

Asstt. Cit Vs. Modicon Network (P.) Ltd.

Asstt. Cit Vs. Modicon Network (P.) Ltd.

SooperKanoon Citation : sooperkanoon.com/75469

Court : Income Tax Appellate Tribunal ITAT Delhi

Decided On : Feb-23-2007

Judge : R Easwar, Vice, R Singh

Appellant : Asstt. Cit

Respondent : Modicon Network (P.) Ltd.

Judgement :

1. The appeal is by the department and the cross-objection is by the assessee. In the appeal, the department has taken the following grounds: 1. On the facts and the circumstances of the case, the learned CIT (Appeals) erred in holding- (a) The learned Commissioner (Appeals) has erred in estimating net income of M/s. Distacom Communication Ltd., Hong Kong at 20 per cent of the total receipts from M/s. Modicom Network Pvt. Ltd. in the nature of fee for technical services, whereas in view of Section 44D of the Income Tax Act, 1961, 100 per cent of such total receipts were income of M/s. Distacom Communication Ltd., Hong Kong.

2. The appellant craves to be allowed to amend, delete or add any other ground(s) of appeal during the course of hearing of this appeal.

2. Before we proceed to discuss and decide the issues arising in the appeal and cross-objection, it is necessary to bring on record the essential facts very briefly. Three companies viz., Modi Well vest Private Limited, Distacom Communications (HK) Ltd. (a company incorporated in Hongkong) and Matorala Inc. (company

incorporated in the USA) formed a consortium, with 51 per cent, 39 per cent and 10 per cent shares respectively, for the purpose of bidding for operation GSM-based cellular services in 18 circles in India in 1995. The original partners of the consortium were different but that it not relevant for our purpose. As is normal in such cases the respective consortium members undertook to bear their own pre-bid expenses till such time the bid was successful. For this purpose, the assessee-company was created as a joint venture vehicle. The understanding was that as soon as the joint venture vehicle was created, the respective members of the consortium would become entitled to get their share of the pre-bid expenses reimbursed out of the capital of the company (viz., the joint venture vehicle). Clause 4. 1 (c) of the agreement between the members of the consortium provided that they would be entitled for the reimbursement subject to a maximum of US \$3 million.

3. In terms of the agreement the members incurred expenses on pre-bid as follows: Distacom Communications (HK) Ltd., hereinafter referred to as the HK company, submitted its invoice No. Nil dated 22-3-1997 to the assessee-company for HK \$12,213,442 along with the reimbursement vouchers for expenses incurred by them in foreign exchange. The invoice was also supported by a certificate from the chartered accountants duly verifying the expenses. It would appear that because of some modification of the terms of the consortium agreement the *members would be entitled to reimbursement of a maximum of US \$1.5 million (as against US \$3 in. as originally agreed) and accordingly the assessee was liable to reimburse the HK company to that extent. This required the permission of the Reserve bank of India ("RBI").

4. Accordingly, the assessee-company wrote to the exchange control department of the RBI seeking approval for remitting the aforesaid amount to the HK company. This was done by a letter dated 26-5-1997 a copy of which is at page 17 of the paper book filed by the assessee.

The assessee also sent copies of the resolution passed by the board of directors authorizing the reimbursement (pages 19-20 of the paper book). By communication dated 18-8-1997 the RBI advised that the assessee-company was

permitted to make a remittance of US \$1.5 million to the HK company (page 14 of the paper book).

5. On receipt of the approval from the RBI the assessee made an application dated Nil (received by the assessing officer on 7-8-1997) under Section 195(I) of the Income Tax Act seeking permission to remit the amount without deduction of income-tax. While processing the application, the assessee placed the relevant facts and figures before the assessing officer and would appear to have explained that since the amount is being remitted only towards reimbursement of pre-bid expenses, there was no income element imbedded therein and that the remittance cannot also be considered as "fees for technical services" ("FTS") because no technical services of any kind were rendered by the HK company. A letter dated 16-9-1997 from the HK company was also addressed to the assessing officer to the same effect.

6. The assessing officer noted that according to the letter dated 16-9-1997 of the HK company, the HK company had engaged another agency for consultancy services for preparation of the bid documents and had paid them for their services and had raised an invoice on the assessee-company for reimbursement of the expenses and no income element was imbedded therein and that they have not rendered any technical services to the assessee-company so as to enable the payment to be called FTS, but refused to accept the claim on the following grounds (a) The provisions of Section 9(1)(vii) read with Explanation 2 thereto, defining the expression "fees for technical services" are applicable; (b) The assessee-company is getting the technical services through the HK company which is acting as its agent in Hongkong and has made the payment on behalf of the assessee-company; The assessing officer however exempted the expenses incurred on trips to India and held that no tax need be deducted on that part of the remittance. As regards the balance, he accepted the assessee's claim only with regard to pro rata reduction having regard to the fact that the actual remittance would be less than the maximum permitted by the RBI. He held that the following payments would be treated as income and tax would be charged at the rate of 30 per cent as per Section 115A of the Act: Consultancy fees to Icen 15,603 (7.296 of expenses shown under the Head office) The aforesaid amount was permitted to

be remitted after deducting tax at the rate of 30 per cent thereon.

7. An appeal was filed against the above order before the Commissioner (Appeals) and detailed submissions were made in writing. The Commissioner (Appeals) agreed with the assessing officer that the HK company, not having any expertise in the field of preparing bids for cellular services in India, engaged another consultancy firm and got the bid prepared by them and that this does not mean that the amount remitted by the assessee to the HK company was in the nature of reimbursement without any element of profit. He noted that the RBI was not competent to decide whether the amount was in the nature of FTS or not and it was only the assessing officer who was entitled to do so and hence the clearance from the RBI is not relevant for deciding the question whether the amount remitted is only a reimbursement or payment of FTS. However, he held that the assessee was liable to deduct tax under Section 195(l) only on the income imbedded in the remittance and that the assessing officer was not right in directing the Assessee to deduct tax at 30 per cent on the entire amount remitted. He estimated the income element embedded in the remittance at 20 per cent of the same, considering the relevant material on record and the submissions of the assessee, and directed tax to be deducted at 30 per cent on 20 per cent of the amount remitted.

8. While the department has filed the appeal challenging the decision of the Commissioner (Appeals) that tax was deductible only on 20 per cent of the amount remitted and contending that the order of the Assessing Officer should be resorted, the assessee is in cross-objection to contend that nothing was deductible as tax from the remittance.

9. In support of the appeal, Mr. K.C. Jain, the learned CIT DR and Mr.

Tripuri, the learned Senior DR submitted that once the CIT (Appeals) had found that the payment was in the nature of FTS, he should have directed that the tax at the rate of 30 per cent on the entire amount ought to have been deducted and there was no basis for holding that only 20 per cent of the amount represents the income imbedded in the payment. They have relied on Section 44D of the Income Tax Act and have submitted that the section was overlooked by the CIT (Appeals). It was pointed out by them that Section 44D gives a statutory clue - though it may

not strictly apply to the assessee's case - to the question as to how much of the remittance can be assessed as income. It has further been pointed out by then) that the assessee has not disputed that the services rendered by the consultancy firm engaged by the HK company were in the nature of technical services. The further argument was that just because the HK company lacked technical expertise and, therefore, had to approach an outside agency for preparing the bid documents, which was a technical exercise, the nature of the remittance does not change. It was argued that the remittance would have been treated as FTS had the assessee-company directly engaged the consultancy firm (which was engaged by the HK company) and the position should not be differently viewed merely because the remittance was routed through the HK company.

10. Mr. Sapra, the learned Counsel for the assessee, in his arguments covering both the appeals filed by the department and the cross-objection filed by the assessee, submitted that Section 195(t) of the Act does not in terms apply to the remittance under consideration which is a mere reimbursement of the expenses incurred by the HK company without any element of income imbedded in it. He pointed out that it is not the stand of the department nor was there any evidence to show that the HK company had rendered any technical services to the assessee-company and, therefore, it is not permissible or possible to treat the amount remitted by the assessee-company to the HK company as FTS. He referred to the evidence adduced before the income-tax authorities in the form of the relevant vouchers, audit certificate etc. sent by the HK company which clearly showed that the HK company was merely claiming reimbursement of the pre-bid expenses incurred by it in terms of the agreement with the other consortium partners. Mr.

Sapra further emphasized that there was absolutely no evidence brought on record by the departmental authorities to show that the consultancy firm engaged by the HK company was in any manner connected with the HK company and that the entire transaction was a pre-planned or pre-arranged affair with the motive of avoiding or evading income-tax.

With regard to the reliance placed by the learned CIT DR and the learned Senior DR on Section 44D, Mr. Sapra submitted that the section invoked for the first time

in the grounds of appeal before the Tribunal and at any rate, it has no application to the present case as rightly submitted even on behalf of the department' According to him, the section can be invoked only while computing the income of foreign company under the Income Tax Act, 1961, and has no application at the remittance stage. Arguing in support of the cross objection filed by the assessee, Mr. Sapra submitted that when there is no liability at all to deduct tax, the CIT (Appeals) was not justified in estimating 20 per cent of the remittance as income element and in directing the assessee to deduct tax at the rate of 30 per cent thereon. He submitted that as a proposition of law, reimbursement of expenses has no element of profit imbedded therein.

11. In support of the above submissions, Mr. Sapra relied on the following authorities: CIT v. Industrial Engg. Projects (P) Ltd. (iii) Hyderabad Industries Ltd. v. Income Tax Officer (1991) 188 ITR 7492 (Kar.); Rolls Royce India Ltd. v. Income Tax Officer (1988) 25 ITD 136 (Delhi)(TM).

The learned Counsel for the assessee also filed a synopsis of his arguments.

12. We have carefully considered the facts and the rival contentions.

Under Section 195(l) of the Act, any person responsible for paying to a non-resident any interest or any other sum chargeable under the provisions of the Act (except salaries) shall, at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, deduct income-tax thereon at the rates in force. Under subsection (2), the person paying the amount, if he considers that the whole of the amount would not be income chargeable to tax in the hands of the recipient, may make an application to the assessing officer to determine the appropriate proportion of such sum so chargeable and upon such determination, the tax shall be deducted only on the chargeable proportion of the amount. It is, therefore, clear that the obligation to deduct tax is only with reference to the income element imbedded in the remittance. This position has been affirmed by the judgment of the Supreme Court in the case of Transmission Corpn. of AP Ltd. (supra) in the penultimate paragraph of the judgment where it has been held that the High Court was right in holding that the obligation of the assessee to deduct tax under Section 195 is limited only to the appropriate proportion of

income chargeable under the Act. It is therefore clear that any remittance which does not have an income element which is chargeable to tax need not suffer tax deduction at source.

13. The question to be considered in the present appeal is whether the amount remitted by the assessee to the HK company contained any income element so as to fasten liability upon the assessee to deduct tax thereon at the appropriate rate. The assessing officer appears to have taken the view that the amount represented FTS in terms of Explanation 2 below Section 9(1)(vii) of the Act and, therefore, the assessee is liable to deduct the tax. A look at the above Explanation shows that it contains a definition of FTS and says that FTS means any consideration for the rendering of any managerial, technical or consultancy services including the provision of services of technical or other personnel, but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries". The content of the Explanation unmistakably is that the payment must be made as quid pro quo for such services rendered as have been enumerated therein. It postulates that the remitter of the amount has received the benefit of the technical services and that the technical services have been rendered by the recipient of the amount.

In the present case, the HK company has not rendered any services, let alone technical services, to the assessee-company for which the amount was remitted. The services were rendered by a consultancy firm engaged by the HK company. The HK company paid the consultancy agency and sought reimbursement of the same from the assessee-company in terms of the consortium arrangement. Thus, the amount remitted by the assessee-company was only by way of reimbursement of the expenses incurred by the HK company and not by way of consideration for rendering any services which are technical services. As pointed out by the learned Counsel for the assessee, there is no evidence on record to show that the HK company and the agency firm engaged by it were connected in any manner or that the entire transaction was a pre-planned or pre-meditated arrangement devised in order to avoid the provisions of tax deduction at source. Therefore, it is not possible to hold that the remittance was in truth and reality

consideration for technical services disguised as reimbursement of the expenses.

14. In the very nature of things, reimbursement of expenses cannot be considered as having an income element imbedded therein so as to attract Section 195(1) of the Act. The question has been considered by the Hon'ble Delhi High Court in Industrial Engg. Projects (P.) Ltd. case (supra). In this case, the assessee had an agreement with a foreign company whereby some services were to be rendered by the assessee for remuneration. The agreement also provided that costs and expenses incurred by the assessee would be reimbursed. In the assessment, the Income Tax Officer disallowed some of the expenses incurred on the ground that they were more than the permissible limit.

The Hon'ble High Court held that reimbursement of expenses can under no circumstances be regarded as revenue receipt and, therefore, the Tribunal was right in deleting the disallowance of the expenses on the footing that the assessee received no amount in excess of the expenses incurred. The question has also been considered by the Authority for Advance Ruling (AAR) in the case of DECTA (supra). In this case, the Government of U.K. made available a huge sum to the Government of India which was utilized by DECTA, which was a British company, for providing assistance to Indian companies under the U.K. Government's Overseas and Development Administration to assist exporters and export promotion organizations in Third World countries. The Indian companies have the benefit of the services of DECTA and in lieu thereof they make a token contribution towards the costs of various projects. The problem faced by DECTA in this situation was whether the contribution made by the Indian companies towards the cost of the projects was liable to tax in India. It, therefore, approached the AAR for a ruling as to whether the contribution could be brought to income-tax as FTS as defined in Explanation 2 below Section 9(1)(vii) of the Income Tax Act. The argument of the department before the AAR was that DECTA provided some services to the Indian companies for which payment was made which must be taken as FTS and the fact that only 25 per cent of the project cost was received by DECTA did not render the amount received any the less consideration for services rendered. It was argued that at best, it could be a case of inadequate consideration. The AAR did not accept the argument on the ground that it failed to

take into account the real nature of the project, the spirit in which it was conceived and the specific terms of the contract. It was held by the AAR that DECTA was merely implementing an agreement between the U.K. and Indian Government under which U.K. Government through DECTA, extended assistance to Indian exporters. After referring to the terms of the agreement, it was held by the AAR that it is really a pooling arrangement or joint arrangement for the management of the projects and the contribution by the Indian companies is the modus operandi by which they are made to meet a part of the expenses incurred on the projects. It was ultimately held at page 200 in DPCTA case (supra) that it would be totally absurd and incorrect to describe these contributions as being in the nature of FTS paid to DECTA within the meaning of Section 9. In the opinion of the AAR, such an arrangement did not contain any element bearing the character of income (page 201). A careful reading of the ruling shows that if under a bona fide arrangement there is a provision for reimbursement of expenses to the parties, which they incur in furtherance of a common objective, such reimbursement cannot be considered as bearing the character of income. In CIT v. S.G. Pagnatale the question of reimbursement was considered in the context of whether it would give rise to any perquisite within the meaning of Section 17(2) of the Income Tax Act. In that case, the assessee was an employee of a French company and he worked in India for an Indian company. The retention salary was paid by the French company and the Indian company agreed to pay living allowance to the assessee. The allowance was likely to be reduced or increased depending upon various factors like the place where the services were to be rendered, whether free accommodation or free transport was allowed etc.

The question arose before the Gujarat High Court as to whether the living allowance constituted a perquisite in the hands of the assessee.

The Gujarat High Court held that the very fact that the allowance was likely to be reduced or increased depending upon the factors mentioned above indicates that it was being given as a reimbursement rather than as personal advantage to the assessee. It was held that though the money would go to the assessee and to his pocket, but since this is by way of reimbursement, it would not be perquisite chargeable under the head 'Salaries'. The ratio of this decision, which we have

ourselves noticed, applies to the present case. The matter is also seen to have been considered by the Delhi I Bench of the Tribunal in the context of Section 44BB in the case of SEDCO Forex International Drilling Inc. v.Dy. CIT (2000) 72 ITD 415 (Delhi). In that case, the assessee got reimbursed for expenditure incurred towards catering and lodging of ONGC employees and also towards supply of certain materials. The agreement provided for reimbursement of the expenses at a particular rate which was even lower than the actual expenditure incurred by the assessee. The amount received by the assessee as reimbursement was included by the assessing officer in the gross receipts for the purpose of Section 44BB which provided for assessing profits at the rate of 10 per cent of the gross receipts. The Tribunal held that the reimbursement of the expenses was based on expenditure actually incurred by the assessee and, therefore, cannot form part of the contract receipts paid by ONGC to the assessee for providing services in connection with the supply of plant and machinery in relation to exploration of mineral oils. In the present case, there is no dispute about the genuineness or bona fide of the terms of arrangement between the partners of the consortium. The relevant clause under which a consortium partner is entitled to defray his share of the pre-bid expenses and get the same reimbursed by the joint venture vehicle has also been placed before the departmental authorities and no question has been raised about the existence of the clause. Since the HK company lacked the expertise to draw up the pre-bid documents, it had to engage the services of another consultancy firm. It paid the consultancy firm and raised an invoice for the amount on the assessee-company, under the terms of the consortium arrangement, to get reimbursed. The argument of the department is that the nature of the remittance as FTS does not change merely because the HK company had to engage another agency to prepare the pre-bid documents. In our view, the argument cannot be accepted having regard to the objective of the consortium and the agreement between the partners of the consortium to the effect that the pre-bid expenses incurred by them will be reimbursed by the joint venture vehicle. Furthermore, in our view, in the light of the authorities cited above, reimbursement per se cannot bear the character of income.

Thus, the preliminary question, namely, whether the amount remitted would in its entirety or partly be considered as income of the HK company has to be resolved

in favour of the view that it being a mere reimbursement it cannot be so considered. As held by the Karnataka High Court in the case of Hyderabad Industries Ltd. (supra), the purpose of deduction of tax at source is not to collect a sum which is not a tax levied under the Act. It is only to facilitate the collection of tax lawfully leviable under the Act. The interpretation put on the statute by the income-tax authorities, as pointed out in the judgment, would result in collection of amounts which are not qualitatively to be considered as a tax.

15. The evidence brought on record by the assessee to show that what it wanted to remit abroad to the HK company was only by way of reimbursement without any element of profit or income imbedded therein has been complied at pages 6 to 13 of the paper book. The break up of the prebid expenses incurred by the HK company for the assessee- company has been given in these pages. It is these expenses which have been reimbursed by the assessee-company. No material has been brought on record to show that the expenses included an income element.

16. Section 44D has no relevance to the present case as it is concerned with the computation of income by way of royalties etc. in the case of foreign companies. It is relevant at the assessment stage and not at the stage of remittance. The reference made by the learned CIT(DR) in the course of his arguments to the fact that the investment by the HK company in the assess ee-company was routed through a Mauritian subsidiary does not turn the case in any manner in favour of the revenue.

17. For the aforesaid reasons, we are unable to hold that there was any income element in the remittance made by the assessee to the HK company. Accordingly, we allow the cross objection of the assessee and dismiss the appeal filed by the revenue.

SooperKanoon - India's Premier Online Legal Search - sooperkanoon.com