

**INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "D": NEW DELHI**

**BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER
AND
SHRI L.P. SAHU, ACCOUNTANT MEMBER**

ITA No.3222/Del/2011
Asstt. Year:2007-08

DCIT Circle-4(1), Room No. 407, 4 th Floor, C.R. Building, I.P. Estate New Delhi – 110 002	Vs.	M/s. Jas Forwarding World Pvt. Ltd. 2 nd Floor, A-Wing, Commercial Complex, Radisson Hotel, NH-8, New Delhi – 110 037 PAN AABCJ5564A
(Appellant)		(Respondent)

ITA No.3296/Del/2011
Asstt. Year:2007-08

M/s. Jas Forwarding World Pvt. Ltd. 2 nd Floor, A-Wing, Commercial Complex, Radisson Hotel, NH-8, New Delhi – 110 037 PAN AABCJ5564A	Vs.	DCIT Circle-4(1), Room No. 407, 4 th Floor, C.R. Building, I.P. Estate New Delhi – 110 002
(Appellant)		(Respondent)

Department by:	Shri Robin Rawan, Sr. DR
Assessee by :	Shri Salil Kapoor, Adv. Shri Rajan Sachdeva, Adv. Shri Hemant Sharma, Adv. Ms. Soumya, Adv.
Date of Hearing	08/02/2019
Date of pronouncement	08/ 05/2019

ORDER

PER AMIT SHUKLA, J.M

The aforesaid cross appeals have been preferred by the Revenue as well as by the Assessee against impugned order dated 18.04.2011, passed by Ld. Commissioner of Income Tax (Appeals) for the quantum of assessment u/s 143(3) for the A.Y. 2007-08.

2. The Grounds of Appeal raised by the Revenue are as under:--

“1. The order of the Learned CIT (A) is erroneous & contrary to facts and Law.

2. On the facts and in the circumstances of the case and in law, the learned CIT (Appeals) has erred in deleting the addition of Rs.21,05,07,858/- made u/s 40 (a)(i) of the IT Act being the payment made to non resident associate enterprise.

2.1 The Ld. CIT (A) ignored the finding recorded by the A.O and the fact that the income in question accrued in India and is liable for TDS.”

2.1 Whereas the Grounds of Appeal raised by the Assessee in its appeal are as under:-

1. “On the facts and in the circumstances of the case and in law, the Learned Commissioner of Income Tax (Appeals) (CIT (A)) on erroneous and insufficient grounds, has grossly erred in confirming an addition of Rs.21,58,139 holding that the expenditure was not made in the course of business or on account of commercial expediency.

2. That the Ld. CIT(A) erred in confirming an addition of Rs.21,58,139 made by the Ld. DCIT u/s 40(a)(i) of the Act, on erroneous and insufficient grounds and without offering any opportunity to the Appellant , erred in not appreciating

that the expenditure was incurred for the purpose of business of the Appellant and was therefore, allowable in full.

- 3. That the sustaining of the addition of Rs.21,58,139 by the Ld. CIT(A) by not offering any opportunity to the Appellant is against the principles of natural justice and is liable to be quashed.*
- 4. That Ld. CIT(A) has failed to appreciate the fact that the Travelling Cost amounting to Rs.1,18,328 (included in Rs.21,58,139) was received/receivable by the Appellant, and was in fact not an expenditure which was claimed as a deduction, therefore, no disallowance, in any case, was called for.*
- 5. That the appellant craves to take up new grounds of appeal, add, amend, vary, omit or substitute at any time before or after the date of hearing of the appeal and also to adduce evidence during the pendency of the appeal”.*

3. The facts in brief are that, for the AY 2007-08, the Assessee had filed its return of income on 29-09-2008 declaring a total income of Rs. 4,11,80,940/-, which was revised on 24-02-2009 declaring a total income of Rs.1,37,76,720/-. The return of income was selected for scrutiny assessment under section 143(2) of the Act, which was completed vide order dated 13.12.2010 determining the total income at Rs.22,64,42,717/-, after making addition/disallowance on account of payment to non-resident of Rs.21,05,07,858/- u/s 40(a)(i); and disallowance of expenditure of Rs. 21,58,139/-. Ld. CIT (A) granted relief of Rs.21,05,07,858/- against which the Revenue is in appeal; and the Assessee is in appeal before us on disallowance of

expenditure of Rs. 21,58,139/-, which has been upheld by the Ld. CIT(A).

4. First, we will take up the appeal of the Revenue, wherein the only issue raised by the Revenue is, whether the Assessee was liable to TDS on the payments made to its Associated Enterprises (AEs) and consequently the disallowance u/s 40(a)(i) made by the Ld. Assessing Officer is correct in law or not. Before adjudicating this issue, it would be pertinent to understand the business model of the Assessee. Assessee is engaged in the business of international freight forwarding through air and ocean. It is part of the network of Associated Enterprises ('AEs') and the transactions entered into by the Assessee have an AE/Affiliate in other jurisdiction which performs the associated function in a particular transaction. The functions performed by the Assessee and its AEs are based on the origin or destination of the consignment. The AEs are carrying on the business of freight forwarding services in their respective jurisdictions which are mirror reflection of the business activities carried on by the Assessee. As submitted by the Ld. Counsel, Sri Salil Kapoor, assessee provides outbound and inbound freight forwarding services, functions performed can be classified three types of services to its customers which has been explained in the following manner:-

ORIGIN SERVICES

- I. These services are provided both in the case of Import as well as Export transactions. In the case of import into India, the origin services are provided by the AEs and in the case

of exports out of India, the origin services are provided by the Assessee.

- II. In these services, the Assessee and the AE provide a mirror reflection of services in their respective countries/ territories. In effect, it means that the AE provides their part of the services in their Territory only and no part of the services are provided in Indian Territory. Similarly, the Assessee provides services in the Indian Territory only and no part of the services is provided by the Assessee in the overseas territory.
- III. That with respect to the above services, the entire revenue earned and expenses incurred for rendering the services is kept by the respective AEs and the Assessee, who perform them in their respective territory only, and no part of such revenue or expenses is shared amongst each other. Example of such services rendered under "origin services" are pick up, local transportation, labeling, packing custom clearance etc.

CROSS BORDER FREIGHT

- I. This service is provided both in the case of import into India as well as export from India from Port to Port. Cross border freight services were commonly carried out by the AEs and the Assessee for which the 'Agency Agreement' was entered.
- II. The said activity only related to shipping of the cargo of the customer (foreign or Indian) from one port to another port, for which air/ shipping lines were arranged by the Assessee

and AEs accordingly. In this case, one port would be an Indian port and the other would be an overseas port. The entire procedure carried out by the Assessee and AEs in their territories in case of imports into India, in the above activity is explained below:-

- III. Customer approaches the Assessee for the import of cargo into India & demands the quote for freight charges; The Assessee inquires about the cost of the freight from the AE for importing cargo into India; AE negotiates freight rates with the carrier (means air/ shipping line) outside India; Assessee receives the freight cost from the AE; After keeping an appropriate margin, the Assessee negotiates the freight charges with customer and transaction is finalized; Customer gives the instructions for execution of shipment; The Assessee passes the instruction to AE to move the cargo into India; AE pays the freight to carrier from its own pocket outside India on behalf of the Assessee; AE moves the cargo into India through the carrier which is independent; Remuneration is calculated as 50:50 (as agreed in the agency agreement) on the difference between freight to be collected from customer and freight paid to the carrier; AE raises a debit note on the Assessee for freight paid to the carrier along with 50% of the profit share; The Assessee makes the remittance to the AE which consists of the freight charges as well as AE share of profit without deducting tax in India. Further, in the entire remittance made to the AE: the freight charges normally account for more than 90% of the remittance

For example, in the above arrangement, the rates charged by the AE situated in Japan relating to the shipping activity say Rs. 120, out of which say Rs. 100 is paid to the air/shipping line for carrying out the shipping activity. The balance amount i.e. Rs. 20 is distributed equally between the AE and the Assessee as profit share.

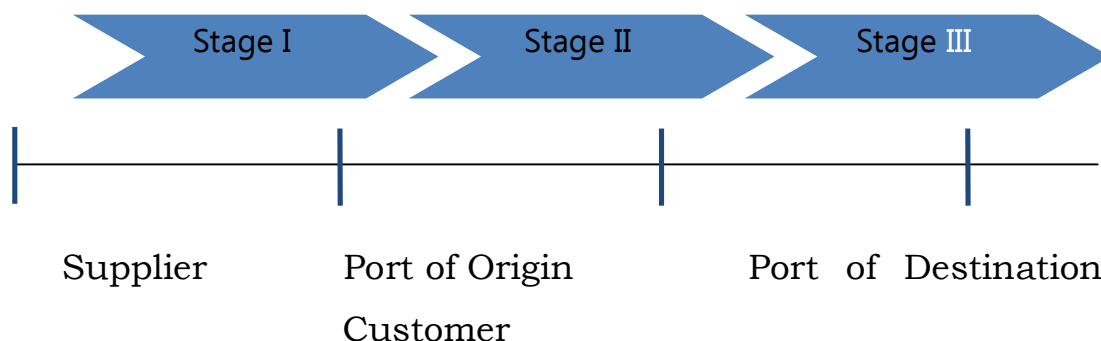
The addition of Rs 21,05,07,858/- is predominantly covered under this service.

DESTINATION SERVICES

- I. These services are being provided both in the case of Import as well as Export transactions. In the case of Export from India, the services are provided by the AE and, in the case of Imports into India, the services are provided by the Assessee. The Assessee and the AE, for these services, provide a mirror reflection of services in their respective countries/ territories. In effect, it means that the AE provides their part of the services in their territory only and no part of the services is provided for in the Indian Territory. Similarly, the Assessee provides services in the Indian Territory only and no part of the services is provided by the Assessee in the overseas territory. That with respect to the above services, the respective AE and the Assessee keeps the entire revenue earned and bears the expenses incurred and no part of such revenue or expense is shared. Example of such services rendered under "Destination Services" is custom clearance and door delivery, local transportation, etc.

II. The payments made by the Assessee to its AEs situated across the world are produce below for reference-

5. The transactions undertaken by JAS India with its AEs/Affiliates can be further categorized into following stages:



5.1 The profit earned during the first stage of the process is retained by the Origin Company, and the profit earned during the third stage of the process is retained by the Destination Company. Accordingly, the costs and risks are borne by the respective entity.

5.2 With respect to the second stage of the process, the profit earned on the third party freight costs (i.e., the difference between the costs paid to the third party transporter and the price received from the customer) is attributable to both the origin and destination companies. All profits earned on stage two of the freight forwarding process are divided equally.

5.3 Accordingly, the Assessee, during the year under consideration, made certain remittances to AEs which includes reimbursement of freight charges and also an element of income for the commercial activities undertaken by AEs in their respective jurisdictions. Out of the total remittances made, 90 percent pertains to reimbursements of third party freight costs

incurred by the AEs on behalf of the Assessee and the balance represents net revenue share towards services rendered by the AEs/affiliates.

6. According to the Assessee, since the non-resident overseas entities did not carry any activity or business operation in India, and they do not render any service in India, no portion of their business profits earned by them exclusively for services rendered outside India can be brought to tax in India, either under Section 9(1) of the Act or otherwise or at all. Since there is no business connection u/s 9(1)(i) of the said Act between the Assessee and the overseas Affiliates, the overseas entities are not chargeable to tax in India on their business profits and accordingly the Assessee took a view that it is not liable to deduct TDS as per the Income Tax Act, 1961.

7. The Assessing Officer however, took a view that the payments made to the overseas AEs were subject to TDS under Section 195 of the Act and accordingly made a disallowance u/s 40(a)(i) of the Act. The Assessing Officer took the view that non-resident associate enterprises have derived income through the presence of the assessee company which falls under the definition of 'business connection in India'. The Assessee in response to query by Assessing Officer furnished its reply, the relevant extracts of which find mention in the assessment order and are also mentioned herein below-

“5. During the course of assessment proceedings, vide order sheet entry dated 29.11.2010, the assessee company was asked to furnish details of payments to nonresidents and if,

tax was deducted at source. In response vide written submission dated 08.12.2010, the assessee company has given details of payments made to non-resident associate enterprises for freight and forwarding services rendered by them amounting to Rs.21,05,07,858/-. Vide order sheet entry dated 08.12.2010, the assessee company was asked to justify non deduction of tax at source on these payments. In response the assessee company vide written submission.....

It is submitted that the facts of the transaction amply demonstrates that the JAS Overseas entities are carrying on the business and not rendering any services in the nature of technical or professional services or getting any income on account of royalty which may attract withholding tax applicability in terms of the DTAA with the respective countries. The JAS Overseas companies are carrying on the businesses which are a mirror reflection of the business being carried on by the assessee in India. Jas India is making payment for freight and this the services rendered for which the payment has been made consists of the Business Income of the parties receiving the payments.

Further, all the companies to whom payments have been effected by the assessee are independent entities having no PE in India. Accordingly, as the payments to overseas group entities of the assessee constitute business income in terms of the relevant treaty, the same are not taxable in India in the absence of their having in PE in India.”

8. Being aggrieved by the order of the AO, the Assessee preferred an appeal before the CIT (A).

9. During the course of the arguments before the CIT (A), the Assessee made the several arguments, which are summarized as below:-

- The Assessee and its Associated Enterprises (AEs), who are non-residents, are engaged in the business of freight and forwarding in India and different countries, respectively. During the concerned year, the Assessee had an effective 'Agency Agreement' with Jas Forwarding Worldwide on behalf of JAS Group of Companies and subsequently had become a member of the JAS Group of Companies Network.
- Further, as per provisions of the said arrangement, profit share between the Assessee and JAS Forwarding Worldwide is 50/50 basis and calculated on the sea freight or air freight, only, irrespective of whether freight is prepaid or collect. Rest of the incomes accruing for services rendered accrues wholly to the respective parties including the Assessee.
- As per the Agency Agreement, the transactions that were to be undertaken amply demonstrate that both the Assessee and JAS Group of Companies would be carrying on the businesses which would be a mere mirror-reflection of each other business activity, i.e. in case of export transactions, the origin services would be provided by the Assessee Company and destination services would be provided by JAS Group of Companies and conversely, in the case of import transactions, the origin services would be provided by JAS Group of

Companies and destination services would be provided by the Assessee Company.

- Basis the above facts, since the non-resident overseas entities did not carry any activity or business operation in India, and they did not render any service in India, no portion of their business profits earned by them exclusively for services rendered outside India can be brought to tax in India, either under Section 9(1) or otherwise or at all. Therefore, there is no question of treating the relationship between the Appellant Company and the overseas entities as a business connection within the meaning of Section 9(1)(i) of the Income Tax Act, 1961.
- It was submitted that a relation to be a "business connection" must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the non-resident. In the absence of a precise meaning of the term, determination of business connection has been the subject matter of litigation and a number of judicial precedents are available on the matter. However, the question whether there is a business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined on the basis of peculiar facts and circumstances prevailing in each case and the available judicial precedents only provide certain general guiding principles, to be considered while evaluating the matter, rather than definitive tests.

➤ Further, from the analysis of the various judgments / decisions of various courts that certain parameters for calling the relationship as business connection, has been carved out, which are enumerated hereunder:-

- i. A real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities within India.*
- ii. Such relationship must contribute to the income of the non-resident.*
- iii. Some part of the activity must be carried out in India.*
- iv.]Continuity of relationship must be there.*

➤ From the above quoted parameters, it is very evident that the various courts have prescribed four conditions to qualify as business connection for the purposes of deemed accrual or arise in India. The Ld. AO very conveniently chose to ignore the third condition which is that some part of the activity must be carried out in India. As already submitted in the facts above, only cross border freight services were commonly carried out by the AEs and the Assessee for which the 'Agency Agreement' was entered. In order to have a real picture of the activity, the Assessee placed an illustration. For instance, in case of imports of cargo from Japan to India, the role of each party in carrying out their respective activities would be-

- a. Role of AE of the Assessee situated in Japan - arrange an air/ shipping line to deliver the cargo from the custom*

frontiers of the Japan to the custom frontiers of India and negotiate freight charges.

b. Role of air/ shipping line - transmit the cargo from the custom frontiers of the Japan to the custom frontiers of India.

c. Role of the Assessee - taking the delivery of the cargo at Indian custom frontier.

10. Basis the abovementioned arguments, evidences and detailed provided by the Assessee, the CIT(A) allowed this ground of appeal. Finding of the CIT (A), for sake of convenience is reproduced herein below-

6.1 I have considered the written .submission on behalf of the Assessee, the findings of the Assessing Officer in the assessment order as well as in the Remand report and also material placed on record. I have also pursued the case laws cited by the Assessing officer and the Assessee. It has not been established by the Assessing officer that there was any relationship between the Assessee and the non-resident associate enterprises and which part of activity was carried out by the above non-resident associate enterprises in India. In other words, the Assessing officer has not been able to establish that any part of the income was attributable to the operations carried out in India and there was any business connection of the non-resident associate enterprises in India. The perusal of the material placed on record reveals that(a) there was no business connection of the non- resident associate enterprises in India; (b) the Assessee was not an agent of the non- resident associate enterprises in India & (c)

the non-resident associate enterprises do not exercise any control over the activities performed by the Assessee.

6.2 It is also observed that the AO has overlooked the expression 'any such sum chargeable under this act' and given a finding contrary to this expression. The AO has placed reliance on the decision of the Hon'ble Supreme Court in the case of Transmission Corporation of AP Vs CIT (1999) 239 ITR 587. I do not find myself in agreement with the observation of the AO that the ratio of Transmission Corporation of AP is applicable to the case of assessee. The observations of the Supreme Court in Transmission Corporation of AP (supra) have to be read in the context of the question before the court i.e. whether tax was deductible on the gross trading receipts or only on the 'pure income profits'. The court was not concerned with the case where the receipt was not chargeable to tax in the hands of the recipient at all. On the other hand the observations of the court make it clear that liability to deduct tax at source arises only when the sum payable to the non-resident is chargeable to tax. This view has also been followed by the jurisdictional High Court of Delhi in the case of Van Oord ACZ India (P) Ltd. v CIT (2010) 323 ITR 130(Del): 189 Taxman 232(Del) 230 CTR(Del) 365. On the issue as to whether section 195(1) arises only if the payment is chargeable to tax in the hands of the recipient, I find that the issue is now covered and settled by the judgment of the Hon'ble Supreme Court in the case of GE India Technology Cent. (P.) Ltd. (2010) 327 ITR 456 wherein the Hon'ble Court reversed the decision of the Karnataka

High Court in the case of CIT (International Taxation) v. Samsung Electronics [2010] 302 ITR 209. The Hon'ble Supreme Court held that a person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not chargeable to tax. It emphasizes the fact that section 195(1) uses the word "Payer" and not the word "Assessee". The payer is not the assessee. It held that the payer becomes the assessee in default only when he fails to fulfill the statutory obligation under section 195(1). If the payment does not contain the element of income, the payer cannot be made liable and he cannot be declared to be an assessee in default. In view of the discussion made above, it is held that the disallowance of Rs.21,05,07,858/- on account of payments made to non-resident associate enterprises by invoking the provisions of section 40 (a)(i) of the Act is not justified and the same is deleted. As a result, grounds. of appeal No. 9 to 13 are treated as allowed."

11. Being aggrieved by aforementioned order, the Revenue is now in appeal before us. During the course of the arguments before us the Ld. CIT(DR) submitted that the Assessee has an agency agreement with JAS Forwarding Worldwide and operates as exclusive agent in India and referred to para 6, page 23 of CIT(A) order. It acts as an intermediary and would take responsibility for entire shipment including loading and unloading, transportation, insurance etc. Thus, it cannot be said that payees have no business connection in India. The Agency Agreement mentions the Assessee as an agent and the payee companies as Principal. It is evident as the Principal has been

defined as “JAS group of companies as listed in the attachment” and the names appearing in the attachment are names of payee companies. Therefore, the said agency agreement has been signed between each of the payee company being Principal and the assessee as agent. The Ld. CIT (DR) relied on the detailed findings of the Assessing Officer and stated that all the essential features/conditions of “business connection” as mentioned and discussed in the assessment order, stand satisfied in the present case.

12. The Ld. Counsel, on the other hand, re-iterated the submissions and the arguments advanced before the Ld. CIT (A) and also put forth some more arguments, which can be summarized herein below:-

- AEs, to whom the payment has been made during the relevant year, are independent entities having no Permanent Establishment (‘PE’) in India.
- Accordingly, since the non-resident overseas entities did not carry any activity or business operation in India, and they did not render any service in India, no portion of their business profits earned by them exclusively for services rendered outside India can be brought to tax in India, either under Section 9(1) or otherwise or at all. Therefore, there is no question of treating the relationship between the Assessee and the overseas entities as a business connection within the meaning of Section 9(1)(i) of the Income Tax Act, 1961. There is no business connection within the meaning of Section 9(1)(i) of the said Act between the Assessee and the overseas

Affiliates, the overseas entities are not chargeable to tax in India on their business profits.

- The Assessee relied on the following decisions in this regard wherein similar issue has been decided in favour of the Assessee

Sl. No.	Case Law	Citation
1.	Balmer Lawrie & Co. Ltd.	[2016] 68 taxmann.com 384
2.	UPS SCS (Asia) Limited	[2012] 18 taxmann.com 302
3.	UPS SCS (Asia) Limited	I.T.A No. 7319/Mum/2012
4.	UPS SCS (Asia) Limited	[2015] 63 taxmann.com 337
5.	Honest Enterprises Limited	I.T.A. No. 2265/Ahd/2015
6.	Leaap International (P.) Ltd.	[2011] 15 taxmann.com 251
7.	Dongnam Logistics India Pvt. Ltd.	I.T.A. No. 1839/Del/2012
8.	Carborandum Co.	[1977] 108 ITR 335 (SC)
9.	Toshoku Limited	[1980] 125 ITR 525 (SC)

13. On the issue of applicability of Section 195 and disallowance u/s 40(a)(i), the Ld. Counsel submitted that:-

- i. The provisions of section 195 of the Act, lays down the conditions for deduction of tax from payments made to non-residents and mandates to withhold taxes only before making any payments chargeable as income under the provisions of the Act. Therefore, the concept of "income" or "any sum chargeable to tax" becomes important.
- ii. Where the payment is not chargeable under the Act and no tax is required to be deducted at source, the section does not get attracted and no disallowance can be made under this section.
- iii. Reliance was placed on the judgment of Hon'ble Supreme Court in the case of **G. E. India Technology Center India Pvt. Ltd Vs. CIT & Anr [234 CTR 153 (SC)]**, wherein the Apex Court observed that disallowance u/s 40(a)(i) can be made when there 'is a liability to deduct tax, and is not deducted. Thus, the Hon'ble Apex Court observed that sec 40(a)(i) ensures effective compliance of Sec 195 by disallowing the sum paid without withholding of tax. The Supreme Court have laid lot of emphasis on the phrase "chargeable under the provisions of this Act" while deciding the issue of tax deduction at source by a person making payment to a non-resident. For this, the Hon'ble Court relied upon an earlier ruling in the case of **CIT v. Cooper Engg. Ltd. (1968) 68 ITR 457 (Bom.)**, wherein it was pointed out that if the payment made by the resident to the non-resident was an amount which was not chargeable to tax in India, then no tax is

deductible at source.

- iv. The Courts have considered the import of words "sum chargeable under the provisions of the Act" appearing in Section 195, which do not find place in other provisions of the Act. The difference can be explained only by attracting an appropriate meaning to the term 'chargeable'. In other words, the Court held that the obligation to deduct tax at source arises only when there is a sum chargeable under the Act and, therefore, section 195 has to be read in conformity with charging provisions, i.e. sections 4, 5 & 9 as well as the provisions of relevant DTAA and this condition has not been satisfied in the present case.

14. In response to the argument of the Ld. CIT (DR) on the agency agreement, the Ld. Counsel submitted all dealings with the Assessee and its AEs are on principal to principal basis. Further, it was submitted that JAS India has not entered into any contracts on behalf of any of its overseas AEs/Affiliates with its customers in India. As apparent from contracts submitted, JAS India acts in an independent and objective manner and has not entered into any contracts in name of AEs/Affiliates. Further, JAS India has not issued any invoice or acted in a contract on directions of the AEs/Affiliates. JAS India acts on a principal-to-principal basis with its clients. The terms of contracts with clients distinctively specify the principal-to principal relationship between the parties. JAS India independently signs contracts with various clients and issues invoices on its accounts. The contracts and ancillary documents distinctively provide that JAS

India signs contracts in its own name and issues invoices on its own name. JAS India is neither influenced nor affected by AEs or Affiliates in negotiations with clients. Further, from the e-mail correspondence it was pointed out before us along with contracts, to show that JAS India has not been impelled by any instructions from AEs/Affiliates. The contracts are concluded based on objective business goals of JAS India. Thus, the crux of the Assessee's argument remains that mere use of the word 'agency' is not the determinative factor and the fact still remains that the AEs have no business connection and since the non-resident overseas entities did not carry any activity or business operation in India, and they did not render any service in India, no disallowance can be made for non-deduction of TDS.

15. We have heard the rival submissions, perused the relevant material referred to before us which includes the written submissions filed by both the parties and the paper book placed on record. During the course of hearing, the Bench had also asked for certain further documents, which have been placed on record by the Assessee and have been perused by us. From the facts and arguments discussed above, it can be clearly inferred that the Assessee and Associated Enterprises though being AEs, are operating on a principal to principal model and there is no 'Principal-Agent' relationship between JAS India and its AEs/Affiliates. From the documentary evidences depicting negotiations, quotations, contracts and exchange of e-mail correspondence between JAS India and end-customers in India along with underlying invoices which have been placed on record pursuant to our directions, it is seen that the terms of contracts

with clients distinctively specify the principal-to principal relationship between the parties. For instance, the particular clause of a customer contract entered with Gates India Private Limited is reproduced below ready reference:-

“MANNER OF PERFORMANCE

Subject to any contract to contrary the contractor shall execute the job/work or contract independently without any interference from the company on day to day basis.

It is specifically agreed and understood between the parties that this contract shall create principal-to principal relationship between the company and the contractor and the contractor shall not be treated as supervisor or agent of the company.

That the contract would be creating relationship of the principal-to-principal between the company and the contractor wherever the context may so require to be ascertained...”

16. From the above clause, the intention of the parties is clear that there is no Principal and agency relationship. Further, the contracts and ancillary documents submitted, distinctively states that JAS India signs contracts in its own name and issues invoices on its own name. An illustration of JAS India invoicing the end customer and AEs subsequently raising an invoice on JAS India for services provided in their territory were placed before us, from which it is quite clear that the charges raised on Hindustan Lever Limited by JAS India is after accounting for the overseas charges. In this case, Overseas Entity namely JAS

Indonesia raised an Invoice on JAS India for the services rendered by them in their territory. Accordingly, JAS India raised an Invoice on the Customer namely Hindustan Lever after adding Local expenses and its profit share. Also, from the e-mail correspondence submitted along with contracts, it is evident that JAS India has not been impelled by any instructions from AEs/Affiliates. The contracts are concluded based on objective business goals of JAS India and AEs have no role to play in the negotiations with clients.

16.1 Furthermore, the said agreement has been framed to specifically provide that the terms of contracts/transactions between AEs/Affiliates and JAS Forwarding Worldwide has independently negotiated and rates of remuneration are fixed so as to maintain a 50:50 share of profits. The relevant Paras from the Agreement are reproduced below:

“...4.2 The Principal shall pay the remuneration to the agents at the rates so agreed, in accordance to this agreement (Clause 5.2)...

...5.1. Payment of collect freight less Profit share will be settled as agreed mutually by both the parties...

...5.2. Profit share between the Principal and Agent shall be on a 50/50 basis and it shall be calculated only on the sea freight or airfreight, irrespective of whether freight is prepaid or collect...”

17. Thus, it can be seen that mere use of the word ‘agency’ is not sufficient to conclude that the Assessee and the AEs do not

operate on principal-to-principal basis and nomenclature is not the determinative factor. The above mentioned evidences filed clear show that JAS India has not been impelled by any instructions from AEs/Affiliates and the specific clause to this effect has been mentioned in the agreement. It has also been informed to us that above principle of 50:50 Profit Split are a widely accepted pricing formula prevalent across the global freight-forwarding industry at large. In support, the Ld. Counsel for the Assessee has placed reliance on recent ruling in case of Balmer Lawrie & co. Ltd. [2016] 68 taxmann.com 384 (Kolkata-Trib.), wherein 50:50 profit split method has been upheld. In the said case this issue had come up for, wherein Tribunal vide para 32 has categorically stated that merely the use of the word agency in the agreement does not amount that there exists a relationship of agency. The Tribunal held that:

“...With regard to the issue of agency relationship we find that both the parties are acting on principal to principal basis. In case of exports the Indian companies engage the assessee with the necessary information of the overseas importers for the delivery of the goods to outside India. This agreement is limited to Indian exporter and the assessee in relation to the logistic services and at no point of time the overseas entity or the Indian exporter has any dealing of whatsoever. The assessee for the services raises the bill to the Indian exporter. After completing the custom formalities, the assessee communicates with overseas entities who are independently engaged for rendering required logistic services and delivers the same to the overseas importer. For such services the

assessee and overseas agent share the profit after the expenses incurred in India. Accordingly the assessee does not deduct the TDS as no service in India and no income accrued or arose in India. The assessee engages the airlines, shipping lines and local transport in India and not as overseas agent. Similar procedure is followed when some overseas agents require import of the goods from India.

In our considered view we find from the facts that there is no agent and principal relationship between the assessee and overseas entities and vice versa. Merely the word used in the 'agency' in the agreement does not amount that there exist the relationship of agency..."

18. Further, it is noticed that this Agency only deals with payment of remuneration by the overseas Principal (viz. overseas AEs/Affiliates) to the so-called agent (viz. JAS India). Accordingly, Agency Agreement deals with cases where there is a non-resident customer who receives invoices from and who makes payment to the respective JAS AE/Affiliate in a foreign jurisdiction. In the second step, the overseas JAS AE/Affiliate compensates JAS India for services rendered in India. The transaction results in 'receipt of income' by JAS India (i.e. inward cash remittances), which is not the subject matter of current disallowance u/s 40(a)(i) of the Act, as the disallowance is mainly on account of non deduction of TDS which is applicable to outbound transactions when payment is being made outside India, attracting Section 195 of the Act. The subject matter of current disallowance u/s 40(a)(i) are the payments made

‘outward cash remittances’ by JAS India to its overseas AEs/Affiliates. These payments are not governed by the Agency Agreement as such, *albeit* the universal 50/50 revenue sharing model is common to both inbound/ outbound transactions and perhaps this universal 50/50 revenue sharing model which is common, has led the Ld. CIT (DR) to raise this argument. The Ld. CIT (DR) relied on a ruling of the AAR (AAR No. 542 of 2001) in the case of ABC. However, it can be seen that the facts of the case before us are different. In the present case, JAS India invoices customers in the capacity of a Principal, and correspondingly deals with overseas AEs/Affiliates on a Principal-to-Principal basis. Quite contrary to the terms of ‘compensation’ (clause 2.12) as defined under the ‘transportation agreement’ in case of ABC, it is JAS India who compensates the overseas AEs/Affiliate on an arm’s length basis for services availed in the respective overseas jurisdictions. The service invoices raised on payments received from Indian customers entirely belong to JAS India as integral part of its own business. Further, unlike the facts in the case of ABC, JAS Worldwide is in no manner responsible for meeting/ reimbursing the salary and other establishment expenses incurred by JAS India in running its day-to-day operations. Thus, this judgment is distinguishable.

19. Even otherwise, we find that there is merit in the alternate plea of the Assessee is that since the above transactions are at arm’s length for the aforesaid year, no further attribution can be made even if PE is established. TPO’s order u/s 92CA (3) dated 26.10.2010, has been placed before us wherein no adverse inference was drawn in respect of the international transactions

undertaken by the Assessee during the relevant year. It is now a settled principle that even if there is a business connection, no further income can be chargeable to tax in India on account of PE since the transaction between the Assessee and its AE has been found at arm's length. Hon'ble Supreme Court has held as under in case of **Morgan Stanley (292 ITR 416 (SC))**.

“...As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the ruling is correct in principle provided that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE...”

This principle of law has been recently again upheld and applied by SC in the case of **Honda Motor Co. (301 CTR 601 (SC))** and **E-funds Solutions (399 ITR 34 (SC))**.

20. Further, we find that the Ld. CIT(A) has discussed the essential ingredients for attracting Section 9(1) of the Act and has held that the non-residents are liable to tax in India on account of 'business connection' and has thereafter has given a finding that there is no business connection in India. On perusal of the material placed on record reveals that:-

- There was no business connection of AEs in India;
- Assessee was not an agent of AEs in India;

- AEs do not exercise any control over the activities performed by the Appellant

Also, the expression '*any sum chargeable under this Act*' under Section 195 of the Act states that sums payable to non-resident is not liable to deduct tax if such sum is not chargeable to tax. This view has been upheld by the Hon'ble **Delhi High Court in the case of Van Oord ACZ India (P) Ltd. vs CIT, 323 ITR 130;** and by Hon'ble **Supreme Court ruling in the case GE India Technology Cent. (P) Ltd (2010); 327 ITR 456.** The Hon'ble Supreme Court has held that person paying interest or any other sum to non-resident is not liable to deduct tax if such sum is not chargeable to tax. Thus, in the absence of any 'business connection, there was no obligation on the Assessee to deduction tax u/s 195 of the Act and thus correspondingly no disallowance could be made u/s 40(a)(i) of the Act.

21. The payments made to non-resident are not on account of rendering any services in the nature of technical or professional services or fees for technical services or getting any income on account of royalty, albeit the nature of activities performed by the non-resident are purely business activities. The AEs are carrying on the business of freight forwarding services in their respective jurisdictions which are mirror reflection of the business activities carried on by the Assessee. This issue has also been discussed and adjudicated in favour of the Assessee in the case of Mumbai ITAT, **UPS SCS (Asia) Limited, [2012] 18 taxmann.com 302 (Mum.),** wherein the Tribunal has held that payments to non-residents for providing freight and logistics services outside India,

is not within the purview of fees for technical services and in the absence of any permanent establishment or 'business connection in India', the same is not taxable.

22. Since as held above that there is no 'business connection in India', therefore, we hold that the Assessee was not under an obligation to deduct tax u/s 195 of the Act. Correspondingly, no disallowance could be made u/s 40(a)(i) of the Act. Thus, we uphold the order of the CIT (A) and the appeal filed by the Revenue accordingly is dismissed.

23. Now, we take up the appeal filed by the Assessee. During the year under consideration, JAS Group incurred certain expenses like server maintenance, netting charges, management expenses, NVOCC insurance charges etc. amounting to Rs. 21,58,139/- on behalf of the Appellant which were reimbursed by Appellant to its AEs on cost to cost basis. The Assessing Officer, however, in his order took a view that the payments made to the overseas AEs were fees for technical services and tax should have been deducted on the amount of reimbursement made under Section 195. The Assessing Officer held that this non compliance with the TDS provisions as mentioned in chapter XVII of the income tax act attracts the provisions of section 40(a)(i) of the I.T. Act. The relevant extracts of the assessment order are mentioned herein below:-

"4. Vide order sheet entry dated 29.11.2010 was asked to furnish details of payments made to non-residents and if tax was deducted at source or not and reason thereof. In response, the assessee company filed submission dated 08.12.2010. The

submissions contain inter-alia details of reimbursement made to non-resident associate enterprises. The same is reproduced as under-

<i>Name of the Company</i>	<i>Country</i>	<i>Amount</i>	<i>Nature of the services</i>
<i>JAS Forwarding Worldwide (PTY Ltd.).</i>	<i>USA</i>	<i>13,780</i>	<i>Reimbursement of server maintenance cost</i>
<i>JAS Worldwide Management LLC.</i>	<i>USA</i>	<i>199089</i>	<i>Reimbursement of netting charges</i>
<i>JAS Worldwide Management LLC.</i>	<i>USA</i>	<i>1012859</i>	<i>Reimbursement of management expenses</i>
<i>JAS Jet Air Service SPA, Milan, Italy</i>	<i>Italy</i>	<i>38797</i>	<i>Reimbursement of travelling cost</i>
<i>JAS (UK) Ltd., London UK</i>	<i>UK</i>	<i>8800</i>	<i>Reimbursement of travelling cost</i>
<i>JAS Forwarding (USA) INC.</i>	<i>USA</i>	<i>50507</i>	<i>Reimbursement of travelling cost</i>
<i>JAS Forwarding GmBH, Frankfurt, Germany</i>	<i>Germany</i>	<i>20224</i>	<i>Reimbursement of travelling cost</i>
<i>JAS Forwarding (USA) INC.</i>	<i>USA</i>	<i>755655</i>	<i>Reimbursement of NVOCC Insurance Expenses</i>
<i>JAS Forwarding (USA) INC.</i>	<i>USA</i>	<i>58428</i>	<i>Reimbursement of NVOCC Tariff Filing Expenses</i>
<i>TOTAL</i>		<i>2158139</i>	

4.2 At the outset, it is to be noted that the sums were paid by way of expenses to non-resident third parties who had rendered services to the assessee. These payments therefore fall within the purview of section 9(1)(vii) and are therefore taxable in India as fee for technical services.

4.3 The contention of the assessee that the payment made is reimbursement against actual expenses, and therefore not chargeable to tax is not acceptable.

4.5 To reiterate, the taxation of fee for included services/royalties/included services is not on net basis, had it been so, out of the receipts, such expenses would be required to be deducted for computing the net income and such income would be taxable at the normal higher rate of tax (as opposed to the rates of TDS).

4.6 The assessee has taken the plea that there is no income embedded in the payment made. However, in that case, taxability of the receipt in the hands of the foreign company to whom the payment has been made by the associated enterprises at the instance of the assessee is material and not that of the associated enterprises. Therefore, it is the statutory provision which would determine the liability of the assessee in this regard and not an internal arrangement made by the assessee”.

24. Before the CIT (A), certain additional evidences were filed such as copies of the ledger accounts and the bills/invoices relating to server maintenance cost, netting charges, management fees, travelling expenses, NVOCC insurance

expenses and NVOCC tariff filing expenses. Thus, accordingly a remand report was called for. In the remand report dated 18.02.2011, the AO stated that-

"The assessee during the appellate proceedings which were remanded back to this office has submitted the proof of payments made to foreign entities. The claim of the assessee cannot be treated as explained as the Assessing Officer at no point of time disputed the payments made to foreign entities. The Assessing Officer has only invoked the provisions of section 195(1) and 195(2) and disallowance is made under section 40(a)(i) of the Income Tax Act, 1961 for the reason that the assessee did not follow the provisions of the Act and not deduct the tax at source which was mandatory before making the payments.

In view of the above, the claim of the assessee needs to be rejected and the additional evidence submitted during the course of appellate proceedings are not sufficient for the claim of the assessee.

It was further observed during the course of assessment that the assessee had reimbursed an amount of Rs.21,05,07,858/- to its associate enterprises who, made payment of behalf of the assessee to foreign entities. In this issue also, the Assessing Officer held that the assessee did not follow the provisions of section 195(1) and made disallowance as per the provisions of section 40(a)(i) of the Act.

The assessee during the course of assessment was asked to justify non deduction of tax at source of payments made to non

residents. The assessee could not submit a satisfactory reply in support of its claim and disallowance was accordingly made. On this issue also the claim of the assessee needs to be rejected as the assessee did not discharge the onus comfort on it under section 195(1) of the Income Tax Act, 1961 which was mandatory.

In view of the above, the claim of the assessee needs to be rejected and the additional evidence submitted during the course of appellate proceedings are not sufficient for the claim of the assessee.”

25. The CIT (A) thereafter admitted the additional evidence and noted that the AO has also not made any adverse comment with regard to admission of additional evidence. Before the CIT (A), the Assessee preferred written submissions explaining the nature of reimbursements. Relevant extracts of the submission which also find mention in the order of the CIT (A) are reproduced herein below-

“The Assessee carried out certain transactions during the year under appeal with overseas JAS Group of Companies and other domestic entities. In this regard, JAS Group of Companies incurred certain expenses totaling Rs.21,58,139/- on behalf of the Assessee which were later on recharged by its associates on cost to cost basis. The nature of such expenses are discussed below:-

(i) Reimbursement of Server Maintenance Cost amounting to Rs. 13,780:-Here, the expenses only represented proportionate expenses incurred by the AE for the maintenance of server

from time to time. An overseas server had been set up to run the business efficiently, which is shared and maintained by Jas Forwarding Worldwide Pty Ltd, Australia (Hereinafter referred to as 'Jas Australia'). Expenses are required to be incurred for the maintenance -of server from time to time; therefore, Jas Australia incurred the expenditure by giving the contract of such maintenance to a third party, which were agreed to be shared between the parties. Accordingly, Jas Australia raised the bill of reimbursement of expenses on the Assessee towards its share.

(ii) Reimbursement of Netting Charges amounting to Rs.1,99,089:- The expenses only represented proportionate expenses incurred by the AE to avail financial settlement services from network services from server situated outside India. In order to carry out its business activities smoothly within India and outside India, the Assessee avails the network of more than/around 150 offices set by the JAS Group globally. The settlement of all the financial transactions incurred between all the members of the JAS Group is handled by a single clearing account, i.e. all the receivable and payables within the Group Companies are handled on the single desk by Jas Worldwide management LLC located at Atlanta, USA, wherein full fledge procedures and software in relation to carry out operation, communications and other matters is set up, so that all the transactions are set out smoothly. It is submitted that in respect of both the netting charges and management expenses, referred to above, the Assessee has not "made

available" any technical knowledge, experience, skill, know-how, or processes, or the alleged services does not consist of the development and transfer of a technical plan or technical design and mere rendering of services is not roped in unless the person utilizing the service is able to make use of the technical knowledge etc by himself in his business or for his own benefit and without recourse to the performer of the services in future. In our case, the services rendered are not left with the Assessee but it is a mere reimbursement of expenses incurred by non-residents on the activities performed by it. For all the said activities, netting centre at USA incurred some cost which they distributed amongst the netting participants, i.e. members of the Group Companies and accordingly the Assessee was required to reimburse its portion of the expenses.

(iii) Reimbursement of Management Expenses amounting to Rs. 10,12,859:Jas Worldwide Management LLC, situated in Atlanta, USA perform administrative, business development activity for common interest of the JAS Group which in-turn help the entities to grow their businesses. In this procedure, they incur some cost which they allocate within the group members which are benefited by the said activity, directly or indirectly. The Assessee was also charged its share of expenses, for which the Assessee made the payment. Further, the expenses only represented proportionate expenses incurred by the non-resident to avail administrative, business development activity.

(iv) *Reimbursement of Traveling Cost amounting to Rs.1,18,328: The said expenses were incurred by the Assessee on behalf of the non-resident on account of local air tickets of foreign delegates coming to India. The same was cross charged by the Assessee to the respective non-resident during the year. However, during the assessment proceedings, when the Assessee provided the details of the payments made to the non-residents, the above travelling cost, which was in fact receivable from the non-resident was inadvertently included as payable in the list. Since the same was received/receivable by the Assessee, therefore, in any case, it does not come within the ambit of section 195 of the Act as no sum was payable to a non-resident, therefore, no disallowance can in any case be made.*

(v) *Reimbursement of NVOCC Insurance Expenses amounting to Rs.7,55,655:- The Appellant is engaged in the business of International freight forwarding, wherein, the goods of customers is required to be transferred from origin to destination, by moving shipments from one point to other internationally, therefore, there is always a risk of something untoward happening during the transit. To cover up this risk, the Appellant need an insurance cover for the goods transmission, for which Jas Group take a joint cover from an International Insurance company and allocate the cost on basis of risk/business involved to the member companies. The Appellant made the payment of its share of insurance expenses to Jas Forwarding (USA) Inc, USA.*

Further, the expenses only represented cross charge of group insurance.

(vi) Reimbursement of NVOCC Tariff Filing Expenses amounting to Rs. 58,428 -It pertained to the payment made by the Assessee to JAS Forwarding (USA) Inc. for the amount charged towards payment made on behalf of the Assessee for filing freight tariff to USA.

26. The Ld. CIT (A) though, accepted the stand of the Assessee that it does not fall within the domain of fees for technical services. Which is evident from his following observations:-

“It is the case of the A.O. that all the payments in question are fees for technical services paid to the non-resident associate enterprises. However, no finding has been made by him as to what was the nature of services-managerial, technical or consultancy, rendered by the non-resident associate enterprises to the assessee. On perusal of the material placed on record, I am of the considered opinion that the payments in question do not fall within the ambit of section 9(1)(vii) of the Act”.

27. Thus, we find that Ld. CIT (A) himself has accepted that these reimbursements do not fall within the domain of fees for technical services. However, the Ld. CIT (A) held that the conditions u/s 37 have not been satisfied and disallowed this amount on account of commercial expediency.

28. Accordingly, before us the Ld. Counsel argued that the amount cross charged represented only reimbursement of expenses without any mark up i.e. actual cost incurred by the AEs of the Assessee on behalf of the Assessee outside India and reimbursement of expenses can never represent “income”, therefore, before making the payments to non-resident, the Assessee was not liable to deduct TDS. In any case, the question of allowability does not arise as these are all basic expenses relatable to the business of the Assessee. During the course of the arguments, the Assessee made the several arguments, which are summarized as below:-

- *That the reimbursement made by the Assessee is reimbursement of cost, thus, there is no income element added to it. Hence, the reimbursements made by the Assessee are not at all income in the hands non-resident in terms of sec 5(2) of the Act. In this regard, reliance is placed-*
- *ACITv. Mis. J.B. Boda Surveyors Pvt. Ltd in ITA No. 4252/Mum/2009.*
- *CITv. Dunlop Rubber Co. Ltd.[142 ITR 493 (Cal)]*
- *Clifford Chance United Kingdom v. Dy. CIT [2002]82 ITD 106(Mum)*
- *Mahindra & Mahindra Ltd. V. Dy. CIT [2005) SOT 896 Mumbai ITAT and Mumbai Tribunal TISCO (ITA No. 3024/3025 of 1984 dated 31.5.2000)*
- *Cholamandalam MS General Insurance Co. Ltd. [309 /TR 356)*

- No opportunity of being heard given to Assessee while making the above disallowance under section 37(1).
- Without prejudice to the above, it is respectfully submitted that while applying the test of commercial expediency for determining whether expenditure was wholly and exclusively incurred for the purpose of business, reasonableness of expenditure has to be adjudged from the point of view of the business and not of the revenue.
- The transactions have been scrutinized in various year by the TPO under the provisions of section 92CA (3) and have been held to be at arm's length for the relevant year and no adverse inference has been drawn.
- Assessee placed reliance on the following judgments-

Case Law	Citation
DLF Commercial Project Corporation	379 ITR 538
Walchand & Co. Private Limited	65 ITR 381
J.K. Woolen manufactures Limited	72 ITR 612
EKL Appliances Limited	24 taxman 199

29. Ld. CIT (DR) on the other hand relied on the order of the Ld. CIT (A), specifically pages 20 to 23, para 5.1 to 5.3 of the order.

30. We have heard the rival submission and have perused the material placed before us which includes the submissions filed by both the parties and the paper book placed on record. We find that the nature of reimbursement is of such expenses which are purely in the nature of day-to-day expenses of the business

activities of the Assessee. The copy of the invoices, ledger accounts etc. have been filed before us. We find that the nature of expenses includes server maintenance Cost, netting charges, management expenses, travelling cost, insurance expense etc., which are an integral part of running of a business and for undertaking day-to-day activities. The Ld. AO/CIT(A) have not doubted the genuineness of the expenses. In fact, even the nature of the expenses stands accepted. Thus, the domain of commercial expediency cannot be entered into. We find that this issue in principle is covered in the case of **S.A. Builders (SC) (288 ITR 1)** and is directly applicable on the facts of the present case as the evidences have already been filed by the Assessee and as stated above, the expenses being reimbursed are regular business expenses. Thus, the appeal filed by the Assessee succeeds.

31. Accordingly, the appeal of the Assessee is allowed whereas the appeal of the Revenue is dismissed.

Order Pronounced in the open court on 8th May, 2019.

sd/-
(L.P. SAHU)
ACCOUNTANT MEMBER
Dated: 08/05 /2019

Veena

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

sd/-
(AMIT SHUKLA)
JUDICIAL MEMBER

ASSISTANT REGISTRAR
ITAT, New Delhi