KPMG

Tax Flash News

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The Indian payer can claim refund of taxes paid under the protest on behalf of the US company whose income is not taxable in India

Executive summary

As a business arrangement, many times a non-resident entity insist an Indian entity to bear the tax component in India. Section 248 of the Income-tax Act, 1961 (the Act) deals with such a situation where the Indian payer may file an appeal to the Commissioner (Appeals) for a declaration that no tax was deductible on the income of the non-resident where the Indian payer has already deducted tax under Section 195 and paid to the government. In such type of arrangements, Indian payers have been asking for refund of taxes paid on behalf of non-resident entities, where the income of the non-resident was not taxable in India.

Recently, the Bombay High Court in the case of Grasim Industries Ltd.[1] (the payer) dealt with the issue of eligibility of refund of tax deducted and deposited under the protest on behalf of the non-resident whose income was not taxable in India. The High Court held that the payer was eligible to claim a refund of the taxes paid on behalf of the non-resident payee as the income of such non-resident was not taxable in India. The tax department's insistence on the payer to deduct and pay the tax amount was not in accordance with the law. The amount of tax paid by the Indian payer must be refunded. The refusal of the tax department to refund the amount was not authorised by law. The payer's case was covered under Section 248 which deals with a situation where a refund could be made to the person by whom income is payable and who has deducted tax at source.

[1] Grasim Industries Ltd. v. ACIT (Writ Petition No. 2505 of 2012) (Bom) - Taxsutra

Facts of the case

- The payer, an Indian company, established a gas-based sponge iron plant in India and entered into a foreign technical collaboration agreement with the US company to avail technical services. The US company agreed to render the services outside India to the payer in relation to the Indian project.
- Under the agreement, it was agreed by both the parties that tax deduction, if any, was to be borne by the payer, and the US company would be paid the full amount decided in the agreement.
- The payer requested a No Objection Certificate (NOC) from the Assessing Officer (AO) to remit the payment to the US company without deduction of tax at source. The payer in its application contended that the technical services were rendered outside India and the fees were also paid outside India in foreign currency. Therefore, the income embedded in the said fees accrued and arose to the US company outside India.
- The AO held that the payment to the US company was taxable in India and the payer was required to deduct tax at source. Accordingly, the payer paid the tax at the rate of 30 per cent under protest.
- Subsequently, for the Assessment Years (AY) 1990-91 and 1991-92, the US company declared nil income in its tax return of income stating that their income does not accrue or arise in India. In that case, the Bombay High Court had directed the AO to pass a fresh order excluding income earned by the US company by way of FTS.

- In the meanwhile, the successor of the US company gave a 'no objection' to the payer for receiving the refund in connection with the taxes paid on FTS.

- Still, the AO refused to give effect to the order of the High Court holding that the payer was not entitled to the refund of tax deducted and deposited as the same was on behalf of the US company.

- Subsequently, both the payer and the US company filed a writ petition[2].

High Court's decision

- The amount deposited by the payer was technically an ad-hoc amount and not a TDS amount. The taxpayer had no option but to deposit 30 per cent tax under protest as directed by the AO.

- The High Court in its earlier decision confirmed that the amount paid to the US company was not chargeable to tax in India. Thus, the tax department's insistence on the taxpayer to pay the tax amount was not in accordance with the law and the amount already paid must be refunded to the taxpayer.

- Section 248 deals with a situation where a refund could be made to the person by whom income is payable and who has deducted tax at source.

- The tax department must proceed on the basis that the taxpayer did not have any obligation to make the payment. Thus, the amount wrongly deducted or paid to the tax department where it was not required to be paid would become refundable to the taxpayer subject to the condition that the person receiving the payment has not claimed credit for the same.

- CBDT Circulars[3] also envisage that in appropriate cases the tax department must grant a refund for the sums collected without lawful authority, independent of the provisions of the Act.

- The Circular dated 23 October 2007[4] states that where no income has accrued to the non-resident due to cancellation of contract or where income has accrued but no tax was due on that income or tax was due at a lesser rate, the amount deposited to the credit of the government, to that extent, cannot be said to be 'tax'.

- The refusal of the tax department to refund the amount was not authorised by law. Thus, the taxpayer was to be refunded the amount paid as TDS along with interest. The High Court referred to various decisions[5].

- The taxpayer's instructions that if there was any claim made by the US company or its successor-in-interest, the taxpayer would indemnify and keep indemnified the tax department harmless including legal fees, if any, was accepted as an undertaking given to the High Court.

- The tax department sought a stay. However, the High Court refused to grant a stay, particularly in view of the fact that the money was out of the hands of the tax department and already stands deposited with the High Court and the amount does not belong to the tax department.

Our comments

This is an important decision of the Bombay High Court where relief has been provided to the Indian payer who had deducted and deposited tax in India on behalf of the foreign company. The High Court directed the tax department to refund the amount of tax paid in India as the income of the foreign company was not taxable in India.

It is important to note that to obtain a refund of the tax deducted and paid by a person in India, there was no recourse prior to AY 2022-23 except by filing an appeal before the Commissioner (Appeals) under Section 248 of the Act. Therefore, the Finance Act, 2022 introduced Section 239A[6] to provide that such a person, who has made the deduction of tax under an agreement or arrangement and borne the tax liability, when no tax deduction was required, may file an application for refund of such tax deducted before the AO. Further such person can file an appeal against such order before the Commissioner (Appeals). However, this decision will help taxpayers to defend their case pertaining to years prior to introduction of Section 239A.

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[2] Writ Petition No. 448 of 1994
[3] Circular No. 769, dated 6 August 1998 and Circular No. 790, dated 20 April 2000
[4] Circular No.7, dated 23 October 2007

[5] Commissioner of Income Tax v. Shelly Products [2003] 261 ITR 367 (SC), New India Industries Ltd & Anr. v UOI & Anr. AIR (1990 Bom 239), Nirmala L. Mehta v. A. Balasubramanian [2004] 269 ITR 1 (Bom), Amalgamated Coalfies Ltd. v. Janapada Sabha (AIR 1961 SC 964), Balmukund Acharya v. DCIT [2009] 310 ITR 310 (Bom)
[6] With effect from AY 2022-23

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