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TAX TRIBUNAL RULES ON TAXABILITY OF REIMBURSEMENT OF WARRANTY EXPENSES ON EXPORT SALES

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Introduction

Recently, the Chennai Bench of the Income Tax Appellate Tribunal (Tribunal) in the case of M/s Nissan Motor India Pvt Ltd vs DCIT [ITA No. 1854/CHNY/2017], ruled in favour of the taxpayer and held that payment to offshore sister concerns, in the nature of reimbursement of warranty expenses, is not taxable in India, as the source of such income is not in India. Hence, the payer is not required to withhold tax at the time of such payment.

As per the provisions of the Income Tax Act, 1961 (IT Act), in case of a non-resident, any income arising or deemed to be arising to such non-resident, in India, is chargeable to tax in India. Section 9 of the IT Act, provides the instances where income shall be deemed to accrue or arise to a non-resident in India. As per section 9(1)(vii)(b) of the IT Act, income in the nature of fees for technical services (FTS) shall be deemed to accrue or arise in India when the payer is a resident of India, unless such FTS is payable in respect of services utilised in (a) a business or profession carried on by such resident outside India; or (b) for the purpose of making or earning any income from a source outside India.

Factual Background

In the relevant year, the taxpayer, M/s Nissan Motor India Pvt. Ltd (Nissan India), an Indian company engaged in the business of manufacturing and selling motor cars in India and abroad, made certain payments to its offshore sister concerns which were acting as Nissan India's dealers (Dealers), in the nature of reimbursement of warranty expenses incurred by them (Warranty Reimbursement).

On a verification of the Form 15CA /CB (a statutory filing to be made prior to remittances to non-residents, setting out the particulars in relation to nature of the remittance and taxability thereof) filed by Nissan India, the tax authorities noted that Nissan India did not withhold tax at the time of making Warranty Reimbursements to the Dealers.

The IT Act requires any person making a payment to a non-resident, which is chargeable to tax in India, to withhold applicable tax therefrom. Further as per the provisions of section 40(a)(i) of the IT Act, a taxpayer would not be allowed a deduction from its business income of expenses where applicable taxes are not withheld. Accordingly, the tax authorities disallowed the expenses claimed by Nissan India, with respect to the payment

of Warranty Reimbursements to the Dealers, and held Nissan India in default for not withholding taxes.

On appeal, the Tribunal, on an analysis of the facts of the case, ruled in favour of Nissan India. The arguments taken by the tax authorities and Nissan India in relation to the taxability of the payment, and the observations of the Tribunal in relation to the same have been summarised below.

Arguments advanced by the Tax Authorities

The tax authorities treated the Warranty Reimbursement as FTS, and therefore, held that the payment was chargeable to tax in India as per the provisions of the IT Act, and the relevant Double Tax Avoidance Agreement (DTAA). The rationale of the tax authorities for holding the same, was as follows:

- It was the responsibility of Nissan India under its agreements with the offshore customers to provide such warranty services to its customers, at its own cost, and the compensation in relation to such services was already factored in the sales price of the motor cars.

- Nissan India had engaged the Dealers to provide the warranty services to its customers, and the expenses incurred by the Dealers were to be reimbursed by Nissan India.

- The warranty scheme was devised and offered by Nissan India, and the offshore customers relied on the warranty offered by Nissan India, and not the Dealers.

- The warranty services included the service and maintaining of the motor cars, and therefore, such service was a "technical service" as technical experts were required to carry out the same.

Accordingly, the tax authorities held that the Warranty Reimbursements were in the nature of FTS, taxable in India.

Arguments advanced by Nissan India

Nissan India contended that the payment of the Warranty Reimbursement, could not be treated as FTS, and was not taxable in India for the following reasons:

- *Not in the nature of FTS:* The Warranty Reimbursement was towards replacement of parts and labor cost incurred in providing the services to the offshore customers. Therefore, this payment was towards repairs and not in the nature of FTS.

- *No income element:* The amount reimbursed to the Dealers was based on the actual cost incurred by them, and therefore, did not include any profit margin. Accordingly, no profit element / income arose in the hands of the Dealers on such amount.

- *Business activity of the Dealer:* As the amount was received by the Dealer in the course of its business, such amount would be treated as business income in the hands of the Dealer and therefore, would be not be taxable in India in the absence of any business connection / permanent establishment.

- *Source outside India:* Without prejudice to the contentions mentioned above, Nissan India contended that even if the amount was treated as FTS, the same was not taxable in India as per section 9(1)(vii) of the IT Act, as such amount was incurred for the purpose of earning income outside India, by Nissan India.

Decision of the Tribunal

The Tribunal referred to the provisions of section 9(i)(vii)(b) of the IT Act, and ruled in favour of Nissan India. The Tribunal observed that the warranty expenses were incurred by Nissan India, to reimburse its offshore Dealers, for the warranty services provided by the Dealers, to the offshore customers of Nissan India, to whom Nissan India had exported its goods. Therefore, such expense was incurred by Nissan India, for the purpose of earning income from a source outside India, and was therefore not taxable in India.

The other contentions taken by Nissan India, regarding the nature of the income, were not analyzed by the Tribunal.

Khaitan Comments

The decision of the Tribunal is a welcome ruling, and may have an impact on intra-group arrangements of similar nature. In relation to such arrangements, the first question that arises is whether the income is in the nature of FTS. If such income is considered to be FTS, the next test that applies is whether exports by a resident, would qualify as a source of income outside India, and would therefore be eligible to fall under the exception provided under section 9(1)(vii)(b) of the IT Act.

The issue regarding whether exports made by residents, can qualify as a source of income outside India, has been a subject matter of litigation. While the Tribunal in the instant case has taken a favourable view, it is important to note that there are contrary rulings on this issue, and it has been held in various judicial decisions that an export of goods by an Indian resident, would not constitute activities of the resident "outside India", if the manufacturing of such goods, and conclusion of contracts with the non-resident in relation to such goods, is taking place in India. Thus, it will be interesting to see how the higher judicial fora looks at this issue, if appealed further.

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