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TAX FLASH NEWS

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Under India-Italy tax treaty, tax is to be deducted on actual payment of royalty

Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Saira Asia Interiors (P.) Ltd.[1] held that under Article 13 of the India-Italy tax treaty (tax treaty), taxability of royalty is dependent on the payment by the resident of a state and receipt of the same by the resident of the other state. Therefore, unless the actual payment takes place, the taxability under Article 13 of the tax treaty does not arise.

Facts of the case

- The taxpayer, an Indian company, was liable to make a payment of INR5 crore on account of technical know-how, to Saira Europe SPA, Italy.
- This liability was duly accounted for in the books of accounts on 22 November 2010, though the payment was made, a bit later, on 12 May 2011. The tax of INR53 lakh was duly withheld from the payment so made, and it was deposited on 20 June 2011.
- A demand for interest under Section 201(1A) of the Income-tax Act, 1961 (the Act) was raised on the taxpayer by treating the due date for depositing tax deductible at source as 7 December 2010, being days from the end of the month in which amount was credited in the books of accounts.
- Aggrieved, the taxpayer carried the matter in appeal before the Commissioner of Income-tax (Appeal) [CIT(A)]. It was contended by the taxpayer that the taxability on the amount of INR5 crore, which was taxable under Article 13 of the tax treaty only at the point of time when it is actually paid, did not arise at the point of time when credit was afforded to the recipient in the books of accounts.
- The CIT(A) rejected the taxpayer's contentions.

Tribunal's ruling

- It is only elementary that the tax deduction source liability under Section 195 of the Act is a vicarious liability in the sense that it's survival in the hands of tax-deductor is wholly dependent on existence of tax liability in the hands of recipient of income. When a credit afforded by, or a payment made by, an Indian resident, to a non-resident, does not trigger the taxability of that income in the hands of recipient, the tax deduction liability does not come into play at all. This scheme of the Act is implicit from the wordings of Section 195(1) of the Act.
- When income embedded in a payment is not taxable under the Act, the tax withholding liability does not get triggered at all. This is what Supreme Court has also held in the case of G E Technology Centre Pvt. Ltd.[2].
- The decision to withhold tax from a credit or payment to a non-resident is not taken in vacuum. It is taken in the light of the tax liability of the non-resident in respect of the amount in question, and, if there were any doubts on this proposition, these doubts have now been set at rest by the Supreme Court.

[1] Saira Asia Interiors (P.) Ltd v. ITO [2017] 79 taxmann.com 460 (Ahd)

[2] G E Technology Centre Pvt Ltd v. CIT [2010] 327 ITR 456 (SC)

- Essentially, therefore, the provisions of Section 195 of the Act are to be read in conjunction with the charging provisions under the statue, as also in conjunction with the relevant double taxation avoidance agreements which override these charging provisions.
- This is subject to the rider, as set out in Section 90(2) itself that the provisions of the relevant tax treaty are to be ignored in a situation in which provisions of the Act are more beneficial to the taxpayer vis-à-vis the provisions of the Act.
- Clearly, therefore, so far as tax deduction at source liability under Section 195 of the Act is concerned, all that is required to be seen is the taxability of income embedded in a payment, in the hands of the non-resident, as existing in law.
- As for the point of time of crediting the amount payable to non-resident, i.e. 'at the time of credit of such income to the account of payee', the royalty so paid by the taxpayer was not taxable in the hands of the resident, for the simple reason that, in terms of Article 13 of tax treaty, taxability of royalty is dependent on the payment by the resident of a contracting state and receipt of the same by the resident of the other contracting state. Unless, therefore, the actual payment takes place, the taxability under Article 13 of India-Italy tax treaty does not arise. This view has also been upheld by the Mumbai Tribunal in the case of National Organic Chemical Industries Ltd[3].
- The payment was made by the taxpayer on 12 May 2011 and the tax so deducted was payable within seven days from the end of May 2011, i.e. by 7 June 2011. The taxpayer has, however, deposited the said tax deducted at source on 20 June 2011. The delay in depositing the tax deducted at source was thus only for 12 days. To this limited extent, the Assessing Officer (AO) could have levied interest under Section 201(1A) of the Act. However, the authorities below have upheld the tax liability under Section 20(1A) by computing the period of delay with reference to the date on which the amount was credited to payee's account. That is where the authorities below were in error and the Tribunal rejected the action of the authorities below to that extent.
- It is only at the point of time when payment takes place, that the income embedded in payment becomes taxable under the tax treaty as also under the domestic law, but then rate of tax prescribed in domestic law being lower, vis-à-vis the rate prescribed in the tax treaty, the taxpayer has the option of adopting the lower rate under the domestic law. The adoption of lower rate under the domestic law, in our humble understanding, does not imply that non-resident recipient could have been saddled with tax liability at the point of accrual when, under the tax treaty provisions, the non-resident could not have been taxed, in respect of accrual of the said income, in India.

Our comments

The issue with respect to taxability of royalty vis-à-vis actual payment has been a matter of debate before the courts.

The Bombay High Court in the case of Siemens Aktiengesellschaft [4] held that the assessment of royalty or fees for technical services under India-Germany tax treaty should be made in the year in which the amounts are received and not otherwise.

In the instant case, the Ahmedabad Tribunal has held that unless royalty has actually been paid, the taxability under Article 13 of the India-Italy tax treaty does not arise. The Tribunal also observed that the taxpayer can adopt a beneficial tax rate under the provisions of the Act, though the timing of deduction of tax at source was determined based on the payment under the provisions of the tax treaty.

[3] National Organic Chemical Industries Ltd. v. DCIT [2005] 96 TTJ 765 (Mum)

[4] DIT v. Siemens Aktiengesellschaft (ITA No. 124/2010) (Bom)

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