ITAT allows benefit of second proviso to sec. 40(a)(ia) in case of payment to NR; Non-discrimination clause invoked

Summary – The Delhi ITAT in a recent case of Mitsubishi Corporation India (P.) Ltd., (the Assessee) held that Rigour of disallowance of payment under Section 40(a)(ia) is relaxed in case of payment to resident if recipient pays taxes on such sum and files return of income - Whether it would be contrary to scheme of DTAA and discriminatory if similar relaxation is not allowed under Section 40(a)(i) in case of payment to non-resident without withholding of taxes if such non-resident pays taxes on such sum and files return of income - Held Yes, Whether relaxation under *second proviso* to Section 40(a)(ia) is to be read into Section 40(a)(i) as well and it was required to be treated as retrospective in effect in the same manner as second proviso to Section 40(a)(i)

On the issue of disallowance for TDS default:

• The AO noted that certain non-resident entities were taxable in India under the provisions of the Income Tax Act ('IT Act') as also under the provisions of relevant DTAA as these entities had a PE in India.

• Thus, in the opinion of the AO, the assessee was required to deduct tax at source from these payments to non-residents, in terms of section 195.

• Provisions of Section 40(a)(ia) and Section 201 provides that no disallowance can be made in respect of payments made to a residents without deduction of tax, if related payments are taken into account by the recipients in computation of their income, taxes thereon are duly paid and related income-tax returns are duly filed by the them under section 139(1).

• Accordingly, the assessee contended that non-discrimination clause of treaty was applicable on impugned payment made to non-residents.

Held:

• Provisions of Section 40(a)(ia) and Section 201 provides that no disallowance can be made in respect of payments made to a residents without deduction of tax, if related payments are taken into account by recipients in computation of their income, taxes thereon are duly paid and related income-tax returns are duly filed by the them under section 139(1).

• However, section 40(a)(i) does not have an exclusion clause similar to *second proviso* to Section 40(a)(ia), so far as payments made to non-residents, without deduction of tax are concerned. Thus, such payments would be disallowable even when the non-resident recipient has taken into account such

payments in computation of his income, has paid taxes on the same and duly filed income-tax return under section 139(1).

• So far as discrimination to the non-resident taxpayers was concerned, the right comparator would be a resident Indian taxpayer. As we were examining the issue of deduction parity, we had to examine the position of deductibility in respect of a similar payment, i.e., without deduction of tax at source, made to a resident Indian taxpayer.

• A different treatment to the foreign enterprise per se was enough to invoke the non-discrimination clause.

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• Therefore, it would be contrary to the scheme of the tax treaties if rigour of disallowance of a payment, on account non-deduction of tax from the related payment, was to be relaxed in the situations in which the resident recipient had taken the said amount into account in computation of income, paid taxes on the income so computed and filed return of income under section 139(1), and yet the rigour of disallowance in respect of payments made, without deduction of tax at source, to the non-residents was not relaxed when such non-resident recipient had taken such receipts into account in computation of income, paid taxes on the income so computed and filed return under section 139(1).

• A different treatment to the foreign enterprise per se was enough to invoke the non-discrimination clause.

• Thus, there was indeed an element of discrimination, in terms of Article 24(3) of the India-Japan DTAA, in the deductibility of payments made to resident entities vis-à-vis non-resident Japanese entities.

• A different treatment to the foreign enterprise per se was enough to invoke the non-discrimination clause.

• Accordingly, the relaxation under second proviso to Section 40(a)(ia) is to be read into Section 40(a)(i) as well and it was required to be treated as retrospective in effect in the same manner as second proviso to Section 40(a)(i) has been treated.

• Thus, the payments made by an Indian enterprise to a resident of Japan would be deductible, in the assessment of India enterprise, under the same conditions as if the payments were made to the Indian residents.