SATURDAY INTERNATIONAL TAX GYAN !!!
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SITG No. 220

TVS Motor Co. Ltd.

v.

Income-tax Officer, International Taxation-II, Chennai

DTAA does not provide process/ mechanism for calculation of income it only provides tax rate and calculation mechanism needs to be derived from domestic tax law.

24.08.2024

[2024] 161 taxmann.com 211 (SC) [19-02-2024]

Jain Shrimal & Co.

Facts of the Case

- The assessee is engaged in the business of manufacture of auto-mobile parts. It entered into an agreement with the University of Warwick, UK for providing technical services.

- The assessee remitted fees for technical services to the said university and as per the agreement with the University, **tax has to be borne by the assessee**.

- Accordingly, the assessee paid tax at 15% on the amount remitted to UK by adopting the provisions of the Double Taxation Avoidance Agreement (DTAA) between India and UK.

Assessee's Contention

- By referring to Section 90 of the Act, it was stated that where DTAA exists, it will override the provisions of the Act and the rates of tax would be the rate in force under the Annual Finance Act or DTAA rates whichever is more beneficial to the assessee.

- The assessee referred to circular No.333, dated 02.04.1982, issued by the Central Board of Direct Taxes (CBDT), which provides that where a DTAA provides for a particular mode of computation of income, the same should be followed, irrespective of the provisions of the Income Tax Act.

- Further, it was contended that if the tax payment requires grossing up of tax, the tax liability has to be restricted to the amount calculated as per the provisions of DTAA, which overrides the provisions of the Income-tax Act.

- **The tax borne by assessee will not be considered as income of the service provider**. Thus, it is contended that the maximum tax required to be borne by the assessee as per the DTAA is only at the rate of 15% of gross amount of such royalty or fees.

Revenue's Contention

- Ld. counsel for revenue contended that the scope of treaty is to reduce tax or tax rate.
- It is submitted that what is not found in any of the treaties is the tax administration or the computation mechanism to arrive at the income and thus the term "gross amount" as used in treaty is not defined in treaty and accordingly as per DTAA it's definition is to be derived from local law.
- If the tax is agreed to be borne by the payer then in such case the tax amount should also be treated as income of seller as he will receive full amount after deduction of tax.
- By referring to Section 198 and Section 2(24)(iva), it is submitted that the tax to be deducted as per Section 195A is deemed to be treated as income of the payee i.e., University of Warwick UK and hence, there has to be tax deducted at source on such deemed income resulting in grossing up of the principal amount as per Section 195A.

Revenue's Contention

- By way of illustration, it is submitted that if the amount to be paid to a recipient is Rs.100/- and the rate of TDS is 10%, then as per Section 195A, the income of the recipient is not just Rs.100/-, but it will be Rs.111.11, since 10% of Rs.111.11 will result in Rs.100/- to the recipient and Rs.11.11 to the Revenue.

- Therefore, the argument of the assessee that the Treaty does not require grossing up of the payments and therefore, there is no need to gross up at all is an argument, liable to be rejected.

- Thus, it is contended that the gross amount received by the University of Warwick would be 2,00,000 X 100 ÷ 85 = 2,35,294/- and the tax to be deducted at source by the assessee is Rs.2,35,294X15÷100= Rs.35,294/-, as against which the assessee had deducted only a sum of Rs.30,000/-.

Legal provisions

Section 195A of the Act:

In a case other than that referred to in sub-section (1A) of section 192, where under an agreement or other arrangement, the tax chargeable on any income referred to in the foregoing provisions of this Chapter is to be borne by the person by whom the income is payable, then, for the purposes of deduction of tax under those provisions such income shall be increased to such amount as would, after deduction of tax thereon at the rates in force for the financial year in which such income is payable, be equal to the net amount payable under such agreement or arrangement.

Article 13 of India UK DTAA:

Royalties And Fees For Technical Services

during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services;

Ruling

- Hon’ble Supreme court has dismissed the SLP of assessee and it was withdrawn and accordingly the order of Hon’ble Madras High Court stands and same is discussed as under [2018] 96 taxmann.com 567 (Madras).

- As per clause 10 of the agreement between assessee and WARWICK, they agreed to pay a fee of 200,000 (net of Indian taxes).

- Accordingly, assessee calculated 15% tax on such 200,000.

- The assessee relied on Section 195A of the Act and submitted that grossing up will be only applicable to the provisions of the chapter relating to TDS and therefore, Section 195A cannot increase the income of the non-resident.

- the word “gross amount” or "income" has not been defined in the treaty and therefore, we are to be necessarily guided by the definition of "income" as defined under Section 2(24) of the Act, which includes, payments net of taxes.

Ruling

- The tax which has been borne by the assessee, is also the income of University of Warwick and since such income is covered by the words "gross amount", as mentioned in the treaty, the Revenue was justified in grossing up by applying Section 195A, as the provisions of the treaty do not provide a mechanism for computation of income, it prescribes only the rate of tax.

- Thus, to apply the correct rate of tax, the first requirement would be to determine the income on which tax is payable.

- Admittedly, in the instant case, there is no exemption granted under Section 10(6A) of the Act for the assessee to contend that the said payment does not form part of total income.

- In the light of the above legal and factual position, for the purpose of deduction of tax at source on the payment made by the assessee to the University of Warwick, the income should be computed in terms of the provisions of the Act and in so doing, it shall be increased by taking into consideration the amount of tax liability undertaken to be borne by the assessee.

Our Comments

- Considering the above case law few important principles about Income tax act and DTAA which we get to know is as under:

  i. DTAA does not prescribe any mechanism to calculate income of assessee which is chargeable to tax in a country, it only prescribes the tax rate which can be charged by a source country on such income.

  ii. Further, while grossing up assessee can use the DTAA rate to gross up the income and it is not necessary to use rate as prescribed under Income tax act to calculate the gross up amount. Earlier there used to be a confusion that whether as per section 195A of the act, assessee has to use income tax act rate to gross up amount although TDS will be deducted as per DTAA.

  iii. The amount grossed up as per the tax rate can be claimed as expense by the assessee.

Section/Article	Section 195A of IT Act
DTAA/Country	India UK
Court	Supreme court
Date of decision	19.02.2024

Note: Case law name in Red- in favor of the revenue, Green-In favor of the Assessee, Orange = Partial

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