Commission paid to NR agent for procurement of export orders outside India wasn't taxable; not liable for TDS

Summary – The Delhi ITAT in a recent case of Welspring Universal., (the Assessee) held that where commission paid by assessee to non-resident agent for procuring export orders was not chargeable to tax in hands of said agent, assessee was not liable to deduct tax at source

Facts

- The assessee was engaged in manufacturing of engineering items.
- The Assessing Officer observed that a sum was paid by the assessee as a foreign commission without deduction of tax at source. On being called upon to justify such non-deduction, the assessee tendered explanation. Getting convinced with the assessee's submissions, the Assessing Officer chose not to make any disallowance under section 40(a)(i).
- However, exercising revisional power under section 263, the Commissioner opined that in view of the amendment to section 195, the assessee was liable to deduct tax at source on such payment of commission to foreign parties.
- On second appeal:

Held

If the amount of commission is taxable in hands of non-resident agent

- The scope of total income of a non-resident is governed by section 5(2) of the Act. This section provides that all income of a non-resident 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, shall be included in his total income. It is patent that the non-resident did not receive such income in India inasmuch as the assessee made payment for such commission to the non-resident outside India. Section 7 defines 'Income deemed to be received'. It refers to the annual accretion to the balance at the credit of an employee participating in a recognized provident fund; transferred balance in a RPF to some extent; and the contribution made by the Central Government or any other employer to the account of an employee under Pension Scheme referred to in section 80CCD. From the description of the contents of section 7, it can be seen that the commission received by a non-resident cannot be characterized as 'income deemed to be received' in India. The next ingredient of section 5(2) is the income which 'accrues or arises in India.' Since the chargeability to tax under this segment is attracted if the income accrues or arises to the non-resident in India, it becomes crucial to find out the place where income from export commission accrues or arises. In this regard, the source of accrual or arising of income cannot be relevant because the incidence of tax is attached with the place of accrual of income and not its source. Ordinarily, there can be several places involved in a transaction, such as,

a place where an agreement is entered into or a place where services are actually performed or a place where the services are utilized or a place where entries are made in the books or a place where consideration is paid or received etc. In the context of rendering of services for procuring export orders by a non-resident from the countries outside India, there can be no way for considering the actual export from India as the place for the accrual of commission income of the non-resident. One should keep in mind the distinction between the accrual of income of exporter from exports and that of the foreign agent from commission. As a foreign agent of Indian exporter operates outside India for procuring export orders and further the goods in pursuance to such orders are also sold outside India, no part of his income can be said to accrue or arise in India. The last component of section 5(2) is income which 'is deemed to accrue or arise' in India. The expression 'Income deemed to accrue or arise in India' has been defined in section 9(1) of the Act. Sub-section (1) of section 9 has seven clauses. Clause (i) deals with income accruing or arising, whether directly or indirectly, through or from any business connection in India or from any property in India or through or from any asset or source of income in India or through the transfer of the capital asset situated in India. It is quite apparent that the commission income cannot be associated with the later contents of this clause, namely, any property or asset or source of income in India. At the most, it can be considered as having some 'business connection.' *Explanation 3* to section 9(1)(i) provides that if business is carried on in India, only so much of the income as is attributable to the operations carried out in India, shall be deemed to accrue or arise in India. Thus, it is clear that in order to bring any income within the ambit of section 9(1)(i), it is *sine qua non* that the activity resulting into such income should be carried out in India. Notwithstanding the existence of a business connection in India, as even understood in the widest possible amplitude, an income will fall under section 9(1)(i) only to the extent it results from the operations carried out in India. If no operations for earning such income from business connection are carried out in India, the applicability of clause (i) to this extent is ruled out. As, admittedly, the non-resident payee carried out his operations outside India, the command of clause (i) of section 9(1) cannot apply. The other six clauses of section 9(1), namely, clauses (ii) and (iii) dealing with income under the head 'Salaries'; clause (iv) dealing with 'Dividend'; clause (v) dealing with 'Interest'; clause (vi) dealing with 'Royalty'; and clause (vii) dealing with 'Fees for technical services', have no application to the facts and circumstances of the instant case. The amount of commission paid to the non-resident cannot be described as salary or dividend or interest or royalty or fees for technical services.

Whether Explanation below section 9(2) will bring instant case within fold of section 9(1)

- Such an argument, is devoid of any merit. *Explanation* below section 9(2) simply states that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or (vi) or (vii) of sub-section (1) and shall be included in the total income of the non-resident whether or not the non-resident has a residence or place of business or business connection in India or the non-resident has rendered services in India. A bare perusal of the

Explanation divulges that if there is some income of the non-resident which is in the nature of interest or royalty or fees for technical services, then, such income shall be deemed to accrue or arise in India irrespective of the non-resident rendering services in or outside India etc. The pre-condition for magnetizing this Explanation is that the income of the non-resident should be in the nature of interest or royalty or fees for technical services. It is only in respect of these three categories of incomes that the deeming provision is attracted notwithstanding the non-resident not having a place of business in India or not rendering services in India. As the commission income of non-resident does not fall in any of these three clauses, namely, (v), (vi) or (vii) of section 9(1) of the Act, it is to be held that *Explanation* below section 9(2) cannot help the Revenue's case.

- It is apparent that the commission income in the hands of the non-resident can neither be considered as received or deemed to be received in India or accruing or arising or deemed to accrue or arise to him in India in terms of section 5(2). Once it is held that the commission income of a non-resident for rendering services outside India does not fall within the scope of his total income, it automatically implies that the same is not chargeable to tax in his hands.
- Sub-section (1) of section 195 provides that any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest 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, whichever is earlier, shall deduct income-tax thereon at the rates in force. A circumspection of this provision indicates that in order to attract the withholding of tax on a payment made to a non-resident, it is essential that the sum should be chargeable to tax in the hands of the payee under the provisions of this Act. It is quite natural also because a liability for deduction of tax at source pre-supposes tax liability in the hands of the payee. If there is no tax liability in respect of the payments made to the payee, there can be no question of deducting any income-tax at source from such payment. The natural outcome, which, therefore, emerges is that there can be no obligation of the assessee-payer to deduct tax at source on such commission payment to the non-resident.