MOOT PROPOSITION

DRAFT PROBLEM

The assessee, M/s. Vulcantech BPO India Private Limited, has filed an appeal before the Hon'ble High Court under Section 260A of the Income Tax Act, 1961 against the order of the Income Tax Appellate Tribunal ("Tribunal") passed in the case of M/s. Vulcantech BPO India Private Limited Vs ACIT for the Assessment Year 2014-15. The assessee raised the following substantial questions of law which have been admitted by the Hon'ble High Court and fixed for final hearing:

1. *Whether on the facts and in the circumstances of the case, the Tribunal was right in holding that second proviso of Section 40(a)(ia) inserted w.e.f 1.4.2013 should be given retrospective effect?*

2. *Whether on the facts and in the circumstances of the case, the Tribunal was right in law in upholding that assesse's payments to Markiv Carras of Markiv Legal, Cyprus u/S.40(a)(i) r.w. S.94A r.w. Notification 86/2013 overriding the provisions of S.90(A) along with Article 15 of the India-Cyprus DTAA?*

In relation to the matter at hand, the following Annexures form part of the record:

Annexure A: The impugned order of the Tribunal

Annexure B: Grounds of appeal filed before the Tribunal

Annexure C: Final Assessment Order

Annexure D: Directions of DRP

Annexure E: Objections before DRP

Annexure F: Draft Assessment Order

Annexure A

IN THE INCOME TAX APPELLATE TRIBUNAL "A" BENCH

BEFORE SHRI F.D.LEGELLO, JUDICIAL MEMBER AND

SHRI ANTHONY VARDON, ACCOUNTANT MEMBER

ITA No. 1027 of 2015

Assessment Year : 2014-15

M/s Vulcantech BPO India Private Limited. ---------- Appellant

- Vs -

The Assistant Commissioner of Income-Tax ---------- Respondent

Appellant by : Shri. Aziz Alam

Respondent by : Shri. Raman Gopalakrishnan

Date of Hearing : 1st December, 2016

Date of Pronouncement : 1st December, 2016

ORDER

PER ANTHONY VARDON, ACCOUNTANT MEMBER

1. This appeal by the assessee is directed against the order of assessment passed by the Income Tax Officer, Company Circle – II(4) u/s 143(3) r.w.s 144C(13) of the Act,

dt 24.10.2016 in pursuance of the directions issued by the Dispute Resolution Panel (DRP in short), vide its order dt 13-10-2016 passed u/s 144C(5) r.w 144C(8) of the Act.

2. The facts of the case, in brief, are as under:

2.1 The assessee filed its Return of Income (ROI) electronically, declaring 'Nil' income for the Assessment Year (AY) 2014-15. The ROI was processed u/s 143(1) of the Income Tax Act (the Act). The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee.

2.2 The Assessing Officer in the course of scrutiny made two disallowances u/s 40(a)(ia) of Rs.4,76,30,766/- and u/s 40(a)(i) r.w. S.94A r.w Notification No.86/2013 *(Rule 21AC and Form No. 10FC)* of Rs. 91,32,564/-

2.3 The assessee filed its objections before the Dispute Resolution Panel (DRP) on 7-4-2016. The DRP heard the assessee and passed an order on 13-10-2016 confirming the disallowances made by the AO and thereby rejecting the objections raised by the assessee. In consequence thereof, the Income Tax Officer passed the final Order of Assessment on 24-10-2016 u/s 143(3) r.w.s 144C(13) of the Act.

3. Aggrieved by the above said order of assessment dt 24-10-2016, the assessee is on appeal before us raising various grounds. Before us, the assessee has reiterated its submissions made before the lower authorities

4. We note that the AO has passed a very detailed, speaking order as to why the disallowances should be upheld. We neither find need to repeat the same points nor interfere with the AO's findings, which have been confirmed by the DRP.

5. Hence, we are unable to accept the contention of the assessee and dismiss the grounds raised by the assessee.

6. The assessee's appeal is thus dismissed.

Order pronounced in the open court on 1st day of December, 2016

Sd/- Sd/-

Accountant Member Judicial Member

ANNEXURE- B

Vulcantech BPO India Pvt Ltd

Assessment Year 2014-15 (PAN : AACBD4392M)

APPEAL BEFORE THE INCOME-TAX APPELLATE TRIBUNAL AGAINST THE ORDER PASSED u/S. 143(3) r.w. S.144C(13)

GROUNDS OF APPEAL

A. Disallowance u/s 40(a)(ia) of Rs.4,76,30,766/-

1. The DRP/ITO erred in disallowing payments made by assessee for technical services u/s 40(a)(ia)

2. The DRP/ITO erred in ignoring the fact that the second proviso of S.40(a)(ia) was declarative and curative in nature and ought to be applied retrospectively. In such a case, given that the payments were offered as income to tax by the recipient, there cannot be any disallowance u/s 40(a)(ia)

3. The DRP/ITO ignored the various judicial precedents while erroneously upholding that S.40(a)(ia) second proviso is only applicable prospectively

B. Disallowance u/s 40(a)(i) r.w. S.94A r.w Notification 86/2013 of Rs. 91,32,564/-

1. The DRP/ITO erred in applying the provisions of S.40(a)(i) r.w. S.94A r.w. Notification No.86/2013 *(Rule 21AC and Form No. 10FC)* to the instant case

2. The DRP/ITO erred in not applying S.90(2) of the Act which holds that provisions of Act are applicable to the extent that they are more beneficial to the taxpayer and hence Article 15 (Independent Personal Services) of India-Cyprus DTAA which prescribe no tax withholding required in the instant case, thus being more beneficial, is solely applicable to the taxpayer

3. The DRP/ITO failed to appreciate that application of DTAA Articles cannot be unilaterally amended by the contracting country, especially by Section S.94A which is not a charging section under the Act.

C. The Appellant prays leave of the Hon'ble ITAT for elaborating the aforesaid grounds and craves leave to adduce additional grounds at the time of hearing.

Director
For Vulcantech BPO India Pvt Ltd
Dated: 2nd November 2016

Annexure C

Income Tax Department

1	Name of the Assessee	M/s.Vulcantech BPO India Private Limited
2	PAN/G.I.R. No.	AACBD4392M
3	Circle	Company Circle – II(4)
4	Status (Domestic/Public/Private, If Applicable)	Company
5	Assessment Year	2014-15
6	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
7	Method of Accounting	Mercantile
8	Previous Year	2013-14
9	Nature of Business	ITES
10	Date of Order	24 October, 2016
11	Section under which assessment order is passed	143(3) r.w.s 144C(13)

FINAL ASSESSMENT ORDER

The assessee is a wholly owned subsidiary of Vulcantech BPO Inc, USA. The assessee is engaged in rendering data conversion services to its ultimate parent company Vulcantech BPO Inc, USA in the area of forms processing, E-publishing, support systems and software services. The assessee company had e-filed its Return of Income for the AY 2014-15 declaring 'Nil' income. The Return was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee. Subsequently, the case was assigned by the Commissioner of Income Tax to the Income Tax Officer, Company Range II, for completion of assessment u/s 143(3) of the Act. The ITO, Company Range-II issued a Draft Assessment Order u/s 143(3) r.w.s 144C dt 31-3-2016, incorporating two disallowances.

The assessee preferred an appeal before the Dispute Resolution Panel (DRP) on 7-4-2016. The DRP passed an order u/s 144C(5) r.w 144C(8) on 13-10-2016 upholding the order of the AO Hence, as per the directions of the DRP vide its Order dt 13-10-2016 the order of the ITO is confirmed.

Income Tax Officer

Company Range – II(4)

Copy to:

Assessee

Annexure - D

Income Tax Department
Dispute Resolution Panel (DRP)

Proceedings to issue directions under sub-section 5 of section 144C read with sub-section 8 of Section 144C the Income Tax Act 1961		
1	F. No. DRP/CHE/98/2014-15	Date of Directions: 13.10.2016
2	Name of Assessee	M/s.Vulcantech BPO India Private Limited
3	PAN	AACBD4392M
4	Assessment Year	2014-15
5	Date of Filing of Objections by the Assessee before the DRP	7-4-2016
6	Date of Direction	13-10-2016
7	Section & Sub-section under which the directions are given	144C(5) r.w 144C(8)

The assessee company had e-filed its Return of Income for the Assessment Year 2014-15 declaring 'Nil' income. The AO passed a Draft assessment order on 31.3.2016 incorporating two adjustments u/s 40(a)(ia) and 40(a)(i) r.w S.94A r.w Notification 86/2013 *(Rule 21AC and Form No. 10FC)*. The assessee filed its objections before the Draft Resolution Panel (DRP) on 7.4.2016 and subsequently, a notice was issued under section 144C(11) and served upon the assessee for providing an opportunity of being heard. The DRP heard the assessee.

Panel : This Panel does not find anything new which has not been considered by the detailed speaking order of the AO.

The AO has already considered threadbare all important aspects and then only taken the decision to disallow under S.40(a)(ia) and S.40(a)(i).

Furth ermore it is pointed out wrt S.40(a)(i) disallowance, subsequent to the order of the AO, on 12th April 2016, the Hon'ble Madras High Court in the case of a Writ Petition ***(T.Rajkumar, K.Dhanakumar, T.K.Dhanashekar rep. By PoA holder Mr.P.Sivakumar vs Uol, CBDT, ITO in WP Nos.17241 to 17243 & 17407 to 17412 of 2015 and all connected pending MPs via order dated 12/4/2016)*** filed challenging the constitutionality of S.94A has elaborately discussed interplay of S.94A and S.90A and held that S.94A is valid. The aforesaid judgment clearly supports the stance of the AO in disallowance u/s 40(a)(i) r.w. S.94A

This Panel therefore finds that all the objections raised by the assessee and confirms the order of the AO in toto.

Sd/-	Sd/-	Sd/-
DIT (Int Taxation) Member, DRP	DIT (Int Taxation) Member, DRP	CIT Member, DRP

Copy Forwarded to:

1. **ITO**
2. **Assessee**
3. **The Guard File**

Annexure - E

Vulcantech BPO India Private Limited

Assessment Year 2014-15

Summary of Objections before the DRP

A. Disallowance u/s 40(a)(ia) of Rs.4,76,30,766/-

1. The ITO erred in disallowing payments made by assessee for technical services u/s 40(a)(ia)

2. The ITO erred in ignoring the fact that the second proviso of S.40(a)(ia) was declarative and curative in nature and ought to be applied retrospectively. In such a case, given that the payments were offered as income to tax by the recipient, there cannot be any disallowance u/s 40(a)(ia)

3. The ITO ignored the various judicial precedents while erroneously upholding that S.40(a)(ia) second proviso is only applicable prospectively

B. Disallowance u/s 40(a)(i) r.w. S.94A r.w Notification 86/2013 of Rs. 91,32,564/-

1. The ITO erred in applying the provisions of S.40(a)(i) r.w. S.94A r.w. Notification No.86/2013 *(Rule 21AC and Form No. 10FC)* to the instant case

2. The ITO erred in not applying S.90(2) of the Act which holds that provisions of Act are applicable to the extent that they are more beneficial to the taxpayer and hence Article 15 (Independent Personal Services) of India-Cyprus DTAA which prescribe no tax withholding required in the instant case, thus being more beneficial, is solely applicable to the taxpayer

3. The ITO failed to appreciate that application of DTAA Articles cannot be unilaterally amended by the contracting country, especially by S.94A which is not a charging section under the Act.

C. The Appellant prays leave of the Hon'ble Dispute Resolution Panel for elaborating the aforesaid grounds and craves leave to adduce additional grounds at the time of hearing.

Authorised Signatory
For Vulcantech BPO India Pvt Ltd
Dated: 7.4.2016

Annexure - F

Income Tax Department

1	Name of the assessee	M/s.Vulcantech BPO India Private Limited
2	PAN/G.I.R. No.	AACBD4392M
3	Circle	Company Circle – II(4)
4	Status (Domestic/Public/ Private, If Applicable)	Company
5	Assessment Year	2014-15
6	Whether Resident/Resident But Not Ordinarily Resident/Non-Resident	Resident
7	Method of Accounting	Mercantile
8	Previous Year	2013-14
9	Nature of Business	ITES
10	Date of Order	31.03.2016
11	Section under which Assessment Order is passed	143(3) r.w.s 144C

DRAFT ASSESSMENT ORDER

The assessee is a wholly owned subsidiary of M/s. Vulcantech BPO Inc, USA. The assessee is engaged in rendering data conversion services in the area of forms processing.

The assessee company had e-filed its Return of Income for the Assessment Year 2014-15 declaring 'Nil' income. The Return was processed under sub-section (1) of section 143 of the Income Tax Act, 1961.

The case was selected for scrutiny and notice u/s 143(2) of the Act was issued to the assessee.

Subsequently, the case was assigned by the Commissioner of Income Tax to the Income Tax Officer, Company Range II, for completion of assessment u/s 143(3) of the Act.

In response to the notices issued, Sri. Ramachandran, CFO and Sri. Venkatraman, Dy. Sr. Manager (Fin) appeared from time to time on various dates. He filed the Power of Attorney to appear before the Income-Tax Authorities. Details relevant to the Return of Income were called for from the assessee and were filed. The case was discussed with the assessee's representative and the scrutiny assessment is completed as under:

Disallowance u/s 40(a)(ia)

The assessee has paid sum of Rs.4,76,30,766/- to Varian Property Developers India Pvt. Ltd. for technical services. No tax was deducted on the aforesaid amount and hence it was put forth to the assessee that the entire amount ought to be disallowed u/s 40(a)(ia) of the Income Tax, 1961 which reads as under:

The assessee in its written submission dated 14.2.2016 has replied as follows:

""""

The payment made to Varian Property Developers Ltd. was in the nature of technical services rendered by them for developing our new office building ……..

We would like to submit that while no tax was deducted on the amount, the recipient namely Varian Properties India Pvt. Ltd.:

(i) had furnished its return of income u/s 139;

(ii) had also taken into account aforesaid amount in the computation of income in such return and

(iii) had paid tax due on the income declared by it in then return.

We also submit that the second proviso to sub clause (ia) of S.40(a) though it was inserted by Finance Act, 2012 w.e.f. 1.4.2013, the same is retrospectively applicable as it has retrospective application:

We also submit that on similar lines the first proviso to S.40(a)(ia) which was w.e.f. 1.4.2010 has been held by a number Hon'ble Courts to be retrospectively applicable and the same principle also applied to the amendment under consideration.

We further rely on the case of ITAT Agra Bench in ***Rajiv Kumar Agarwal vs. ACIT (ITA No.337/Agra/2013 dated May 29, 2014)*** *in which it was held that the second proviso to Section 40(a)(ia) is declaratory and curative in nature and should be given retrospective effect from 1st April, 2005. In coming to their decision,* ***the Hon'ble ITAT held as follows:***

"2. ……

Relying upon a Special Bench decision in the case of Bharati Shipyard Ltd Vs. DCIT (141 TTJ 129), herejected this plea and concluded that insertion of second proviso to Section 40(a)(ia) cannot be held to have retrospective effect. The disallowance was thus confirmed by the learned CIT(A). The assessee is aggrieved and is in appeal before us.

3. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

4. Let us first take a look at the legislative amendment of section 40(a)(ia), vide Finance Act 2012, and try to appreciate the scheme of things as evident in the amended section. Second proviso to Section 40(a)(ia), introduced with effect from 1 st April 2013, provides, that ***"where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this subclause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso"****. In other words, as long as the assessee cannot be treated as an assessee in default, the disallowance under section 40(a)(ia) cannot come into play either. To understand the effect of this proviso, it is useful to refer to first proviso to section 201(1), which is also introduced by the Finance Act 2012and effective1st July 2012, and which provides that* ***"any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident-(i) has furnished his return of income under section 139; (ii) has taken into account such sum for computing income in such return of income; and(iii) has paid the tax due on the income declared by him in such return of income, and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed."*** *The unambiguous underlying principle seems to be that in the situations in which the assessee's tax withholding lapse have not resulted in any loss to the exchequer, and this fact can be reasonably demonstrated, the assessee cannot be treated as an*

assessee in default. The net effect of these amendments is that the disallowance under section 40(a)(ia) shall not be attracted in the situations in which even if the assessee has not deducted tax at source from the related payments for expenditure but the recipient of the monies has taken into account these receipts in computation of his income, paid due taxes, if any, on the income so computed and has filed his income tax return under section 139(1). There is also a procedural requirement of issuance of a certificate, in the prescribed format, evidencing compliance of these conditions by the recipients of income, but that is essentially a procedural aspect of the matter. The legislative amendment so brought about by the Finance Act, 2012, so far as the scheme of disallowance under section 40(a)(ia) is concerned, substantially mitigates the rigour of, what otherwise seemed to be, a rather harsh disallowance provision.

5. As for the question as to whether this amendment can be treated as retrospective in nature, even in the case of Bharti Shipyard (supra)- a special bench decision vehemently relied upon in support of revenue's case,the special bench, on principles, summed up the settled legal position to the effect that ***"any amendment of the substantive provision which is aimed at …… (inter alia) removing unintended consequences to make the provisions workable has to be treated as retrospective notwithstanding the fact that the amendment has been given effect prospectively"****. It was held that if the consequences sought to be remedied by the subsequent amendments were to be treated as "intended consequences", the amendment could not be treated as retrospective in effect. The special bench then proceeded to draw a line of demarcation between intended consequences and unintended consequences, and finally the retrospectivity of first proviso was decided against the assessee on the ground that this special bench was of the considered view that* ***"the objective sought to be achieved by bringing out section 40(a)(ia) is the***

augmentation of TDS provisions" *and went on to add that* ***"If, in attaining this main objective of augmentation of such provisions, the assessee suffers disallowance of any amount in the year of default, which is otherwise deductible, the legislature allowed it to continue"****. It was further observed that* ***"this is the cost which parliament has awarded to those assessees who fail to comply with the relevant provisions by considering overall objective of boosting TDS compliance"****(Emphasis by underlining supplied by us). In other words, the amendment was held to be prospective because, in the wisdom of the special bench, the 2010 amendment to Section 40(a)(ia) by inserting first proviso thereto, which is what the special bench was dealing with, was an "intended consequence" of the provision of Section 40(a)(ia).*

6. However, the stand so taken by the special bench was disapproved by Hon'ble Delhi High Court in the case of CIT Vs Rajinder Kumar (362 ITR 241). While doing so, Their Lordships observed that, "The object of introduction of Section 40(a)(ia) is to ensure that TDS provisions are scrupulously implemented without default in order to ***augment recoveries****……..Failure to deduct TDS or deposit TDS* ***results in loss of revenue and may deprive the Government of the tax due and payable****" (Emphasis by underlining supplied by us)". Having noted the underlying objectives, Their Lordships also put in a word of caution by observing that,* ***"the provision should be interpreted in a fair, just and equitable manner"****. Their Lordships thus recognized the bigger picture of realization of legitimate tax dues, as object of Section 40(a)(ia), and the need of its fair, just and equitable interpretation. This approach is qualitatively different from perceiving the object of Section 40(a)(ia) as awarding of costs on the "assessees who fail to comply with the relevant provisions by considering overall objective of boosting TDS compliance". Not only the conclusions arrived at by the special bench were disapproved but the very*

fundamental assumption underlying its approach, i.e. on the issue of the objec t of Section 40(a)(ia), was rejected too. In any event, even going by Bharti Shipyard decision (supra), what we have to really examine is whether 2012 amendment, inserting second proviso to Section 40(a)(ia), deals with an "intended consequence" or with an "unintended consequence".

7. When we look at the overall scheme of the section as it exists now and the bigger picture as it emerges after insertion of second proviso to section 40(a)(ia), it is beyond doubt that the underlying objective of section 40(a)(ia) was to disallow deduction in respect of expenditure in a situation in which the income embedded in related payments remains untaxed due to non deduction of tax at source by the assessee. In other words, deductibility of expenditure is made contingent upon the income, if any, embedded in such expenditure being brought to tax, if applicable. In effect, thus, a deduction for expenditure is not allowed to the assessees, in cases where assessees had tax withholding obligations from the related payments, without corresponding income inclusion by the recipient.That is the clearly discernable bigger picture, and, unmistakably, a very pragmatic and fair policy approach to the issue – howsoever belated the realization of unintended and undue hardships to the taxpayers may have been. It seems to proceed on the basis, and rightly so, that seeking tax deduction at source compliance is not an end in itself, so far as the scheme of this legal provision is concerned, but is only a mean of recovering due taxes on income embedded in the payments made by the assessee. That's how, as we have seen a short while ago, Hon'ble Delhi High Court has visualized the scheme of things – as evident from Their Lordships' reference to augmentation of recoveries in the context of "loss of revenue" and "depriving the Government of the tax due and payable".

8. With the benefit of this guidance from Hon'ble Delhi High Court, in view of legislative amendments made from time to time, which throw light on what was actually sought to be achieved by this legal provision, and in the light of the above analysis of the scheme of the law, we are of the considered view that section 40(a)(ia) cannot be seen as intended to be a penal provision to punish the lapses of non deduction of tax at source from payments for expenditure- particularly when the recipients have taken into account income embedded in these payments, paid due taxes thereon and filed income tax returns in accordance with the law. As a corollary to this proposition, in our considered view, declining deduction in respect of expenditure relating to the payments of this nature cannot be treated as an "intended consequence" of Section 40(a)(ia). If it is not an intended consequence i.e. if it is an unintended consequence, even going by Bharti Shipyard decision (supra), "removing unintended consequences to make the provisions workable has to be treated as retrospective notwithstanding the fact that the amendment has been given effect prospectively". Revenue, thus, does not derive any advantage from special bench decision in the case Bharti Shipyard (supra).

9. On a conceptual note, primary justification for such a disallowance is that such a denial of deduction is to compensate for the loss of revenue by corresponding income not being taken into account in computation of taxable income in the hands of the recipients of the payments. Such a policy motivated deduction restrictions should, therefore, not come into play when an assessee is able to establish that there is no actual loss of revenue. This disallowance does deincentivize not deducting tax at source, when such tax deductions are due, but, so far as the legal framework is concerned, this provision is not for the purpose of penalizing for the tax deduction at source lapses. There are separate penal provisions to that effect. Deincentivizing a lapse and punishing a lapse are two different things and have distinctly

different, and sometimes mutually exclusive, connotations. When we appreciate the object of scheme of section 40(a)(ia), as on the statute, and to examine whether or not, on a "fair, just and equitable" interpretation of law- as is the guidance from Hon'ble Delhi High Court on interpretation of this legal provision, in our humble understanding, it could not be an "intended consequence" to disallow the expenditure, due to non deduction of tax at source, even in a situation in which corresponding income is brought to tax in the hands of the recipient. The scheme of Section 40(a)(ia), as we see it, is aimed at ensuring that an expenditure should not be allowed as deduction in the hands of an assessee in a situation in which income embedded in such expenditure has remained untaxed due to tax withholding lapses by the assessee. It is not, in our considered view, a penalty for tax withholding lapse but it is a sort of compensatory deduction restriction for an income going untaxed due to tax withholding lapse. The penalty for tax withholding lapse per se is separately provided for in Section 271 C, and, section 40(a)(ia) does not add to the same. The provisions of Section 40(a)(ia), as they existed prior to insertion of second proviso thereto, went much beyond the obvious intentions of the lawmakers and created undue hardships even in cases in which the assessee's tax withholding lapses did not result in any loss to the exchequer. Now that the legislature has been compassionate enough to cure these shortcomings of provision, and thus obviate the unintended hardships, such an amendment in law, in view of the well settled legal position to the effect that a curative amendment to avoid unintended consequences is to be treated as retrospective in nature even though it may not state so specifically, the insertion of second proviso must be given retrospective effect from the point of time when the related legal provision was introduced. In view of these discussions, as also for the detailed reasons set out earlier, we cannot subscribe to the view that it could have been an "intended consequence" to punish the assessees for non deduction of tax at source by declining the deduction in respect of related payments, even when the corresponding

income is duly brought to tax. That will be going much beyond the obvious intention of the section. Accordingly, we hold that the insertion of second proviso to Section 40(a)(ia) is declaratory and curative in nature and it has retrospective effect from 1st April, 2005, being the date from which sub clause (ia) of section 40(a) was inserted by the Finance (No. 2) Act, 2004.

10. In view of the above discussions, we deem it fit and proper to remit the matter to the file of the Assessing Officer for fresh adjudication in the light of our above observations and after carrying out necessary verifications regarding related payments having been taken into account by the recipients in computation of their income, regarding payment of taxes in respect of such income and regarding filing of the related income tax returns by the recipients. While giving effect to these directions, the Assessing Officer shall give due and fair opportunity of hearing to the assessee, decide the matter in accordance with the law and by way of a speaking order. We order so."

*We also would like to submit the decision of **Allied Motor P Ltd. vs. CIT** (1997 224 ITR 677 SC) where in the Apex Court considered the scope and applicability of the first proviso to Section 43B inserted by the Finance Act 1987, with effect from 01.04.1988. On examination of the legislative history the Apex Court found that the language of Section 43B was causing undue hardship to the tax payers and the first proviso was designed to eliminate unintended consequences which cause undue hardship to the assessees and which made the provision unworkable or unjust in a specific situation. Accordingly, the court held that the proviso was remedial and curative in nature and on that basis held the proviso to be retrospective in operation. In Alom Extrusions (supra) also following the judgment in Allied Motors (supra), the Apex Court held that provisions of the Finance by which the second proviso to Section 43B was deleted and the first proviso was amended, were curative in nature and therefore retrospective.*

*We also submit the decision of **CIT vs. Hindustan Coca Cola Beverages Pvt. Ltd.** (293 ITR 226 SC) even before the amendment to S.201(1) and S.40(a)(ia) were passed*

wherein it was held that if recipient offered the tax, then no disallowance u/s 201 was possible and that only interest u/s 201(1A) till date of filing of return by recipient could be levied.

We submit if the disallowance u/s 40(a)(ia) is upheld when the recipient has offered the same amount for income and paid the tax, it would amount to doubly taxing the amount in question – once in the hands of the payer and the second in the hands of the recipient, which is against the very canons of taxation.

Hence, we kindly submit to your good self that given the above judicial precedents, as well as the facts and circumstances of the instant case, that the aforesaid payments should not be disallowed u/S.40(a)(ia)

“””

The assessee's submissions are thoroughly considered and rejected for reasons recorded hereinunder.

At the outset, it is to be noted that it is not in dispute as to whether assessee withheld TDS or not – it did not. It only relies on the retrospective application of second proviso of S.40(a)(ia) and has submitted a Form. 26A as prescribed in the second proviso from a Chartered Accountant declaring that the amount in question was offered to income by the recipient, Varian Property Developers P Ltd.

Now, let us analyze the second proviso of S.40(a)(ia) which reads as under:

> *“Provided further that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of Section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso”*

Admittedly this proviso was specifically inserted w.e.f 1.4.2013 by the Finance Act, 2013. I find that that Hon'ble Kerala High Court on dealing with this very same issue in ***Thomas George Muthoot vs. CIT in (ITA No.278 of 2014, dated 03-07-2015)*** held that

> *"15. A statutory provision, unless otherwise expressly stated to be retrospective or by intendment shown to be retrospective, is always prospective in operation. Finance Act 2012 shows that the second proviso to Section 40 (a)(ia) has been introduced with effect from 01.04.2013. Reading of the second proviso does not show that it was meant or intended to be curative or remedial in nature, and even the appellants did not have such a case. Instead, by this proviso, an additional benefit was conferred on the assessees. Such a provision can only be prospective as held by this Court in* ***Prudential Logistics and Transports (364 ITR 689 Ker.)****. Therefore, this contention raised also cannot be accepted.*
>
> *In so far as the judgment in Hindustan Coca Cola case (Supra) is concerned, that was rendered in the context of section 201(1), the object of which being compensatory in nature, cannot be of any assistance to the appellants to resist a proceeding under Section 40(i)(ia) of the Act. This contention, therefore, is only to be rejected."*

Therefore, the amount of Rs.4,76,30,766/- is disallowed u/s 40(a)(ia)

Addition Rs.4,76,30,766/-

Disallowance u/s 40(a)(i) r.w. S.94A on payments to Cyprus company:

During the course of assessment proceedings, it was noticed that assessee has claimed expenditure of Rs.91,32,564/- being the amount paid to non-residents for payments made towards legal fees paid to Mr. Markiv Carras, Partner, Markiv Legal in Nicosia.

The assessee was asked to furnish details and break-up of the same and has submitted a brief write up on the legal services rendered by partner of said law firm and the invoices raised therein in his name. The services were rendered via email in the form of written opinions on issues relating to acquisition of a company the assessee intended to make in that country. More importantly, it is seen that no TDS was withheld on the payments made to the assessee.

On questioning the assessee regarding the failure to withhold tax on said payments; the assessee has quoted the India-Cyprus DTAA in existence at the time of payments and stated as follows:

""""

We submit to your good self that the payments made to a lawyer in Cyprus squarely fall under Article 15 of the India-Cyprus DTAA which reads as follows:

"ARTICLE 15

INDEPENDENT PERSONAL SERVICES

1. Income derived by a resident of a Contracting State in respect of professional services or other independent activities of a similar character shall be taxable only in that State except in the following circumstances when such income may also be taxed in the other Contracting State :

(a) if he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or

(b) if his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in the relevant fiscal year; in that case only so much of the income as is derived from

his activities performed in that other State may be taxed in that other State.

2. The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities, as well as the independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants."

We submit that said lawyer, Mr.Markiv Carras, did not visit India for rendering his opinion ie did not have a fixed base in India and that the 'professional services' envisaged in the section clearly include lawyers. Hence, there is no question of tax under the India-Cyprus DTAA read with Section 90A of the Income Tax Act which states as follows:

"S.90A(2) Where a specified association in India has entered into an agreement with a specified association of any specified territory outside India under sub-section (1) and such agreement has been notified under that sub-section, for granting relief of tax, or as the case may be, avoidance of double taxation, ***then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee****."*

""""

The assessee was asked why the disallowance cannot be made u/s 201(1) r.w. S.94A wherein S.94A has been inserted through Finance Act 2011 to bring into tax bracket "notified jurisdictional areas" (NJA's) and a Notification dated 1-Nov-2013 was issued notifying Cyprus as one of the NJA's.

The assessee's replied is reproduced herein under

""""

*We rely on the Supreme Court decision in **Union of India Vs. Azadi Bachao Andolan [2004 (10) SCC 1]**, wherein it was held that Section 90 of the Income Tax Act is specifically intended to enable and empower the Central Government to issue a notification for implementation of the terms of a Double Taxation Avoidance Agreement and that when it happens, the provisions of such an Agreement would operate*

*Furthermore, we rely also on **CIT vs. P.V.A.L.Kulandagan Chettiar (2004 (6) SCC 235)** In paragraphs 6 and 7 of the said decision, the Supreme Court pointed out that the traditional view with regard to the concept of double taxation, underwent a considerable change, in the light of Section 90 of the Income Tax Act. In paragraph 8, the Court held that the provisions of Sections 4 and 5 of the Act are subject to the provisions of an agreement entered into between the Central Government and the Government of a foreign country for avoidance of double taxation, as envisaged under Section 90. The Court further held that if a tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or for altogether avoiding the liability.*

We would also like to submit that S.206AA of the IT Act also has a non-obstante clause and seeks to override treaty benefits and various decisions of the Tribunal including but not restricted to DCIT vs. Serum Institute (ITA No.792/PN/2013) in which the Tribunal held:

> *"Therefore, in view of the aforesaid schematic interpretation of the Act, section 206AA of the Act cannot be understood to override the charging sections 4 and 5 of the Act. Thus, where section 90(2) of the Act provides that DTAAs override domestic law in cases where the provisions of DTAAs are more beneficial to the assessee and the same also overrides the charging sections 4 and 5 of the Act and hence, also section 206AA of the Act."*

We humbly submit that the benefits under the Treaty are decided bilaterally between two countries ie in this case India and Cyprus and cannot be unilaterally subject to tax.

Without prejudice to the above, we would also like to point out that the payments in question are clearly not in the nature of tax planning, tax avoidance or any capital-gains tax reduction scheme or any misuse of treaty benefits but rather mere payment for legal fees and should not be treated under the ambit of tax avoidance for which S.94A has been introduced.

We therefore submit the India-Cyprus DTAA Article 15 squarely applies in the instant case and tax is not exigible on payments made by assessee to the foreign lawyer.

“"”

The assessee's contentions are thoroughly considered and rejected for the reasons recorded hereinunder.

The provisions of S.94A are as follows:

“”"Section - 94A, Income-tax Act, 1961-2016

Special measures in respect of transactions with persons located in notified jurisdictional area.

94A. (1) The Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify by notification in the Official Gazette such country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee.

*(2) **Notwithstanding anything to the contrary contained in this Act**, if an assessee enters into a transaction where one of the parties to the transaction is a person located in a notified jurisdictional area, then—*

(i) all the parties to the transaction shall be deemed to be associated enterprises within the meaning of section 92A;

(ii) any transaction in the nature of purchase, sale or lease of tangible or intangible property or provision of service or lending or borrowing money or any other transaction having a bearing on the profits, income, losses or assets of the assessee including a mutual agreement or arrangement for allocation or apportionment of, or any contribution to, any cost or expense incurred or to be incurred in connection with a benefit, service or facility provided or to be provided by or to the assessee shall be deemed to be an international transaction within the meaning of section 92B,

and the provisions of sections 92, 92A, 92B, 92C except the second proviso to sub-section (2), 92CA, 92CB, 92D, 92E and 92F shall apply accordingly.

(3) ***Notwithstanding anything to the contrary contained in this Act****, no deduction,—*

(a) in respect of any payment made to any financial institution located in a notified jurisdictional area shall be allowed under this Act, unless the assessee furnishes an authorisation in the prescribed form authorising the Board or any other income-tax authority acting on its behalf to seek relevant information from the said financial institution on behalf of such assessee; and

(b) in respect of any other expenditure or allowance (including depreciation) arising from the transaction with a person located in a notified jurisdictional area shall be allowed under any other provision of this Act, unless the assessee maintains such other documents and furnishes such information as may be prescribed, in this behalf.

(4) ***Notwithstanding anything to the contrary contained in this Act****, where, in any previous year, the assessee has received or credited any sum from any person located in a notified jurisdictional area and the assessee does not offer any explanation about the source of the said sum in the hands of such person or in the hands of the beneficial owner (if such person is not the beneficial owner of the said sum) or the explanation offered by the assessee, in the opinion of the Assessing Officer, is not satisfactory, then, such sum shall be deemed to be the income of the assessee for that previous year.*

(5) ***Notwithstanding anything contained in any other provisions of this Act, where any person located in a notified jurisdictional area is entitled to receive any sum or income or amount on which tax is deductible under Chapter XVII-B, the tax shall be deducted at the highest of the following rates, namely:—***

(a) at the rate or rates in force;

(b) at the rate specified in the relevant provisions of this Act;

(c) at the rate of thirty per cent.

(6) In this section,—

(i) "person located in a notified jurisdictional area" shall include,—

(a) a person who is resident of the notified jurisdictional area;

(b) a person, not being an individual, which is established in the notified jurisdictional area; or

(c) a permanent establishment of a person not falling in sub-clause (a) or sub-clause (b), in the notified jurisdictional area;

(ii) "permanent establishment" shall have the same meaning as defined in clause (iiia) of section 92F;

(iii) "transaction" shall have the same meaning as defined in clause (v) of section 92F.""" (emphasis supplied)

The Central Govt. has further **notified (vide Notification No.86/2013) the country of Cyprus as a notified jurisdictional area (NJA)** under the above section on 01-November-2013 in the following manner:

"

Press Information Bureau

Government of India

Ministry of Finance

01-November-2013 17:51 IST

Cyprus Notified as a notified Jurisdictional Area Under Section 94a of the Income-Tax Act,1961 ; All Parties to the Transaction with a Person in Cyprus shall be Treated as Associated Enterprises and the Transaction shall be Treated

as an International Transaction Resulting in Application of Transfer-Pricing Regulations Including Maintenance of Documentations

Section 94A was introduced in the Income-tax Act, 1961, through the Finance Act, 2011, in respect of transactions with persons located in notified jurisdictional area as an anti-avoidance measure. As per section 94A, the Central Government may, having regard to the lack of effective exchange of information with any country or territory outside India, specify the said country or territory as a notified jurisdictional area in relation to transactions entered into by any assessee. The rules under section 94A were notified as Income-tax (8th Amendment) Rule, 2013, through S.O. 1856 (E) dated 26th June, 2013, by inserting Rule 21AC and Form 10FC in the Income-tax Rule, 1962.

India and Cyprus have entered into an agreement for avoidance of double taxation of income and prevention of fiscal evasion which is in force since 21st December, 1994. Both the Contracting States under this agreement have a legal obligation to exchange such information as is necessary for carrying out the provisions of the agreement or of domestic laws of the Contracting States, in particular for the prevention of fraud or evasion of taxes.

Since Cyprus has not been providing the information requested by the Indian tax authorities under the exchange of information provisions of the agreement, it has been decided to notify Cyprus as a notified jurisdictional area under section 94A of the Income-tax Act, 1961 through Notification No. 86/2013 dated 1st November, 2013 published in Official Gazette through SO 4625 GI/13.

The implications of such a Notification are summarized as under:

- *If an assessee enters into a transaction with a person in Cyprus, then all the parties to the transaction shall be treated as associated enterprises and the transaction shall be treated as an international transaction resulting in application of transfer-pricing regulations including maintenance of documentations [Section 94A(2)].*

- *No deduction in respect of any payment made to any financial institution in Cyprus shall be allowed unless the assessee furnishes an authorization allowing for seeking relevant information from the said financial institution [Section 94A(3)(a) read with Rule 21AC and Form 10FC].*

- *No deduction in respect of any other expenditure or allowance arising from the transaction with a person located in Cyprus shall be allowed unless the assessee maintains and furnishes the prescribed information [Section 94A(3)(b) read with Rule 21AC].*

- *If any sum is received from a person located in Cyprus, then the onus is on the assessee to satisfactorily explain the source of such money in the hands of such person or in the hands of the beneficial owner, and in case of his failure to do so, the amount shall be deemed to be the income of the assessee [Section 94A(4)].*

- ***Any payment made to a person located in Cyprus shall be liable for withholding tax at 30 per cent or a rate prescribed in Act, whichever is higher [Section 94A(5)].***

Reading the provisions of the Act as well as the Notification, the following points are to be considered in the instant case:

First of all, it is observed that the assessee did not maintain the documents as prescribed under Rule 21AC and Form 10FC for the purposes of Sec. 94A. Therefore, at the outset, the entire expenditure is liable to be disallowed. Further, the assessee has not deducted tax at source as prescribed u/S 94A(5) and Sec. 40(a)(i).

Secondly, the S.94A clearly contain a non-obstante clause making it abundantly clear that it overrides the other provisions of the Act including S.90A When there is a specific provision inserted by the legislature, that too later in time, it has to be applied and hence S.94A is clearly applicable in the instant case.Thirdly, S.90A which the assessee relies on does not have a non-obstante clause *(ie on the lines of "Notwithstanding anything contained in other provisions of this Act")* and clearly cannot be said to be overriding S.94AFourthly, no question arose directly either in ***Azadi Bachao Andolan*** (*supra*) or in ***Kulandagan Chettiar*** cases (*supra*) as to whether or not the Parliament has the power to make a law in respect of a matter covered by a Treaty. Therefore, the observations found in these two decisions, to the effect that the provisions of the Treaty will have effect even if they are in conflict with the provisions of the statute, cannot be stretched too far to conclude that the Parliament does not have the power to make a law in respect of a matter covered by a Treaty.Further, I refer to the landmark cases of ***Jolly George Varghese Vs. The Bank of Cochin [AIR 1980 SC 470]***, wherein the Supreme Court held that the executive power of the Government of India to enter into international Treaties does not mean that international law, ipso facto, is enforceable upon ratification. The Supreme Court observed that the Indian Constitution followed the 'dualistic' doctrine with respect to international law. Consequently, the Court held that international Treaties do not automatically form part of international law, unless incorporated into the legal system by a legislation made by the Parliament. In that case, the Court was actually dealing with Article 11 of the International Covenant on Civil and Political Rights, ratified by India. The Convention was taken note of by the Supreme Court for the purpose of giving an enlarged meaning to Article 21 of The Constitution. The same principle was reiterated and further expounded in the Apex Court's decision in ***State of West Bengal Vs. Kesoram Industries Ltd. [2004 (10) SCC 201]*** The Supreme Court pointed out that the doctrine of "Monism" as prevailing in the European countries, does not prevail in India and that the doctrine of dualism is applicable and that "a Treaty entered into by India cannot become law of the land and

it cannot be implemented unless Parliament passes a law as required under Article 253."

Thus I do not see how the assessee can fall under the DTAA benefit when clearly the DTAA benefit has been overriden by a later-in-time, non-obstante section specifically inserted for bringing into the net specific areas ie tax havens, something which is the prerogative of the Indian Govt. **With respect to the Income Tax Act, the short point is S.94A will prevail over S.90A**

Thus, on payments made to non-residents amounting to Rs. 91,32,564/- tax has to be withheld at the flat rate of 30% under section 94A of the Income Tax Act and that the assessee made the payments after the above introduction of S.94A r.w. Notification dated 1-Nov-2013 and hence the amounts ought to be disallowed u/s 40(a)(i) of the Act.

Addition: Rs. 91,32,564/-

Penalty proceedings are to be initiated separately for both disallowances.

(G. Krishnamurthy)
Income-tax Officer
Company Circle-II(4)