Corporate Update

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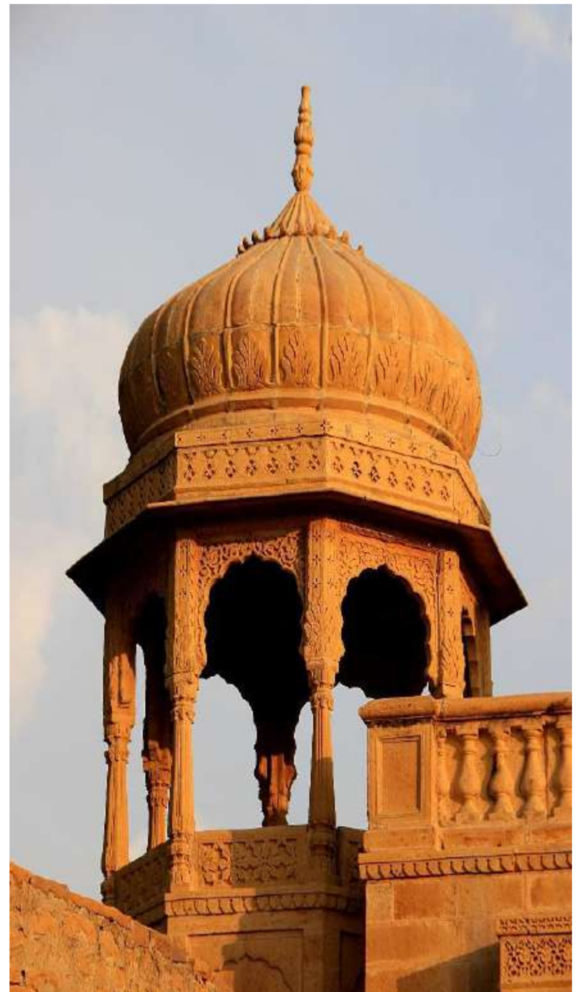

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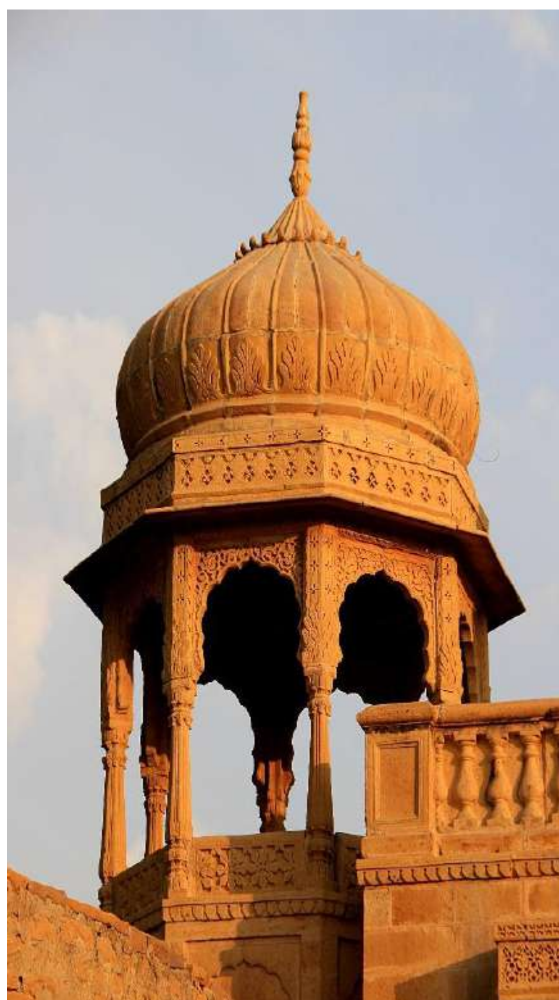

FOREWORD

Dear Reader,

Voting for election of members of Indian Parliament is presently in progress in India and is likely to be completed in a few phases ending on June 01, 2024. It is expected that results of voting would be declared on June 04, 2024 and thereafter a new Government would be formed. The Government would, thereafter, announce its policies and present the full Annual Budget for the fiscal year ended March 31, 2025 sometime in the month of June / July 2024.

In the meantime Indian Economy continues to do well, having achieved GDP growth of around 7% in the year ended March 31, 2024. The Direct Tax collections surpassed the Revised Budget Estimates by 17% and Indirect Tax collection also showed good growth.

In this update we cover summary of important judgments of Courts, Tribunals on Direct Taxes, as well as information on notification issued by the Ministry of Finance, Government of India.

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DIRECT TAXES

INTERNATIONAL TAXATION

CASE LAWS

Issue of draft order is mandatory as per sec 144(1) even if the order is passed pursuant to the revisionary order passed by the Commissioner.

In a recent decision in case of **Sinogas Management Pte Ltd versus Deputy Commissioner of Income Tax & ANR [W.P.(C) 1879/2023],** the High Court of Delhi quashed the order passed by the AO pursuant to the directions of the CIT under section 263, without first issuing the draft order as per section 144(1) of the Act.

In the instant case, the assessee, a tax resident of Singapore, is primarily engaged in the business of operating ships. It filed its return of income in India declaring NIL income for the Assessment Year ("AY") 2017-18. The return of income was selected for scrutiny under section 143(3) of the Act. The assessee submitted the details sought asserting that it does not have a permanent establishment in India and that its income fell within the purview of Article 8 of the India-Singapore Double Taxation Avoidance Agreement ("DTAA") and as such is taxable only in Singapore. The return of income filed by the assessee was accepted, and an order was passed without making any additions to the total income declared.

However, CIT issued a notice under section 263 of the Act, proposing to revise the assessment order on the grounds that the AO had failed to appreciate various relevant factual and legal aspects before accepting the assessee's computation. CIT held that the assessment order passed by the department was not only flawed, but also detrimental to revenue's interest. Thus, the CIT remanded the matter back to the AO with instructions to revise the assessment order and tax the income received by assessee, as per the provisions of the Act.

Consequently, the AO issued the final assessment order overruling the earlier assessment order, whereby the assessee's claim to benefits under the DTAA was negated, and its income was assessed to tax under the Act.

Aggrieved, the assessee filed a Writ Petition before the High Court contending that as the assessee is a foreign company, it qualifies as an 'eligible assessee' as per section 144C(1) of the Act. Therefore, a draft assessment order before passing the final assessment order was required to be passed to entitle it to raise objections before the Dispute Resolution Panel ("DRP").

Revenue argued that section 144C would not apply to revisionary powers under section 263, as the purpose of the latter is disparate from the former. Schematic method of interpretation should be used, with the design or purpose of the relevant provisions in mind, rather than the letter of the legislation. Further, as per section 144C(14A), such provisions do not apply to any assessment/ re-assessment order passed by the AO with prior approval of Principal Commissioner or Commissioner as provided under section 144BA(2).

The High Court observed that 'Schematic and teleological method of interpretation as advanced by the revenue underscores the significance of understanding the larger purpose behind a provision, rather than adopting a strictly literal interpretation. It must therefore be ascertained whether bypassing the procedures of Section 144C(1) would align with such an interpretative approach.

The High Court held that order passed by the AO in remand proceedings to give effect the directions of the CIT, issued under Section 263 of the Act, yet it qualifies as a fresh assessment order within the ambit of Section 143(3) of the Act. The process outlined in Section 144C(1) of the Act is not discretionary, but mandatory. It must be adhered to even when the assessment order is issued in line with directions from a higher authority. The omission to do so renders the subsequent actions and orders/ notices ensuing from this foundational oversight, as unlawful. Consequently, it renders the order issued by the AO void of jurisdiction. The High Court also held that the nature of proceedings initiated under section 144BA differs from the ones commenced under section 263. Section 144C(14A) does not dispense with the AO's obligation to intimate a draft order to an eligible assessee, which includes foreign companies like assessee. Therefore, the reliance placed by the Revenue on section 144C(14A) is misconceived.

On the argument of the Revenue of existence of an alternate remedy to challenge the AO's order, the High Court reiterated that procedural lapses, especially ones that could impact the jurisdiction of an order, need rectification at the earliest stage. Delaying this to appellate stages, results in unnecessary procedural complexities and prolonged litigation, which is contrary to the principles of effective and efficient justice delivery.

The High Court therefore quashed order the assessment order along with demand notice and penalty notice. The matter was remanded back to AO to proceed in terms of order dated March 24, 2022 passed by CIT under Section 263 of the Act.

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Management/Processing Fee linked to ECB loan guaranteed by Hermes Deckung is not taxable under Article 11 of India-Germany DTAA

Aka Ausfuhrrkreditgesellschaft MBH [TS-43-ITAT-2024 (DEL)]

In a recent judgment, the Tax Tribunal, Delhi bench held that the management/processing fee linked to the external commercial borrowing loan granted by a German banking company (taxpayer) to an Indian company (guaranteed by Hermes Deckung) shall not be liable to tax under Article 11(3)(b) on 'Interest' under India- Germany DTAA.

In terms of Article 11(3)(b) of tax treaty between India and Germany, interest paid in consideration of loans guaranteed by HERMES-Deckung are exempt from Indian tax.

On the facts of the case, the assessee granted an external commercial borrowing (ECB) loan to an Indian company, which was guaranteed by HERMES Deckung. The taxpayer received interest along with connected fees such as, management/ processing fee, documentation fee and commitment fee.

The assessee adopted the position that such interest as well as the management/ processing fee, documentation fee and commitment fee were exempt from tax in terms of the specific provisions of Article 11(3)(b) of the tax treaty.

The tax authorities, while scrutinizing the aforesaid tax position, accepted the assessees's claim of non-taxability of interest, documentation fee and commitment fee. However, the authorities held that management/processing fee is not covered under the definition of interest under Article 11 of DTAA. The tax authorities held that such fee is taxable as fee for technical services (FTS) under Article 12 of the tax treaty.

When the matter travelled to Tax Tribunal, the Tax Tribunal analysed Article 11(3)b) of DTAA and noted that 'interest' as defined under the tax treaty includes income from debt claim of any kind. The Tribunal also noted that the term 'interest' under section 2(28A) of the Act includes 'service fee' as well as other charges in respect of monies borrowed or debt incurred. Thus, the Tribunal arrived at a conclusion that interest covers all kinds of payments attached to the loan.

The Tax Tribunal held that management/processing fee is closely linked to the loan and cannot be distinguished from the documentation fee and commitment fee. It was undisputed that documentation fee and commitment fee would be included within the scope of interest and hence, the management fee/ processing fee would also be given a similar tax treatment.

Accordingly, the management/processing fee was held to be exempt from taxation in India in terms of Article 11(3)(b) of the DTAA.

Note: A Hermes cover (Hermesdeckung) is an Export Credit Guarantee (ECG) by the German Federal Government.

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PROTOCOL / NOTIFICATION, REGARDING DTAA

Protocol amending India-Mauritius tax treaty signed to make it compliant with BEPS

Under the Base Erosion and Profit Shifting (BEPS) initiative of the OECD, various action statements were introduced to address the issue of tax evasion. More specifically, an Action Statement 6 was issued that made certain recommendations to counter abuse of tax treaty provisions to derive tax benefits. Such recommendations included changing of the preamble, inclusion of a Limitation of Benefit clause and inclusion of a Principal Purpose test ('PPT').

Mauritius was earlier considered a preferred route for inbound investments into India. This was due to the favourable capital gains provisions (Article 13) that existed in the tax treaty between India and Mauritius. In terms of such provision, capital gains on sale of shares held by a Mauritius resident in an Indian company were not chargeable to tax in India.

In 2016, Article 13 of the DTAA was revised through which India received taxing rights on capital gains in respect of shares acquired on or after April 01, 2017 (subject to certain conditions, such as the Limitation of Benefits clause in Article 27A).

However, investments made prior to April 1, 2017, were grandfathered and as such, capital gains thereon were not liable to tax in India.

Now, certain recommendations of Action Statement 6 have been introduced in the tax treaty between India and Mauritius, by way of an amending protocol that was signed on March 07, 2024. In terms of the amending protocol, the following amendments have been made:

a. The preamble of the existing tax treaty stated that the objective of entering of the tax treaty was for avoidance of tax and 'encouragement of mutual trade and investment'. The latter phrase has been removed and instead, it has been emphasized that the purpose of entering into the treaty is not to create opportunities for 'non-taxation' or 'reduced taxation'.

   The amendment to Preamble shall ensure that the tax treaty is not misused by multinational enterprises to achieve double non taxation or reduced taxation.

b. Introduction of PPT rules through new Article 27B, in terms of which, tax administrations can deny benefits of the tax treaty benefit if the principal purpose of the arrangement / transaction was to obtain benefit under the treaty. PPT rules will ensure that treaty benefits are granted only to transactions entered into with a *bonafide* purpose.

The protocol shall enter into force after both contracting states complete the respective internal formalities. However, it is noteworthy that the amending protocol appears to have retrospective application. Unlike the 2016 amendments made to the tax treaty, the present Protocol appears to apply the aforesaid preamble and PPT rule even to capital gains, the shares in respect of which, were acquired prior to April 01, 2017. In other words, the capital gains which were hitherto understood to be exempt on account of grandfathering provisions, shall now be tested under the new PPT rule, to be eligible for exemption.

Thus, it is widely being speculated that the grandfathering of investments made prior to April 01, 2017 has been watered down to some extent.

Nevertheless, the Indian income tax authorities have clarified on a social media platform that the queries related to the above development shall be addressed when the Protocol comes into force.

It is apt to state here that the Multilateral Convention framework ('MLI') also included the aforesaid changes to the preamble, introduction of PPT rules etc. Although both India and Mauritius are signatories to the MLI, the tax treaty between India and Mauritius is not a covered tax agreement therein. As such, the aforesaid measures have been introduced at a bilateral level.

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Reduction in Applicable Tax Rate on Royalties and Fees for Technical Services under India- Spain DTAA

Notification no. 33/2024 F.No. 503/2/1986-FTD-I dated March 19, 2024

Recently, the Supreme Court in the landmark case of *Nestle S A [2023] 155 taxmann.com 384* held that the benefit of a lower rate of tax agreed by India in a subsequent tax treaty cannot be directly imported to another treaty by way of a Most Favoured Nation ('MFN') clause, unless the same is separately notified by the Government of India. Thus, MFN clause is not self-executing and it is mandatory to

issue a notification under section 90 of the Income-tax Act to implement changes in the provisions of a tax treaty.

The protocol to India-Spain DTAA also contains a MFN clause, in terms of which, if India enters into a DTAA with an OECD member country which comes into force after January 1, 1990 and limits its taxation on royalties and FTS to a rate lower or scope more restricted, the same rate or scope shall apply to the India-Spain DTAA also.

Under the erstwhile provisions of Article 13(2)(ii) of India- Spain DTAA, the prescribed rate of tax for Royalties and FTS was 20%. However, for royalties relating to the payments for the use of, or the right to use, industrial, commercial or scientific equipment, a concessional tax rate of 10% was applicable pursuant to Article 13(2)(i) of DTAA. It may be mentioned that Germany, which is an OECD member since October 26,1996, had entered into a DTAA with India, wherein, the corresponding tax rates for Royalties and FTS under Article 12 is 10%.

The Government of India has now given effect to the MFN clause under the India-Spain DTAA by way of notification number 33/2024 dated March 19, 2024, substituting Article 13(2) of the India-Spain DTAA.

In terms of this notification, the applicable tax rates for Royalties and FTS under the India-Spain DTAA have been brought at par with the corresponding tax rates prescribed under the India-Germany DTAA.

Resultantly, the prescribed tax rate for all royalties and FTS under Article 13 of the India-Spain DTAA is now 10%. As per the notification, the amendment shall be applicable with effect from the Assessment Year 2024-25.

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DOMESTIC TAXATION

CASE LAWS

Provision for Liquidated Damages is allowable as a deduction

PCIT v. Humboldt Wedag India (P.) Ltd. [2024] 160 taxmann.com 605 (Del HC)

Recently, the Delhi High Court has, in respect of the above issue raised before it, held that provision for liquidated damages is an allowable deduction under Section 37(1) of the Income-tax Act.

Brief facts of the case are that the assessee is engaged in the business of manufacturing cement plant technology equipment and provision of services towards supply of such equipment. It entered into a written contract with its customers which contained a specific clause for payment of liquidated damages to the customers for delay in deliverables. Since time was essence of the contract, any delay in delivery would have resulted in liability to damages, the assessee created a provision for liquidated damages. The assessee created a provision for liquidated damages at the year-end as a percentage of the contract value considering the period of delay in meeting its contractual obligations. Thereafter, it proceeded to claim deduction of such provision in its return. In case the customers waived a portion of the liquidated damages in subsequent year, the assessee reversed the amount of earlier provision created and offered to tax such amount in the return of such year.

In the year under consideration of subject appeal, the assessee claimed deduction of provision of liquidated damages amounting to INR 89.8 million in its return. The tax officer disallowed such deduction on the premise that the assessee was not able to substantiate the scientific methodology adopted for quantifying such provision. However, the Commissioner (Appeals) as well as the Tax Tribunal decided the appeal in favour of the assessee by allowing the claim of liquidated damages.

In appeal by the Revenue before the Delhi High Court, the Court noted that both the Commissioner (Appeals) and the Tax Tribunal had held that the assessee created the provision of liquidated damages due to its contractual obligation, past experience and reasonable basis of estimation regularly followed by it. It was also noted that where in any particular year, the customer waived a portion of the liquidated damages, the assessee had shown that it had reversed such provision in its financial statements and had paid taxes on such reversal.

Based on the aforesaid, the Tax Tribunal concluded that once it is proved that the assessee had made payment of taxes on reversal of excess provision, and liquidated damages on delay in deliverables, the assessee is eligible to claim deduction of the provision for liquidated damages as an admissible expenditure under Section 37(1) in its return.

Based on the above, the Delhi High Court sustained the aforesaid finding of the Tax Tribunal and answered the appeal in favour of the assessee.

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Employee Contributions for Provident Fund (PF) & Employee State Insurance (ESI) deposited beyond due date is disallowable under section 143(1)

In a recent decision in the case of **Rohan Korgaonkar vs. Deputy Commissioner of Income Tax [TS-85-HC-2024(BOM)],** the High Court of Bombay at Goa upheld the disallowance under section 143(1) for payment of Contribution towards PF and ESI deposited beyond due date under the relevant Acts. The High Court held that it makes no difference whether or not adjustment to the income is made under section 143(3) of the Act upon assessment.

In the instant case, the assessee failed to deposit the contributions to ESI and PF in the employee's accounts for the AY 2018-19 by the due date under the relevant Acts. However, such contributions were deposited before filing of return of income under section 139(1) of the Act.
The AO, CIT(A) and ITAT decided the issue against the assessee.

The ITAT relying upon the decision of **Hon'ble Supreme Court in Checkmate Services Pvt. Ltd. & ors. V/s Commissioner of Income Tax & ors (2022) 448 ITR 518 (SC**) held that no deductions could be claimed for delayed deposits even if the amounts were deposited before the due date of filing the return of income.

The assessee filed an appeal before the High Court against the order passed by ITAT.

The assessee relying upon the decision of ITAT in the case of **M/s P.R. Packaging Service V/s Assistant of Commissioner of Income Tax, ITA No. 2376/MUM/ 2022** submitted before the High Court that Checkmate Services Pvt. Ltd. (Supra) was a matter where the assessment was made under section 143(3) of the Act and not

under section 143(1)(a) as in the present case.

The High Court, however, held the fact that the assessment order in Checkmate case (supra) was made under section 143(3) and the assessment order in the present case is under section143(1)(a), makes no difference to the principle involved in the matter. Therefore, the High Court dismissed the appeal of the assessee.

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Share premium money is a capital receipt; violation of any provision of other Act would not alter the nature of such receipt

Shendra Advisory Services (P.) Ltd. [2024] 159 taxmann.com 557 (Bombay)

The Bombay High Court has held that the money received on account of issue of shares at premium is a capital receipt. Non-compliance of provisions of Companies Act, 1956 regarding share premium would not turn it into a revenue receipt.

From Assessment Year 2008-09 to 2012-13, the Assessee issued shares to its promoters, including a foreign promoter to whom shares were issued at premium. This share premium money was invested by the Assessee. During the scrutiny proceedings of Assessment Year 2011-12, the Assessing officer ('AO') treated the entire share premium as unexplained cash credit and added the same to its income. The AO alleged that there was no justification for charging premium on issue of shares. The AO further alleged that the Assessee has violated Section 78 of the Companies, Act, 1956 which prescribes limited purposes for which share premium can be used.

On further appeal, the order of the AO was upheld by the Commissioner (Appeals) and the Tax Tribunal.

On further appeal before the High Court of Bombay, the Assessee submitted that just because the amount that was received by appellant company was invested would not amount to contravention to Section 78 of the Companies Act, 1956 because no company would keep its money idle. Further, it is a settled law that even a breach of provisions of Section 78 of the Companies Act, 1956 would not make the premium received on shares issued, would amount to income. The Assessee also relied on the co-ordinate bench decision in *Credit Suisse Business Analysis (India) (P.) Ltd [2016] 72 taxmann.com 131 (Mumbai-Trib.)* on the same issue.

The tax department urged that there was no justification to charge a premium. Further, the premium charged was excessive and much beyond the intrinsic value of the shares and only one promoter was made to pay premium. Also, there was a breach of the provisions of Section 78 of the Companies Act, 1956.

The Bombay High Court observed that in its earlier decisions of *SLS Energy (P) Ltd. [2023] 154 taxmann.com 400* and *Godrej Projects Development Pvt Ltd. [2024] SCC Online Bom 366*, the Court has already held that the premium on issue of shares constitutes a capital receipt and chargeability of the same to tax is outside the purview of Income-tax Act, 1961. The Court further referred to its decision in the case of *Vodafone India Services (P) Ltd. [2014] 50 taxmann.com 300*, wherein, it was held that a capital account transaction does not fall within the statutory definition of income, and

as such, cannot be charged to tax. There is no provision under the Act to tax the receipt of share premium for the assessment year under consideration.

Referring to the decision of Tax Tribunal in *Credit Suisse Business Analysis (India) (P.) Ltd (supra)*, the Court held that the breach of any provisions of the Companies Act, 1956 would not turn the share premium amount received into a revenue receipt. It is not a fair or judicious approach to deal with the subjects of the State.

Based on examination of the financial statements, the Court held that there is nothing on record from the balance sheet filed that the share premium amount has been utilized for purposes other than what is prescribed in Section 78(2) of the Companies Act, 1956. The closing balance and the opening balance of the share premium money only indicates that there is an increase in the share premium account by way of infusion of funds and not depletion. There is nothing to indicate that the assessee has used the share premium money to invest in shares. The tax authorities have failed to understand the difference between utilization of funds and creation of share premium account in the books of accounts for the share premium receipt. Resultantly, the orders of the AO as upheld by the Commissioner (Appeals) and ITAT, were quashed.

Note: The use for which Share Premium Account can be applied (called Securities Premium Account in the 2013 Companies Act), as laid down in Section 78(2) of the Companies Act, 1956 are the same as laid down in Section 52(2) of the 2013 Act.

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Scope of limited scrutiny: Revenue cannot decide the issues not covered under the limited scrutiny without obtaining approval for a complete scrutiny

In a recent decision in the case of **Principal Commissioner of Income Tax versus M/s. Weilburger Coatings (India) Pvt. Ltd. [TS-613-HC-2023 (CAL)],** the Calcutta High Court held that for the cases selected under limited scrutiny, scrutiny assessment proceedings should be confined only to the issues under limited scrutiny.

In the instant case, the assessee received a notice for limited scrutiny assessment and the assessment proceedings under section 143(3) of the Act were completed making addition on certain issues including carry forward of losses of earlier years.

The assessee filed an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)] which was contested on merits without challenging that the issue of carry forward of lossess of earlier years was not a subject matter of limited scrutiny. The CIT(A) granted part relief on certain issues.

Aggrieved, the assessee filed an appeal before the Income Tax Appellate Tribunal (ITAT) for the disallowed portion of the order alongwith an additional ground contending that the action of CIT(A) in confirming the addition made by the Assessing Officer in making additions in respect of issues not mentioned in limited scrutiny were beyond the jurisdiction of the Assessing Officer.

The Department raised an objection on the additional ground raised by the assessee. However, the ITAT overruled the said objection holding that the said issue is jurisdictional issue and can be raised by the assessee at any point of time. Further, observing that the issue decided by the Assessing Officer was not part of the limited

scrutiny for which the assessment was directed to be scrutinised, the ITAT taking note of the CBDT Instruction No. 5 of 2016 held that the Assessing Officer has exceeded his jurisdiction.

The High Court concurring with the findings of the ITAT, held that the ITAT rightly allowed the assessee's appeal on the aforesaid issue.

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TDS under section 194C (TDS on payments to contactors) /194-I (TDS on Rent) is inapplicable on 'minimum guarantee payment' made to hotels

In a recent judgement, Income Tax Appellate Tribunal of Delhi, (ITAT) [ITA No. 6370/DEL/2019], has held that Section 194C/194I TDS is inapplicable on 'minimum guarantee payment' made to hotels by Oravel Stays Pvt. Ltd. (OYO).

OYO enters into merchant agreement with various hotels for facilitating booking of hotel rooms through its platform, The hotel conducts its operations in terms of providing lodging and accommodation services whereas the assessee provides technology, sales and marketing services to the hotels relating to provision of lodging and accommodation services through its platform. OYO assures minimum occupancy of hotel and if benchmark is exceeded then the service fee is payable by the hotel and in case of shortfall OYO is required to meet the same i.e. OYO compensates the shortfall by way of minimum guarantee.

OYO filed its return of income for AY 2015-16, declaring loss of Rs. 29,82,76,660/. During the course of scrutiny assessment, the assessing officer noticed that the assessee has not deducted TDS on minimum guarantee expense of Rs. 3,61,98,948/- and hence, invoked provisions of section 40(a)(ia) of the Act, and made disallowance of Rs. 1,08,59,584/-.

The assessee appealed before CIT(A) that the payment does neither fall under Section 194I nor 194C. After considering the facts and submissions and drawing support from the CBDT Circular No. 5/2002 dated 30.07.2002, the CIT(A) was convinced that the minimum guarantee payment was not in the nature of rent liable for TDS under section 194I of the Act. However, the ld. CIT(A) confirmed that TDS under the provisions of section 194C does apply thereon.

Aggrieved by the order of CIT(A), the Assessee filed the appeal before Delhi ITAT and the assessee contended that the payments made by the assessee towards minimum guarantee expense cannot be considered as payment under contract (TDS u/s 194C of the Act) as no work has been carried out and that the payment is in the nature of compensatory payment for shortfall in room occupancy only.

The departmental representative contended that the assessee is in fact providing service towards minimum occupancy of the rooms in the hotels and, therefore, ought to have deducted tax at source.

The ITAT observed that since as per the records no work has been carried out, the provision of section 194C have no application. Regarding the tax department's contention that the Assessee is providing service, the ITAT held that same cannot be accepted as neither the Assessing Officer nor the ld. CIT(A) have invoked the relevant provisions of the Act applicable for

provisions of service.

Therefore, the ITAT deleted the addition and allowed the appeal of the Assessee.

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Supreme Court holds that the discount given by telecom service provider to distributors for the sale of pre-paid SIM/Recharge vouchers does not attract withholding tax (TDS) under section 194H in the absence of principal–agent relationship

The Supreme Court (SC) in the case of Bharti Cellular Ltd (and others) vs Assistant Commissioner of Income Tax [TS-135-SC-2024], has set at rest the issue regarding application of TDS provisions under section 194H of the Income Tax Act ("the Act") on sale of Sim/Recharge vouchers to the distributers by the telecom service providers.

In the present case, the Assessees, mobile telephone service providers, had entered into franchise/distribution agreements with various parties for selling the prepaid starter kits and recharge vouchers of the specified value to the end-users. The Assessees sold these starter kits and recharge vouchers to franchisees/distributors at a discounted price. The discounts were given on the printed price of the packs.

The Assessees claimed that such discount was not a commission/brokerage, liable for TDS under section 194-H of the Act, whereas as per tax authorities, the difference between the discounted price paid by the franchisee/distributor and the sale price received by the franchisee/distributor was to be treated as commission or brokerage as per section 194-H of the Act and the relationship between the Assessee and franchisee/distributor was in the nature of principal and agent.

The controversy reached different High Courts whereby the High Courts of Karnataka, Rajasthan and Bombay decided the issue in favour of the Assessees whereas the High Courts of Delhi and Calcutta in favour of tax authorities.

The SC observed that section 194H of the Act states that any person responsible for paying at the time of credit or at the time of payment, whichever is earlier, to a resident any income by way of commission or brokerage, shall deduct income tax at the prescribed rate. Further, as per explanation (i) to sec 194H, "commission or brokerage" includes any payment received or receivable, directly or indirectly, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities;"

The SC stated that the words "another person" refer to "the person responsible for paying". The words "direct" or "indirect" in Explanation (i) to Section 194-H of the Act are with reference to the act of payment and the expression 'acting on behalf of another person' postulates the existence of a legal relationship of principal and agent, between the payer and the recipient/payee.

The SC opined that the law of agency is technical. Whether in law the relationship between the parties is that of principal-agent is answered by applying Section 182 of the Contract Act, 1872. For examining whether a legal relationship of a principal and agent

exists, the following factors/aspects should be taken into consideration:

a. The essential characteristic of an agent is the legal power vested with the agent to alter his principal's legal relationship with a third party and the principal's co-relative liability to have his relations altered.

b. As the agent acts on behalf of the principal, one of the prime elements of the relationship is the exercise of a degree of control by the principal over the conduct of the activities of the agent. This degree of control is less than the control exercised by the master on the servant and is different from the rights and obligations in case of principal to principal and independent contractor relationship.

c. The task entrusted by the principal to the agent should result in a fiduciary relationship. The fiduciary relationship is the manifestation of consent by one person to another to act on his or her behalf and subject to his or her control, and the reciprocal consent by the other to do so.

d. As the business done by the agent is on the principal's account, the agent is liable to render accounts thereof to the principal. An agent is entitled to remuneration from the principal for the work he performs for the principal.

The SC relying on its earlier judgements stated that in case of an agency to sell, the agent who sells them to the third parties, sells them not as his own property, but as a property of the principal, who continues to be the owner of the goods till the sale. In such a case, the transferee is the debtor and liable to account for the price to be paid to the principal, and not to the agent for the proceeds of the sale. An agent is entitled to his fee or commission from the principal for the work he performs.

To decide whether a contracting party acts for himself as an independent contractor, it should be examined whether in the course of work, he intends to make profits for himself, or is entitled to receive prearranged remuneration. If the party is concerned about acting for himself and making the maximum profits possible, he is usually regarded as a buyer, or an independent contractor and not as an agent of the principal. This would be true even when certain terms and conditions have been fixed relating to the manner in which the seller conducts his business.

The SC suggested that there can be several situations where one person represents or acts for another, but this does not create the relationship of principal and agent. It is only when the representation or action on another's behalf affects the latter's legal position, that is to say his rights against, or his liability towards, other people, that the law of agency applies.

Based on the analysis of the terms and conditions of the franchises/distributor agreement, the SC observed that the franchise/distributor is appointed for marketing of prepaid services and for appointing the retailer or outlets for sale promotion. The retailers or outlets for sale promotion are appointed by the franchisee/ distributor and not the assessee. The franchisees/distributors have agreed not to undertake activities mentioned in the agreement for any other competitive cellular mobile telephone service provider in the business. The franchisee/distributor have to comply with statutory, regulatory and municipal permissions while conducting the business. At no point of time, the right, title, or interest in the prepaid cards shall pass on to the franchisee/distributor. All rights, title ownership and property rights in the cards shall rest with the assessee, The

franchisee/distributor was free to sell the prepaid products at any price below the price printed on the pack The franchisee/distributor determined his profit/income.

Regarding the tax authority's objection that the prepaid SIM cards were not the property of the franchisee/distribution, and no right, title or interest was transferred to them, the SC held that it is a mandate and requirement of the license issued to the Assessee by the DoT.

The tax authorities by placing reliance on the co-ordinate bench ruling in Singapore Airlines Ltd & (and others) vs Commissioner of Income Tax contended that even if the franchisee/distributor received payment in the form of income from the retailer/end-user/customer, it would be required to deduct TDS, as payment received or receivable, "directly or indirectly", is to be subjected to TDS. The SC held that the expression "direct or indirect" used in section 194-H of the IT Act is meant to ensure that "the person responsible for paying" does not dodge the obligation to deduct TDS, even when the payment is indirectly made by the principal payer to the agent. It is not to be extended to apply to true/genuine business transactions where the taxpayer is not the person responsible for paying or crediting income.

The SC further held that the sale price and accordingly the income of the franchisee/distributor is determined by the franchisee/distributor and the third parties. The assessee does not, at any stage, either pay or credit the account of the franchisee/distributor with the income by way of commission or brokerage. The Assesse is not privy to the transaction between franchisees/distributors and third parties. Therefore, it is impossible for the Assessee to deduct TDS under section 194-H of the Act on the difference between the total consideration received by the franchisees/distributors from third parties and the amount paid by the distributors/franchisees to the Assessee.

The SC observed that the tax authorities' argument that the Assessee should periodically ask for the data regarding SIM cards sold by franchisee/distributor is far-fetched, imposing an unfair obligation and inconveniencing the Assessee, beyond the statutory mandate. Further, it will be impossible to deduct as well as make payment of the tax deducted within the timelines prescribed by law, since the timelines trigger when the amount is credited to the account of the payee by the payer or when payment is received by the payee, whichever is earlier.

The SC propounded that the deduction of tax provisions should be pragmatically and realistically construed, and not by adopting a catch-as-catch-can approach. In case of legal or contractual doubt in a given case, the taxpayer can rely on the doctrine of presumption against doubtful penalisation. Whether or not the said doctrine should be applied will depend on the facts and circumstances of the case, including the past practice followed by the taxpayer and accepted by the tax authorities.

The SC therefore held that, the Assessees are not under any legal obligation to deduct TDS on the income/profit component in the payments received by the franchisees /distributors from the third parties /customers, or while selling/transferring the pre-paid coupons or starter kits to the distributors.

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