

## Delhi High Court rules that obligation to withhold tax would arise only if the income is liable to tax in India

The Delhi High Court has delivered a landmark ruling on the obligation of the payer to withhold tax on the reimbursement of costs to a non resident. The High Court has held that the withholding tax obligation would arise only if there was income liable to tax in India.

### Facts of the case

- Van Oord ACZ India Private Limited (“VO India”) is an Indian company and a wholly owned subsidiary of Van Oord ACZ Marine Contractors BV, Netherlands (“VOAMC”), a Dutch company.
- VO India was engaged in the business of dredging, contracting, reclamation and other marine activities. VOAMC was awarded a dredging contract at a port in India, which in turn was assigned to and executed by VO India.
- VOAMC contracted with various non-resident service providers for mobilization and demobilization services related to transportation of dredger, survey equipment and other machineries for execution the contract. VO India reimbursed those mobilization/ demobilization charges to VOAMC based on the invoices of the non resident service providers.
- VO India earlier made an application to the Revenue under section 195(2) of the Income tax Act, 1961 (“the Act”) for issuing a nil withholding certificate for the above payments. The Revenue held VO India as a dependent agent permanent establishment (“PE”) of VOAMC in India and issued directions to withhold tax on certain proportion of the reimbursement. VO India deducted the tax and paid the balance to VOAMC.
- Later on, VOAMC filed its return and claimed the refund of taxes withheld by

### Upcoming Events

- [Transfer Pricing Documentation and Dispute Resolution: Making or Breaking the Corporate Tax](#)
- [Workshop on 'Successful EPC Contracting in India – Addressing Fiscal and Legal Challenges', May 13-15, 2010, New Delhi, India](#)

### Awards & Recognitions

- [BMR Advisors ranked second most active transaction advisor \(Private Equity\) in 2009, Venture Intelligence League Table](#)
- [BMR ranked Tier 1 Tax Transactional Firm, International Tax Review's online poll, 2010](#)
- [BMR is Transfer Pricing Firm of the Year and wins India Case of the Year award, International Tax Review Asia Awards, 2009](#)

### Contributors

- [Sriram Seshadri](#)
- [Ashka Dave](#)

### Contacts

- Bobby Parikh, Mumbai

VO India. The Revenue granted the refund under a summary audit.

- Thereafter, VO India reimbursed the charges to VOAMC without withholding tax and claimed the expenditure in the return of income.
- The Revenue disallowed the reimbursement under section 40(a)(i) of the Act on the basis that VO India failed to withhold tax. On appeal, the Tribunal by relying upon the decision of Supreme Court in Transmission Corporation of AP, held in favour of the Revenue and confirmed the disallowance.

### Questions before the High Court

- Whether the Tribunal erred in holding that VO India was liable to withhold tax under section 195 of the Act on reimbursement of mobilization cost?
- Whether the Tribunal erred in holding that VO India was obliged to withhold tax and it had no right to determine the liability to tax in India of a sum to be paid?

### Appellant's contentions

- The obligation to withhold tax under section 195 of the Act would arise only if the non resident was liable to tax in India. Hence, before withholding tax, it is essential to determine the liability to tax on the non-resident in India.
- The direction of Revenue under section 195(2) of the Act would not apply as the Revenue itself had refunded the taxes withheld by VO India under a summary audit under section 143(1) of the Act. The refund of taxes by Revenue would clearly show that VOAMC did not have any PE in India and thus the reimbursement made by VO India was not liable to tax in India and therefore, the disallowance under section 40(a)(i) of the Act was not warranted.

### Revenue's contentions

- VO India itself made an application to the Revenue for determining its withholding tax liability on reimbursement made to VOAMC. Once the Revenue issued direction to withhold tax on reimbursement, VO India's liability to withhold tax was crystallized.
- VO India could not produce any details to demonstrate that there was no element of income in the remittance of mobilization / demobilization charges and therefore, VO India was obliged to withhold tax.

+91 22 3021 7010

[bobby.pariikh@bmradvisors.com](mailto:bobby.pariikh@bmradvisors.com)

- Mukesh Butani, New Delhi  
+91 11 3081 5010  
[mukesh.butani@bmradvisors.com](mailto:mukesh.butani@bmradvisors.com)
- Rajeev Dimri, New Delhi  
+91 11 3081 5050  
[rajeev.dimri@bmradvisors.com](mailto:rajeev.dimri@bmradvisors.com)
- Abhishek Goenka, Bangalore  
+91 80 4032 0100  
[abhishek.goenka@bmradvisors.com](mailto:abhishek.goenka@bmradvisors.com)
- Sriram Seshadri, Chennai  
+91 44 4298 7000  
[sriram.seshadri@bmradvisors.com](mailto:sriram.seshadri@bmradvisors.com)
- Gagan Malik, Singapore  
+65 6408 8004  
[gagan.malik@bmradvisors.com](mailto:gagan.malik@bmradvisors.com)

## Decision of the High Court

- The issue before the Supreme Court in the case of Transmission Corporation was whether tax should be withheld under section 195 of the Act on the gross payment or only on the profit element therein. The Supreme Court was not confronted with a situation where the payment was not liable to tax in India at all.
- Once the sum payable is chargeable to tax, the taxpayer cannot determine the quantum of income on which tax should be withheld. However, the liability to withhold tax would arise only when the payment to the non resident was liable to tax in India.
- Section 195(2) of the Act allows the taxpayer to seek the determination of taxability of the payments to non resident. However, it is only a tentative determination. At that stage, the Revenue cannot be said to have taken a final view on the liability to tax in India.
- Where an application is made under section 195(2) of the Act and the Revenue determines that the payment is liable to tax in India, the payer would be obliged to withhold tax on such payment. However, since the Revenue has refunded the taxes so withheld by accepting the return filed by the non-resident, even though in a summary audit, the taxpayer would not be obliged to withhold tax in subsequent years.
- VO India cannot be held to be liable to withhold tax merely based on the probability that Revenue can proceed to carry out a scrutiny audit against the return filed by VOAMC and hold it liable to tax on the mobilization cost. If the income of VOAMC is found to be liable to tax in India in a subsequent proceeding, it would be open for the Revenue to treat VO India as having defaulted in its obligation to withhold tax.

Accordingly, the High Court held that VO India was not liable to withhold tax on the reimbursement of mobilization / demobilization charges to VOAMC.

### **BMR comments and analysis**

This is an important ruling as the High Court has reiterated the principle that obligation to withhold tax would arise only if the income is liable to tax in India. The High Court has also dissented with the recent ruling of the Karnataka High Court in the case of Samsung Electronics wherein it was held that the payer should withhold tax on all payments to non-residents and that the payer cannot

determine whether or not, the income was liable to tax in India. Further, this ruling also approves the Special bench decision in the case of Mahindra and Mahindra, where it was held that reimbursement of expenses is not liable to tax in India. All attention will now be on the proceedings and decision of the Supreme Court as it hears the appeals against the Samsung and other rulings of the Karnataka High Court.

**Disclaimer:**

This newsletter has been prepared for clients and Firm personnel only. It provides general information and guidance as on date of preparation and does not express views or expert opinions of BMR Advisors. The newsletter is meant for general guidance and no responsibility for loss arising to any person acting or refraining from acting as a result of any material contained in this newsletter will be accepted by BMR Advisors. It is recommended that professional advice be sought based on the specific facts and circumstances. This newsletter does not substitute the need to refer to the original pronouncements.



[Contact Us](#) | [Archives](#)

