IN THE ITAT BANGALORE BENCH 'B'

Jeans Knit (P.) Ltd.

v.

Deputy Commissioner of Income-tax, International Taxation, Circle-1(1)

SMT. P. MADHAVI DEVI, JUDICIAL MEMBER

AND JASON P. BOAZ, ACCOUNTANT MEMBER

IT Appeal NOS. 19 & 23 (BANG.) OF 2010

[ASSESSMENT YEAR 2007-08]

JUNE 29, 2012

ORDER

Smt. P. Madhavi Devi, Judicial Member - These appeals are filed by the assessee. The appeals are directed against the order of the Commissioner of Income-tax (Appeals) - IV at Bangalore dated 15.10.2009. The appeals arise out of the order passed u/s 201(1) and 201(1A) of the Income-tax Act, 1961.

2. In both the appeals, the assessee is aggrieved by the order of the CIT(A) in confirming the order passed by the AO u/s 201(1) and 201(1A) of the Income-tax Act.

3. The brief facts of the case are that the assessee is a 100% export oriented undertaking and is engaged in the business of manufacturing and export of garments. During the relevant financial year, the assessee has made the following remittances to M/s Sharp Eagle International Ltd. (SEL), a non-resident company incorporated in Hongkong.

Date of remittance	*Amount*	*INR*
23/07/2007	Euro 13,45,710	8,01,53,981/-
23/07/2007	UDS 14,78,691	6,47,66,697
	Total	14,49,30,678/-

4. The Assessing Officer observed that the assessee company has made these remittances without deduction of tax at source as per provision of sec. 195(1) read with sec. 9(i)(vii) of the Income-tax Act. Therefore, he initiated proceedings on 31.3.2008 by issuing a notice u/s 201(1). The assessee's representatives appeared and submitted that the assessee being manufacturer of garments, especially jeans, had to import fabrics and accessories from other countries and mostly from Europe and for this purpose, the assessee company had engaged M/s SEL, Hongkong to render various services at the time of imports, such as inspection of fabrics, timely dispatch of

material etc. and for these services, the assessee company had to pay 12.5% of imported value as charges to the non- resident company. It was also submitted that the choices of fabrics and accessories to be used for the production of final products are done by the assessee company jointly by discussion and consultation with its buyers and in most of the cases buyers have tie-up with international manufacturers of denim fabrics from whom the fabric is imported by the assessee. It was submitted that the services of M/s SEL were engaged by the assessee in order to ensure that the imports are received in India on time and in correct quantity, so that production schedule can be met and garments can be shipped to buyers as per the commitment given by the assessee to deliver the same. The assessee also filed copy of the agreement dated 1.3.2006 with M/s SEL before the AO. After considering the contentions of the assessee and also the agreement dated 1.3.2006, the AO held that to understand the exact nature of services and also whether they would fall within the purview of taxability in India, the same has to be considered in the light of a treaty between India and Hongkong. He held that no treaty existed between India and Hongkong and, therefore, taxability of the transaction needs to be looked at under the provisions of the Domestic Tax Laws i.e in view of the explanation 2 to sec. 9(1)(vii) of the Income-tax Act.

5. He therefore proceeded to consider as to whether the services rendered by M/s SEL are in the nature of technical or consultancy or managerial, as defined in the section. He observed that -

(*a*) the duties of the service provider are not clearly spelt out in the agreement between the parties, but as per the assessee's submissions and material available on record, it is understood that the service provider has to inspect the fabrics to be imported before the shipment. He held that the inspection of fabrics is not a simple job and requires the technical knowledge and technical skills in the filed of textiles and that it also requires good experience to inspect and analyze the material and to detect any defects therein. He, therefore held that the services rendered by the non-resident are in the nature of technical services.

(*b*) Thereafter, he observed that the service provider has to advice on any defects in the material to the assessee and has to clarify whether the material is to be imported or to be rejected and these activities would fall within the category of consultancy services.

(*c*) The AO also proceeded to consider whether the activity falls in the category of managerial services and observed that the non- resident has to attend to the work given by the assessee and has to manage things as desired by the assessee and, therefore, is also discharging the managerial services.

6. In view of these observations, the AO held that the charges paid to the non-resident company are nothing but fees for technical services (FTS) as defined in explanation 2 to sec. 9(1)(vii) of the Income-tax Act. He thus, held that the assessee ought to have deducted tax at source @ 10% as per the sec. 115A(1)(b)(BB) read with sec. 115A(3) of the Income-tax Act and since the assessee has failed to do so, the assessee company is to be considered as defaulter u/s 201(1) and also liable to pay interest u/s 201(1A) of the Income-tax Act from the date of credit made to the account of the non-resident in the books of the assessee. He accordingly treated the assessee, as 'an assessee in defaulter' u/s 201(1) and also charged interest u/s 201(1A) of the Income-tax Act.

7. Aggrieved, the assessee preferred an appeal before the CIT(A) reiterating the submissions made before the AO.

8. The CIT(A) after considering the assessee's submissions also called for the correspondence between the assessee and M/s SEL and also the other buyers to understand the nature of transactions. The assessee produced the email correspondence between the assessee M/s SEL and various suppliers of denim. After considering the same, the CIT(A) came to the conclusion that the main correspondence of the assessee and its denim suppliers is with one Mr. Manfred, who is an Italian agent and representative of Ms/ SEL and with Ms. Caternia, who is working under him. He held that the assessee has not furnished any evidence to show that Mr. Manfred is the representative of M/s SEL and also that no evidence has been filed by the assessee to show that the quality, standard and other technical information are provided by the assessee to M/s SEL as claimed. He, thus raised a doubt about the services rendered by M/s SEL to the assessee. Thereafter he also proceeded to confirm the order of the AO about the nature of services being technical, managerial and consultancy services.

9. Aggrieved by the confirmation of the order of the AO by the CIT(A), the assessee is in second appeal before us.

10. The learned counsel for the assessee has drawn our attention to various facets of the case and has tried to demonstrate as to how the nature of services rendered by M/s SEL to the assessee company are not technical, managerial or consultancy as mentioned under explanation to sec. 9(i)(vii) of the Income-tax Act. He submitted that M/s SEL is only an agent appointed by the assessee to oversee the quality and quantity of the shipment and also that the shipment reaches the assessee company on time. He submitted that it was the assessee in joint consultancy with its buyers, who decides on the type and quality of the material to be imported and also the prices at which the said material is to be imported and the samples are then sent to M/s SEL only to compare and see that the material being shipped conforms to the quality and the quantity ordered by the assessee. He submitted that for this purpose, there is no technical expertise required nor are any managerial or consultancy services rendered by M/s SEL. He submitted that only a physical verification of the material is required and also to act on behalf of the assessee in accordance with the directions of the assessee, which definitely cannot fall within the purview of technical and managerial services. As regards the AO's contention that the services fall under 'consultancy services', the learned counsel for the assessee submitted that the prices and the quantity are already decided by the assessee and, therefore, there is no consultation between the assessee and M/s SEL as regards the quality and quantity or prices of the material to be shipped and, therefore, no consultancy services are being rendered. Thereafter, he tried to demonstrate before us that the observation of the AO, that the non-resident company is rendering services for which 'fees for technical services' is paid is incorrect, he has drawn our attention to CBDT Circular No.23 dated 23.7.1969, where at para 4, it is mentioned that where the foreign agent of an Indian exporter operates in his own country and no part his income arises in India and his commission is usually remitted directly to him and is, therefore, not received by him or on his behalf in India, such an agent is not liable to Income-tax in India on the commission. He also drew our attention to Circular No.786 of 2000, wherein it has been explained that "the deduction of tax at source u/s 195 would arise if the payment of commission to the non-resident agent is chargeable to tax in India. In this regard attention to CBDT Circular No.23 dated 23.7.1969 is

drawn, where the taxability of foreign agent of Indian exporters was considered along with certain other specific situations. It had been clarified then that "where the non-resident agent operates outside the country, no part of his income arises in India. Further since the payment is usually remitted directly abroad, it cannot be held to have been received by or on behalf of the agent in India. Such payments were, therefore, held to be not taxable in India. The relevant sections, namely sec. 5(2) and sec. 9 of the Income-tax Act 1961 not having undergone any change in this regard, the clarification in CBDT Circular No.23 shall prevail. No tax is, therefore, deductible u/s 195 and consequently the expenditure on export commission and other related charges payable to non-resident for services rendered outside India becomes allowable expenditure. On being apprised of this position, the comptroller and Auditor General have agreed to drop the objection referred to above."

11. He also filed before us a copy of table containing amendments to sec. 9(1)(vii) commencing with financial year 2006-07 i.e assessment year 2007-08. By this table, the assessee has drawn our attention to the provision as it stood prior to amendment vide Finance Act of 2007 and the amendment carried out by Finance Act 2007 and also amendment carried out vide Finance Act 2010. He submitted that the period relevant to the transaction is Apr, 2006 to Mar, 2007 and, therefore, the provision of law as it stood prior to the amendment of Finance Act 2007 is applicable. He submitted that the assessee cannot be expected to imagine and foresee the amendment that would be made to the Act to set at naught the effect of the judgments which would be pronounced by the various Courts. He submitted that it would amount to grave injustice to say that the assessee will have to deduct tax at source at the time of making the payment by foreseeing such amendments. According to him, the assessee cannot be asked to do an impossible act. He submitted that the assessee has acted in accordance with law prevailing at the time of making the remittance and, therefore, is not in under any obligation to deduct tax at source.

12. Further, he placed reliance upon the provision of clause (a) to clause (i) of sub section (1) to sec. 9 of the Income-tax Act to submit that where the operations of the non-resident company are entirely outside India, the income does not arise or accrue to the non resident company in India and, therefore, no part of his income is taxable in India and in such cases, the provision of sec. 195(1) is not applicable. He has tried to distinguish the decisions relied upon by the AO. He submitted that the decisions of Authority for Advance Ruling in the following cases were relied upon by the AO. (He submitted that the facts in these cases are distinguishable from the facts of the case before us).

(1) M/s Wallace Pharmaceuticals Pvt. Ltd., 278 ITR 97

(2) *Rajiv Malhotra* v. *CIT* 284 ITR 564

(3) *S.A.R.I* v. *DIT* 288 ITR 534.

13. He submitted that in all the above cases either the source of income was in India or the activities of non-resident company were carried out in India. He submitted that the decision of the AAR is applicable only to applicant before the AAR and Department and not to any other assessee as provided u/s 245 of the Income-tax Act.

14. The learned DR on the other hand supported the orders of the authorities below and submitted that both AO as well as CIT(A) have clearly brought out how the services rendered by M/s Sharp Eagle International (SEL) were in the nature of managerial, technical and consultancy services.

15. Having heard both the parties and having considered their rival contentions, we find that the basic question to be considered by us is whether the nature of services rendered by SEL fall within the ambit of technical, managerial and consultancy services as defined under Explanation 2 to clause (vii) of sub-sec (1) to sec. 9 of the IT Act. As per the said explanation, fees for technical services means any consideration (including any lump sum consideration) for rendering any managerial, technical or consultancy services (including provision of services of technical or other personnel). As brought out in the earlier paragraphs of this order, the agreement between the assessee and M/s SEL stipulates that M/s SEL shall be responsible for the shipment of raw material to the assessee from its importers within the stipulated time and as per the specific quality and quantity. The learned counsel for the assessee has elaborately pointed out that it is the assessee, in the consultation with its exporters, which identifies the manufacturer and the quality and the price of the material to be imported. Therefore, SEL nowhere is involved in the above identification of the exporter or in selecting the material and negotiating the price. In such circumstances, it cannot be said that SEL is rendering any of the consultancy services. Further, it also seen that the quality of material is already determined by the assessee and the SEL is only to make a physical inspection of the material to see if it resembles the quality specified by the assessee. It only has to compare the material with the samples provided by the assessee and for this activity, not much of technical knowledge is required. The elementary knowledge of the type of material and fair sense of identifying the correctness of the quality is sufficient. Therefore in our opinion, SEL is not required to employ any skilled technical personnel to discharge its obligation under the agreement and, therefore, we hold that the assessee is not discharging any technical services. Further, as seen from the facts of the case before us, it is seen that SEL is acting on behalf of the assessee as its agent and there is no independent application of thought process in any of the activities to be carried out by SEL. It has only to act at the behest of the assessee and also discharge its commitments as per the direction of the assessee. Therefore, we agree with the learned counsel for the assessee, that there are no managerial services being rendered by SEL to the assessee.

16. In view of the same, we hold that the above payments do not fall within the ambit of fee for technical services and, therefore, the provision of sec. 195(1) is also not attracted. As we have already held that TDS provision are not applicable to the above payments, the other alternative arrangements of the assessee are only academic and hence need no adjudication.

17. In the result, the appeals filed by the assessee are allowed.