



Withholding tax provisions cannot be applied to payments representing reimbursement of expenses. Further when income is computed as per the special provisions (section 42), no disallowance of expenditure can be made (under section 40(a)(i) of the Income-tax Act).

The Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of M/s. Cairn Energy India Pty. Ltd.¹ held that the withholding tax provisions under section 195 of the Income-tax Act, 1961 (the Act) cannot be applied to payments representing reimbursement of expenses having no element of income.

Further it was held that when income is computed as per the special provisions of section 42, no disallowance can be made under section 40(a)(i) as it is a settled law that general provisions cannot override special provisions.

Facts of the case

The taxpayer, a non-resident company, incorporated in Australia was engaged in prospecting for and production of mineral oils in India. It carried out its activities under a Production Sharing Contract (PSC), approved by the Parliament as per the requirements of section 42 of the Act.

The taxpayer had made certain reimbursements to its non-resident parent company in respect of expenditure incurred by the parent company in connection with the business activity carried on by the taxpayer in India and these amounts were claimed as revenue expenditure by the taxpayer under section 42.

¹ *M/s. Cairn Energy India Pty. Ltd. v. ACIT [2006] ITA Nos. 208 to 211(Mds)*

The Assessing Officer (AO) disallowed the above expenditure under section 40(a)(i) of the Act on the ground that the taxpayer failed to deduct the tax at source under section 195 of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] confirmed the order of the AO.

Issue raised before the Tribunal

Whether the expenditure is disallowed under section 40(a)(i) of the Act on the ground that the taxpayer had failed to deduct tax at source under section 195 of the Act?

Taxpayer's contentions

- Section 40 has to be strictly interpreted and its application has to be restricted only to those provisions over which it has the overriding effect i.e. sections 30 to 38 of the Act.
- Section 42 of the Act is a special provision² and therefore the computation of income had to be made in accordance with that section only and provisions of a section 40 being a general section cannot be applied to section 42.
- The payments represented reimbursement of the expenditure incurred by the parent company and had no element of profit in it³; consequently the provisions of section 195 could not be applied. In this context, attention was drawn towards the clauses of the PSC and the auditor's certificate of the parent company to stress that the payments represented actual expenditure.
- Neither the services were rendered in India nor the payment was received in India by the parent company and therefore the provisions of section 44BB could not be applied. Consequently the parent company was not chargeable to tax as per the provisions of the Act and therefore even on this ground the provisions of section 195 could not be applied.
- Alternatively, it was contended that in respect of assessment years 1998-99 and 1999-00 tax has been paid in the subsequent year and therefore deduction should be allowed in the year of payment.

Tax Department's contentions

- The provisions of sections 195 as well as section 40(a)(i) are applicable for all kinds of payments irrespective of the element of

² Reliance was placed on the Supreme Court's decision in the case of *CIT v. Enron Oil and Gas India Ltd.* [2008] 305 ITR 75 (SC) for the proposition that section 42 is a special provisions and a complete code in itself.

³ Reliance was placed on *CIT v. Siemens Aktiengesellschaft* [2008] 177 Taxman 81 (Bom) wherein it was held that no profit element is involved in the reimbursement of expenses

profit⁴ and that profit element is not required for deduction of taxes at source⁵.

- Section 42 is only a provision enabling special deductions and not a special provision, therefore the payments covered by section 42 are subject to application of section 40(a)(i), and section 42 does not have an overriding effect on section 40(a)(i).
- It is for the AO to decide the applicability of section 195 and not for the taxpayer⁶. If the taxpayer was of the view that no profit element was there, then it should have applied to the AO under section 195(2) and in absence of the same the provisions of section 195 became applicable.
- The taxpayer has not adduced any evidence to prove that the recharges by the parent company were made at cost and there may be income hidden or otherwise embedded therein.
- The taxpayer is deducting tax for and from the AY 2001-02 on similar payments and since there is no change in law and circumstances in the AY 2001-02, the taxpayer cannot argue now that it is not liable for deducting taxes at source⁷.

Tribunal's ruling

- A sum can be chargeable to tax only when it contains element of profit, if there is no element of profit embedded, then provisions of section 195 would not apply. The Tribunal referred to various rulings to hold that no income accrued to the parent company from payments by way of reimbursement of expenses and hence the provisions of section 195 were not applicable⁸. The Tribunal while discussing the rulings relied upon by the tax department held that all the decisions were distinguishable and therefore cannot be applied to the present case.
- The Tribunal referred to the clauses of the PSC and the auditor's certificate of the parent company and agreed with the taxpayer's

⁴ Reliance was placed on Alsthom Ltd. (Chennai); Frontier Offshore Exploration (India) Ltd. (Chennai); Transmission Corporation of India [1999] 239 ITR 587(SC); CBDT Circular no. 152, dated 27 November 1974

⁵ Reliance was placed on Cochin Refineries Ltd. [1996] 222 ITR 354; Timken India Ltd. AAR no. 617 of 2003 [2005] 273 ITR 67, Danfoss Ltd. AAR no.606 of 2002 [2004] 268 ITR 1 (AAR)

⁶ Reliance was placed on Poompuhar Shipping Ltd. [2006] 297 ITR 219 (Chennai)

⁷ Reliance was placed on the decision of Madras HC in the case involving Ramanlal [1976] 108 ITR 73 and the decision of Supreme Court in the case involving *East Coast Commercial Co. Ltd.*[1966] 63 ITR 449 (SC).

⁸ *CIT v. Siemens Aktiengesellschaft* [2008] 177 Taxman 81 (Bom, HC), *CIT v. Enron Oil and Gas International*[2005] ITA nos. 857 to 860 (Del/)

contention that the payments represented reimbursement of actual expenditure and there was no profit element embedded therein.

- The argument of the tax department that the taxpayer has himself deducted taxes at source on similar payments in subsequent years and that the taxpayer cannot argue now that it is not liable for deducting taxes at source, was not accepted by the Tribunal in light of the Supreme Court's decision in the case of National Thermal Power Co. Ltd. (229 ITR 383), wherein it has been held that even if the taxpayer has returned an income, the same can be challenged before the appellate authority on the ground that it is not taxable.
- The Tribunal further held that scheme of the Act makes it clear that the provisions of section 42 would prevail over the general provisions⁹ of computing income contained in section 30 to 38. Provisions of section 40 cannot be invoked when the income is to be computed under section 42 of the Act as it is a settled law that general provisions must give way to the special provisions¹⁰.

Our comments

This ruling has discussed and distinguished popular rulings which are generally relied upon by the tax department to bring such reimbursements into the withholding tax net and it would provide relief to overseas companies having bona fide cost to cost recharge from their overseas group companies. It stresses the need for the taxpayers to maintain robust documentation to substantiate the reimbursements being free of any profit elements.

However, the matter is not free from further litigation. Until then, it would be advisable for the taxpayers to go through the route of seeking a tax dispensation certificate under section 195(2) before remitting such sums to avoid unwarranted litigation at lower levels.

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⁹ Reference was also made to the CBDT Circular no. 308, dated 29 June 1981 and the Supreme Court's decision in the case of *CIT v. Enron Oil and Gas India Ltd.*

¹⁰ Reference was made to the Supreme Court's decision in the case of *CIT v. Shahzada Nand and Sons and Others*, [1966] 60 ITR 392 (SC) and the decision of Madras HC in the case of *CIT v. Cores Vulcan Inc.*[1987] 167 ITR 884(Mad)

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