TDS on Payment of commission to Non-Residents

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Residents in India acquire the services of non-resident agents for canvassing of overseas contacts, for export of their products and/or for the provision of ancillary support services etc. Commission is paid to the non-resident agents in lieu of the services rendered by them. The chargeability and deduction of tax on such payments has been a controversial subject. This article intends to discuss the issue in the light of the applicable provisions, circulars issued and recent judicial pronouncements pertaining to the same.

1. Applicable provisions

1.1 Basis of charge

The basis of charge is determined in accordance with Section 4 of the Act. As per the provision of Section 4(1) of the Act, "where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person.

1.2 Income chargeable to tax

Further, as per the provisions contained in Section 5(2), the total income of previous year of a person, who is a non-resident, is chargeable to tax in India if it is

- Received or is deemed to be received in India or
- Accrues or arises or is deemed to accrue or arise to him in India.

Explanation 1 to the Section further clarifies that income accruing or arising outside India shall not be deemed to be received in India within the meaning of the said section by reason of the fact that it is taken into account in the balance sheet prepared in India.

1.3 Deeming fiction u/s 9(1)

Section 9(1)(i) of the Act, stipulates that income which accrues or arises directly or indirectly **through or from any business connection** in India in India, or through or from any property in India, or **through or from any asset or source of income** in India, or through the transfer of a capital asset situate in India, is deemed to accrue or arise in India. Explanation 2 to the Section defines the term Business connection to include specified activities carried out through a person acting on behalf of the non-resident.

Section 9(1)(vi) of the Act states that **royalty payable by a resident** shall deem to accrue or arise in India except where the royalty is payable in respect of any right, property or information used or service utilised for the purposes of business or profession carried on by such person outside India or for the purposes of making any income from any source outside India.

Section 9(1)(vii) of the Act states that income by way of **fees for technical services payable by a resident** shall be deemed to accrue or arise in India except where the fees is payable in respect of service utilized in a business or profession carried on by such person outside India or for the purposes of making any income from any source outside India

2. Applicability of Section 195 of the Act

Section 195 imposes a statutory obligation on any person responsible for paying to a non-resident any interest (not being interest u/s 194 LB, 194 LC, 194 LD) or any other **sum chargeable under the provisions of the Act** (not being salaries), to deduct income-tax at the rates in force. Whether or not the payment of commission to the non-residents agent falls within the ambit of any sum chargeable needs to be determined after a combined analysis of the relevant provisions of the Act discussed hereunder.

2.1 Interoperability of Section 4, Section 5(2) and Section 9(1) of the Act

Let us understand the issue with the help of an example. Mr A has paid commission to a non-resident agent Mr B in UK for securing orders abroad and for the provision of other ancillary support services. Mr B does not have any Permanent Establishment in India, and the remittance is made directly to him. It is important to answer the following question in order to determine the chargeability thereof: -

- **Are such payments received in India?**
- **Does the payments accrue or arise in India?**
- **Are such payments deemed to accrue or arise in India?**
    a. **Does there exist any Business connection/asset/source of income in India?**
    b. **Can such payments be classified as royalty/fees for technical services?**

2.1.1 Are such payments received in India?

The payments in lieu of commission are remitted directly to the non-resident agent Mr B and the same is not received by him or on his behalf in India. Even in a situation where the sales to the end customers abroad is effected through Mr B, and the sale proceed thereof are remitted to Mr A, who thereafter remits the appropriate amount of commission as is payable to Mr B, the same cannot be considered as receipt of commission by Mr B in India.

2.1.2 Do the payments accrue or arise in India?

Also such payments do not accrue or arise in India, as they are pursuant to services rendered abroad. A similar view has been held by the Bangalore Tribunal in the case of **Exotic Fruits (P.) Ltd. *v.* Income-tax Officer (International Taxation) Ward -1(1),** Bangalore wherein it was held that "The income of the non-resident(s) by way of commission in the present case cannot be considered as accrued or arisen or deemed to accrue or arise in India as the services of such agents, as asserted by the assessee, were rendered/utilised outside India and the commission was also paid outside India".

2.1.3 Are such payments deemed to accrue or arise in India u/s 9(1)(i)?

Classification of such payments as deemed to accrue or arise in India requires establishing among other things, of the fact that the same is rendered

- Through or from any **business connection** in India as defined in Explanation 2 to Section 9(1)(i) or
- Through or from any asset or **source of income** in India.

a. Does there exist any Business connection in India?

The term "business connection" has been interpreted by the Supreme Court to mean something more than mere business. The same is not equivalent to carrying on business, but a relationship between, the business carried on by a non-resident which yields profits and some activities in India, which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and their activities in India. Mr B does not carry on any

business activity in India which shall enable him in delivering the services for which commission is being paid to him. Accordingly there does not exist any business connection of Mr B in India.

Refer: - CIT vs. R.D. Aggarwal and Company (1965) 56 ITR 20 (SC),
Carborandum & Co. vs. CIT (1977) 2 SCC 862
Ishikawajma-Harima Heavy Industries ltd. vs. DIT, Mumbai (2007) 3 SCC 481

b. Does there exist any source of income in India?

The term "source" has not been defined in the Act. However, the term has been referred to in certain judicial pronouncements. The Judicial Committee in the case of *Rhodesia Metals Ltd.* v. *CIT* [1941] 9 ITR (Suppl.) 45 (PC) observed that a "source" means not a legal concept but one which a practical man would regard as a real source of income.

A source of income was described by R.S. Pathak, J. in the following words in *Seth Shiv Prasad* v. *CIT*[1972] 84 ITR 15 (All.) at page 18: *"A source of income, therefore, may be described as the spring or fount from which a clearly defined channel of income flows. It is that which by its nature and incidents constitutes a distinct and separate origin of income, capable of consideration as such in isolation from other sources of income, and which by the manner of dealing adopted by the assessee can be treated so."*

The non-resident agent Mr B has been appointed by Mr A for the purposes of securing orders abroad and for the provision of other ancillary support services. One possible view which may be taken is that the source of the commission income vests in the sale of goods to the non-resident end users/customers pursuant to orders secured by Mr B. Thus, the services of Mr B are utilized for earning income from sources outside India. Accordingly, the commission received by Mr B cannot be said to be derived through or from any source of income in India. A similar view in case of royalty income has been taken by the Madras High Court in the case of **CIT vs. Aktiengesellschaft Kuhnle Kopp and Kausch W. Germany by BHEL [2002] 125 taxmann 928** wherein it was held that "As far as royalty on export sales was concerned, that amount was also exempt under section 9(1)(vi). Though the royalty was paid by a resident in India, it could not be said that it was deemed to have accrued or arisen in India as the royalty was paid out of the export sales and, hence, the source for the royalty was the sales outside India. Since the source for the royalty was from the source situated outside India, the royalty paid on export sale was not taxable."

The other view which may be taken is that the term "source of income" is distinct from the term "source of receipts". The source of the commission income as is being paid to the non-resident agent Mr B can be interpreted as the activity of exports which is actually generating the income. Since the goods are manufactured by Mr A in India and thereafter sent to Mr B pursuant to the contracts secured by them it may be inferred that the actual source of the commission income received by Mr B vests in India. The export proceeds which are ultimately derived from persons located outside India, can be interpreted as the source of the receipts which differs from the source of the income. Thus, the commission income may be deemed to accrue or arise in India since the source of such income lies in India. A similar view has been held by the Delhi High Court in the case of **CIT v. Havells India Limited [2012] 21 taxmann.com 476** wherein it was held that **"**In view of the decision in CIT v. Anglo French Textiles [1993] 199 ITR 785 (Mad.), the export activity having taken place or having been fulfilled in India, the source of income was

located in India and not outside. Mere fact that the export proceeds emanated from persons situated outside India did not constitute them as the source of income."

However, even if it is presumed that such commission income is derived from any business connection in India or asset or source of income in India, only such proportion of the income as is reasonably attributable to the operations carried out by the non-resident agent in India shall be deemed to accrue or arise in India. Where the non-resident agent Mr B does not carry out any operations in India which would facilitate him in providing the services outside India in lieu of which the commission is being paid to him, no portion of the income shall be deemed to accrue or arise in India.

2.1.4 Can such payments be deemed to accrue or arise in India as royalty/FTS?

Fees for technical services is defined in Explanation 2 to Section 9(1)(vii) as consideration for the rendering of managerial, technical or consultancy services including the provision of services of technical or other personnel.

It is imperative to determine whether the services rendered by the commission agent are of managerial, technical or consultancy nature. Payment of commission to the non-residents for services rendered by them otherwise cannot be classified as fees for technical services. Such services are of regular/routine nature and do not involve any technical skills or knowhow so as to be roped in within the ambit of managerial, technical or consultancy services. Accordingly, where Mr B is habitually rendering such routine services abroad in the ordinary course of his business, the same shall not be classified as fees for technical services. Accordingly, no income shall be deemed to accrue or arise in India, except where the same is attributable to any operations carried out by the non-resident in India.

However, where the commission agreement between the resident and the non-resident agent is so drafted that in substance it relates to rendering of services which are of managerial, consultancy or technical nature, then the agreement may be disregarded as such and the commission payments may be construed by the Department as fees for technical services. By virtue of the provisions contained in Section 9(1)(vii)(b), such payments shall then be deemed to accrue or arise in India if the services are utilised for carrying on any business or profession in India or for the purposes of earning any income from any source in India. Further, pursuant to the provisions of Section 9(2) of the Act, such fees for technical services shall be deemed to accrue or arise in India irrespective of whether the non-resident has a place of residence or business connection in India, and whether or not such services are rendered in India.

3. Analysis

A combined reading of Section 4, Section 5 and Section 9 of the Act suggests that, if the payments to the non-resident agent are purely towards commission and the provisions of section 9(1)(i) are not fulfilled then there is no deemed accrual of such income in India. This means that there is no income which can be said to be includible in the total income of Mr B u/s 5(2) and accordingly, there is no requirement for charging income-tax in respect of the commission payments made to Mr B, u/s 4(1) of the Act.

Thus, if such payments are not chargeable to tax, then there does not arise any liability to deduct taxes in respect thereof u/s 195 of the Act. Accordingly, the explanation (2) to sub-section (1) of Section 195 which clarifies that the obligation to comply and make deduction

thereunder applies/extends and shall be deemed to have always applied/extended to all persons, resident or non-resident, whether or not the non-resident person has a residence/place of business/business connection/any other presence in any manner whatsoever in India also remains inapplicable to such payments.

However, it is pertinent to note that the terms of the agreement should be read carefully. As discussed in the prior paragraphs where the terms of the agreement suggest otherwise, and it appears that the actual services rendered are not in the nature of a pure commission agent then such services should be appropriately classified and the liability to tax should be determined accordingly.

4. Withdrawal of erstwhile Circulars

The Central Board of Direct Taxes has vide Circular No 7 dated 22nd October, 2009 withdrawn its earlier circulars namely:-

- Circular No 23 dated 23rd July, 1969
- Circular No163 dated 29th May, 1975 and
- Circular No 786 dated 7th February, 2000.

The earlier circulars clearly furnished illustrations to explain that such commissions can be paid without deduction of tax. However, the withdrawal of such Circulars shall not have any significant impact on the issue since the law and the provisions of the various section of the Act pertaining to the same continue to remain unchanged.

5. Recent Judicial pronouncements

- The ITAT Panaji Bench in the case of ACIT vs. Karishma Global Mineral (P.) Ltd. [2015] 56 taxmann.com 265 held that "Once DLM does not have permanent establishment, the business profit earned by DLM by way of commission are not chargeable to tax in India and therefore, the assessee was not under obligation to deduct tax at source as per provisions of section 195".

- The Delhi Tribunal in the case of Welspring Universal vs. JCIT [2015] 56 taxmann.com 174 held that "It is apparent that the commission income in the hands of the non-resident can neither be considered as received or deemed to be received in India or accruing or arising or deemed to accrue or arise to him in India in terms of section 5(2). Once it is held that the commission income of a non-resident for rendering services outside India does not fall within the scope of his total income, it automatically implies that the same is not chargeable to tax in his hands".

- The ITAT Chennai Bench 'B' in the case of ACIT vs. T. Abdul Wahid & Co. [2014] 46 taxmann.com 75 has held that "Agency/sales commission paid by assessee to non-resident agents for services rendered by them outside India in procuring export orders for assessee, is not chargeable to tax in India and consequently the assessee is not under any obligation to deduct TDS under section 195 on said commission payment. Therefore, provisions of section 40(a)(i) have no application".

- The ITAT Chennai Bench 'A' in the case of DCIT, Company Circle-II(1), Chennai v. Farida Prime Tannery Pvt. Ltd. [2014] 45 taxmann.com 174 wherein following prior judgements in the cases of ITO v. Faizon Shoes (P.) Ltd. [2013] 58 SOT 245/34 taxmann.com 79 (Chennai) (para 6), it was concluded that the transactions of commission payments to the non-residents for procuring export orders, are not assessable to tax in India and

consequently the assessee company is not under any obligation to deduct the TDS on the above commission payments u/s.195 of the Act. Therefore, the provisions of section 40(a)(i) have no application in the case.

- The ITAT Chennai Bench 'B' in the case of DCIT, Chennai vs. Rane (Madras) Ltd. [2014] wherein the assessee had entered into agreement with agents outside India for procurement of export orders and marketing purposes, held that "From the above scope of services of the agreement, we do not find any managerial/technical services are to be provided to the assessee by the overseas agent M/s. James Druchas, USA so as to attract the provisions of *section 195 of the Act. However, this agreement which was entered into on 5.6.2008 is relevant to the assessment year 2009-10 and the assessment year under appeal now before us is 2007-08. Neither the assessee nor the Revenue placed an agreement relevant for the assessment year under consideration. Therefore, we restore this issue to the file of the Assessing Officer to examine afresh with reference to the agreement and the case laws relied on this issue".*

- The ITAT Delhi Bench 'B' in the case of **Deputy Commissioner of Income-tax, Circle 11(1), New Delhi *v.* Eon Technology (P.) Ltd. [2011] 11 taxmann.com 53** wherein it was held that "The *operations carried out by ETUK were not carried out in India. ETUK did not have any permanent establishment in India. ETUK was acting as the assessee's marketing agent and was providing marketing and sales support to all purchases executed by the assessee-company for its overseas clients. It was for the rendering of such service that the commission was paid by the assessee to ETUK. The payment was remitted outside India. [Para 17]. Therefore, the provisions of section 9(1)(*i *) were not fulfilled and there was no deemed accrual of income in India".*