IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 15.09.2020

CORAM:

THE HON'BLE MR.JUSTICE N.KIRUBAKARAN
and
THE HON'BLE MR.JUSTICE P.VELMURUGAN

T.C.A.No.527 of 2018

Growing Opportunity Finance (India) Pvt. Ltd.,
Door No.73, 1st Floor, Y Block
6th Street, Anna Nagar
Chennai-600 040 ..Appellant/Appellant /assessee

-Vs-

Principal Commissioner of Income Tax 2
121 Mahatma Gandhi Road
Nungambakkam
Chennai-600 034 ..Respondent/Respondent

Prayer:Tax Case Appeal filed under Section 260-A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal Madras 'A' Bench dated 15.11.2017 made in ITA.No.74/Mds/2017 Against the order dated 29.11.2016 made in ITA.NO.293/CIT(a)-6/15-16 on the file of the Commissioner of Income Tax (Appeals-6),chennai against the order dated 23.12.2015 made in PAN.No.AACCG6770 E on the file of the Assistant Commissioner of Income Tax (OSD),Corporate Range-2,Chennai for the Assessment Year 2012-2013.

For Appellant : Mr.N.V.Balaji

For Respondent : Mr.Karthik Ranganathan, Standing Counsel

JUDGMENT

P.VELMURUGAN,J.

The Tax Case Appeal is filed by the assessee as against the order of the Income Tax Appellate Tribunal Madras 'A' Bench dated 15.11.2017 made in ITA.No.74/Mds/2017. At the time of admission, since a preliminary objection has been raised by the learned Standing counsel for the assessee with regard to Section 90 of the Income Tax Act and Double Taxation Avoidance Agreement between India and USA, as it was not raised or canvassed before the Assessing Officer or the Commissioner of Income Tax (A) or the Tribunal, a Division Bench of this Court while admitting the Tax Case Appeal, proposed to frame one more substantial question of law as to be decided as the first question as under:-

1) Whether the assessee would be entitled to raise the issue relating to Section 90 of the Income Tax Act r/w.DTAA

between India and United States of America as raised by them in the substantial question framed by the assessee for the first time before this court?.
The other substantial questions of law on which the appeal was admitted are as under:-

2) Whether under facts and circumstances of the case the Tribunal was right in holding that the payments made by the appellant to Opportunity International is Fees for Technical Services and affirming the disallowance under Section 40(a)(ia) without considering the provisions of Section 90 of the Income Tax Act read with the Double Taxation Avoidance Agreement between India and USA?

3) Whether under facts and circumstances of the case, the payment made by the appellant is to be treated as fees for technical services under Section 9(1)(viii) read with the double taxation avoidance agreement between India and United States of America?

4) Whether tribunal was within its power to direct the assessing officer to examine whether tax was deducted at source and consider disallowance under section 40(a)(ia), in respect of the part of the issue which was not in appeal before it? and

5) Whether under facts and circumstances of the case and in law the Tribunal was right in directing the assessing officer to examine whether tax has been deducted in respect of part of the expenditure which was not in appeal before it and further directing the assessing officer to disallow the same if tax has not been deducted?”

2.1 The facts of this case are that the appellant/assessee is a company engaged in the business of providing micro finance. The appellant is a member of Opportunity International, USA, a network of organisations involved in microfinance. E-Return of income for the assessment year 2013-14 has been filed by the appellant on 04.09.2013 declaring total income of Rs.37,90,160/-. The said return was processed under Section 143(1) of the Income Tax Act, 1961 [hereinafter called as “Act”] The case was selected for scrutiny under CASS and a notice under Section 143(2) was issued by the DCIT-Company Circle II(2) on 04.09.2014 which was duly served on the assessee on 24.09.2014.

2.2 For completion of pending scrutiny assessment for assessment year 2013-14, notice under Section 143(2) r/w. Section 129 dated 28.07.2015 was duly issued and served on the assessee. A notice u/s.142(1) dated 28.07.2015 was also issued calling for details.

2.3 After discussing the case with the authorized representative of the assessee and considering the documents produced, the assessment was completed noticing that the amounts under the heads “Prior Period Expenses” , “provision for Gratuity”, “disallowance u/s.40(a)(ia)”, “Sundry assets written off”, “Women's day celebration expenses”, had been disallowed by the assessing officer, as they are not revenue in nature. Interest on total taxable income at Rs.1,20,21,109/- was charged u/s.234, Demand Notice u/s.156 of the Act was issued and Penalty notice u/s.271(1)9c) was issued.

2.4 Thus, demand for tax payable to the tune of Rs.36,17,970/- was raised. Aggrieved against the said order of assessment, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals).

2.5 On the ground that disallowance of “Prior Period Expenses” of Rs.43,08,727/- does not relate to the assessment year in question and that the disallowance of Rs.11,61,966/- on the ground that the assessee has not deducted tax at source under Chapter XVII-B of the Act, is not correct as the Assessing Officer has failed to take into account that the nonresident does not have any Permanent Establishment in India and hence no Tax need be deducted from payments made to such non-resident and as far as Women's day expenses, the assessee sought that the same may be treated as business expenditure.

2.6 The CIT (Appeals), by his order dated 29.11.2016, u/s.250(6) of the Act, had gone through the detailed observation submitted by the Authorized Representative and following the judicial precedents, held that with regard to Prior Period Expenses & Credit Rating Expenses, the liability for the appellant company for the payment to M/s.Opportunity International, Chicago, crystallized only on the settlement of dispute with the foreign company. The Assessing Officer has not disputed that the impugned expenditure had not been booked or accounted for in the earlier years. Therefore, the CIT (Appeals) viewed that the appellant company is right in claiming the expenditure in the present Assessment Year 2013-14 on crystallization of the liability following the settlement of the dispute. Therefore, the disallowance made by the Assessing Officer of Rs.43,08,727/- was deleted by the CIT (Appeals).

2.7 With regard to disallowance of Credit Rating Expenses, CIT (Appeals) directed the Assessing Officer to allow the credit rating expenditure only in so far as it relates to current financial year 2012-13 and the disallowance of the amount relating to the prior period i.e Financial Year 2011-12 was confirmed. Thus, the CIT (Appeals), partly allowed the disallowance.

2.8 As far as disallowance under Section 40(a)(ia) of the Act, since the assessing officer has pointed out that an amount of Rs.27,01,189/- has been credited in the books of account of the assessee, the assessee was liable for deduction of tax at source under Chapter XVII-B of the IT Act. Since no tax has been deducted at source, Assessing Officer added Rs.14,06,564/- u/s.40(a)(ia) being the liability includes Rs.12,94,625/- and Rs.2,44,598/- which is prior period expenses and proposed for addition. Even though, the assessee put forth its submission that the payments was made to non-resident company and the assessee company has not obtained any technology transfer, the CIT (Appeals), after going into the detailed submissions and the decisions relied on by the assessee, held that judicial decisions relied upon by the assessee are not relevant, to the facts of the case as the nature and purpose of payments made are entirely different. The CIT (Appeals) found that the entire edifice of assessee company's business operation, right down to the format and periodicity of Management Information Systems is provided by the Non-Resident, which falls within the realm of providing technical services. The only requirement of Section 9(i)(vii) is that fees for technical services is paid by a person, who is resident in India, and this fact is not in dispute. Hence, even if the non-resident party does not have a permanent establishment in India, payment of fees for technical services by the assessee is taxable in the hands of the foreign party as per the deeming provisions of Section 9(1)(vii) of the Act and hence TDS is deductible from such payments. Thus, it is held that the disallowance under Section 40(a)(ia) is to be taken at Rs.27,01,189/- and dismissed the challenge made by the assessee.

2.9 However, the disallowance on Women's Day expenses was deleted and allowed the issue, whereas under "Provision for Gratuity", disallowance was confirmed.

3. Aggrieved by the order of Commissioner of Income Tax (Appeals), the assessee filed further appeal before the Income Tax Appellate Tribunal, against the disallowance dealing with foreign payments.

4. The Income Tax Appellate Tribunal, by order dated 15.11.2017, held that each of the payments is in respect of services utilized in India and in the nature of Fee for Technical Services (FTS). Collateral support, is to secure the membership of an entity and benefits for the conduct of its business in India under its aegis; they are clearly in the nature of managerial and technical services falling within the purview of FTS covered u/s.9(1)(vii). Thus, the ITAT dismissed the appeal filed by the assessee with a direction to claim deduction for the year of payment, by remitting the withholding tax and grossing it up.

5. Aggrieved by the dismissal order passed by the ITAT, the appellant/assessee preferred this Tax Case Appeal.

6. The learned counsel for the appellant/assessee by placing reliance on Article 12 of India-USA, Royalties and Fees for Included Services, referred to U.S.-India Tax Treaty Memorandum of Understanding concerning fees for included services which described the category of services defined in paragraph 4 of Article 12. It provides examples of services intended to be covered within the definition of included services and those intended to be excluded, either because they do not satisfy the tests of paragraphs 4, or because, notwithstanding the fact that they meet the tests of paragraph-4, they are dealt with under paragraph 5.

7. Article 12 includes only certain technical and consultancy services. Under paragraph 4, technical and consultancy services are considered included services only to the following extent:

(1) as described in paragraph 4(a), if they are ancillary and subsidiary to the application or enjoyment of a right, property or information for which are royalty payment is made; or

(2) as described in paragraph 4(b), if they make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design. Thus, under paragraph 4(b), consultancy services which are not of a technical nature cannot be included services.

Example 1 relates to facts that Indian company to use manufacturing processes in which the transferor has exclusive rights; as part of the contractual arrangement, the US manufacturer agrees to provide certain consultancy services to the Indian company in order to improve the effectiveness of the latter's use of the processes. The question that arose is that "Are the payments for these services, fees for "included services"?

The Analysis says that the payments are fees for "included services". The services described in this example are ancillary and subsidiary to the use of manufacturing process protected by law as described in paragraph 3(a) of Article 12 because the services are related to the application or enjoyment of the intangible and the granting of the right to use the intangible as the clearly predominant purpose of the arrangement. Because the services are ancillary and subsidiary to the use of the manufacturing process, the fees for these services are considered for included services under paragraph 4(a) of Article 12, regardless of whether the services are described in paragraph 4(b).

8. From a reading of the above terms of the Agreement, it is seen that Paragraph 4(b) of Article 12 refers to technical or consultancy services that make available to the person acquiring the services, technical knowledge, experience, skill, know-how, or processes. Further, it says that similarly the use of a product which embodies technology shall not per se be considered to make the technology available.

9. The only issue involved in this Tax Case Appeal is as to whether the appellant/assessee is eligible for disallowance under Section 40(1)(ia) of the Income Tax Act by taking into consideration the provisions of Section 90 of the Income Tax Act read with the Double Taxation Avoidance Agreement between India and USA.

10. As per the Memorandum of Understanding concerning fees for included services in Article 12 of U.S.-India Tax Treaty dated May 15, 1989, clause 4 speaks about "fees for included services" and sub clause (b) refers to technical or consultancy services that make available to the person acquiring the services, technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design to such person. Technology will be considered "made available" when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not per se mean that technical knowledge, skills etc., are made available to the person purchasing the service, within the meaning of paragraph 4(b). Similarly, the use of a product which embodies technology shall not per se be considered to make the technology available.

11. According to the learned counsel for the Revenue, the assessee has not raised the issue relating to Section 90 of the Income Tax Act read with Double Taxation Avoidance Agreement (DTAA) between India and United States of America before the Assessing Officer, CIT (Appeals) and the Income Tax Appellate Authority but for the first time raised before this Court and the substantial questions of law raised in this Tax Case Appeal pertains to Section 90 of Income Tax Act.

12. Now the only question is that whether the disallowance u/s.40(a)(ia) of the Act, without considering the provisions of Section 90 of the Income Tax Act read with the Double Taxation Avoidance agreement between India and USA is correct?

13. Admittedly, the issue relating to Section 90 of the Income Tax Act read with Double Taxation Avoidance Agreement between India and United States of America has not been raised before the Assessing Officer or before the CIT (Appeals) or before the ITAT. But for the first time, the appellant/assessee has raised the issue before this Court and the said issue has also been raised in the substantial questions of law. Therefore, there is no occasion to decide this issue viz., as to whether the disallowance under Section 40(a)(ia) of the Act, without considering the provisions of Section 90 of the Income Tax Act read with Double Taxation Avoidance Agreement between India and USA, is correct or not, since the said point has not been discussed before the authorities below.

14. The respondent/Revenue has also not disputed the fact that Section 90 of the Act was not considered before the lower authorities. Therefore under these circumstances, to decide whether Section 90 of the Income Tax Act read with Double Taxation Avoidance Agreement is also to be considered while making disallowance for the payments made by the assessee to the Opportunity International by the Assessing Officer, would not arise at all, as there is no discussion in the order impugned herein. In such circumstances, whether the assessee is liable to pay the Service Tax charges or not, has to be decided by the Assessing Officer.

15. The contention of the appellant/assessee is that as per Section 90 of the Act, the assessee is not liable to deduct the tax at source as the assessee did not make available any technical knowledge and therefore, the payment need not be treated as Fees for Technical Services. Admittedly, this point has not been raised before any of the authorities below, but for the first time, this point is raised as substantial question of law, hence, there is no occasion to deal with the said issue in this Tax Case Appeal.

16. Therefore, we are of the considered view that this is a fit case for remitting the matter back to the Assessing Officer for considering the issue by taking into account the claim made by the assessee. It is for the assessee/appellant to make their claim before the Assessing Officer regarding Section 90 of the Act read with Double Taxation Avoidance agreement and raise the contention as raised in the substantial questions of law herein, which shall be decided by the Assessing Officer. The appellant/assessee is at liberty to make his submission before the Assessing Officer. The Assessing Officer, after giving due opportunity to the appellant, shall decide the matter in accordance with law. Thus the substantial questions of law raised by the appellant/assessee is left open to the assessing officer to deal with the same.

16. The Tax Case Appeal is disposed of with the above direction. No costs.

nvsri Sd/-

Assistant Registrar(CS III)

//True Copy//

Sub Assistant Registrar

To

1.The Income Tax Appellate Tribunal, A Bench, Chennai.

2. The Commissioner of Income Tax (Appeals)-6
121 MG Road, Nungambakkam, Chennai-600 034

3. The Assistant Commissioner of Income Tax (OSD),Corporate Range-2,Chennai

T.C.A.No.527 of 2018
A.SK(15/10/2020)