

Payment to third party through a related entity cannot be considered as "reimbursement" of expenses

Summary - Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of M/s. C. U. Inspections (I) Pvt. Ltd. (Taxpayer) has passed a ruling on the issue of withholding obligation and consequential impact on deductibility of payments made by the Taxpayer to its holding company towards certain common expenses and training expenses incurred on behalf of the Taxpayer.

Facts

- C.U. Inspections (I) Pvt. Ltd. ('the taxpayer'), is an Indian subsidiary of P.S.O. Beheer B.V., Netherland ('PSO').
- During the assessment year 2006-07, PSO arranged for the training for the employees of the taxpayer. The training was rendered by third party trainers and the taxpayer made payments aggregating to Rs. 15.44 lacs to PSO for such training expenses, which in turn made the payment to outside trainers. No tax was withheld at source from such payments under section 195 of the Income-tax Act, 1961 ('the Act') by the taxpayer on the basis that it was merely a reimbursement of expenses to PSO .
- The expenses were disallowed by the Tax Officer under section 40(a)(i) of the Act since no taxes were withheld on the said payments.
- The Commissioner of Income-tax (Appeals) upheld the disallowance made by the TO.

Held

- Reimbursement of expenses contemplates the actual incurring of expenses by the related party, which is subsequently made good. For payment to be considered as reimbursement of expenses, it should ultimately stop at related party.
- If expenses are not actually incurred by the related party but by some third party abroad and the payment is only routed through the related party, it cannot be considered as reimbursement of expenses.
- If an Indian company incurs expenses or makes purchases or avails any services from third party abroad and payment to such third party is routed through its related company abroad, then withholding tax provisions would be applicable as if the payment to such independent party is being made by the Indian company, de hors the routing of payment through the holding company.
- If payment to third party, routed through a holding or related company is considered as reimbursement of expenses, then probably all the withholding tax provisions will become redundant and such a route is not permissible under the law.

- Thus, the payment made by the taxpayer to PSO, for the training provided to the taxpayer's employees by a third party would not be considered as a reimbursement of expenses.

Comments

The Mumbai Tribunal decision has clarified the circumstances under which a payment made for services etc. would be considered as a reimbursement, the absence of which would render the payments being subject to the provision of withholding tax. Thus, the routing of expenses through holding or related party would not absolve the person from withholding obligations.