K C Mehta & Co.

Chartered Accountants

kcmSpark

International Tax

Supreme Court's PILCOM Ruling

World Cup 1996 continues to haunt

Dec 02, 2020

Snapshot

Background and Coverage

Belonging to a larger Indian community that loves Cricket immensely and also belonging to a smaller community that loves the subject of Tax as much as Cricket, the judgment of Supreme Court in the case of PILCOM v. CIT (Civil Appeal No. 5749 of 2012) created a sense of curiosity as we started to read and analyse it. Considering that most of our readers would have already read umpteen articles on the judgment, we would briefly touch upon the judgment with going into the basics of the judgment and then plunge into some aspects of the judgment that warrant consideration.

In brief

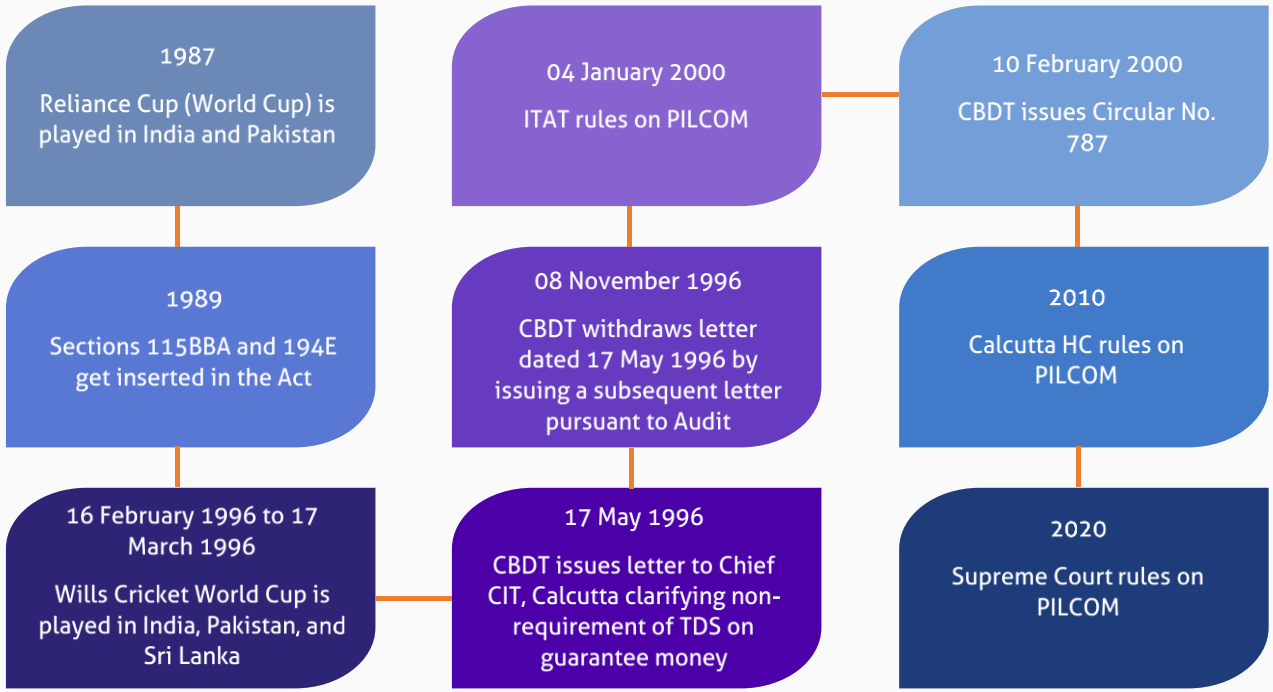
PILCOM (a committee created by cricketing Boards of Pakistan, India and Sri Lanka for World Cup 1996) made certain payments from its London Bank Account to ICC and other cricketing Boards under different modes including guarantee money in respect of the World Cup 1996. Calcutta High Court (HC) upheld that out of seven types of payments, two payments to cricketing Boards in proportion to matches played in India were taxable in India under section 115BBA of the Income-tax Act, 1961 ('the Act') and taxes should have been withheld on the same under section 194E of the Act.

In the context of section 115BBA and section 194E, Supreme Court upheld Calcutta HC's decision that the obligation to withhold tax under section 194E was not affected by DTAA. It further held that benefit of DTAA could be pleaded by the *payee* who could claim a refund if the taxability was to be disputed but it would not absolve the *payer* from its liability to withhold tax.

Please note that even if DTAA were applied in PILCOM's case, the result would not have been different and PILCOM might still have been liable to withhold tax even after considering the provisions of DTAA. However, considering the possible repercussions of this SC Judgment on other cases, it becomes important to analyse the mishits arising from this judgment.

Interesting sequence of events

Before we plunge into the technical arguments, it would be interesting to have a look at the way the sections 115BBA and 194E have evolved parallelly with the evolution of one-day cricket in India, right from 1987 till the recent Supreme Court ruling in 2020, and may be even beyond!



As can be seen from the above, the way the story has unfolded clearly shows how important a role the two Cricket World Cups have played in insertion of and subsequent interpretations / clarifications on the provisions of sections 115BBA and 194E in the Act.

Having had a look at the sequence of events at a high-level, we shall now discuss about the minute aspects arising out of the Supreme Court and High Court decision in PILCOM's case.

Was the aspect of applicability of DTAA not argued before the High Court?

While dealing with the issue of DTAA, Supreme Court has observed that *"We now come to the issue of applicability of DTAA. As observed by the High Court, the matter was not argued before it in that behalf, yet the issue was dealt with by the High Court."*

On an isolated reading of this statement, it appears that the aspect of DTAA was never argued before the High Court and that the High Court had *suo moto* provided its view on the issue. However, on a perusal of the ITAT and HC Orders, it can be seen that the aspect of DTAA was deliberated upon at length, both, by the

Taxpayer as well as the Department at various levels, including ITAT and at the HC.

The HC, in addition to the arguments put forth by the parties concerned, *suo moto* took up the aspect of whether section 194E is affected by a DTAA or not and held that the said section was not affected by DTAA as tax withheld under section 194E was not the final payment of tax, nor could it be said to be an assessment of tax. The HC has also categorically observed the absence of requirement of income being *chargeable to tax* in section 194E and held that language employed in section 194E has no co-relation to taxability.

Further, the HC went on to hold that advantage of DTAA could be pleaded and taken by the real assessee on whose account the deduction is made and not by the payer. In our opinion, this view should not be read without context. It should be read in the context provided earlier and should only be read while interpreting section 194E and not for other sections. A different reading could mean that even for cases falling under section 195, which actually refers to "sum chargeable to tax", DTAA benefit could not be claimed by the payer to determine taxability of the transaction, except for rates as provided in the DTAA, which appears to be an absurd interpretation.

Interestingly, the ITAT had upheld the principle that even for the purpose of withholding tax, in case of conflict between the provisions of the Act and DTAA, the provisions that are beneficial should apply. ITAT had taken a holistic view and also evaluated the said two payments from the perspective of DTAA and after detailed reasoning, came to a conclusion that the two types of payments were still taxable in India and hence, provisions of section 194E read with section 115BBA were applicable.

Interplay of sections 5, 9 and 115BBA

Worth noting that in denying the benefit of DTAA, HC had observed that section 115BBA was completely independent of other sections and that it had got nothing to do with the accrual or assessment of income in India as mentioned in section 9. Further, the HC observed that that section 5(2) was subject to other provisions of the Act (including section 115BBA) and hence, section 115BBA was not subject to section 5.

HC has upheld that ITAT's decision that out of seven, only two types of payments were chargeable to tax in India. Ironically, in arriving at the conclusion that only two types of payments fell within the purview of section 115BBA, the ITAT had taken recourse to section 5 read with section 9 and had held that section 115BBA was subservient to section 9(1)(i). Accordingly, it held that only when an income arose through a source in India, it could fall within the purview of section 115BBA. However, this aspect has not been negated by the HC. This leads to self-contradicting conclusions arrived at by the HC.

It is important to note that section 115BBA falls under "Chapter XII – Determination of Tax in Certain Special Cases". As the Heading suggests, the Chapter only provides for determination of tax in certain cases, it does not provide for creation of a new charge. Section 4 provides for Charge of income-tax and falls under "Chapter II – Basis of Charge". Thus, it is aptly clear that section 4 read with section 5 and section 9 should govern chargeability and section 115BBA should come into picture once chargeability is established under section 4 read with sections 5 and 9. Take for example, royalty being taxed under section 115A. Section 115A is not de hors section 9(1)(vi). Section 5 read with section 9(1)(vi) provides for a deeming provision for chargeability of income

in the nature of royalty. One cannot say that section 115A provides for charging mechanism for royalty. Section 115A also gets covered by Chapter XII and the same analogy should be applicable for the income of the nature described in section 115BBA.

First Principles for withholding tax

Section 4(1) of the Act provides for charge of income-tax in respect of total income of a particular year in accordance with and subject to provisions of the Act. As per Section 4(2), *in respect of income chargeable* under sub-section (1), income-tax should be withheld at source or paid in advance, where it is to be withheld or is payable under any provision of the Act. Further, as per section 190 of the Act, the *tax on income* should be payable by withholding or collection at source or by way of advance payment. Section 190 deals with Collection and Recovery of Tax and is a machinery provision.

Thus, as per first principles, an income should first be chargeable to tax under the Act (section 4 read with sections 5 and 9) to be liable for payment either in the form of withholding of tax or in the form of payment of tax. If it is so, the question of payment / collection in the form of withholding taxes or advance tax would arise. If an income is not chargeable in the first place, the question of discharging liability either in the form of withholding tax / direct taxes thereon should not arise. There is no provision under the Act which is contrary to section 4 read with section 190 of the Act i.e. a provision which states that withholding of tax is independent activity *de hors* the charging provision, should continue to apply irrespective of the income not being chargeable. In case of a non-resident, determination of chargeability would also factor provisions of DTAA.

The first principles are enunciated in multiple judgments including the Supreme Court judgment in the case of **Transmission Corporation v. CIT, CIT v. Eli Lilly & Co. Further,** Karnataka High Court in the case of **Bharti Airtel Ltd. v. DCIT** also upheld that withholding tax provisions were to be read along with the charging sections. There are multiple other judgments wherein it has been held that withholding tax provisions (being machinery provisions) have to be read in sync with the charging provisions. One may argue that most of these judgments were delivered in the context of section 195 which uses a particular language. However, it should be noted that the principles around withholding tax would not differ merely based on language of a particular provision.

Merely because taxes withheld could not be considered as a final payment of tax should not mean that there is no linkage between withholding tax provisions and the provisions regarding chargeability of income. For example, if a payee does not provide necessary documents / details as mandated by section 90 of the Act, a payer may withhold tax (though not required under a DTAA) resulting in a difference between the tax liability of the payee and the withholding tax obligation of the payer. This is in sync with the understanding that withholding tax is not a final payment of tax. Similarly, if a payer withholds tax at a lower rate under a *bona fide* understanding and based on details provided by the payee, and at a later date, it is found that the payee was not entitled to DTAA benefit, the shortfall could be recovered. Accordingly, the said principle of withholding tax not being a final liability of tax would not mean that withholding tax provisions are to be adhered to without factoring the chargeability of income of the payee.

A combined reading of section 4, 5, 9, 90, 115BBA, 190 along with the withholding tax provisions leads to an interpretation that the withholding tax provisions under the Act are subservient to the main charging sections and that determination of chargeability for the purpose of withholding tax itself encapsulates determination of benefit, if any under section 90 of the Act. Further as per section 4(2) read with section 190, withholding tax provisions are not independent of charging provisions. It is worth nothing that unlike few countries, India does not have a codified law for payers / payees to compulsorily approach the Government upfront for availing DTAA benefits for the purpose of withholding taxes. As a principle, availing DTAA benefit is left at the discretion of the payer and payee which may be verified at a later date during the course of routine assessment proceedings or during the proceedings initiated under section 201 of the Act.

Section 194E – Requirement of income being chargeable to tax

Section 194E makes a reference to *"any income referred to in section 115BBA"* payable to a non-resident sportsman. It is important to note here that the reference to section 115BBA has to be seen and read in context. The reference is not merely to income of *the nature* referred to in section 115BBA, the reference is to income as such, meaning an income on which tax is payable under section 115BBA by virtue of it being taxable in the first place. Thus, only when the income is taxable in India, the question of making a reference to section 115BBA arises. If at the first stage, income is not taxable in India (say, by virtue of a DTAA), then such income would not be considered for the purpose of section 115BBA and accordingly should be out of the purview of section 194E of the Act.

Having considered the first principles, it should be easy to answer if a difference in language between section 194E and section 195, specifically, absence of the words "chargeable to tax" in section 194E would make any difference to the withholding tax obligation in absence of there actually being no income chargeable to tax. Based on first principles, withholding tax liability should arise only if income is chargeable to tax in India in the first place. However, the High Court had given significant importance to the fact that section 194E did not refer to income being "chargeable to tax" and hence, held that withholding tax liability under section 194E had no correlation to taxability of income and such liability had to be fulfilled independent of any tax liability. This may well be against the first principles.

Section 195 and section 194E read with section 40(a)(i) poses an interesting proposition. The language of section 195 reads as under:

"Any person responsible for paying to a non-resident, not being a company, or to a foreign company, *any interest* (not being interest referred to in section 194LB or section 194LC or section 194LD) ***or*** *any other sum chargeable under the provisions of the Act*.....

There could be two possible views on a reading of the section:

View 1 – the phrase "chargeable under the provisions of the Act" applies to both, "interest" and "any other sum" and hence, withholding tax liability arises only if "interest" is also chargeable under the provisions of the Act.

Bombay High Court in the case of **CIT v. Cooper Engineering Limited**, in the context of whether "chargeable to tax" should be read with

"interest" for section 195 observed that the phrase was to be read with interest. Hence, as per this view, both the phrases are to be read together.

This would bring up an interesting proposition in the context of section 40(a)(i) which reads as under:

"(a) in the case of any assessee

(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable..."

Ideally speaking this provision is in sync with section 195 of the Act. As can be seen, it also uses a very similar language and if interpreted in the same light, it would mean that the disallowance would be warranted only if tax is not withheld from any payment of *any sum chargeable to tax under the Act.*

In context of section 194E, if one were to accept decision of SC, it would mean that under section 194E, tax will have to be withheld even if the amounts were not chargeable to tax considering the provisions of DTAA. However, not withholding tax from such amounts which are not chargeable to tax, would not render the expenditure disallowable because section 40(a)(i) refers to disallowance in respect of sums *chargeable to tax under the Act.* This in our opinion, would not be logical.

View 2 – *the phrase "chargeable under the provisions of the Act" applies only to "any other sum" and not to "interest", and therefore even if interest is not chargeable to tax, section 195 should apply*

If this view was to be adopted, it would mean that considering that the phrase is not added after "interest", it should not be entitled to treaty benefits so far as "chargeability" is concerned. However, rate as per DTAA should be allowed considering the definition of "rates in force" that follows. In the context of section 194E, this view would be in sync with the SC decision, as it would mean that DTAA benefit should not be available in absence of both the phrases, viz. "chargeable to tax" and "rates in force" in section 194E. However, this would create an interesting and unwanted situation in section 195 as a taxpayer would not be entitled to claim non-chargeability if a particular DTAA provided for exemption from taxing interest in India, being the source country. This again, in our view, appears illogical.

View 3 – *Even in absence of specific use of the phrase "chargeable to tax" along with "interest", it should apply considering first principles*

In this connection, it is interesting to note that in the case of **Cooper Engineering Limited *(supra)***, the HC held that *"at any rate, there is nothing to show or suggest that the provisions of section 4(1) would not apply to "interest""*. This was an alternative observation of the HC and would imply that even if one was to say that the words "chargeable to tax" were not used along with interest, one was to first check chargeability of interest under section 4(1) of the Act.

If one were to adopt this View, it could imply in context of section 194E that the payments should first be chargeable to tax in India in order to attract withholding tax obligation. Once such amounts are chargeable to tax in India and no taxes are withheld therefrom, disallowance under section 40(a)(i) stands warranted. In our opinion, this View appears logical.

Reference to SC decision in the case of GE Technology

The Taxpayer had relied upon the SC decision in the case of GE Technology to argue that if an income was not chargeable to tax in India, there could not be a withholding tax obligation. However, the SC stated that the judgment had no application in PILCOM's case on a very interesting basis. It held that *"To the extent the payments represented amounts which could not be subject matter of charge under the provisions of the Act, appropriate benefit already stands extended to the Appellant.*

The above observation arises from the fact that out of seven different types of payments, the ITAT and HC had already held that five types of payments were not chargeable to tax in India and only two types of payments were taxable in India. In continuation to such a finding by ITAT / HC, SC observed that the benefit on account of specific amounts not being chargeable to tax in India was already extended to the Taxpayer by the ITAT and HC. Thus, SC has not rejected the reliance on the case of GE (supra) on any other count but merely on the fact that benefit, if any, pertaining to chargeability, has already been granted. Ironically, if that be the case, the SC has faltered in not going into the details of possible non-chargeability of the remaining two payments under the DTAA.

CBDT Circular No. 787 dated 10 February 2000

We would like to bring to notice of the readers, CBDT Circular No. 787 dated 10 February 2000 which specifically deals with the issue. It has been categorically mentioned in the Circular that payment in the nature of "guarantee money" paid to non-resident sports association needs to be considered in terms of the Article on "Other Income" or on "Income not expressly mentioned" of the relevant DTAA. The Circular further states that *"In cases where such guarantee money is taxable in India under the DTAA, income would be determined in accordance with section 115BBA of the Income-tax Act and the tax deducted at source under section 194E of the Income-tax Act".*

The Circular is amply clear that only if the "guarantee money" is taxable under the Article on "Other Income", it will be taxed as per provisions of section 115BBA and tax will have to be withheld thereon under section 194E. It appears that surprisingly, neither the Department nor the Taxpayer has taken recourse to the said Circular during the course of the hearing, at the HC / SC level.

It is interesting to note that during the course of hearing with the ITAT, while the Taxpayer had placed reliance upon Article 22 of the DTAA to put forth a claim that the amounts were not taxable in India, the ITAT had concluded by holding that the payment would get governed by Article 17 – Entertainers and not by "Article 22 – Other Income". The ITAT had rendered its ruling on 04 January 2000 and the CBDT Circular was rolled out on 10 February 2000. Accordingly, the reason for roll out of the CBDT Circular could be anybody's guess. This is also evident from the beginning lines of the Circular which read as *"The Board had in the recent past, occasion to examine taxation issues concerning national and international events or shows for entertainment, sports, etc."* Considering that the Circular was rolled out in backdrop of its own case, it is surprising that PILCOM did not rely upon the same at the time of representation with higher authorities including the Supreme Court. It is all the more surprising that while High Court *suo moto* decided to adjudicate upon

an issue that was not even argued by the Department, i.e. section 194E overriding DTAA, it could have definitely considered the CBDT Circular No. 787 dated 10 February 2000 and held that while DTAA is to be considered, having regard to the facts of the case, income would still be taxable.

History of 115BBA and 194E

Section 115BBA and section 194E were inserted in the Act vide Direct Tax Laws (Second Amendment) Act, 1989. The rationale behind introduction of section 115BBA and section 194E are given in Circular No. 554 dated 13 February 1990. It would be important to reproduce the same for ready reference of our readers:

> *Under the provisions of the Income-tax Act, any income which accrues or arises or is deemed to accrue or arise in India is taxable in the hands of a non-resident. As per section 9(1)(i) of the Income-tax Act, all incomes accruing or arising directly or indirectly from any source of income in India are deemed to accrue or arise in India. Therefore, any guarantee money paid to the foreign sports teams/Boards and payments to individual players on account of the sports activities taking place in India is liable to be taxed in India. Under section 195 of the Income-tax Act, it is also necessary to deduct tax at source at the time of payment/credit of such income. On the other hand, in countries like the United Kingdom, Australia and New Zealand, the income of the visiting non-resident sportsmen of sports bodies is either not taxed or taxed at lower rates. Further, practical difficulties were being experienced in enforcing the provisions of the Income-tax Act with regard to the payments to be made to the non-resident sportsmen or sports bodies. Therefore, as a measure of reciprocity and rationalization, a new section 115BBA has been introduced in the Income-tax Act providing that the income of the non-resident sports bodies and non-resident sportsman (who are not citizens of India) other than the income chargeable under section 115BB will be chargeable to tax at a flat rate of 10% of the gross payments due to them. This rate will also be applicable in respect of income derived by non-resident sportsmen from their other activities like participating in advertisements and writing in newspapers, etc. It has also been prescribed that, in such cases, there will be no necessity for filing the return of income by such non-residents once tax has been deducted at source. It has further been prescribed that the person responsible for paying any sum to these non-resident sports bodies/players will be required to deduct the tax at source at the rate of 10% of the gross payments.*

Our readers would recollect that 1987 was the year in which India along with Pakistan hosted its first ever Word Cup, popularly knows as the Reliance Cup. In view of the same, insertion of the new provisions in 1989 along with the aforesaid amendment explanation / justification does not seem out of place or without context either.

As can be seen from the extract of the Circular, till the introduction of section 115BBA and 194E, guarantee money paid to overseas sports bodies was being taxed under section 9(1). Further, taxes were to be withheld under section 195 of the Act. However, the same was posing practical challenges in terms of computation on a net basis, etc. Accordingly, the Government decided to have a gross model of taxation for levy and withholding of tax to remove difficulties and to provide for a rationalized rate of tax.

In the context of withholding tax provisions under section 195 (which was the erstwhile mechanism), there is not an iota of a doubt that the taxpayer could have access to DTAA in order to determine taxability and withholding tax liability. It would therefore be principally fatal to assume that merely because there was a change in method of taxation / withholding tax introduced for such payments by way of specific sections 115BBA and 194E, access to DTAA would not be available, which was otherwise available.

What if decision of SC continues to hold good?

While the observations of HC and SC may not have made a difference to the outcome of the judgment under discussion, they are bound to impact more cases wherein case pertains to sections that have language similar to section 194E.

For example, let us take the case of section 194LC dealing with specific types of interest payments. Section 194LC does not use the phrase "chargeable to tax" and therefore the same logic as applied by the HC and SC would ideally apply in cases pertaining to section 194LC as well. Theoretically speaking, in cases where DTAA provides for exemption from taxability of a particular type of interest, the payer would still be under an obligation to withhold tax under section 194LC. However, if conditions specified in section 194LC were not fulfilled, the payer would have been liable to withhold tax under section 195 and ironically, in such a case, the payer would have been able to take recourse to exemption available pursuant to the DTAA based on the phrase "chargeable to tax" used in section 195.

Similarly, in context of section 115BBA, let us assume that an entertainer performs in Dubai for an Indian company. Considering that the entertainer performs in Dubai, provisions of section 115BBA would not apply. However, income might still be taxable in India as per normal provisions under section 9(1) *(one may make an indirect reference to judgment in the case of Volkswagen Finance delivered by Mumbai ITAT)*. In such a case, section 194E would not apply to the payer as the income would not be falling within the scope of section 115BBA and accordingly, considering that the case would be governed by section 195 of the Act, the payer would be entitled to take recourse to DTAA benefit, if any. On the contrary, if the entertainer would have performed in India, section 115BBA and 194E would have applied and going by the logic given by the HC & SC, the payer would not have been entitled to take recourse to provisions of DTAA, even if there was a possible benefit.

Similar could be the implications in case of sections 194LB (Interest from infrastructure debt fund), 194LD (Interest on certain bonds and Government securities), 196A (Income in respect of units of non-residents), 196C (Income from foreign currency bonds or shares of Indian company), 196D (Income of FIIs from securities), etc.

Food for thought

It is worth noting that under the scheme of the Act, while for certain types of payments, withholding tax provisions (including the rates for withholding tax) are provided in specific sections (like section 194LC, 194E, 196C, 196D, etc.), for other types of payments to non-residents, section 195 along with Part II of the First Schedule provides for the withholding tax provisions and rates. *Is there any specific reason for separately providing for withholding tax*

provisions for certain types of payments to non-residents where there is already section 195 which could cover all such transactions read with Part II of First Schedule?

Further, there are no provisions similar to sections 195(2) / 195(3) / 197 available for section 194E, 194LC, 196D, etc. whereby the payer / payee could approach the authorities for lower / NIL withholding tax orders. Can this be of any help to draw an inference for the issue under consideration?

May be, answers to the above could provide us with a concrete answer to the questions arising out of the Supreme Court judgment, maybe not.

Conclusion

Going by the first principles read with provisions of section 90(2) of the Act, we believe that the judgment rendered by Supreme Court on applicability of DTAA could have factored the nuances surrounding the first principles.

Having said that, the way the position stands as on date, especially after considering the judgment of Supreme Court, is that availing DTAA benefit in case of withholding provisions under the Act (except for section 195) could be difficult if one were to go by the literal reading of the language used therein. Practically, in the context of section 196D, companies have already been adopting a position that while paying dividends to FIIs, taxes should be withheld @ 20% (rate provided for in section 194E) without recourse to provisions of DTAA and that, benefit, if any, under a particular DTAA could be claimed by the payee by filing a tax return in India. This would create additional compliance requirements for payees on whose account taxes are withheld (for example, entertainers, sports associations, FIIs, etc.), in case they wish to avail DTAA benefits.

Should you need more information, kindly reach out to

Dhaval Trivedi
Director

dhaval.trivedi@kcmehta.com
+91 79 4910 2204 (Direct)
+91 99983 24622 (Handheld)

About kcmSpark

kcmSpark *is a periodic, highly research-oriented publication which covers research and analysis on specific topics by our subject matter experts. As the name suggests, our endeavour is to present to you, interesting and thought-provoking aspects about a particular topic, in each edition of* **kcm**Spark.

Locations

Ahmedabad
Arpit Jain
Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015
+ 91 79 4910 2200
arpit.jain@kcmehta.com

Bengaluru
Payal Shah
19/4, Between 7th & 8th Cross,
Malleswaram,
Bengaluru - 560 003
+91 80 2356 1880
payal.shah@kcmehta.com

Mumbai
Vishal Doshi
508, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai – 400 069
+91 22 2612 5834
vishal.doshi@kcmehta.com

Vadodara
Milin Mehta
Meghdhanush,
Race Course,
Vadodara - 390 007
+91 265 2440400
milin.mehta@kcmehta.com

Independent Member of
BKR INTERNATIONAL