KHAITAN &CO
Advocates since 1911

UPDATE

ERGO

Analysing developments impacting business

OBLIGATION TO WITHHOLD TAX AT THE SPECIFIC RATE UNDER INDIAN INCOME TAX LAW STANDS UNAFFECTED BY TAX TREATY

29 May 2020

The Supreme Court of India (SC) in its recent case of PILCOM (Civil Appeal No. 5749 of 2012 with Special Leave Petition (Civil) No. 6829 and 7315 of 2019) ruled that the obligation of the payor to withhold tax at a specified rate of 10% under section 194E of Indian Income tax Act, 1961 (IT Act) on payments made to non-residents, is not affected by the tax treaty applicable to such non-resident recipient.

Background

Under the provision of section 194E of the IT Act, any person making guarantee payment to a non-resident sport association or institution in relation to any game or sport played in India, is required to withhold tax at source at the rate of 10% (The present applicable rate is 20%).

In the instant case, PILCOM (Taxpayer), a joint management committee formed between cricket boards of India, Pakistan and Sri Lanka made certain payments including guarantee money (Guarantee Money) to non-resident sports associations where cricket teams of these associations played various matches in India. While making these payments, the taxpayer did not withhold any tax under the IT Act on the basis that Guarantee Money did not accrue to the recipient in India as the same was for grant of a privilege and not towards the matches.

The tax officer however held that Guarantee Money paid to non-resident sports association is in relation to the matches played in India and attracts withholding of tax under section 194E of the IT Act. This position was affirmed by the Commissioner of Income tax (Appeals).

Before the Income Tax Appellate Tribunal (Tribunal), the Taxpayer additionally contended that withholding of tax was not required as Guarantee Money was not taxable under the tax treaty between India and respective countries of various recipients. The Tribunal on this argument held that applicable tax treaty does not provide for any exemption from tax in India on the Guarantee Money under consideration. This view was affirmed by the High Court.

Further, though not argued either by taxpayer or the department, the High Court held that obligation to withhold tax under section 194E is not affected by the tax treaty applicable to the recipient. If the income on which withholding of tax is required, is not taxable or taxable at a lower rate under the tax treaty, refund of excess tax can be claimed by the recipient.

Ruling

The Supreme Court noting the fact that Guarantee Money paid to the non-resident sports association was in connection with the matches played by the cricket team of

these associations in India, held that Guarantee Money has accrued in India thereby attracting PILCOM's liability to withhold tax under section 194E of the IT Act.

As regards applicability of beneficial provisions under the tax treaty applicable to the recipient, the SC held that PILCOM's obligation to withhold tax under section 194E of the IT Act is not affected by the provisions under the tax treaty. The SC concurred with High Court's view that the tax treaty benefit, if any, can be availed by the recipient, and any excess tax paid would be refunded along with applicable interest to the recipient.

Comments

The SC in this ruling has held that where the IT Act provides for a specific withholding tax rate on payment to non-residents, the payor is required to comply with the same irrespective of the final tax position of such non-resident recipient under the applicable tax treaty.

Section 194E at the centre of dispute provides for withholding of tax for the income referred to in section 115BBA which is the charging section for guarantee income of a non-resident sports association. It is a settled position that in case of a non-resident with which India has a tax treaty, the provisions under the IT Act shall be applicable to the extent they are more beneficial as compared to the tax treaty. The Supreme Court has however held that this principle is relevant qua the recipient of income and not where the payor is required to withhold tax at the specified rate.

Interestingly, SC in some of the earlier cases (involving payment of management fees, capital gains, etc), where taxes were required to be withheld under section 195 of the IT Act at the '*rates in force*', has held that tax treaty benefit can be allowed for determining the amount of tax to be withheld. Given that section 194E is applicable on income referred to in section 115BBA and does not have the language of '*rates in force*', the judicial precedents on section 195 of the IT Act could be distinguished.

This decision of SC is binding on all the courts in India unless an amendment is made to relevant provisions under the IT Act or if a larger bench of SC takes a different view.

Given the binding nature of the ruling, shift in dividend tax regime, special tax rate for interest on non-convertible debentures accruing to Foreign Portfolio Investors (FPIs), etc the ruling could have an impact on various such payments where the specific withholding tax rate under the IT Act is higher than the final tax rate applicable for the recipient under the applicable tax treaty. Some of such payments include (a) payment of dividend to FPIs and holders of Global Depositary Receipts (b) distribution of dividend by a business trust (received from a special purpose vehicle that has opted for concessional tax regime) to its non-resident unitholders and (c) interest payment to FPIs. For these payments, there is presently no mechanism to approach the tax officer for obtaining lower or nil tax deduction certificate, unlike for the payment to non-residents covered by section 195 of the IT Act.

It therefore becomes essential to review the existing arrangement/structures including those where tax cost is agreed to be borne by the payor and assess the withholding tax and cash flow impact considering this ruling.

- *Direct Tax Team*

For any queries please contact: editors@khaitanco.com

We have updated our Privacy Policy, which provides details of how we process your personal data and apply security measures. We will continue to communicate with you based on the information available with us. You may choose to unsubscribe from our communications at any time by clicking here.

For private circulation only

The contents of this email are for informational purposes only and for the reader's personal non-commercial use. The views expressed are not the professional views of Khaitan & Co and do not constitute legal advice. The contents are intended, but not guaranteed, to be correct, complete, or up to date. Khaitan & Co disclaims all liability to any person for any loss or damage caused by errors or omissions, whether arising from negligence, accident or any other cause.

© 2020 Khaitan & Co. All rights reserved.

Mumbai
One Indiabulls Centre, 13th Floor
Tower 1 841, Senapati Bapat Marg
Mumbai 400 013, India

T: +91 22 6636 5000
E: mumbai@khaitanco.com

New Delhi
Ashoka Estate, 12th Floor
24 Barakhamba Road
New Delhi 110 001, India

T: +91 11 4151 5454
E: delhi@khaitanco.com

Bengaluru
Simal, 2nd Floor
7/1, Ulsoor Road
Bengaluru 560 042, India

T: +91 80 4339 7000
E: bengaluru@khaitanco.com

Kolkata
Emerald House
1 B Old Post Office Street
Kolkata 700 001, India

T: +91 33 2248 7000
E: kolkata@khaitanco.com