii) also in the negative i.e. in favour of the Assessee and against the Revenue. Nevertheless, since extensive arguments were advanced by the Revenue on the scope of Section 195 (1) of the Act, and in particular Explanation 2 thereof, it is discussed hereafter.

42. The insertion of Explanation 2 to Section 195 of the Act does not affect the pre-condition for its applicability viz., that the sum from which TDS is deducted is 'chargeable' to tax. Explanation 2 to Section 195 emphasises the obligation to comply with sub-section (1) thereof. It is now deemed to "have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident whether or not the non-resident person has (i) a residence or place of business or business connection in India or (ii) any other presence in any manner whatsoever in India.

43. There is merit in the contention of the Assessee that the above Explanation emphasises the obligation of the 'payer' whether resident or non-resident and does not obviate the pre-condition of the sum having to be chargeable to tax, which is written into sub-section (1) of Section 195 and which requirement has not undergone any change. This is also acknowledged in the Memorandum explaining the insertion of Explanation 2 by the Finance Bill, 2012 (reported in 342 ITR (St) 234 @ p.265), the relevant extract of which reads thus:

> "... Section 195 of the Income-tax Act requires any person to deduct tax at source before making payments to a non-resident if the income of such non-resident is chargeable to tax in India. "Person", here will take its meaning from section 2 and would include all persons, whether resident or non-resident. Therefore, a non-resident person is also required to deduct tax at source before making payments to another non-resident, if the payment represents income of the payee non-resident chargeable to tax in India. There are no other conditions specified in the Act and **if the income of the payee non-resident is chargeable to tax, then tax has to be deducted at source, whether the payment is made by a resident or a non-resident**..." (emphasis supplied)

44. In the context of the present case, before proceeding to deduct TDS from the payments to the Thailand and Singapore entities for purchases made from them, MI would have to ascertain if the said sums were in fact chargeable to tax in India. Considering that they were non-resident entities the transactions with whom were governed by the respective DTAA, this question is even more relevant.

45. In this context, it requires to be noticed that Section 195 does not begin with a *non-obstante* clause. It is subject to the other provisions of the Act

and in particular Section 90 (2) of the Act in terms of which if there is a provision of the Act that is more beneficial to the Assessee than the DTAA provision, then the Act will apply. Conversely, the provision of the DTAA would apply, if it is more favourable to the Assessee than the provision of the Act. The decision of the Supreme Court in ***Azadi Bachao Andolan*** *(supra)* clarifies the position. In any event for determining the chargeability of a sum to tax, the provisions of the DTAA where applicable, would have to be taken into account.

The decision in the **Transmission Corporation** ***case***

46.1 The decision of the Supreme Court in ***Transmission Corporation*** (*supra*) and that of the Karnataka High Court in ***CIT (International Transaction) v. Samsung Electronics Co. Ltd.*** (*supra*) were relied upon by the AO in the present case to hold that it was mandatory for MI to have deducted TDS while making payment to the non-resident entities. The said decision of the Supreme Court requires to be discussed first.

46.2 The facts in ***Transmission Corporation*** (*supra*) were that a resident entity made payments to a non- resident pursuant to a 'composite contract' comprising supply of plant, machinery and equipment in India, as well as its installation and commissioning in India. It was not in dispute that the erection and commissioning of the plant and machinery in India gave rise to income taxable in India. It was, therefore, clear to the payer that the payments to the non-resident included an element of income which was exigible to tax in India.

46.3 The contention of the Assessee in that case was that TDS was deductible only to ‘pure income’ payments and not to ‘composite payments’ which had an element of income embedded or incorporated in them. It was in that context that the Supreme Court held against the Assessee and observed that:

> "9. The scheme of sub-sections (1), (2) and (3) of Section 195 and Section 197 leaves no doubt that the expression 'any other sum chargeable under the provisions of this Act' would mean 'sum' on which income-tax is leviable. In other words, the said sum is chargeable to tax and could be assessed to tax under the Act. **Consideration would be - whether payment of sum to non-resident is chargeable to tax under the provisions of the Act or not? That sum may be income or income hidden or otherwise embedded therein. If so, tax is required to be deducted on the said sum**. What would be the income is to be computed on the basis of various provisions of the Act including provisions for computation of the business income, if the payment is a trade receipt. However, what is to be deducted is income tax payable thereon at the rates in force. Under the Act, total income for the previous year would become chargeable to tax under Section 4. Sub-section (2) of Section 4, inter alia, provides that in respect of income chargeable under sub-section 9 (1), income tax shall be deducted at source where it is so deductible under any provision of the Act. If the sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted.” (emphasis supplied)

46.4 It should be noticed that the above decision was in the context of payments made for a composite contract which admittedly included payment for the erection and commissioning of a plant in India which gave rise to taxable income of the payee (non-resident) in India. Secondly, the question whether the payment would be governed by the provisions of a DTAA did not arise and in any event was not considered by the Supreme Court when it

gave the above decision. Thirdly, the Supreme Court did emphasise that for deducting TDS in terms of Section 195 (1) of the Act a pre-condition was that the sum paid had to be chargeable to tax.

***The decision in* GE India**

47.1 The issue regarding deductibility of TDS for payments made to non-resident entities was revisited by the Supreme Court in ***GE India*** (*supra*). A detailed analysis was undertaken by the Supreme Court of Section 195 (1) of the Act. The Supreme Court in the said decision used the expression 'deduction of Tax at Source (TAS).' The following observations in that regard are relevant:

> "7. Under Section 195 (1), the tax has to be deducted at source from interest (other than interest on securities) or any other sum (not being salaries) chargeable under the Income-tax Act in the case of non-residents only and not in the case of residents. Failure to deduct the tax under this section may disentitle the payer to any allowance apart from prosecution under section 276B. Thus, Section 195 imposes a statutory obligation on any person responsible for paying to a non-resident, any interest (not being interest on securities) or any other sum (not being dividend) chargeable under the provisions of the Income-tax Act, to deduct Income-tax; at the rates in force unless he is able to pay income-tax thereon as an agent.……**The most important expression in Section 195(1) consists of the words "chargeable under the provisions of the Act". A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the Income-tax Act**. For instance, where there is no obligation on the part of the payer and no right to receive the sum by the recipient and that the payment does not arise out of any contract or obligation between the payer and the recipient but is made voluntarily, such payments cannot be regarded as income under the Income-tax Act. It may be noted that Section 195 contemplates not merely amounts, the whole of which are pure

income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct TAS in respect of such composite payments. The obligation to deduct TAS is, however, limited to 'the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. This obligation being limited to the appropriate proportion of income flows from the words used in Section 195(1), namely, "chargeable under the provisions of the Act". **It is for this reason that vide Circular No. 728 dated 30-10-1995 that the CBDT has clarified that the tax deductor can take into consideration the effect of DTAA in respect of payment of royalties and technical fees while deducting TAS**. It may also be noted that Section 195(1) is in identical terms with Section 18(3B) of the 1922 Act…..The application of Section 195 (2) presupposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident but is not sure as to what should be the portion so taxable or is not sure as to the amount of tax to be deducted. In such a situation, he is required to make an application to the ITO (TDS) for determining the amount. It is only when these conditions are satisfied and an application is made to the ITO (TDS) that the question of making an order under Section 195 (2) will arise. …..While deciding the scope of Section 195(2) **it is important to note that the tax which is required to be deducted at source is deductible only out of the chargeable sum. This is the underlying principle of Section 195**. ….”

8. **If the contention of the Department that the moment there is remittance the obligation to deduct TAS arises is to be accepted then we are obliterating the words “chargeable under the provisions of the Act” in section 195(1)**. The said expression in section 195(1) shows that the remittance has got to be of a trading receipt, the whole or part of which is liable to tax in India. The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not as assessable, there is no question of TAS being deducted.

9. One more aspect needs to be highlighted. Section 195 falls in Chapter XVII which deals with collection and recovery. Chapter XVII-B deals with deduction at source by the payer. On analysis of various provisions of Chapter XVII one finds use of different expressions, however, the expression "sum chargeable under the provisions of the Act" is used only in Section 195. ….Therefore, section 195 has to be read in conformity with the charging provisions, i.e., sections 4, 5 and 9. This reasoning flows from the words "sum chargeable under the provisions of the Act" in section 195(1). The fact that the revenue has not obtained any information per se cannot be a ground to construe section 195 widely so as to require deduction of TAS even in a case where an amount paid is not chargeable to tax in India at all. We cannot read section 195, as suggested by the Department, namely, that the moment there is remittance the obligation to deduct TAS arises. If we were to accept such a contention it would mean that on mere payment income would be said to arise or accrue in India. Therefore, as stated earlier, if, the. contention of the Department was accepted it would must obliteration of the expression "sum chargeable under the provisions of the Act" from section 195(1)…..Hence, the provisions relating to TDS applies only to those sums which are chargeable to tax under the Income-tax Act. If the contention of the Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department would be entitled to appropriate the moneys deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the Income- tax Act by which a payer can obtain refund. Section 237 read with section 199 implies that only the recipient of the sum, i.e., the payee could seek a refund. It must therefore follow, if the Department is right, that the law requires tax to be deducted on all payments. The payer, therefore, has to deduct and pay tax, even if the so-called deduction comes out of his own pocket and he has no remedy whatsoever, even where the sum paid by him is not a sum chargeable under the Act. The interpretation of the Department, therefore, not only requires the words "chargeable under the provisions of the Act" to be omitted, it also leads to an absurd consequence. The interpretation placed by the Department would result in a situation where even when the income has no territorial nexus with India or is not chargeable in India, the

> Government would nonetheless collect tax. ……As stated hereinabove, Section 195(1) uses the expression "sum chargeable under the provisions of the Act." We need to give weightage to those words. Further, section 195 uses the word 'payer' and not the word "assessee". The payer is not an assessee. The payer becomes an assessee-in-default only when he fails to fulfil the statutory obligation under Section 195(1). If the payment does not contain the element of income the payer cannot be made liable. He cannot be declared to be an assessee-in-default. The abovementioned contention of the Department is based on an apprehension which is ill founded. The payer is also an assessee under the ordinary provisions of the Income-tax Act. When the payer remits an amount to a non-resident out of India he claims deduction or allowances under the Income-tax Act for the said sum as an "expenditure". Under section 40(a) inserted vide Finance Act, 1988 with effect from 1-4-1989, payment in respect of royalty, fees for technical services or other sums chargeable under the Income-tax Act would not get the benefit of deduction if the assessee fails to deduct TAS in respect of payments outside India which are chargeable under the Income-tax Act. This provision ensures effective compliance of section 195 of the Income-tax Act relating to tax deduction at source in respect of payments outside India in respect of royalties, fees or other sums chargeable under the Income-tax Act. In a given case where the payer is an assessee he will definitely claim deduction under the Income-tax Act for such remittance and on inquiry if the Assessing Officer finds that the sums remitted outside India comes within the definition of royalty or fees for technical service or other sums chargeable under the Income-tax Act then it would be open to the Assessing Officer to disallow such claim for deduction…..” (emphasis supplied)

47.2 It is therefore plain from the decision in ***GE India*** (*supra*) that:

(i) Under Section 195 (1) of the Act, a person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax under the Act.

(ii) Circular No. 728 dated 30th October 1995 issued by the CBDT clarifies that the payer who is expected to deduct TDS can take into consideration the effect of DTAA on such payment.

(iii) If the contention of the Revenue that the moment there is remittance, the obligation to deduct TDS arises is accepted, then it would result in obliterating the words "chargeable under the provisions of the Act" in Section 195 (1) of the Act.

(iv) The link between Section 195 (1), which is in Chapter XVII B and Section 40 (a) (i) of the Act was acknowledged. It was noted that where the payer is an Assessee he will claim the payment made to the non-resident as a deduction. If on inquiry the AO finds that the sum paid in respect of which TDS was not deducted is one chargeable to tax under the Act, he can disallow such deduction. It is not as if the payer has to invariably first deduct the TDS irrespective of the amount being chargeable to tax and then leave it to the payee to claim refund.

47.3. It also requires to be noticed that in its decision in ***GE India*** (*supra*), the Supreme Court dwelt at length on the earlier decision in ***Transmission Corporation***(*supra*). After discussing the facts of ***Transmission Corporation*** (*supra*), the Supreme Court, in para 10 of the decision in ***GE India*** (*supra*), observed as under:

> "10……In our view, Section 195(2) is based on the "principle of proportionality". The said sub-Section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court stated, "If no such application is filed, income-tax on such sum is to be deducted and it is

the statutory obligation of the person responsible for paying such `sum' to deduct tax thereon before making payment. He has to discharge the obligation to TDS". If one reads the observation of the Supreme Court, **the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India**. In our view, the above observations of this Court in *Transmission Corporation* case (*supra*) which is put in italics has been completely, with respect, misunderstood by the Karnataka High Court to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TAS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of the plain words of Section 195 (1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the I.T. Act, i.e., chargeable under Sections 4, 5 and 9 of the I.T. Act."

47.4. It is plain that in ***GE India*** (*supra*), the Supreme Court distinguished the decision in ***Transmission Corporation*** (*supra*) as being one given in the context of composite payments in which taxable income was thought to be embedded. It disapproved of the approach of the Karnataka High Court in its decision in ***CIT (International Transaction) v. Samsung Electronics Co. Ltd.*** (*supra*). Incidentally, it is the latter two decisions that have been heavily relied upon by the AO in the present case.

48. After the above clarification of the legal position that for deduction of TDS under Section 195 (1) of the Act from payments made by MI to the non-resident entities of Thailand and Singapore, the provisions of the DTAA have to be accounted for, it is plain that Explanation 2 to Section 195 (1)

will not compel deduction of TDS where the payer is reasonably certain that the sum paid for purchases is not chargeable to tax.

49. Before concluding this discussion, a reference may be made to the decision in ***Aggarwal Chamber of Commerce v. Ganpat Rai*** (*supra*), relied upon by learned counsel for the Revenue. There the Supreme Court was not called upon to decide any issue in the context of a DTAA. The issue considered was whether for the purposes of deduction of TDS, determination of the world income of the payee was essential and whether the payer was required to consider the impact of losses on taxability of the sum paid and in respect of which TDS was to be deducted. Both issues were answered in the negative. In the present case, the questions arise in an entirely different context. The computation of income and the chargeability of a sum to tax are two different concepts.

50. As far as question (ii) is concerned, it is plain that the Revenue had not discharged its onus of showing that the Thailand and Singapore entities had a PE in India. The AO had simply relied on the AO's own earlier decision holding that Metal One Corporation Japan had a PE in India and on that basis held that the Thailand and Singapore entities also had a PE in India. This conclusion had no factual basis since neither entity had even an LO in India. In any event the ITAT itself subsequently set aside that decision of the AO in the case of Metal One Corporation, Japan and held that even the latter did not have a PE in India. In the circumstances, the conclusion of the ITAT in this regard cannot be faulted. Question (ii) is accordingly answered in the negative, i.e. in favour of the Assessee and against the Revenue.

Points of divergence

51. The reasons for the divergence of views are, therefore, obvious. As far as question (i) is concerned, one fundamental reason is the premise on which the opinion of my learned colleague proceeds viz., in para 41 of her opinion that "Moreover, as per the facts of this case it is not a case of only purchase of goods or a trading receipt…..the Assessee's income is for rendering services as an intermediary between the customer and the vendor." Further in para 47 she observes: "Moreover, in the present case, it is not a case of mere purchase of goods but the Petitioner is also rendering other services as recorded in the AO's order, thus the transactions are composite in nature."

52. The issue here is about the Assessee not being allowed a deduction under section 40 (a) (i) of the Act in respect of the sums **paid by it** for the purchases made by it to non-resident entities for purchases made from the latter. For this issue, whether the Assessee is itself rendering any other service is not relevant. The question is whether the sum paid to the non-resident is chargeable to tax as income of the non-resident **payee**. Secondly, it is nobody's case, and certainly not the Revenue's, that the payment by MI is for composite transactions. The final assessment order of the AO, as noted hereinbefore, itself makes it clear that the payments to the Japanese and US entities (and for that matter to the Thailand and Singapore entities) was for purchases. They were not for 'composite transactions'. In other words the payment was not for any other services rendered by such non-resident entities, as was perhaps the case in ***Transmission Corporation*** (*supra*). In determining whether TDS is to be deducted from such payments, the provisions of the DTAA have to be considered. I, therefore, do not subscribe

to the view of my colleague as expressed in para 48 of her opinion that "the obligation under Section 195 operates and exists independently of Section 40."

53. The second major reason for the divergence of opinion stems from my conclusion that even after insertion of sub-clause (ia) in Section 40 (a) of the Act, with effect from 1st April 2005, the discrimination in the consequence for non-deduction of TDS for payments made for purchases from non-residents and those made to residents for purchases, is apparent. In my considered view the decision of this Court in ***Herbalife HC*** also holds likewise after noticing the insertion of sub-clause (ia) in Section 40 (a) although that case pertained to AY 2001-02 whereas the present case pertains to AY 2006-07. Therefore, I conclude that Section 40 (a) (i) of the Act will not apply to deny the Assessee the deduction. I am also of the view that ***Herbalife HC*** is conclusive as to the interpretation of the expressions 'other disbursements' and 'same conditions' in Article 26 (3) of the Indo US DTAA (which is identical to Article 24 93) of the Indo Japan DTAA.

54. As far as question (ii) is concerned, I have taken note of the stand of both the Assessee and the Revenue that the issue arises in the limited context of the payments made to the non-resident entities of Thailand and Singapore, the DTAAs with whom do not contain a non-discrimination clause similar to the ones in the Indo-Japan and Indo US DTAAs. Factually, it has been held by the ITAT that neither entity has even an LO in India. The finding of the AO that that both entities had a PE was based only on his decision in the case of Metal One Corporation Japan, which decision has

been set aside by the ITAT. I also, therefore, do not agree that question (ii) requires to be modified to include the question whether the said entities have a 'business connection' in India.

55. Finally, as regards Explanation 2 to Section 195 (1) of the Act, inserted by the FA 2012 with retrospective effect from 1st April 1962, I have concluded that the said Explanation, obligates the 'payer', whether a resident or a non-resident, to deduct TDS. It does not dispense with the fulfilment of the pre-condition that the sum in respect of which TDS is to be deducted has to be shown to be chargeable to tax. In this regard I rely on the decision in ***GE India*** (*supra*) as well as the Explanatory Memorandum to the said amendment inserted by FA 2012.

56. I also have taken note of the CBDT Circular dated 30th October 1995 which clarifies that the payer who is expected to deduct TDS can take into consideration the effect, if any, of the DTAA on such payment. I, therefore do not agree with the opinion of my colleague as expressed in para 33 that "the obligation to deduct tax under Section 195 is inescapable insofar as the payer is concerned." These are the broad points of divergence. The details are in our respective opinions.

Conclusion

57. The two questions framed should, in my considered opinion, be answered in the negative, that is in favour of the Assessee and against the Revenue.

58. Consequently the present appeal of the Revenue is dismissed.

S. MURALIDHAR, J.

NOVEMBER 17, 2017
dk/rd

HIGH COURT OF DELHI
सत्यमेव जयते