Tax Flash News

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The Indian subsidiary of a Korean company is not an 'assessee-in-default' for non-deduction of tax at source on the income attributed towards a notional payment to the Korean company

Executive Summary

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of LG Electronics India Ltd[1] (LG India) observed that that the Assessing Officer's (AO) attribution of profit relating to transaction of LG India and its Korean holding company (LG Korea) was on a notional basis and not based on any actual payments. The Dispute Resolution Panel (DRP) had suggested a notional income for attribution as a 20 per cent mark-up on the 50 per cent salary cost of expatriate employees. However, LG India had not made any direct payment to LG Korea towards the salary cost of expatriate employees. The salary cost was paid to the expatriate employees and on that LG India had deducted tax at source under Section 192 of the Income-tax Act, 1961 (the Act). Thus, LG India cannot be expected to perform the impossible act of computing TDS on a notional payment. Since there was no obligation on LG India to withhold tax under Section 195, it cannot be treated as an 'assessee in default' in terms of Section 201(1)/201(1A).

Facts of the case

- LG India is a wholly-owned subsidiary of LG Korea. It is engaged in trading, assembly, manufacturing, marketing and sales of electronics and home appliances.

- During the relevant assessment years[2], LG India had entered into various international transactions with LG Korea and other associated non-resident companies for purchase of raw materials, finished goods, capital goods, etc. LG India had not deducted tax at source while making payments for such transactions.

- The Assessing Officer (AO) held that the payments made by LG India towards the purchase of raw materials, finished goods, capital goods to LG Korea and other non-resident associated companies, were taxable in India, as all those entities have a PE in India. Therefore, LG India was liable to deduct tax at source under Section 195 and in the absence of the same LG India was treated as an 'assessee in default' under Section 201(1)/201(1A).

- LG India filed a writ petition before the Delhi High Court. The High Court set aside the orders passed by the AO and held that the orders were passed in violation of the rules of natural justice. The High Court directed that the AO may issue a fresh show-cause notice and decide the issue.

- The AO then issued fresh show-cause notices under Section 201 on 12 July 2011, to which LG India submitted its reply on 17 August 2011. Thereafter, no further steps were taken by the AO. Again, after almost four years, the AO issued another show-cause notice on 9 January 2015.

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[1] LG Electronics India Ltd. v. ITO (ITA No.7929/Del/2018) (Del) – Taxsutra.com

[2] Assessment Years 2005-06 to Assessment Years 2011-12

- The AO rejected the objection filed by LG India and passed the orders under Section 201(1)/201(1A) treating LG India as an 'assessee in default'.

- The first appellate authority rejected all the contentions of LG India. However, confirmed the attribution of profit to the PE to the extent of 20 per cent markup over 50 per cent of the salary paid to expatriate employees as per the DRP's order.

- Thus, LG India filed an appeal before the ITAT.

Tribunal's decision

- While passing orders under Section 201(1)/201(1A), the basis for the computation of TDS default was payment to LG Korea and other non-resident group entities towards the purchase of raw materials, capital goods, spare parts, etc. However, subsequently, the position changed substantially as in the case of payee entities, the DRP held that only LG Korea had a PE in India and no other non-resident group entities had any PE in India.

- The method of attribution of profit to the PE of LG Korea was changed from payment made towards the purchase of raw material, finished goods, spare parts, etc. to a notional payment of 20 per cent mark-up on 50 per cent salary cost of expatriate employees.

- The basis of attribution of profit to LG Korea was purely notional as LG India had not paid any salary cost of expatriate employees directly to LG Korea.

- On the salary cost paid to the expatriate employees, LG India had deducted tax at source under Section 192.

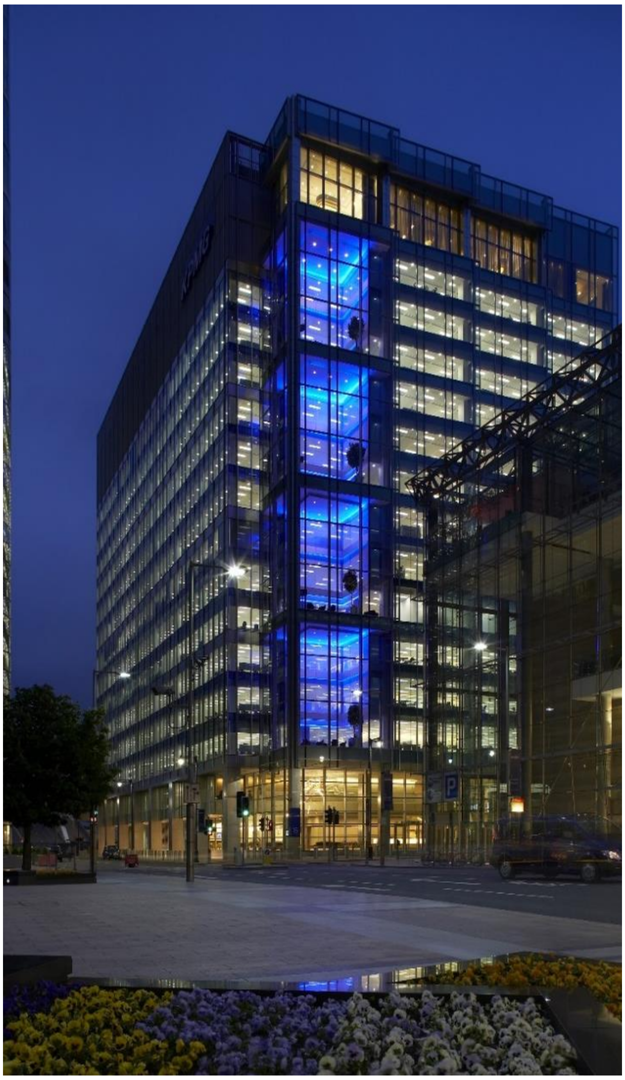
- Thus, when LG India had not made any direct payment to LG Korea towards the salary cost of expatriate employees, there was no liability on LG India to deduct tax on such notional payments.

- LG India cannot be expected to perform the impossible act of computing TDS on a notional payment. The Tribunal relied on the decision of the Delhi High Court in Samsung India Electronics Pvt. Ltd[3].

- As per assessment proceedings and ITAT order in the case of LG Korea for the assessment years under consideration, there was no tax liability of LG Korea in India. Since there was no obligation on LG India to withhold tax under Section 195, it cannot be treated as an 'assessee in default' in terms of Section 201(1)/201(1A).

Our comments

Attribution of income to a foreign company's PE in India has been a complex issue. The deduction of tax on payment to foreign companies considering such attribution of income creates further complexities. The Delhi Tribunal in this decision laid down important principles concerning the deduction of tax at source on notional payments to foreign companies. The Tribunal held that the Indian company cannot be expected to perform an impossible act of computing TDS on a notional payment. This decision may help taxpayers where no actual payments have been made by the Indian company to a foreign company and the AO has determined the attributable profit on a notional basis.



[3] Samsung India Electronics Pvt. Ltd. v. DCIT [2014] 364 ITR 103 (Del)

KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally
Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
2nd Floor, Block T2 (B Wing),
Lodha Excellus, Apollo Mills Compound, N M
Joshi Marg, Mahalaxmi, Mumbai- 400011
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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