आयकर अपीलीय अधिकरण "सी" न्यायपीठ मुंबई में।

IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH, MUMBAI

BEFORE SHRI SHAILENDRA KUMAR YADAV, JUDICIAL MEMBER AND SHRI RAMIT KOCHAR, ACCOUNTANT MEMBER

आयकर अपील सं./I.T.A. No.1562/Mum/2014

(**निर्धारण वर्ष** / Assessment Year: 2010-11)

A.C.I.T. 19(3), Mumbai Room No – 305, 3rd Floor, Piramal Chambers, Parel, Mumbai – 400 012.	**बनाम**/ v.	M/s Pahilajrai Jaikishin Makhija Chambers, 6th Floor, 196, Turner Road, Bandra (West), Mumbai- 400 050.

आयकर अपील सं./I.T.A. No.994/Mum/2014

(**निर्धारण वर्ष** / Assessment Year: 2010-11)

M/s Pahilajrai Jaikishin Makhija Chambers, 6th Floor, 196, Turner Road, Bandra (West), Mumbai- 400 050.	**बनाम**/ v.	D.C.I.T. 19(3), Mumbai 3rd Floor, Piramal Chambers, Parel, Mumbai – 400 012.
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAAFP1242K		
(अपीलार्थी /**Appellant**)	:	(प्रत्यर्थी / **Respondent**)

Revenue **by**	:	Shri C.W. Angolkar
Appellate **by**	:	Shri P. Daniel

सुनवाई की तारीख / **Date of Hearing**	:	29/10/2015
घोषणा की तारीख / **Date of Pronouncement**	:	01/02/2016

आदेश / O R D E R

Per Ramit Kochar, Accountant Member:

These are cross appeals by the assessee firm and the Revenue directed against the Order by the learned Commissioner of Income Tax (Appeals)-30, Mumbai ('CIT(A)' for short) dated 30/12/2013 for the assessment year 2010-11, bearing ITA No.994/Mum/2014 and ITA no 1562/Mum/2014, respectively.

2. First we will take up assessee firm's appeal and the Grounds of Appeal raised by the assessee firm in its appeal in the memo of appeal filed with the Tribunal being ITA No.994/Mum/2014 read as under:

> "*1. The Learned Commissioner of Income Tax (A) has erred in confirming the disallowance of Rs. 15,36,264/- uls. 14-A of the Act without properly considering the facts of the case in totality as well case law relied upon by the appellant.*
>
> *2. Without prejudice to the above the appellant submits that Learned CIT (A) has erred in confirming the disallowance merely on the ground that in appellants' case Learned CIT(A) (his predecessor) for Assessment Year 2009-10 had confirmed the similar disallowance in an order for Assessment Year 2009-10 without appreciating that*
>
> *(i) Appellant was in appeal against said disallowance before Hon'ble ITAT which appeal was pending.*
>
> *(ii) That every assessment year is an independent assessment & therefore the concerned authority has to consider the facts of that year and the case laws relied upon.*
>
> *3. Without prejudice to the above*
> *The appellant submits that Learned Assessing Officer has erred in holding that interest payable to partners on their capital u/s. 40 (b) is an expenditure of the firm instead of holding same as an allowance*

claimed by the assessee & therefore and does not fall within the ambit of section 14-A.

4. The Appellants crave leave to add, amend alter and / or vary any of the grounds at the time or before the hearing of this appeal.

5. The Appellants therefore pray that disallowance of Rs. 15,36,264/- uls. 14 A made by the Learned Assessing Officer & confirmed by the Learned CIT (A) may please be deleted."

3. The brief facts of the case are that the assessee firm is a partnership firm engaged in the business of manufacturing , trading and export of textile goods.

4. During the course of assessment proceedings u/s 143(3) read with Section 143(2) of the Income Tax Act,1961 (Hereinafter called "the Act") , from the perusal of the computation of income filed by the assessee firm with the Revenue, it was observed by the learned assessing officer (Hereinafter called "the AO") that the assessee firm has received the dividend income which is exempt from tax. From the perusal of the Balance Sheet , it was observed by the AO that the assessee firm has made investments in mutual funds, shares etc. , income there-from would be exempt from tax. While in the Profit & Loss a/c the assessee firm has claimed several expenses including interest expenses. However, no expenditure has been disallowed by the assessee firm in relation to earning of exempt income in the computation of income. The assessee firm was asked to explain that why disallowance should not be made u/s 14A of the Act read with Rule 8D of Income Tax Rules, 1962. The assessee firm submitted that only expenses debited against earning of exempt income are Rs.18633/- being Securities Transaction Tax (STT) and Rs 1724/- being Portfolio Management Services (PMS) charges paid to portfolio managers , totaling to Rs.20,357/- and as such these expenses do not relate to export business of the assessee firm and the same is clearly disallowable u/s 37(1) of the Act and which may be

disallowed .The assessee firm submitted that interest paid to the partner on their capital u/s. 40(b) of the Act cannot be considered as an expenditure in the hands of assessee firm for the purpose of section 14A of the Act as has been clarified by Hon'ble Apex Court in the case of CIT v. Walfort Share & Stock Brokers (P) Ltd (2010) 326 ITR-1(SC) wherein the Hon'ble Supreme Court held that expenditure referred to in Section 14A of the Act refers to expenditure on rent, taxes, salaries, interest etc in respect of which allowances are provided for u/s Section. 30 to 37 of the Act and every payout is not entitled to disallowances for deduction. The assessee firm submitted that since, interest paid on capital of partners is only a statutory allowance allowable under the provision of sec. 40(b) of the Act, same cannot be held as an expenditure incurred for earning of an exempt income under the ambit of Section 14A of the Act. The assessee firm submitted that interest paid to partners on capital is not an expenditure but forms part of appropriation account and thus as per principles of accountancy it goes below the line. In this case of partnership firm , profit(loss) is arrived at before paying interest and remuneration to partners which is considered as actual profit earned by a firm and it is only thereafter that the interest and/or profit is payable to partners. The assessee firm relied upon decision of the Ahmedabad Tribunal-Special Bench in the case of Sh. Vishnu Anant Mahajan v. ACIT in ITA No. 3002/Ahd./2009 dated 25-05-2012 to contend that depreciation was held to be statutory allowance and shall not be considered for disallowance u/s 14A of the Act as Section 14A of the Act deals with only expenditure incurred and not any statutory allowances and depreciation is a statutory allowance u/s 32 of the Act relying upon the decision of Hon'ble Supreme Court in the case of Nectar Beverages Private Limited v. DCIT (2009) 314 ITR 314(SC).

5. The AO rejected the contentions of the assessee firm and held that the basic objective of introduction of section 14A into the Act is to disallow the direct and indirect expenditure incurred in relation to income which does not form part of total

income. The assessee firm has invested in shares and mutual funds whose income would be exempt from tax. The assessee firm has received dividend income which is exempt from tax. The assessee firm has incurred interest on borrowed fund to the tune of 1.39 crores. The assessee firm has shown investment in mutual funds to the tune of Rs. 4.75 crores whose income would be exempt in the hands of the assessee firm. The AO held that the assessee firm case falls under Section 14A(3) of the Act. Thus the AO made a disallowance u/s 14A of the Act read with Rule 8D of Income Tax Rules, 1962 as under:-

Computation of 14A Disallowance as per Notification No. 45/2008 dated 24/3/2008

A	**Directly Attributed Expenses**			**Amount**
	Direct Expenses			
	Total Direct Expenses			**20,357**
B	**Interest Expenses**			
	Interest which cannot be directly attributed		1,38,68,778	
	Average value of Investment related to Tax free income			
	Opening Investment	5,22,02,950.00		
	Closing Investment	4,74,88,371.17	4,98,45,660	
	Average Total Assets in Balance Sheet			
	Opening Total Assets	50,37,32,643		
	Closing Total Assets	58,77,80,214	54,57,56,428	
	Interest Expenses			**12,66,679**
C	**Deemed Expenses**			

	Average Value of Investment related to			
	Tax free income			
	Opening Investment	5,22,02,950.00		
	Closing Investment	4,74,88,371.17	4,98,45,660	
	0.5% of Average Investments			**2,49,228**
D	**Total 14A Disallowance**			**15,36,264**

Thus, the AO disallowed expenses of Rs.15,36,264/- u/s 14A of the Act read with Rule 8D of Income Tax Rules, 1962 of the Act vide assessment orders dated 07-03-2013 passed u/s 143(3) of the Act.

6. Aggrieved by the assessment orders dated 07-03-2013 passed u/s 143(3) of the Act by the AO, the assessee firm filed the first appeal before the CIT(A) and contended that no expenditure has been incurred in earning of exempt income or even if the expenditure is incurred for earning an exempt income, it is not claimed as and by way of deduction while computing the total income , so the provision of Section 14A of the Act are not attracted in such case. The assessee firm submitted that it has received the dividend on mutual funds for which the assessee firm has to simply make an application for allotment of units and the partners are well educated to do themselves. The dividend income on same directly gets credited in assessee's bank account through ECS and hence the assessee firm has not incurred any expenditure of whatsoever nature for earning the exempt income , thus the question of any disallowance does not arise. The assessee firm submitted that no disallowance was made u/s 14A of the Act in the assessment year 2006-07 to 2008-09, but in the assessment year 2009-10 , a sum of Rs. 11,73,949/- was disallowed by the AO and confirmed by the CIT(A), against which the appeal is pending before the Tribunal .

The CIT(A) held that for the assessment year 2009-10 , The CIT(A) has held that the AO was justifying in invoking the provisions of Section 14A of the Act and working out disallowance as per the Rule 8D of Income Tax Rules, 1962 for which adequate reasons has been given by the AO and Rule 8D of Income Tax Rules, 1962 is applicable from the assessment year 2008-09 and same has to be applied in the case of the assessee firm . The CIT(A) held that there is no change in the position during the year vis-à-vis the preceding assessment year and the facts relating to the disallowance remains the same which was confirmed by the CIT(A) vide orders dated 30.12.2013.

7.Aggrieved by the orders of the CIT(A) dated 30.12.2013, the assessee firm filed the appeal before the Tribunal.

8.The assessee firm reiterated its submissions as made before the authorities below which are not repeated for sake of brevity. The assessee firm also submitted that disallowance of the interest paid on partners capital is to be deleted as the same is not covered u/s. 14A of the Act as the issue is squarely covered by the decision of Mumbai Tribunal dated 11.03.2015 in assessee firm's own case in the immediately preceding assessment year i.e. 2009-10 in ITA No. 6870/Mum/2012. The assessee firm contended that disallowance was deleted by the Mumbai Tribunal to the extent of disallowance u/s 14A of the Act on account of interest paid on capital contributed by the partners on the premise that there is direct relation between the share in the profit of the firm and the interest on capital account , then the said interest cannot be treated as an expenditure to be attributable for earning the dividend income and hence the Tribunal has deleted the addition to the extent of disallowance u/s 14A of the Act on account of interest expenditure which is not on the borrowed fund but on the capital contributed by the partners.

9.The ld. DR on the other hand relied upon the orders of the authorities below.

10. We have considered the rival submissions and perused the material on record including case laws relied upon. We have observed that the Mumbai Tribunal in ITA No. 6870/Mum/2012 in the assessee's own case for the assessment year 2009-10 has held as under:-

> "*We have considered the rival submissions as well as relevant material on record. It is pertinent to note that the profit of the partnership firm is distributed among the partners in the ratio of their profit sharing. The interest payment to the partners on their capital balance is not revenue neutral as the same is taxable in the hands of the partners. In a case, where no interest is provided on the capital account of partners, the corresponding profit/income of the partnership firm is assessed to tax and the share of the partner is exempt in their hands. Therefore, when there is a direct relation between the share in the profit of the firm and the interest on capital account then the said interest cannot be treated as an expenditure to be attributable for earning the dividend income. Accordingly, in the facts and circumstances of the case, we delete the addition to the extent of disallowance u/s 14A on account of interest expenditure which is not on the borrowed fund but on the capital contributed by the partners. Accordingly, this ground of the assessee's appeal is partly allowed.*"

The major issue in dispute in the instant appeal is ***purely a legal issue requiring us to adjudicate question of law*** and is with respect to the treatment of interest paid by the assessee firm to its partners on the capital contributed by the partners, i.e. whether it is an expenditure under the provisions of the Act or part of the profit distributable to Partners being merely appropriation of profits chargeable to tax in the hands of the partners u/s 28(v) of the Act ?.

Whether it is an 'expenditure' as is referred to in Section 14A of the Act incurred and attributable to in relation to earning of an exempt income?.

Whether it falls within the definition of Section 36(1)(iii) of the Act being an expenditure or it falls u/s 40(b) of the Act being an statutory allowance claimed by the assessee and therefore does not fall within ambit of 'expenditure' as envisaged under Section 14A of the Act ? .

The Mumbai Tribunal in ITA No 6870/Mum/2012 vide orders dated 11.03.2015 in assessee firm's own case, has held that the addition to the extent of disallowance u/s 14A of the Act on account of interest expenditure on capital contributed by the partner and which is not on borrowed funds but on the capital contributed by the partners of the assessee firm cannot be disallowed u/s 14A of the Act read with Rule 8D of Income Tax Rules, 1962 as there is a direct relation between share in the profit of the firm and the interest on capital of the partners and hence the interest cannot be treated as an expenditure to be attributable for earning the dividend income . The Tribunal vide its orders dated 11.03.2015 has deleted the addition to the extent of disallowance u/s 14A of the Act on account of interest expenditure which is not on the borrowed fund but on the capital contributed by the partners. , while the rest of disallowance as computed under Section 14A of the Act read with Rule 8D of Income Tax Rules,1962 was affirmed by the Tribunal, as disallowed by the AO and sustained by the CIT(A) in the first appeal.

Now, before we proceed further with this issue in the appeal, it is important to highlight that as emerging from the orders of the Mumbai Tribunal in the assessee firm's own case in ITA No. 6870/Mum/2012 for the assessment year 2009-10, the two important decisions of the Hon'ble Court/Tribunal were not brought to the notice of the Tribunal, namely:

1. Hon'ble Supreme Court decision in the case of Munjal Sales Corporation v. CIT (2008) 168 Taxman 43(SC) : 298 ITR 298(SC).

2. Ahmedabad Tribunal decision in the case of Shankar Chemicals Works v. DCIT (2011) 12 taxmann.com 461(Ahd.).

While the assessee firm , inter-alia, brought to the notice of the Tribunal, decision of Hon'ble Supreme Court in the case of CIT v. R.M.Chidambaram Pillai (1977) 106 ITR 292(SC) which is a decision pronounced by Hon'ble Supreme Court on 17th November 1976, which is a decision rendered prior to major and substantial amendment's in the scheme of taxation of Partnership firms and partners by the Finance Act,1992 , while the decision of Hon'ble Supreme Court in the case of Munjal Sales Corporation(supra) is a decision pronounced on 19.02.2008 which is a decision which considered the substantial and major amendment's to the scheme of taxation of the partnership firm and the partners by the Finance Act,1992 and the Hon'ble Supreme Court has discussed the impact on the taxability of partnership firm and its partners and settled the controversy , brought in by the substantial amendments made by the Finance Act,1992. **<u>We are also fully aware that law declared by Hon'ble Supreme Court is binding on all courts within the territory of India under Article 141 of Constitution of India which is binding on us and we are bound to follow the same.</u>** In the case of ***CIT* v. *Smt. Godavari Saraf* <u>[1978] 113 ITR 589 (Bom.)</u>,** the Bombay High Court held that the Judgment of non-Jurisdictional High Court was binding on the Tribunal if there were no contrary judgments .The above Judgment runs contrary to Article 141 of the Constitution as per which only the Supreme Court's Judgments are binding on all Courts within India. The **Bombay High Court in the case of *CIT* v. *Thane Electricity Supply Ltd.* <u>[1994] 206 ITR 727</u>**overruled the Judgment in the above case of *Godavari Saraf(supra)* holding that the decision of one High Court was not a binding precedent for another High Court or Lower Courts outside the jurisdiction.

Under the above background , we are now proceeding to adjudicate the issue in this appeal which, in our considered view, majorily deals purely with **<u>a legal issue being question of law</u>** as detailed by us.

The assessee firm has raised capital from the partners, on which interest of Rs.1.39 crores was paid. The assessee firm has made investments in Mutual Funds to the tune of Rs. 4.75 crores , income of which would be exempt from tax. The AO by invoking Section 14A of the Act read with Rule 8D of Income Tax Rules, 1962 has disallowed the interest expenditure paid to the partners of Rs.12,66,679/- incurred by the assessee firm in relation to earning of exempt income, which was sustained by the CIT(A) in the first apppeal. Now, the issue is before us for adjudication and the Mumbai Tribunal in assessee's own case for preceding assessment year in ITA No. 6870/Mum/2012 has held in the favour of the assessee firm.

The Finance Act, 1992, brought about far-reaching changes in the provisions of the Income-tax Act, 1961 pertaining to taxation of partnership firms. **One of the major changes effected was that the remuneration and interest paid to a partner were made allowable deductions in calculation of the firm's taxable income**, while on one hand, firms were subjected to tax at the maximum marginal rate. In order to allow these deductions of remuneration and interest to partners, section 40(*b*) of the Act was reframed. Under the present scheme of taxation of partnership firms, the firm is taxed as a separate entity at a maximum marginal rates on its income and the share of a partner in the income of the firm is not included in computing his total income. While computing the total income of the firm, salary and interest paid to partners are allowed as deductions subject to limits laid down in section 40(*b*) of the Act. However, such salary and interest are taxed in the hands of partners of the firm as income under the head 'Profits and gains of business or profession'. This scheme of taxation of partnership, which was introduced in the Act, by the Finance Act, 1992 with effect from April 1, 1993, has been designed with a view to avoid double taxation of the same income both in the hands of the firm and its partners. A partnership firm is accorded a distinct status assessable to tax as a separate entity under the Income-tax Act, 1961. Under section 2(*23*) of the Act, the terms 'firm', 'partner' and 'partnership' have the same meaning as in the Indian Partnership Act, 1932 with one difference, *viz.,* that for the purpose of the Income-tax Act, 'partner' includes a minor admitted to the benefits of partnership. The relationship between the partners and the incidence of the partnership are, thus, mainly governed according to the provisions of the Indian Partnership Act, 1932 and are subject to the conditions and formalities laid down under the provisions of the Income-tax Act and the rules made there-under.

Salary ,commission and interest payable to partners

The legal position as it existed prior to the amendment made by the Finance Act, 1992, was that any amount paid as remuneration to the partners, whether called salary, bonus, commission or by any other name and interest paid to partners, was required to be disallowed and added back to the income of the partnership firm under the provision of section 40(*b*) of the Act of the pre-amended Act. The result was that any payment so made was, on the one hand, disallowed in the hands of partnership firm while, on the other hand, on allocation of the profits or losses in the hands of the partners, the amount so paid was added to the income of the respective partners and their shares in the registered firm were determined accordingly.

The Finance Act, 1992 effected a material change in as much as the substituted section 184 of the Act permitted the payment of salary and commission to the partners subject to the condition that it was so authorised by the deed of partnership. The maximum percentage prescribed for payment of interest on the capital contributed by the partners or loan advanced by them to the firm has been prescribed at 18 per cent per annum (now reduced to 12 per cent per annum) while salary, commission or any other remuneration payable to the partners has been limited to the specified percentage of book profit.

The Finance Act, 1992 inserted a new clause (*v*) in section 28 of the Act which enumerates classes of income which are chargeable to income-tax under the head 'Profits or gains of business or profession', and it is under this clause that any interest, salary, bonus, commission or remuneration by whatsoever name called due to or received by a partner of the firm from such firm is to be charged under the head 'Profits and gains of business or profession', and, accordingly, all such payments to the partners are to be treated as income under the head 'Profits or gain of Business or Profession'.

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. Persons who have entered into partnership are individually called partners and collectively called a firm.

Section 4 of the Act provides for the charging of income-tax in respect of total income of the previous year of every person, at the rates prescribed in theFinance Act. Person has been defined under section 2(31) to include a 'firm'. By virtue of section 2(23), the words 'firm', 'partner' and 'partnership' have the same meanings as assigned to them under the Partnership Act, 1932 and that partner shall also include any person, who, being a minor, has been admitted to the benefits of partnership.

Under the Act, the partnership firm is treated as a separate taxable entity. The law relating to assessment of partnership firms underwent a sea-change effective from the assessment year 1993-94, whereby the distinction between registered and unregistered firms *qua* the question of assessment has been removed. Under the new scheme, all 'firms' as understood under the Indian Partnership Act are assessed as firms. This type of assessment is available only when the firm fulfils the requirements as stated in section 184 of the Income-tax Act.

HISTORICAL BACKGROUND

The position under the 1922 Act was that where a firm was unregistered, the tax payable by the firm itself was determined, as in the case of any other distinct entity and the levy was made on the firm itself. On the other hand, where a firm was registered, the firm itself did not pay any tax but each partner's share of profit was added to his other income and the tax payable by each partner on the basis of his total income was determined and the levy was made on the partners individually. There was, thus, no double taxation in this case.

Changes were effected by the Finance Act, 1956 whereby income-tax at a special low rate came to be assessed on registered firms and this came to be known as the registered firms' tax. The partners of such a firm were in addition liable to be taxed in their individual assessment in respect of their share in the firm's income. There was, thus, double taxation of the identical income, once in the hands of the registered firm and second time in the hands of the partners on allocation of the firm's income amongst them. This scheme of double taxation was criticized by the Law Commission in its 12th Report, 1958. The position under the 1961 Act was the same as existed after the 1956 amendment under the 1922 Act. Till 1969, rebate was permitted to a partner in respect of his share of the tax paid by the firm. From 1969 onwards, the provision for rebate was substituted by a method whereby the tax payable by the firm was straightway deducted from the total income of the firm before its apportionment amongst the partners. Further, the tax liability was dependent on the issue whether the firm was registered or not. In the case of a registered firm, the firm paid tax on its total income according to the rates specified for registered firms in the schedule. An unregistered firm was taxed at the rates applicable for individuals.

By the amendment introduced by the Finance Act, 1992 effective from April 1, 1993, the distinction between registered and unregistered firms has been removed and section 2(*39*) and section 2(*48*) of the Act have been omitted. A firm would be taxed as a separate entity and the share of the partner in the total income of the firm will not be included in calculating his total income, by virtue of section 10(*2A*) of the Act. **Further, subject to section 40(*b*) of the Act, remuneration and interest paid to a working partner would be deductible from the income of the firm, but would be taxed in the hands of the partners by virtue of section 28(*v*) of the Act.**

REQUIREMENTS OF SECTIONS 184 AND 185

If a firm stands constituted as a partnership firm under the Partnership Act, 1932 and the requirements as stated in section 184 of the Act are complied with, it would be assessed as a firm for the purposes of the Income-tax Act.

It is profitable to reproduce here circular no 636 dated 31-08-1992 explaining the changes brought in by The Finance Act,1992 to the scheme of taxation of partnership firm :

> ***"Finance Act, 1992***
>
> ***Taxation of firm's income***
>
> ***48.*** *Before the changes made by the Finance Act, the system of levy of tax on firms involved double taxation. The firm as such was taxed in respect of its total income at rates varying from 5% to 18% (the maximum rate being applicable at Rs. 1 lakh and above). After deducting the tax payable by the*

firm, the balance of income was distributed amongst the partners and they were again taxed at the appropriate rates. Further, the tax liability of a firm and its partners depended upon the question whether the firm was granted registration under the Income-tax Act or not. In the case of a registered firm, the firm paid tax on its total income according to the rates prescribed in the Schedule for registered firms. An unregistered firm was taxed at the rates applicable to individuals, with the share income included in the hands of the partners for rate purposes only. There has been a consistent demand for removal of the double taxation. A new scheme of assessment of firms has been introduced from assessment year 1993-94. The scheme is modelled after the scheme introduced by the Direct Tax Laws (Amendment) Act, 1987, with suitable modifications to take care of the difficulties pointed out in the context of the 1987 scheme. The scheme contained in Direct Taxes Laws (Amendment) Act, 1987 sought to tax firms at the maximum marginal rate after allowing interest and remuneration to partners. Further there was a rigorous definition of "Whole time working partners" to whom alone remuneration was payable. The deduction for remuneration and interest allowable to partners and allowing remuneration to any partner or partners at the discretion of the firm, have been suitably restructured.

48.1 <u>A firm will now onwards be taxed as a separate entity</u> *(sections 184 & 185). There will be no distinction between registered and unregistered firms, and clauses 39 and 48 of section 2 containing the definition of "registered firm" and "'unregistered firm" have been omitted.* ***<u>After allowing remuneration and interest to the partners, the balance income of the firms will be subject to maximum marginal rate of tax of income-tax,</u>*** *which will be 40% for assessment year 1993-94. The surcharge on income-tax will be* *at the rate of 12%, of the total tax, if the income exceeds Rs. 1,00,000. The earlier distinction between rates of income-tax for professional and non-professional firms has been removed.* ***Partners are not liable to tax in respect of the share of income from the firm. However, remuneration and interest allowed to partners will be charged to income-tax in their respective hands.*** *The only distinction between professional and non-professional firms will be in respect of slabs for allowing deduction to firms in respect of remuneration.*

48.*2 The share of the partner in the income of the firm will not be included in computing his total income [section 10(2A)]. However, interest, salary, bonus, commission or any other remuneration allowed by the firm to a partner will be liable to be taxed as business income in the partner's hand, [section 2(24)(ve) and section 28(v)]. An Explanation has been added to the newly inserted clause (2A) of section 10 to make it clear that the remuneration or interest which is disallowed in the hands of the firm will not suffer taxation in the hands of the partner. In case any remuneration paid to a partner is disallowed in the hands of the firm or the amount is varied in subsequent proceedings, the partner's assessment can be rectified [section 155(1A)].*

48.3 The gross total income of the firm is to be determined in the normal way under different heads as in the case of any taxable entity. The gross total income so computed is reduced by salary, bonus, commission, or any remuneration payable or paid to a partner [section 40(b)]. *Remuneration due to or received by a partner is not to be assessed as income under the head "Salaries" (Explanation 2 to section 15).* ***Any salary, interest, bonus,***

commission or remuneration due to or received by a partner in view of clause (v) to section 28 shall be chargeable to income-tax under the head "Profits and gains of business or profession".

48.4 *The payment of remuneration only to a working partner is allowable [defined in Explanation 4 to section 40(b)]. Only individuals are capable of being working partners.*

48.5 *The payment should be duly authorised by and in accordance with the terms of the partnership deed. These payments will be allowed as deduction only for a period beginning with the date of the partnership deed and not for any earlier period. Thus, if a partner is allowed a higher remuneration by varying the terms of the deed on a particular date, such higher remuneration cannot be allowed to him for any period prior to the said date. However, as the financial year 1992-93 had already commenced, by the time the Bill received the Presidential assent, it would not have been possible for assessees to change the partnership deed with effect from 1-4-1992. Therefore, the Finance Act has provided that for the previous year 1992-93 interest or remuneration would be allowed if the partnership deed provides for such payment any time during the accounting period. Thus for the previous year 1992-93, relevant to assessment year 1993-94, the terms of the partnership deed may be amended to have retrospective operation. There is no restriction as to the number of times the terms of a partnership deed may be changed during a previous year in so far as payment of salary, bonus, commission or other remuneration to a working partner is concerned. It is also possible that a partner who is not a 'working partner' may become a* *'working partner' at any point of time during a year (or vice versa). In such a situation also, the said terms of the deed may be suitably amended.*

48.6 *Of the aggregate payment to all partners by way of salary, bonus, commission or other remuneration up to Rs. 50,000 is fully allowable in the hands of the firm. In case the aggregate payment exceeds the limit of Rs. 50,000, certain monetary limits have been prescribed under section 40(b)(v) in the form of a percentage of "book profit" [defined in Explanation 3 to section 40(b)]. Up to a "book-profit" of Rs. 1,00,000 or a loss, in the case of a professional firm and Rs. 75,000, in the case of a non-professional firm, the limit is 90% of the "book-profit" or Rs. 50,000, whichever is higher. For "book-profit" exceeding Rs. 1,00,000 in the case of a professional firm and Rs. 75,000 in the case of a non-professional firm, the limit is 60% of the "book-profit" in this slab. For the balance of the "book-profit" after these two slabs, the limit is 40% .*

48.7 *Under the provisions of section 40A(2) an Assessing Officer can disallow any expenditure, if it is excessive, having regard to the legitimate needs of the business. There have been several representations on this issue. A demand has been raised that this provision should not be used in the case of remuneration paid by a firm to its partners, since a ceiling is already separately provided. The Finance Minister, in his speech dated 30-4-1992 in Parliament during the Budget discussion stated as follows:*

> *"There seems to be some apprehension that the provisions of section 40A(2) of the Income-tax Act, may be indiscriminately resorted to by the Assessing Officer to make disallowance out of salary paid to the partners as being excessive. The Central Board of Direct Taxes will be*

> *asked to issue instructions to the Assessing Officers so as to ensure that this power is not used in the case of small firms and even otherwise, it should be used sparingly."*

The Assessing Officers who invoke the provisions of section 40A(2) in any case, must keep in mind the assurance given by the Finance Minister to Parliament.

48.8 ***Interest paid to a partner would be allowed as a deduction in the hands of the firm. The payment of interest should be in pursuance of the partnership deed. The maximum rate of interest allowed would be 18% simple interest per annum [section 40(b)(iv)].***

48.9 ***Changes have been made in the scheme of set off and carry forward of losses.*** *The existing provisions relating to firms and their partners in sections 76 and 77 have been omitted.* ***Under the new scheme, the firms are treated as a separate entity and the losses suffered by them would be allowed to be carried forward in their hand only.*** *There would be cases where brought forward losses apportioned to a partner have not been set off in the hands of the partner prior to assessment year 1992-93. A provision has been made for dealing with brought forward losses pertaining to assessment years prior to assessment year 1993-94. In such cases, the carried forward losses of a partner will be allowed as a set off in the assessment income of the firm subject to the condition that the partner continued to remain a partner in the said firm (section 75).*

48.10 *Although, the distinction between a registered and unregistered firm has been removed, a partnership will be assessed as a firm only if—*

(i) the partnership is evidenced by an instrument; and

(ii) the individual shares of the partners are specified in that instrument.

A copy of the partnership instrument duly certified has to accompany the return of income for the relevant year for which assessment as a firm is first sought. Thereafter, assessment as a firm will continue to be made so long as the constitution of the firm remains unchanged. Whenever there is a change in the constitution of a firm, a copy of the new partnership instrument has to be similarly filed. Where a firm does not comply with the provisions of section 184 for any assessment year, the firm shall be assessed as for the assessment year in the same manner as an association of persons and all the provisions of this Act shall accordingly be applicable (section 185).

[Sections 3, 4, 6, 11, 16, 35, 36, 39, 40, 41, 49, 62 to 69, 83, 84, 86 and 88]

Modification of the provisions regarding deduction of tax at source

49. *Under the provisions of section 194A of the Income-tax Act, deduction of income-tax at source is to be made from interest in respect of time deposits with banks, etc., at the rates in force. Similarly, under the provisions of section 194H of the Act, deduction of income-tax at source is to be made from income by way of commission (other than insurance commission) or brokerage, at the rate of ten per cent thereof. These changes came into force from 1st October, 1991."*

Thus, We have seen that Finance Act,1992 has brought major and substantial changes in the scheme of taxation of partnership firm and partners. The interest paid to partner is allowed as deduction while computing income of the firm under the Act to the extent of 18 percent per annum (now 12 percent per annum) , while the interest paid to partner to the extent as is allowed as deduction while computing income of the firm under the Act, is charged to tax as income of the partner under the head 'Profit and Gains of Business or Profession', under the new scheme of taxation of partnership firm. The firm shall be allowed as deduction of the interest paid to partner to the extent of 18/12 percent per annum even though there are no profits in the hands of the firm and the un-absorbed losses are allowed to be carried forward to the subsequent years by the partnership firm, while the partner income shall be computed after including interest paid to the partner to the extent allowed as deduction as per limit prescribed u/s 40(b)(iv) of the Act.

The assessee firm has contended that the said interest is nothing but profit of the firm , as the interest to partners is not allowed as deduction under Section 30 to 37 of the Act but u/s 40(b) of the Act and hence interest on capital paid to partner is nothing but statutory allowance and is part of allocable profits to the firm. This argument of the assessee firm is misconceived and fallacious. The Hon'ble Apex Court in the case of Munjal Sales Corporation v. CIT (2008) 168 Taxman 43(SC) has elaborately discussed the provisions of Section 30 to 38 of the Act vis-à-vis Section 40(b) of the Act and has settled the controversy by holding that interest paid to partners is an expenditure whereby claim of deduction u/s 36(1)(iii) of Act is to be firstly established by the taxpayer, and then Section 40(b)(iv) of the Act is not a standalone section but is a corollary section to Section 36(1)(iii) of the Act , restricting the deduction as per provisions of Section 40(b)(iv) of the Act, as under:

> ***"9.*** *The basic question which arises for determination is : whether section 40(b) of the 1961 Act is a stand-alone section or whether it operates as a limitation to the deduction under sections 30 to 38 of the 1961 Act?*
>
> ***10.*** *On the above question of law, Mr. S. Ganesh, learned senior counsel appearing on behalf of assessee, contended that prior to 1-4-1993, section 40(b) referred to disallowances per se but after the Finance Act, 1992 the said section 40(b)(iv) allows deduction, subject to the above limit of 18/12*

per cent per annum. According to learned counsel, section 40(b)(iv) talks about statutory deduction and that the question of disallowance comes in only to the extent that payment of interest to the partner exceeds 12/18 per cent per annum. In this case, according to learned counsel, all the conditions of section 40(b)(iv) have been satisfied and, therefore, the assessee was entitled to the benefit of deduction there under. In this connection, it was further argued that deduction under section 40(b)(iv) is not for expenditure; that it was a statutory deduction and that the contribution by the partner to the firm cannot be equated to a loan to the firm and that the former falls only under section 40(b)(iv) and, therefore, the said section 40(b) was a stand-alone section having no connection with the provisions of section 36(1)(iii) of the 1961 Act. Further, according to learned counsel, in this case section 36(1)(iii) had no application as this was a case of payment of interest to the partner on his capital contribution which cannot be equated to monies borrowed by the firm from third parties, hence the present case fell only under section 40(b)(iv) and not under section 36(1)(iii) of the 1961 Act.

11. *Mr. Prag P. Tripathi, learned Addl. Solicitor General appearing for the Department, submitted that object behind enactment of Finance Act, 1992 is not only to avoid double taxation but also to put the firm as an assessee on par with other assessees. In this connection, learned counsel submitted that in view of the changed language of section 40(b)(iv) of the 1961 Act, which is in the nature of a proviso, it can no longer be said that sections 30 to 38 are not applicable to the firm as an assessee and that it will apply to all other assessees. That, prior to 1-4-1993, section 40(b)(iv) disallowed* *interest paid to the partners but after 1-4-1993 the firm has to establish its claim for deduction under sections 30 to 38 and that it was not disentitled under section 40(b) would apply. According to learned counsel, section 40 is in nature of a proviso to sections 30 to 38 and, therefore, even if the assessee establishes its claim for deduction under section 36(1)(iii), it has still to prove that it is not disentitled under section 40(b)(iv). Therefore, according to learned counsel, after Finance Act, 1992 the assessee has to establish deductions under sections 30 to 38 and it has also to prove that it is not disentitled under section 40 of the 1961 Act, like any other assessee.*

12. *We quote herein below sections 36(1)(iii), 40(b) as it existed before 1-4-1993 and 40(b)(iv) after Finance Act, 1992 with effect from 1-4-1993 which read as follow :*

"36. Other deductions.—(1) The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—

*(i)and (ii)******

(iii)the amount of the interest paid in respect of capital borrowed for the purposes of the business or profession :-

****

Explanation.—Recurring subscriptions paid periodically by shareholders, or subscribers in Mutual Benefit Societies which fulfil such conditions as may be prescribed, shall be deemed to be capital borrowed within the meaning of this clause.

40. Amounts not deductible.—Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing *the income chargeable under the head 'Profits and gains of business or profession',—*

*(a)******

(b)in the case of any firm, any payment of interest, salary, bonus, commission or remuneration made by the firm to any partner of the firm;

Explanation 1.—Where interest is paid by a firm to any partner of the firm who has also paid interest to the firm, the amount of interest to be disallowed under this clause shall be limited to the amount by which the payment of interest by the firm to the partner exceeds the payment of interest by the partner to the firm.

Explanation 2.—Where an individual is a partner in a firm on behalf, or for the benefit, of any other person (such partner and the other person being hereinafter referred to as 'partner in a representative capacity' and 'person so represented' respectively,)—

(i)interest paid by the firm to such individual or by such individual to the firm otherwise than as partner in a representative capacity, shall not be taken into account for the purposes of this clause;

(ii)interest paid by the firm to such individual or by such individual to the firm as partner in a representative capacity and interest paid by the firm to the person so represented or by the person so represented to the firm, shall be taken into account for the purposes of this clause.

Explanation 3.—Where an individual is a partner in a firm otherwise than as partner in a representative capacity, interest paid by the firm to such individual shall not be taken into account for the purposes of this clause, if *such interest is received by him on behalf, or for the benefit, of any other person;"*

Section 40(b)(iv) after Finance Act ,1992 with effect from 1-4-1993 :

"40. Amounts not deductible.—Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head 'Profits and gains of business or profession',—

*(a)******

(b)in the case of any firm assessable as such,—

(iv)any payment of interest to any partner which is authorized by, and is in accordance with, the terms of the partnership deed and relates to any period falling after the date of such partnership deed insofar as such amount exceeds the amount calculated at the rate of eighteen per cent simple interest per annum;"

Issue

***13.** Whether the claim for special deduction made by the assessee exclusively came only under section 40(b)(iv) and that it never came under section 36(1)(iii) of the 1961 Act as argued on behalf of the assessee?*

Legal Position Explained

***14.** Before enactment of Finance Act, 1992, broadly speaking, payment of interest by the firm to any partner of the firm, constituted Business Disallowance per se. After Finance Act, 1992, section 40(b)(iv) of the 1961 Act places limitations on the deductions under sections 30 to 38. Prior to Finance Act, 1992, payment of interest to the partner was an item of*

Business Disallowance. ***However, after Finance Act, 1992, the said section 40(b) puts limitations on the deductions under sections 30 to 38 from which it follows that section 40 is not a stand-alone section.*** *Section 40, before and after Finance Act, 1992, has remained the same in the sense that it begins with a non obstante clause. It starts with the words 'Notwithstanding anything to the contrary in sections 30 to 38' which shows that even if an expenditure or allowance comes within the purview of sections 30 to 38 of the 1961 Act, the assessee could lose the benefit of deduction if the case falls under section 40.* ***In other words, every assessee including a firm has to establish, in the first instance, its right to claim deduction under one of the sections between sections 30 to 38 and in the case of the firm if it claims special deduction it has also to prove that it is not disentitled to claim deduction by reason of applicability of section 40(b)(iv). Therefore, in the present case, the assessee was required to establish in the first instance that it was entitled to claim deduction under section 36(1)(iii) and that it was not disentitled to claim such deduction on account of applicability of section 40(b)(iv).*** *It is important to note that section 36(1) refers to Other Deductions whereas section 40 comes under the heading 'Amounts not Deductible'. Therefore, sections 30 to 38 are Other Deductions whereas section 40 is a limitation on that deduction. It is important to note that sections 28 to 43C essentially deal with Business Income. Sections 30 to 38 deal with Deductions. Sections 40A and 43B deal with Business Disallowances. Keeping in mind the said scheme the position is that sections 30 to 38 are deductions which are limited by section 40. Therefore, even if an assessee is entitled to deduction under section 36(1)(iii), the assessee (firm) will not be entitled to claim deduction for interest payment exceeding 18/12 per cent per se. This is because section*

40(b)(iv) puts a limitation on the amount of deduction under section 36(1)(iii).

15. *It is vehemently urged on behalf of the assessee that partner's capital is not a loan or borrowing in the hand of a firm. According to the assessee, section 40(b)(iv) applies to partner's capital whereas section 36(1)(iii) applies to loan/borrowing. Conceptually, the position may be correct but we are concerned with the scheme of Chapter IV-D.* ***After the enactment of Finance Act, 1992, section 40(b)(iv) was brought to the statute book not only to avoid double taxation but also to bring on par different assessees in the matter of assessment. Therefore, the assessee-firm, in the present case, was required to prove that it was entitled to claim deduction for payment of interest on capital borrowed under section 36(1)(iii) and that it was not disentitled under section 40(b)(iv).*** *There is one more way of answering the above contention. Section 36(1)(iii) and section 40(b)(iv) both deal with payment of interest by the firm, for which deduction could be claimed, therefore, keeping in mind the scheme of Chapter IV-D every assessee who claims deduction under sections 30 to 38 is also requires to establish that it is not disentitled under section 40. It is in this respect that we have stated that the object of section 40 is to put limitation on the amount of deduction which the assessee is entitled to under sections 30 to 38. In our view, section 40 is a corollary to sections 30 to 38 and, therefore, section 40 is not a stand-alone section.*

****

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18. *Before concluding, we may mention that the importance of the judgment is the clarification which we were required to give in the context of* *deductions under sections 30 to 38 to be read with the limitation prescribed under section 40. Since there was some confusion with regard to the status of section 40, particularly, after enactment of Finance Act, 1992, we have explained the law in the context of deductions under Chapter IV-D of the 1961 Act. We have accepted the submissions advanced by the learned Addl. Solicitor General in that regard. However, the assessee succeeds in this batch of civil appeals on the peculiar facts of this case.*

***19.** Accordingly, the impugned judgments of the High Court are set aside and the civil appeals preferred by the assessee stand allowed with no order as to costs."*

The above decision of the Hon'ble Supreme Court in the case of Munjal Sales Corporation(supra) which has adjudicated the issue under the post amendment period effected by the Finance Act, 1992 where by substantial changes were effected to the scheme of taxation of partnership firm and the partners , was not brought to the notice of the Tribunal while adjudicating the appeal for assessment year 2009-10.We are bound by law to follow the decision of Hon'ble Supreme Court vide Article 141 of Constitution of India whereby the law declared by Hon'ble Supreme Court is binding on all Courts in the Territory of India , including us. The Principle of Res-judicata is strictly not applicable to the Income Tax Proceedings as was held by Hon'ble Supreme Court in the judgment of Radhasoami Satsang reported in 193 ITR 321 (SC). The Hon'ble Supreme Court in the case of Munjal Sales Corporation (supra) has held that the taxpayer has to first establish its claim of deduction with respect to the payment of interest u/s 36(1)(iii) of the Act and then the same shall be subject to limitation placed by Section 40(b) of the Act as Section 40(b) of the Act is not a standalone Section but is a corollary to Section 30 to 38 of the Act. Thus, the contention of the assessee firm is fallacious and misconceived that the interest on capital paid to partner is allowed u/s 40(b) of the Act being a statutory allowance and is not an expenditure being claim of deduction referred to in Section 30 to 38 of the Act viz. Section 36(1)(iii) of the Act and hence the contentions of the assessee firm that as per decision of Hon'ble Supreme Court in the case of CIT v. Walfort Share and Stock Brokers Private Limited (2010) 192 taxman 211 (SC) interest paid to partner on capital contribution cannot be treated as an 'expenditure' being incurred or attributable to earn exempt income u/s 14A of the Act as the said interest is itself not 'expenditure' but a 'statutory allowance' , cannot be accepted in view of the decision of the Hon'ble Apex Court in Munjal Sales Corporation(supra).

The Ahmedabad Tribunal in the case of Shankar Chemicals Work v. DCIT (2011) 12 taxmann.com 461(Ahd.) has under identical facts and circumstances passed an elaborate and detailed order and held as under:

> ***"5.*** *At the time of hearing before us, on behalf of the assessee, Shri S.N. Soparkar along with Shri Jaimin Gandhi appeared and filed a paper book containing 8 pages which, inter alia, include (1) submissions before CIT(A) - 1 to 4 pages, (2) Comparative tax working at page No. 5, (3) Balance-sheet & Profit & Loss A/c. at page Nos. 6 and 7 and (4) Alternative calculation of interest disallowance under section 14A at page No. 8. The first contention raised by the assessee is that no nexus is established. Therefore, following the decision of Hon'ble Gujarat High Court in the case of CIT v. Gujarat Power Corporation Ltd. [Tax Appeal No. 1587 of 2009, dated 28-3-2011] (unreported), the disallowance of Rs. 17,04,535 made under section 14A be deleted. As against this, the ld. D.R. pointed out that no interest-free funds*

were available to the assessee. Therefore, disallowance has rightly been made. It is pertinent to note that no interest-free funds were available. The investments were made from capital of the partners on which interest at the rate of 10.5 per cent per annum is paid. Therefore, this plea of the assessee's counsel is hereby rejected.

***5.1** The second plea raised by the ld. Counsel of the assessee is that as per clause (v) of section 28 of the Income-tax Act, 1961, interest paid to partner of a firm is chargeable to tax. Therefore, disallowance of interest under section 14A will amount to double disallowance. To buttress this contention, the ld. Counsel of the assessee submitted that firm and partners are not different entity. On the other hand, the ld. D.R. pointed out that firm in question is a registered firm. Interest on capital paid to partners amounting to Rs. 21,66,108 has been allowed under section 40(b)(ii) of the Income-tax Act, 1961. This expenses has been claimed against exempted dividend income. Therefore, whether this expense is claimed or allowed under section 36(1)(iii) or 40(b)(ii) will not make any difference for the purpose of applying provisions of section 14A of the Income-tax Act, 1961. In rejoinder, the Counsel of the assessee drew our attention to para 48 of circular No. 636 dated 31-8-1992 wherein CBDT has explained the provisions of Finance Act, 1992 regarding assessment of the firm. In the said circular in para 48.2, it is stated that shares of partner in a firm will not be included in computing his total income under section 10(2A). However, interest, salary, bonus, commission, or any other remuneration allowed by the firm to the partner will be liable to tax as business income in the partner's hand [sections 2(24)(ve)] and 28(v). An explanation has been added to the newly inserted clause (2A) of section 10 to make it clear that the remuneration or* *interest, which is disallowed in the hands of the firm, will not suffer taxation in the hands of the partner. Thus, if the interest is disallowed in case of the firm then it will not be taxed in the case of the partner. It may be noted that in case of the assessee firm, the partners to whom interest is paid are taxable at the maximum rate. He further submitted that amendment in the assessment of a firm has been made to avoid double taxation of the income. Interest paid to partners is distribution of profit allocated to the partners in the form of interest. Interest to partners can be taxed once either in the hands of the firm or in the partner's hand. It cannot be taxed in both places. Since, the partners have paid tax on interest received from the firm and all the conditions laid down in the provisions of section have been fulfilled, no portion of interest paid to partners can be disallowed. If it is disallowed, it will amount to double taxation.*

6. *We have heard both the sides on various pleas but we are not satisfied. We decide each and every contention raised by the ld. Counsel of the assessee. The first contention raised by him has already been rejected by us in para No. 5 above. Regarding the second contention raised by him that any disallowance of interest under section 14A will amount to double disallowance, we would like to point out that this contention is also devoid of any merit. For the purpose of deciding this aspect, we first reproduce the provisions of sub-section (1) of section 14A, which is as under :*

"14A. (1) For the purposes of computing the total income under this Chapter, no deduction shall be allowed in respect of expenditure incurred by the assessee in relation to income which does not form part of the total income under this Act."

6.1 *As per the provisions contained in section 14A(1) as reproduced above, we find that the expenditure incurred for earning exempt income shall not be considered for computing total income under Chapter IV. It implies that such expenditures are to be allowed as deduction, while working out exempt income under Chapter III. Hence under section 14A, only some specific treatment is to be given to those expenditure, which are incurred for earning exempt income. This treatment is this that those expenses should be disregarded for computing total income under Chapter IV and should be reduced from exempt income under Chapter III. Hence, there is no double addition or double disallowance. Partners have share in all the incomes of the firm. As per the aforesaid treatment in the hands of the firm regarding expenses incurred for earning exempt income, taxable income of the firm will increase and exempt income of the firm will go down by same amount and hence total of both will remain same. The total share of profit of the partner in the income of the firm will also remain same but his share in those income, which are exempt in the hands of the firm, will be less and the share in those income, which are taxable in the hands of the firm, will be more but the entire share of profit receivable by a partner from a firm is exempt and hence there is no impact in the hands of the partner. Since there is no disallowance as such in the hands of the firm and the expenditure incurred for earning exempt income are not allowed to be reduced from taxable income but can be reduced from exempt income, there is no effective disallowance in the hands of the firm for the expenses incurred for earning exempt income and hence there is no question of any double disallowance or double addition. Therefore, this plea of the ld. Counsel of the assessee is also rejected.*

6.2 *One more contention raised by the ld. Counsel of the assessee is that if at all any disallowance has to be made in the hands of the firm, direction should be given that, to that extent, interest income should not be taxed in the hands of concerned partners. In this regard, he drew our attention to the provisions of section 28(v), which reads as under :*

"28. (v) any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm :

Provided *that where any interest, salary, bonus, commission or remuneration, by whatever name called, or any part thereof has not been allowed to be deducted under clause (b) of section 40, the income under this clause shall be adjusted to the extent of the amount not so allowed to be deducted."*

6.3 *From the above proviso to section 28(v), it is seen that if there is any disallowance of interest in the hands of the firm due to clause (b) of section 40, income in the hands of the partner has to be adjusted to the extent of the amount not so allowed to be deducted in the hands of the firm. Hence, it is seen that the operation of the proviso to section 28(v) will come into play only if there is some disallowance in the hands of the firm under clause (b) of section 40 but in the present case, the disallowance is under section 14A and not under section 40(b) and therefore, the proviso to section 28(v) is not applicable and the partner of the assessee firm did not deserve any relief on this account. Moreover, before us is the assessee firm only and not the partners and hence, we do not give any direction on this aspect.*

6.4 *The ld. Counsel of the assessee also drew our attention to the provisions of sub-section (2A) of section 10 and its explanation and it has been* *contended that as per the provisions of this Explanation to section 10(2A), remuneration or interest, which is disallowed in the hands of the firm, will not suffer taxation in the hands of the partner. This contention of the ld. Counsel of the assessee is also devoid of any merit. We reproduce the relevant provision, which is as under :*

"10. (2A) In the case of a person being a partner of a firm which is separately assessed as such, his share in the total income of the firm.

Explanation.—For the purposes of this clause, the share of a partner in the total income of a firm separately assessed as such shall, notwithstanding anything contained in any other law, be an amount which bears to the total income of the firm the same proportion as the amount of his share in the profits of the firm in accordance with the partnership deed bears to such profits."

***6.5** From the above provision, we find that it has been specified in the same that share of a partner in the total income of a firm is exempt. There is no dispute on this aspect. What is being contended by the ld. Counsel of the assessee is this, that if any interest is disallowed in the hands of the firm, the same should not form part of total income in the hands of the partner but the Explanation to section 10(2A) does not support his case. In our humble understanding, as per this Explanation to section 10(2A), the total income of the firm, as assessed, should be considered and the share of the concerned partner should be worked out, as per its profit-sharing ratio, as specified in the partnership deed and such share of the relevant partner should be considered as exempt under section 10(2A). Hence, this contention of the ld. Counsel is also rejected.*

6.6 *Next contention raised by him is this that interest paid to partners is distribution of profit allocated to the partners in the form of interest and hence interest to partners can be taxed once, either in the hands of the firm or in the hands of the partner and it cannot be taxed in both hands. It is also his contention that since the partners have paid tax on interest received by them from the firm, no portion of interest paid to partners can be disallowed and if it is disallowed, it will amount to double taxation. This contention of the ld. Counsel is also devoid of any merit because interest to partners by the firm is not distribution of profit by the firm because interest is payable to the partners, if it is so prescribed in the partnership deed, even if there is no profit in the hands of the firm. If the firm pays interest to the partners and the firm is having loss, loss of the firm will increase to that extent and it will be allowed to carry forward in the hands of the firm and therefore, payment of interest by the firm to its partners is not distribution of profits by the firm to the partners. We have also observed somewhere in above paragraphs that there is no disallowance as such of interest in the hands of the firm and only the manner of allowing deduction on account of interest or other expenses incurred for earning exempt income is specified in section 14A, as per which, deduction on account of expenses incurred for earning exempt income cannot be allowed for computing total income under Chapter IV and hence, impliedly, the same has to be deducted from the exempt income to be computed under Chapter III. This contention of ld. Counsel of the assessee is also rejected.*

6.7 *One more contention has been raised by him that section 14A talks of disallowing expenditure incurred by the assessee in relation to exempt income and interest paid to partners is not an expenditure at all and it is a* *special deduction allowed to the firm under section 40(b). This contention of the ld. Counsel of the assessee is also devoid of any merit because there is no deduction allowed under section 40(b). In fact, section 40(b) is a restricting section for various deductions allowable under sections 30 to 38. As per clause (ii) of section 40(b), interest paid to any partner is not allowable, if it is not authorised by or not in accordance with the terms of the partnership deed. As per clause (iv) of section 40(b), it has been specified that even if payment of interest to partner is authorised and is in accordance with the terms of the partnership deed, the interest allowable should not be more than the amount calculated at the rate of 12 per cent simple interest per annum. Hence, we have seen that section 40(b) is actually restricting and regulating deduction allowable to the firm on account of payment of interest to partners and is not an allowing section. Hence, allowing section for allowing deduction of interest remands section 36(1)(iii) and therefore, the payment of interest to partners is also an expenditure only and therefore, the same is also hit by the provisions of section 14A, if it is found that the same has been incurred for earning exempt income. This contention is also rejected.*

6.8 *The last plea of the ld. Counsel of the assessee is that disallowance of interest should be restricted to Rs. 8,62,465, as per the working given at page 8 of the paper book. The ld. Counsel of the assessee explained that this is an alternative plea, without prejudice to ground No. 2. Elaborating this plea, the ld. Counsel of the assessee pointed out that the Assessing Officer disallowed the interest in proportion to amount of investment and total fund employed whereas it should be in proportion to taxable and non-taxable and payment of interest. This plea of the ld. Counsel of the assessee is also liable to be rejected because if any expenditure has been incurred for earning exempt* *income, the same has to be disallowed even if there is no actual earning of any exempt income. If interest-bearing borrowed funds are utilised for the purpose of investment in shares and there is no receipt of dividend income or if there is only meagre amount of dividend income, even then, the whole amount of interest expenditure incurred for this purpose will be subject to disallowance under section 14A because the same has been incurred for earning exempt income. Hence, the actual earning of exempt income is not relevant. In the earlier period, when dividend income was not exempt, interest expenditure incurred on borrowed funds used for investment in shares was held to be fully allowable expenses, even if, there was no actual receipt of dividend or insufficient/meagre amount of dividend income. The logic was that the entire expenditure has been incurred for earning taxable dividend income and hence, it is allowable, even if there is nil or small amount of dividend income. This aspect has been approved by various courts and hence, the same judgment supports this view also that even in case of 'nil' or small amount of dividend income, the entire interest expenditure incurred for making investment in shares is to be considered as expenditure incurred for earning exempt income and the same has to be disallowed under section 14A. Hence, this plea is also rejected.*

6.9 *In view of the above discussion, we are of the view that no interference is called for in the orders of the ld. CIT(A), as per which, he has confirmed the disallowance of interest of Rs. 17,04,535 which was made by the Assessing Officer under section 14A of the Income-tax Act. We are, therefore, inclined to uphold the order of the ld. CIT(A). Resultantly, all the grounds raised by the assessee in this appeal are rejected.*

7. *In the result, the appeal of the assessee is dismissed.*"

The above decision of the Ahmedabad Tribunal in the case of Shankar Chemicals Works(supra) was also not brought to the notice of the Tribunal while adjudicating appeal for the assessment year 2009-10. The Ahmedabad Tribunal after elaborately discussing the law in detail , after its amendment by the Finance Act,1992 has held that interest paid to partner on capital is an expenditure covered under the provisions of Section 36(1)(iii) of the Act and is not a statutory allowance u/s 40(b) of the Act and if this expenditure is incurred in relation to or attributable to earning of exempt income as envisaged u/s 14A of the Act, the same shall be allowed as an expense / deduction only against the exempt income earned by the taxpayer u/s 14 A of the Act or in other words shall suffer disallowance u/s 14A of the Act being incurred in relation to earning of an income which does not form part of the total income of the taxpayer.

We have observed that the assessee firm has relied upon following case laws:

a) CIT v. Walfort Share & Stock Brokers Private Limited(20100 326 ITR 1(SC)

b) CIT v. R M Chidambaram Pillai (1977)106 ITR 292(SC)

c) Nectar Beverages Private Limited v. DCIT(2009) 314 ITR 314

d) Vishnu Anant Mahajan v. ACIT in ITA no 3002/Ahd/2009(Ahd.-SB)-(2012) 22 taxmann.com 88

e) Maxopp Investments Limited & Ors. V. CIT (2012) 247 CTR 162(Del.)

f) Kodak India Private Limited v. Addl. CIT (ITA No 7349/Mum/2012)

g) ACIT v. SIL Investment Limited(2012) 50 SOT 54(Del.)

h) CIT v. Hero Cycles Limited (2010) 323 ITR 518(P&H.)

We will now review all the above decisions in the light of our above discussions as above:

a) CIT v. Walfort Share and Stock Brokers Private Limited (2010) 326 ITR 1(SC) , whereby the Hon'ble Supreme Court held that expenditure incurred as is referred to in Section 14A of the Act refers to the expenditure in respect to which allowance are provided u/s 30 to 37 of the Act . We have already discussed that the claim of deduction of interest on capital paid to partner is to be allowable firstly if all the conditions as stipulated u/s 36(1)(iii) of the Act is complied with, and that Section 40(b)(iv) of the Act is not a stand alone section and is a corollary to Section 36(1)(iii) of the Act and its object is to put limitation on the amount of deduction which the assessee firm is otherwise entitled to under Section 36(1)(iii) of the Act (Reference- decision of Hon'ble Supreme Court in the case of Munjal Sales Corp.(supra)). Hence, the reliance of the assessee firm on the decision of Walfort Share and Stock Brokers Private Limited(supra) is devoid of merit and is rejected.

b) CIT v. R M Chidambaram Pillai (1977)106 ITR 292(SC) – This decision has been rendered by Hon'ble Supreme Court under the Indian Income Tax Act,1922 read with Indian Income Tax Rules, 1922 for assessment years 1956-60 and 1960-61 , while the instant appeal is for assessment year 2010-11 whereby the scheme of taxation of partnership firm has gone substantial and major change by the Finance Act,1992 . The Hon'ble Supreme Court in 106 ITR 292 held that :

> *"First principles plus the bare text of the statute furnish the best guide light to understanding the message and meaning of the provisions of law. Thereafter, the sophisticated exercises in precedents and*

booklore. Here the first thing that we must grasp is that a firm is not a legal person even though it has some attributes of personality. Partnership is a certain relation between persons, the product of agreement to share the profits of a business. "Firm" is a collective noun, a compendious expression to designate an entity, not a person. ***In income-tax law a firm is a unit of assessment, by special provisions, but is not a full person*** *which leads to the next step that since a contract of employment requires two distinct persons, viz., the employer and the employee, there cannot be a contract of service, in strict law, between a firm and one of its partners. So that any agreement for remuneration of a partner for taking part in the conduct of the business must be regarded as portion of the profits being made over as a reward for the human capital brought in. Section 13 of the Partnership Act brings into focus this basis of partnership business.*

This legal ideology expresses itself in the Income-tax Act in section 10(4)(b) and section 16(1)(b). A firm, partner and partnership, according to section 2(6B) of the Act, bear the same sense as in the Partnership Act. The taxable income of a firm has to be its business profits, as provided in sections 10(1), 10(2) and 10(4). What is the real nature of the salary paid to a partner vis-a-vis the income of the firm? On principle, payment of salary to a partner represents a special share of the profits and is, therefore, part of the profits and taxable as such. And section 10(4)(b) stipulates accordingly. May be, we may usefully read here sections 10(1) and 10(4) to the extent relevant:

"10. (1) The tax shall be payable by an assessee under the head 'Profits and gains of business, profession or vocation' in respect of the profits or gains of any business, profession or vocation carried on by him……

(4) Nothing in clause (ix) or clause (xv) of sub-section (2) shall be deemed to authorise the allowance of any sum paid on account of any cess, rate or tax levied on the profits or gains of any business, profession or vocation or assessed at a proportion of or otherwise on the basis of any such profits or gains; and ***nothing in clause (xv) of sub-section (2) shall be deemed to authorise—…..***

(b) any allowance in respect of any payment by way of interest, salary, commission or remuneration made by a firm to any partner of the firm;…"

It is plain that salaries paid to partners are regarded by the Income-tax Act, as retaining the character of profits and not excludible from the tax net, whatever the reason behind it be*. The procedure for computation of the total income of a partner, found in section 16(1)(b) also fits into this understanding of the law behind the law. Section 16 (relevant part) reads thus:*

"16. (1) In computing the total income of an assessee—….

(b) when the assessee is a partner of a firm, then, whether the firm has made a profit or a loss, his share (whether a net profit or a net loss) shall be taken to be any salary, interest, commission or other remuneration payable to him by the firm in respect of the previous year increased or decreased respectively by his share in the balance of the profit or loss of the firm after the deduction of any interest,

salary, commission or other remuneration payable to any partner in respect of the previous year;

Provided that if his share so computed is a loss, such loss may be set off or carried forward and set off in accordance with the provisions of section 24;......."

The anatomy of the provision is obvious, even if the explanation or motivation for it may be more than one. It is implicit that the share income of the partner takes in his salary. The telling cost is that where a firm suffers loss the salaried partner's share in it goes to depress his share of income. Surely, therefore, salary is a different label for profits, in the context of a partner's remuneration.

The scheme of the Act, eyeing it with special reference to sections 10(4)(b) and 16(1)(b), designates employee's salary as profit, where the servant is none other than a partner, i.e., co-owner of the business. If such be the rationale of the relevant provisions, the key to the solution of the problem is within easy reach."

While the scheme of taxation of partnership firm has undergone substantial change by Finance Act,1992 where by now firm is taxed as a separate entity and allowance is made for deduction from income of the firm of payment of salary, bonus, commission or remuneration and of interest paid to partners as per provisions of Section 30 to 37 of the Act read with Section 40 of the Act . The salary, bonus, commission or remuneration so allowed as deduction while computing income of the firm shall be added to the income of the partners albeit under section 28(v) of the Act read with Section 2(24)(ve) of the Act while as per the *law as applicable prior to Finance Act,1992, the said salary, bonus, commission or remuneration payable to partner and interest paid to partner was added to the income of the firm being profit of the firm and tax was computed in the hands of the firm and Hon'ble Supreme Court in Munjal Sales Corporation 168 taxmann 43 holding that the expenses on account of salary,commission,bonus or remuneration and interest to partner has to be firstly satisfy the requirements of Section 30 to 38 of the Act and then Section 40 is merely a corollary to Section 30 to 38 of the Act limiting the deduction as per Section 40 of the Act . Thus, decision in R M Chidambaram Pillai in 106 ITR 292 cannot be applied under the new changed law post Finance Act,1992 whereby the partnership firm is taxed as a separate entity.*

c &d) Nectar Beverages Private Limited v. DCIT(2009) 314 ITR 314(SC) & Vishnu Anant Mahajan v. ACIT in ITA no 3002/Ahd/2009(Ahd.-SB)-(2012) 22 taxmann.com 88 – The reliance of the assessee firm on the above decisions to contend that since depreciation u/s 32 of the Act is held to be statutory allowance and cannot be considered as an 'expenditure' as envisaged u/s 14A of the Act for disallowance and on the same analogy interest paid on partner capital by the partnership firm cannot be considered as an expenditure u/s 14A of the Act is again misconceived as we have already observed that Hon'ble Apex Court in Munjal Sales corporation , 168 taxman 43 has already held that interest on capital paid to partner has to firstly satisfy the mandate of Section 36(1)(iii) of the Act while Section 40(b)(iv) of the Act is not a standalone section and is a corollary to Section 36(1)(iii) of the Act limiting the deduction. Thus, the contention of the assessee firm that interest paid to partner is a statutory allowance and cannot be considered as an 'expenditure' as envisaged u/s 14A of the Act for disallowance cannot be accepted and is rejected.

e &f) Maxopp Investment Limited & Ors. V. CIT (2012) 247 CTR 162(Del.) & Kodak India Private Limited v. Addl. CIT (ITA No 7349/Mum/2012)- The contention of the assessee firm that the AO should have recorded his dis-satisfaction with the correctness of the claim of the expenditure made by the assessee or with the correctness of the claim of the assesssee firm that no expenditure has been incurred by the assessee firm . In the instant case , we have observed that the AO is not satisfied with the claim of the assessee firm that it has not incurred any expenditure in relation to the earning of exempt income. The assessee firm has paid interest on partner capital to the tune of Rs.1.39 crore and has no other borrowings while investments to the tune of Rs 4.75 crores has been made in Mutual Funds out of partner's capital contribution which yield exempt income. The AO has by applying Rule 8D(2)(ii) of Income Tax Rules, 1962 has proportionately disallowed Rs.12,66,679/- as interest bearing funds being capital contribution by partners were utilised to invest in Mutual Funds which yielded tax free income to the assessee firm .Thus, the AO has duly complied with the provisions of Section 14A of the Act read with Rule 8D of Income Tax Rules, 1962 for making disallowance.The Hon'ble Bombay High Court has already held in the case of Godrej and Boyce Manufacturing Company Limited (2010) 194 Taxman 203(Bom.) that Rule 8D of Income Tax Rules, 1961 is applicable from assessment year 2008-09 and the assessment year under instant appeal is 2010-11.

g&h) ACIT v. SIL Investment Limited(2012) 54 SOT 54(Del.) & CIT v. Hero Cycles Limited (2010) 323 ITR 518(P&H.)- The contention of the assessee firm that the AO should have proved nexus of expenditure with exempt income before invoking provisions of Section 14A of the Act read with Rule 8D of Income Tax Rules, 1962 again is devoid of merits as the assessee firm has paid interest on capital to partners and the same funds are deployed to make investment in Mutual Fund and by applying Rule 8D (2)(ii) of Income Tax Rules, 1962 the proportionate disallowance as per formula provided in the said rule is made by the AO, the nexus of deployment of partner capital on which interest has been paid by the assessee firm in the Mutual Fund on which exempt income is to be earned is already proved by the AO. The said Rule 8D of Income Tax Rules, 1962 is held to be applicable w.e.f. assessment year 2008-09 by Hon'ble Bombay High Court in Godrej and Boyce Manufacturing Company Limited (2010) 194 Taxman 203(Bom.), while impugned assessment year is 2010-11. Thus, this contention of the assessee firm is also rejected.

We are bound by the decision of Hon'ble Supreme Court in the case of Munjal Sales Corporation (supra) and we also fully agree with the decision of Ahmedabad Tribunal in the case of Shankar Chemical Works(supra) . Moreover, under the new scheme of taxation of partnership firm introduced by the Finance Act,1992, the interest paid to the partner on capital has to be claimed as deduction u/s 36(1)(iii) read with Section 40(b) of the Act, from the income of the firm and if after allowing such interest , if the loss results in the hands of the firm, it will be allowed to be carried forward by the firm , while the partner shall be charged to tax for the total interest paid by the firm despite the fact that the firm could not claim the entire deduction due to absence of profits and resultant loss is to be carried forward to be set off against income of the subsequent years . Thus, we hold that interest paid by the assessee firm to the partners on capital contribution is covered as an 'expenditure' as envisaged u/s 36(1)(iii) of the Act and the assessee firm has to firstly establish its claim of deduction of interest on capital by satisfying the provisions of Section 36(1)(iii) of the Act and then, Section 40(b) of the Act puts limitation on allowability of interest once it passes the requirements of provisions of Section 36(1)(iii) of the Act and thus , interest paid to partners on capital contribution is not a statutory allowance u/s 40(b) of the Act but is an expenditure u/s 36(1)(iii) of the Act. Thus, if this expenditure is incurred in relation to the income which does not form part of the total income under this Act as envisaged u/s 14A of the Act, the same shall only be allowed as deduction only against the exempt income u/s 14A of the Act or in other words , such interest expenditure on the partner capital shall be disallowed u/s 14A of the Act. Our above discussions will also take care of the contention of the assessee firm that under the presumptive scheme of taxation under Section 44AD and 44AE of the Act, the salary and the interest payable to partner is deducted from the income of the firm computed under 44AD(1) and 44AE(1) of the Act , subject to the conditions and limits specified in clause (b) of section 40 , rather this contention of the assessee support the stand that the salary and interest payable to partners are an 'expenditure' covered under Section 30 to 37 of the Act as held by Hon'ble Supreme Court in Munjal Sales Corporation(supra) . Thus, we hold that 'expenditure' as envisaged by Section 14A of the Act, duly include interest paid to the partners by the assessee firm if the same is incurred in relation to the income which is not includible in the total income u/s Section 14A of the Act and in that circumstances this interest paid to partners are to be considered as allowable expenditure only against the exempt income u/s 14A of the Act provided other conditions are fulfilled. Thus, we hold that the interest on partner's capital to the tune of Rs.12,66,679/- as computed by the AO u/s 14A of the Act read with Rule 8D of the Income Tax Rules, 1962 is an expenditure , which is allowable as an expenditure being incurred by the assessee firm in relation to an income which does not form part of the total income of the assessee firm under the Act , and shall be allowed as deduction from the dividend income from Mutual Funds earned by the assesse firm as envisaged u/s 14A of the Act and shall go to reduce the exempt income earned by the assessee firm from dividend income from Mutual Funds as computed by the AO after applying provisions of Section 14A of the Act read with Rule 8D of Income Tax Rules, 1962 or in other words we uphold the disallowance of interest on partners capital to the tune of Rs 12,66,679/- u/s 14A of the Act read with Rule 8D(2)(ii) of Income Tax Rules,1962.. We further hold that these allowance / deduction of expenditure of Rs.12,66,679/- against the exempt income u/s 14A of the Act or in other disallowance u/s 14A of the Act, will not entitle the partner to claim relief in their individual return of income which shall be chargeable to tax as per the existing and applicable provisions of Section 28(v) of the Act read with Section 2(24)(ve) of the Act after including the afore-said interest income in the hands of the partners.

Further, the AO has computed disallowance of Rs. 20,357/- under Section 14A of the Act read with Rule 8D(2)(i) of Income Tax Rules, 1962 being direct expenses incurred by the assessee firm having being incurred on STT paid of Rs. 18,633/- and PMS charges of Rs.1,724/- paid to portfolio managers which is admitted to be paid by the assessee firm in relation to the earning of the exempt income, which disallowance we uphold .

The AO has computed deemed expenses @0.5% of average investment under Section 14A of the Act read with Rule 8D(2)(iii) of Income Tax Rules, 1962 as per method vide formula laid down under Rule 8D(2)(iii) of Income Tax Rules, 1962 to cover administrative and other indirect expenses, which disallowance also we uphold. It is noteworthy that Rule 8D of Income Tax Rules, 1962 is held to be applicable w.e.f. assessment year 2008-09 by Hon'ble Bombay High Court in the case of Godrej and Boyce Manufacturing Limited(supra).

11. In the result, the appeal filed by the assessee firm in ITA No. 994/Mum/2014 is dismissed.

ITA No.: 1562/Mum/2014(Revenue Appeal)

12. The Grounds of appeal raised by the Revenue in the memo of appeal filed with the Tribunal in ITA No. 1562/Mum/2014 read as under:

> *" 1. On the facts and the circumstances of the case and in law, the learned CIT(A) erred in deleting the disallowance u/s 40a(ia) of Rs.34,18,126/- holding that the assessee was using the services of overseas commission agent for procuring export orders and not for providing managerial/technical services attracting TDS.*
>
> *2. The appellant prays that the order of the CIT(A) on the above ground be set aside and that of the AO be restored."*

13. It was observed by the AO from the perusal of the Profit and Loss A/c that the assessee firm has claimed expenses on foreign commission of Rs. 34,18,126/- .The

assessee firm, during the course of assessment proceedings u/s 143(3) of the Act read with Section 143(2) of the Act has produced the details of commission payment as under:-

Sr. No.	Name	Amount
1.	Tawfiq Ahmed Al Rasheed	90127
2.	Mian Shafiq Ahmed Mushtaq	26946
3.	K.T Varindani	505147
4.	Doulat Aswani	2544625
5.	Mahesh Rupani	109541
6.	Bin Helabi Trading Est	117270
7.	Al Moudi (Shafif)	50490
		3444146
	Less: Last year provision but not to pay	26020
	Total	3418126

The AO observed that no tax was deducted at source by the assessee firm on such payments. The assessee firm was asked to explain why the expenses should not be disallowed u/s. 40(a)(i) of the Act The assessee firm submitted that circular No. 786 dated 07/02/2000 has clarified that in the case of non resident whose income is not liable to tax in India as per the provisions of the Act , on the payment of commission made to them which is either remitted through banking channels with due permission or as directly deducted from the sale proceed received in convertible foreign exchange , no tax is required to be deducted and the expenses on export commission and other related charges payable to a non-resident for services rendered outside India shall be allowed as deduction . The assessee firm submitted that CBDT has issued circular bearing no. 07/2009 dated 22.10.2009, whereby CBDT has withdrawn circular No. 23 dated 23.7.1969 as well as circular No. 786 dated 07.02.2000 . The said CBDT circular No. 7/2009 dated 22.10.2009 is applicable for the assessment year 2010-11 w.e.f. 22.10.2009 and not retrospectively and the instant assessment year is also 2010-11.

The assessee firm relied upon the decision of Hyderabad Tribunal in the case of DCIT v. Divi's Laboratories Limited in appeal no 601 to 604/Hyd./2009 whereby it was held that commission paid to non-resident agent for services rendered outside India not being chargeable to tax in India could not be disallowed u/s 40(a)(ia) of the Act and Section 195 of the Act clearly speaks that unless the Income is liable to be taxed in India, there is no obligation to deduct tax at source and Section 9 of the Act does not provide scope for taxing such commission payment because the basic criteria provided in the section is about genesis or accruing or arising of income in India, by virtue of connection with the property in India, control and management vested in India, which are not satisfied and hence withdrawal of earlier circular issued by CBDT has not been of assistance to Revenue in disallowing such expenditure.

The assessee firm submitted that non-resident agents book the orders on behalf of the assessee firm from their countries and send the same to the assessee firm for execution for which the commission is paid by the assessee firm through banking channels or buyer deduct the commission from the sale proceeds and give the same to the agents. The services are rendered by the agent in their country only and payments are also received in the foreign country on which no tax is deductible at source on these payments , which are claimed as business expenses by the assessee firm. The services by these agents were rendered abroad and no part of it is attributable to Indian Territory. The assessee firm submitted that no technical/managerial services were involved since non-resident agents are merely commission agents appointed to procure sale orders for the assessee firm and have not rendered any technical/managerial services. The assessee firm submitted that the nature of service referred by the agent were as under as per the confirmation submitted by the agents :-

"In connection with the above and as requested by you we hereby confirm of having received a commission of $..... for acting as your commission agent in our country. We are acting as commission agent on your behalf canvassing your business, visit the customers and procure business of textile items after knowing requirements of various customers discussing with you telephonically / by e-mail, again communicating with customers here and then fix the price and thereafter place orders on behalf of the prospective buyers with you as per samples given to us. Sometimes, we get samples from you which we show to various customers and book orders on your behalf. It is also placed on record after the goods are shipped from India you send a duplicate copy of documents. We contact the customers to get the documents released and thereafter not only follow up for the payments but ensure the timely payments of sale proceeds are received by you. At times, during your visits in our country we take you/ accompany you to have oral discussion with the customers, know their specific requirement, colors, designs and ensure your direct interaction with them.
We further confirm that for all the above services rendered by us in your country we get from you commission @..... %.

We confirm that we have neither any permanent establishment in India nor are assessed to tax in India."

The AO observed that these foreign agents are doing the following activities on behalf of the assessee firm:-

"

(i) The agent helps the company to facilitate and secure the overseas orders and collect the payments from different overseas.

(ii) He gets samples of products approved by the overseas buyers and book the new orders.

(iii) He helps in the development of new customized products Apart from that he helps by providing market feedbacks, information samples etc..

(iv) He carries out liaison work on behalf of the assessee.

(v) He coordinates with customers and follows up for payment if and when required.

(v) He gives the information about the new developments in the markets, competition and their products.

(vii) He facilitates the assessee's interaction with the customers during the visits to their respective countries. "

14. The AO concluded that these foreign(non-resident) commission agents are providing services which included broad gamut of services which include marketing of assessee's various products, providing information relating to the overall demand position of the concerned country and informing the assessee of the respective government policies, restrictions and requirements, providing information about the competition, their products, strength and weakness, coordinating existing customers, follows up for payment, providing information about the new development in the markets, trade affairs, exhibition and helps to the assessee in obtaining VISA.

Thus , the AO held that the payment made to the foreign commission agent are covered under managerial services and are not commission simply as claimed by the assessee firm. Thus, since the assessee firm has not deducted the tax at source, it is hit by the provisions of section 40(a)(i) of the Act and tax should have been deducted at source by the assessee firm u/s 195 of the Act or an application should have been made by the assessee firm for no deduction of tax at source u/s 195(2) of the Act . Thus the AO held that these payments to non-resident by assessee firm is income deemed to accrue or arise in India and chargeable to tax u/s 9(1)(vii) of the Act and as per the explanation to section 9(2) of the Act , the fees for technical services means any consideration for rendering of managerial , technical or consultancy services . The AO also held that as per explanation inserted to Section 9(2) by the Finance Act,2007 with retrospective effect from 01-06-1976 , the income of the non-resident is deemed to accrue or arise in India whether or not the non-resident has a resident or place of business or business connection in India. The AO relied upon the decision of the Hon'ble Karnataka High Court in the case of CIT v. Samsung Electronics (2009) 320

ITR 209(Kar.) , the AO also relied on the decision of Mumbai Tribunal in the case of ACIT v. Anchor Health and Beauty Care Pvt. Ltd. in ITA No. 7164/Mum/2008 for the AY 2004-05 which held that:

" in the light of the decision of Hon'ble Karnataka High Court and also in the absence of any contrary decision on this issue, I am of the view that the assessee cannot escape from taxation by virtue of provisions of section 40(a)(i) of the Act, in the event of non-payment of tax at source u/s 195 of the Act without obtaining clearance u/s. 195(2) of the Act. "

Hence in the light of above discussions, the AO held that the services offered by the agents are covered under managerial services that are included in fee for technical services (defined in explanation 2 u/s 9(1)(vii)) and since the assessee firm has not obtained the certificate u/s 195(2) of the Act, the payment made to foreign agent of Rs.34,18,126/- was disallowed by the AO u/s 40(a)((i) of the Act , vide assessment orders dated 07-03-2013 passed u/s 143(3) of the Act.

15. Aggrieved by the assessment orders dated 07-03-2013 passed by the AO u/s 143(3) of the Act, the assessee firm filed the first appeal with the CIT(A) and submitted that the AO erred in terming the payment as management service charges while the payment were made to persons abroad purely for procuring the business at the rates and other terms of the assessee firm and they had no authority to either reduce the price or change any other term of the supply. The commission agents is helping in securing the overseas orders and help in collecting the payments from the customers, the commission is paid for procuring orders while in collecting the payment, the agent does this for his own interest as the agents are paid only after sale proceeds are realized. The assessee firm submitted that the agent get samples of products sent by the assessee firm approved by the overseas buyers and the orders

cannot be obtained unless the samples sent by the assessee firm are shown to the buyers to get the orders . With respect to the AO holding that the agent helps in development of new customized products , market feed back and information etc. , the assessee firm submitted that agent has given the feedback of the market by informing the assessee firm what is in demand and ultimately it is the suppliers choice to develop the particular product or not and the agent has no say in the same. The assessee firm submitted that these agents tries to maximize the sale with the buyers to increase their commission and hence the amount of commission is paid for booking of the orders and by stretch of no imagination these are managerial/management services rendered by the said foreign agents. These services abroad by a non-resident for which payment is made abroad , income there from cannot be said to have accrued in India and hence cannot be brought to tax in India.

The assessee firm relied upon the decision of the Hon'ble Delhi High Court in the case of CIT v/s. Eon Technology Pvt. Ltd. (343ITR266(Del.)) wherein similar issue was decided in favour of the taxpayer . The assessee also relied upon the decision of Mumbai Tribunal in the case of Armayesh Global v. ACIT in ITA No. 8822/Mum/2010 dated 04.05.2012 whereby Mumbai Tribunal held that the taxpayer was using services of overseas commission agents for procuring export orders it was only acting as an agent on commission basis and had not been providing any managerial/technical services.

The assessee firm also furnished party-wise details of commission paid to non-resident agents for procuring business from 2006-07 to 2010-11, along with copies of P & L Account and Balance Sheet for those year. The assessee firm submitted that for the assessment year 2006-07, 2007-08 and 2008-09, no disallowance on account of commission payment has been made, whereas for the assessment year 2009-10, commission of Rs. 49,31,888/- on the above ground was disallowed by the AO , but was allowed by the CIT(A).

The CIT(A) observed that the commission payment of Rs. 34,18,126/- has been made to seven parties, out of which major payment of Rs. 25,44,625/- has been made to Shri Daulat Aswani a non-resident Indian, residing in Gambia, West Africa. Payment of commission to Aswani has been regularly made from financial year relevant to the assessment year 2006-07 onwards. In the assessment year 2009-10, payment of commission made was Rs.34,95,099/-. Of the remaining six parties, from the details it was observed that the commission payment to five parties was found regularly made every year. There is only one party i.e. Tawfiq Ahmed Al Rasheed to whom payment of Rs. 90,127/- has been made for the first time. The CIT(A) observed that payment of commission was discussed in details in the appellate order for the assessment year 2009-10.

The CIT(A) observed that the AO has given the findings which clearly shows that the agents did not render any managerial, technical or consultancy services including the provisions of services of technical or other personnel and they were made to facilitate and secure the overseas orders and to collect the payment from different overseas parties and to carry out liaison work, on behalf of the assessee firm. The CIT(A) observed that the facts in the case of the assessee firm are different from the facts in the case of Samsung Electronics(supra) decided by the Karnataka High Court . The CIT(A) held that there is nothing on record to suggest that these agents were providing managerial, technical or consultancy services and the agreement was for providing non-technical services . The CIT(A) referred to the decision of the Mumbai Tribunal in Armayesh Global 51 SOT 564(Mum.) and Mumbai Special Bench decision in Mahindra and Mahindra Limited (2009) 122 TTJ 577(Mum-SB.) whereby it was held that where for procuring export orders , the taxpayer was using services of overseas commission agent, it was only acting as an agent on commission basis and has not provided any managerial/technical services. The CIT(A) held that these commission agents were not having permanent establishment in India, amount in question did not accrue or arise in India and, thus, there was no need for deducting tax at source u/s. 195 of the Act . The CIT(A) referred to decision of the Mumbai Tribunal in the case of Yash Raj Films Private Limited (2013) 140 ITD 625. Thus, addition of Rs.34,18,126/- made by the AO u/s 40(a)(i) of the Act was deleted by the CIT(A) vide orders dated 30.12.2013.

16. Aggrieved by the decision of the orders dated 30.12.2013 passed by the CIT(A), the Revenue filed the appeal with the Tribunal.

17.The ld. DR relied upon the order of the AO.

18. On the other hand, The Ld. Counsel of the assessee firm reiterated its submissions as were advanced before the authorities below which are not repeated for the sake of brevity. The ld. AR submitted that the decision of Hon'ble Karnataka High Court in the case of Samsung Electronics(supra) has been over-ruled by the Hon'ble Supreme Court in the case of GE India Technology Centre Private Limited (2010) 7 taxmann.com 18 (SC). The ld Counsel of the assessee firm submitted that amount has been paid by the assessee firm to the commission agents for procuring orders and the same was not allowed by the AO , the assessee firm also relied on the decisions of the Mumbai Tribunal in the assessee's own case vide orders dated 11.03.2015 in ITA No. 6870/Mum/2012 & 7335/Mum/2012 for the assessment year 2009-10 and submitted that these expenses should be allowed as deduction while computing income of the assessee firm. The assessee firm also relied on the decisions of M/s. Indo Industries Ltd. v. ITO in ITA No. 183/Mum/2014, for the assessment year 2010-11 whereby the Tribunal allowed the claim of the taxpayer for deduction of commission paid to

various non-residents foreign brokers for rendering services outside India in relation to export orders and recovery of sale proceeds, whereby the said foreign brokers did not have place of establishment in India .

The assessee firm also contended that circular No. 07/2009 dated 22.10.2009 has been introduced prospectively and earlier circulars clearly stipulating no tax is to be deducted at source on payments of export commission to foreign brokers for services rendered outside India for sourcing export orders and for collecting payments which are withdrawn from 22.10.2009. The assessee firm submitted that these foreign agents did not have any PE in India and hence the disallowance cannot be made and assessee relied on the following decisions:-

Sr.No.	**Particulars**
1.	Commissioner of Income Tax v. Faizan Shoes Pvt. Ltd. 364 ITR -155 (Madras High Court)
2.	Commissioner of Income Tax v. Angelique International Ltd. 359 ITR - 9 (Delhi High Court)
3.	Commissioner of Income Tax v. Eon Technology Pvt. Ltd. 343 ITR – 366 (Delhi High Court)
4.	G.E.India Technology Centre Pvt. Ltd. v. CIT 327 ITR – 456 (S.C.)
5.	Director of Income Tax(International Taxation-II) v. Panalfa Autolektrik Ltd. 49 Taxmann.com 412 (Delhi)

The assessee firm contented that no managerial/technical services has been rendered by these foreign agents and the commission on exports should be allowed.

19. We have considered the rival contentions and perused the material on record including case laws relied upon. We have observed that the assessee firm has paid the export commission of Rs. 34,18,126/- to the foreign agents for rendering services abroad in relation to sourcing of export orders and for collecting payments on behalf of the assessee firm, on which no tax was deducted at source by the assessee firm u/s 195 of the Act. The AO has disallowed the expenses of Rs. 34,18,126/- on account of export commission paid by the assessee firm u/s 40(i)(a) of the Act read with Section 195 of the Act by holding the said services to be managerial / technical services as defined under explanation 2 to Section 9(1)(vii) of the Act . The facts as emerging from records reveals that these foreign agents do not have any permanent establishment or any place of establishment in India .These foreign agents are operating in their respective countries and rendering services to the assessee firm from abroad and no part of the such income can be reasonably attributable to any operation carried out in India by these foreign brokers as per the facts which has emerged from records. The payments to said foreign brokers have been sent by the assessee firm from India directly to their bank accounts abroad through banking channels with the approval of Reserve Bank of India or payments are deducted by the foreign buyers from the payment due to the assessee firm for making payment to these foreign agents directly. We have observed from the facts as emerging from records that commission income neither accrued nor arose in India in view of the decision of Hon'ble Delhi High Court in the case of EON Technology Pvt. Limited , 343 ITR 366 (Del.) Revenue has not brought on record any cogent material to substantiate that there is any PE or business association in India of these foreign agents , nor any evidence is brought on record to establish that there is any portion of services rendered by these foreign agents from India. In our considered view, these foreign agents have rendered services for sourcing export orders and for collecting payments for and on behalf of the assessee firm which is their business income not liable to tax in India . The other services such as sample approvals etc. are incidental to the main activity of sourcing

of export orders by these foreign brokers for the assesssee firm . These services cannot be described as managerial, consultancy or technical services as contemplated under explanation 2 to Section 9(1)(vii) of the Act to come within deeming provisions of Section 9(1)(vii) of the Act, rather the foreign brokers have rendered services from abroad to the assessee firm for sourcing of export orders in favour of the assessee firm and collection of payments for the assessee firm. Under Section 9(1)(vii) of the Act , income is deemed to accrued or arise in India if fees payable for any technical services utilised in a business or profession in India or for earning any income from any source in India. Fees for technical services include managerial , technical or consultancy as stipulated in explanation 2 to Section 9(1)(vii) of the Act. The Hon'ble Delhi High Court in the judgment in the case of DIT v. Panalfa Autoelektric Limited (2014 49 taxmann.com 412(Delhi) for the assessment year 2010-11 has elaborately discussed the export commissions payable for generation of export orders in the hand of taxpayer and has held that these services cannot be held to be managerial, technical or consultancy services to fall within the definition as contemplated under explanation 2 to Section 9(1)(vii) of the Act and held that commission paid to foreign agent is for performing sales related activity i.e. procurement of order and does not constitute managerial services. The decision of Hon'ble Delhi High Court is reproduced as under:

> *"The present appeal by the Revenue, which arises out of proceedings under Section 195/197 of the Income-tax Act, 1961 ('Act', for short), relating to assessment year 2010-11 on an application filed by Panalfa Autoelektrik Ltd. (assessee, for short), requires adjudication of the following substantial question of law:—*
>
> > *"Whether the ITAT was right in holding that the commission paid to Agenta World Trading and Consulting Establishment for procuring export orders, is not fee for technical services under Section 9(i)(vii) of the Income-tax Act, 1961?"*
> >
> > **2.** *For the sake of clarity, we record that the impugned order passed by the Income Tax Appellate Tribunal ('Tribunal', for short) is dated 25th October, 2013 and was passed in ITA 4654/Del/2012.*

3. *The assessee made an application dated 16th February, 2010 under Section 195(2) for authorization to remit Euro 1,40,055.53 as commission for arranging export sales and realizing payments to Agenta World Trading and Consulting Establishment, a non-resident company registered in Liechtenstein. There is no Double Taxation Avoidance Agreement between India and Liechtenstein and, therefore, in the present appeal we are only concerned with the question of receipt, accrual or deemed accrual of the said income in India as per the mandate of the Act.*

4. *The Assessing Officer relying upon the decision of the Authority for Advance Rulings in In Re: Wallace Pharmaceuticals (P.) Ltd., In re [2005] 278 ITR 97/48 Taxman 347 (AAR) held that the commission payment to the non-resident company on procuring orders was taxable as 'fee for technical service' under sub-clause (b) to Section 9(1) (vii) of the Act. The initial direction that the tax should be deducted at source @ 20% recorded in the order dated 4th May, 2010, was modified/reduced to 10% vide order dated 8th November, 2010 after recording that deduction at a higher rate would not be applicable in the present case.*

5. *The Commissioner of Income Tax (Appeals), however, reversed the aforesaid finding holding that the commission payment in the present case was not in the nature of 'fee for technical service' and he distinguished the decision in the case of Wallace Pharmaceuticals P. Ltd. (supra). The said finding has been affirmed by the Tribunal in the impugned order.*

6. *In order to appreciate the controversy, we would first like to refer and interpret Sections 5(2), 9(1)(i) and 9(1)(vii) of the Act, though, the Assessing Officer in the present case had not invoked Section 9(1)(i) of the Act. The relevant provisions read as under:—*

'5. Scope of total income. —

** ** **

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which —

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1. — Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

** ** **

9. Income deemed to accrue or arise in India.—(1) The following incomes shall be deemed to accrue or arise in India-

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation-1 — For the purposes of this clause -

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;

** ** **

Explanation 4 — For the removal of doubts, it is hereby clarified that the expression "through" shall mean and include and shall be deemed to have always meant and included "by means of", "in consequence of" or "by reason of".

** ** **

(vii) income by way of fees for technical services payable by—

** ** **

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

** ** **

Explanation 2. — For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient, or consideration which would be income of the recipient chargeable under the head "Salaries".'

7. *Section 5(2) states that total income of a person, who is a non-resident, includes income from all sources which (a) is received or deemed to be received in India in such year by or on behalf of such person; (b) accrues or arises in India; or (c) is deemed to accrue or arise in such year in India. Explanation 1 of the aforesaid section clarifies that income accruing or arising out of India shall not be deemed to be received in India by reason of the fact that it is taken into account in a balance sheet prepared in India. We are required to decide, whether the commission paid to non-resident would be income deemed to be earned in India.*

8. *Section 9, as is clear from the heading itself, does not deal with income which is received or accrued or has arisen in India but deals with income which does not fall under any of the aforesaid categories. Section 9 creates a deeming fiction of income which is not received in India or accrues or arises in India but is deemed to accrue or arise in India. While interpreting a deeming clause, the courts have to be cautious that they should not expand the scope beyond what is mandated and required by the deeming clause. The deeming clause by its very nature enacts a fiction to treat what is unreal as real and, therefore, unless the situation is covered under the language of the provision, its scope should not be expanded and widened beyond what is clearly apparent and perceivable. In such cases, purpose should be ascertained why the legal fiction is created and then full effect should be* *given to it without being boggled down or bidden when it comes to the inevitable corollaries, because we imagine the unreal as real.*

9. *Section 9(1)(i) brings to tax income of a non-resident accruing or arising, whether directly or indirectly, through and from any business connection in India, or through or from any property in India etc.*

10. *What is meant by 'business connection' has been interpreted by the Supreme Court in the case of CIT v. R.D. Aggarwal & Co. [1965] 56 ITR 20 and subsequently inBarendra Prasad Ray v. ITO [1981] 129 ITR 295/6 Taxman 19 (SC). We need not dwell on the said aspect in detail for several reasons, though* ***Circular No. 23 dated 23rd July, 1969*** *issued by the Central Board of Direct Taxes would not be applicable as it stands withdrawn with effect from 22nd October, 2009 vide Circular No.7 of 2009. Firstly, the Assessing Officer had not invoked the said provision; secondly, as per Explanation 1 clause (a) to Section 9, in case of a business of which all operations are not carried out in India, only such part of income as is reasonably attributable to the operations carried out in India is deemed to be accrued or arisen in India under clause 9(1)(i). By Finance Act, 2012, Explanation 4 has been added with retrospective effect from 1st April, 1962, clarifying the expression "through" to have always meant and included, "by means of", "in consequence of" or "by reason of". There is no finding by the Assessing Officer and there is no allegation that a non-resident was carrying on any operation whatsoever in India. Thus, there is no question of attributing any income to operations carried on by the non-resident in India. No such argument has been addressed.*

11. *The Assessing Officer in his order under Section 195/197 of the Act has relied upon the judgment in the case of Wallace Pharmaceuticals (P.) Ltd. (supra), which has been distinguished on facts by the first appellate authority and the Tribunal. The factual matrix, including the agreement between the assessee and the non-resident and the terms, have not been spoken of by the Assessing Officer. These have been referred to and examined by the Commissioner of Income Tax (Appeals). But first, we examine Section 9(1)(vii) of the Act.*

12. *In the present case, clause (b) to Section 9(1)(vii) would be applicable as the respondent-assessee, the payer was a resident of India. The exceptions carved out under clause (b) are not applicable as it is not the case of the respondent-assessee that the fee paid* *was in respect of services to be utilised in business or profession carried out by the payer outside India, or for the purpose of making or earning of any income from any source outside India. The respondent-assessee's manufacturing unit was in India and it would be proper to hold that the source of income would be the manufacturing unit of the respondent-assessee in India, even if the sale proceeds were on account of exports.*

***13.** The main question and issue, which would arise is whether the payment made to the non-resident would be covered under the expression, "fee for technical services" as defined in Explanation 2 quoted above. There are three categories of technical services as per Explanation 2; managerial services, technical services and consultancy services, and it includes provisions for services of technical and other personnel albeit there are specific exclusions, but we are not concerned with the same in the present appeal.*

***14.** The expressions "managerial, technical and consultancy services" have not been defined either under the Act or under the General Clauses Act, 1897. The said terms have to be read together with the word 'services' to understand and appreciate their purport and meaning. We have to examine the general or common usage of these words or expressions, how they are interpreted and understood by the persons engaged in business and by the common man who is aware and understands the said terms. The expression "management services" was elucidated upon by this Court in J.K. (Bombay) Ltd. v. CBDT, [1979] 118 ITR 312/1 Taxman 537 in the following terms:—*

'6. It may be asked whether management is not a technical service. According to an Article on "Management Sciences", in 14 Encyclopaedia Britannica 747, the management in organisations include at least the following:

"(a) discovering, developing, defining and evaluating the goals of the organization and the alternative policies that will lead toward the goals,

(b) getting the organization to adopt the policies,

(c) scrutinizing the effectiveness of the policies that are adopted,

(d) initiating steps to change policies when they are judged to be less effective than they

ought to be."

Management thus pervades all organisations. Traditionally administration was distinguished from management, but it is now recognised that management has a role even in civil services. According to the Fontana Dictionary of Modern Thought, page 366, management was traditionally identified with the running of business. Therefore, management as a process is practised throughout every organization from top management through middle management to operational management.'

Recently this Court in CIT v. Bharti Cellular Ltd., [2009] 319 ITR 139/[2008] 175 Taxman 573 had observed:—

'The word "manager" has been defined, inter alia, as: "a person whose office it is to manage an organization, business establishment, or public institution, or part of one; a person with the primarily executive or supervisory function within an organization, etc., a person controlling the activities of a person or team in sports, entertainment, etc."

It is, therefore, clear that a managerial service would be one which pertains to or has the characteristic of a manager. It is obvious that the expression "manager" and consequently "managerial service" has a definite human element attached to it. To put it bluntly, a machine cannot be a manager.'

Reference can be also made to the decision of the Authority for Advance Rulings in Intertek Testing Services India (P.) Ltd., In re [2008] 307 ITR 418/175 Taxman 375, wherein it was elucidated:—

'First, about the connotation of the term "managerial". The adjective "managerial" relates to manager or management. Manager is a person who manages an industry or business or who deals with administration or a person who organizes other people's activity [New Shorter Oxford Dictionary]. As pointed out by the Supreme Court inR. Dalmia v. CIT [1977] 106 ITR 895, "management" includes the act of managing by direction, or regulation or superintendence. Thus, managerial service essentially involves controlling, directing or administering the business.'

15. *The services rendered, the procurement of export orders, etc. cannot be treated as management services provided by the non-resident to the respondent-assessee. The non-resident was not acting as a manager or dealing with administration. It was not controlling the policies or scrutinising the effectiveness of the policies. It did not perform as a primary executor, any supervisory function whatsoever. This is clear from the facts as recorded by the Commissioner of Income Tax (Appeals), which have been affirmed by the Tribunal. The Commissioner of Income Tax (Appeals) has quoted excerpts of the agreement between the respondent-assessee, who has been described as 'PAL', and the non-resident, who has been described as 'AGENTA'. The relevant portions thereof read as under:—*

"2. Appointment

(1) PAL hereby appoint AGENTA as its commission agent for sale of its products within the territory to the purchaser(s) during the terms of this agreement, subject to and in accordance with terms and conditions set out herein and AGENTA agrees to and accepts the same.

(2) It is agreed by and between the parties that AGENTA'S representations and acts on behalf and for PAL viz-a-viz any third party shall be legally binding on PAL only when the same are authorized by virtue of a written and signed authorisation executed by PAL in favour of AGENTA.

**   **   **

4. Commission

(a) PAL agrees and AGENTA accepts that the amount of commission payable to it shall be the difference between consideration which PAL receives in terms of the purchase contract/order form the purchaser(s) and the pre determined guaranteed consideration settled and agreed between the parties, as described in Annexure 1 annexed hereto;

(b) The parties agree that all the taxes applicable and required to be deducted in India to the transaction contemplated herein at the date of execution of this agreement and at any time in future during the terms of this agreement shall be deducted from the

commission (as described herein above) before the same is paid and transferred to the bank account of AGENTA (herein referred to as the commission payable)"

16. *The non-resident, it is clear was appointed as a commission agent for sale of products within the territories specified and subject to and in accordance with the terms set out, which the non-resident accepted. The non-resident, therefore, was acting as an agent for procuring orders and not rendering managerial advice or management services. Further, the respondent-assessee was legally bound with the non-residents' representations and acts, only when there was a written and signed authorization issued by the respondent-assessee in favour of the non-resident. Thus, the respondent-assessee dictated and directed the non-resident. The Commissioner of Income Tax (Appeals) has also dealt with quantification of the commission and as per clause 4, the commission payable was the difference between the price stipulated in the agreement and the consideration that the respondent-assessee received in terms of the purchase contract or order, in addition to a predetermined guarantee consideration. Again, an indication contra to the contention that the non-resident was providing management service to the respondent-assessee.*

17. *The Revenue, which is the appellant before us, has not placed copy of the agreement to contend that the aforesaid clauses do not represent the true nature of the transaction. The Assessing Officer in his order had not bothered to refer and to examine the relevant clauses, which certainly was not the right way to deal with the issue and question.*

18. *It would be incongruous to hold that the non-resident was providing technical services. To quote from Skycell Communications Ltd. v. Dy CIT [2001] 251 ITR 53/119 Taxman 496 (Mad), the word 'technical' has been interpreted in the following manner:—*

'Thus while stating that "technical service" would include managerial and consultancy service, the Legislature has not set out with precision as to what would constitute "technical" service to render it "technical service". The meaning of the word "technical" as given in the New Oxford Dictionary is adjective 1. of or relating to a particular subject, art or craft or its techniques: technical terms (especially of a book or article) requiring special knowledge to be understood: a technical report. 2. of involving, or concerned with applied

and industrial sciences: an important technical achievement. 3. resulting from mechanical failure: a technical fault. 4. according to a strict application or interpretation of the law or the rules: the arrest was a technical violation of the treaty.

Having regard to the fact that the term is required to be understood in the context in which it is used, "fee for technical services" could only be meant to cover such things technical as are capable of being provided by way of service for a fee. The popular meaning associated with "technical" is "involving or concerning applied and industrial science".'

19. *The said term was also interpreted by this Court in case of Bharti Cellular Ltd. (supra) where emphasis was laid on the element of human intervention, but we are not concerned with the said aspect in the present case. The non-resident had not undertaken or performed "technical services", where special skills or knowledge relating to a technical field were required. Technical field would mean applied sciences or craftsmanship involving special skills or knowledge but not fields such as arts or human sciences (see paragraph 24 below).*

20. *The moot question and issue is whether the non-resident was providing consultancy services. In other words, what do you mean by the term "consultancy services"? This Court in Bharti Cellular Ltd. (supra) had referred to the term "consultancy services" in the following words:—*

'14. Similarly, the word "consultancy" has been defined in the said Dictionary as "the work or position of a consultant; a department of consultants." "Consultant" itself has been defined, inter alia, as "a person who gives professional advice or services in a specialized field." It is obvious that the word "consultant" is a derivative of the word "consult" which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Consult has also been defined in the said Dictionary as "ask advice for, seek counsel or a professional opinion from; refer to (a source of information); seek permission or approval from for a proposed action". It is obvious that the service of consultancy also necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant.'

The AAR in the case of Advance Ruling P. No. 28 of 1999, In re [1999] 242 ITR 208/105 Taxman 218 (AAR - New Delhi) had observed:—

"By technical services, we mean in this context services requiring expertise in technology. By consultancy services, we mean in this context advisory services. The category of technical and consultancy services are to some extent overlapping because a consultancy service could also be technical service. However, the category of consultancy services also includes an advisory service, whether or not expertise in technology is required to perform it."

21. *The word 'consultant' refers to a person, who is consulted and who advises or from whom information is sought. In Black's Law Dictionary, Eighth Edition, the word 'consultation' has been defined as an act of asking the advice or opinion of someone (such as a lawyer). It may mean a meeting in which parties consult or confer. For consultation service under Explanation 2, there should be a provision of service by the non-resident, who undertakes to perform it, which the acquirer may use. The service must be rendered in the form of an advice or consultation given by the non-resident to the resident Indian payer.*

22. *In the present, case commission paid for arranging of export sales and recovery of payments cannot be regarded as consultancy service rendered by the non-resident. The non-resident had not rendered any consultation or advice to the respondent-assessee. The non-resident no doubt had acquired skill and expertise in the field of marketing and sale of automobile products, but in the facts, as notice by the Tribunal and the Commissioner of Income Tax (Appeals), the non-resident did not act as a consultant, who advised or rendered any counselling services. The skill, business acumen and knowledge acquired by the non-resident were for his own benefit and use. The non-resident procured orders on the basis of the said knowledge, information and expertise to secure "their" commission. It is a case of self-use and benefit, and not giving advice or consultation to the respondent-assessee on any field, including how to procure export orders, how to market their products, procure payments etc. The respondent-assessee upon receipt of export orders, manufactured the required articles/goods and then the goods produced were exported. There was no element of consultation or advise rendered by the non-resident to the respondent-assessee.*

23. *Decision in the case of Wallace Pharmaceuticals (P.) Ltd. (supra) is clearly distinguishable as in the said case the non-resident consultant had to perform several services in the nature of attending meetings on mutually agreeable dates and providing* *advice and counselling, which were in the nature of consultancy services as they entailed support from a product team, compliance with all legal and administrative formalities, including registration and marketing strategy, creation of entry into new markets, development and distribution channels, etc. The work being rendered was in the nature of services as a consultant to the Indian assessee. It included an element of advice and was certainly recommendatory in nature.*

***24.** The OECD Report on e-commerce titled, Tax Treaty Characterisation Issues arising from e-commerce: Report to Working Party No.1 of the OECD Committee on Fiscal Affairs dated 01st February 2001, has elucidated:—*

'Technical services

39. For the Group, services are of technical nature when special skills or knowledge related to a technical field are required for the provision of such services. Whilst techniques related to applied science or craftsmanship would generally correspond to such special skills or knowledge, the provision of knowledge acquired in fields such as arts or human sciences would not. As an illustration, whilst the provisions of engineering services would be of a technical nature, the services of a psychologist would not.

40. The fact that technology is used in providing a service is not indicative of whether the service is of a technical nature. Similarly, the delivery of a service via technological means does not make the service technical. This is especially important in the e-commerce environment as the technology underlying the internet is often used to provide services that are not, themselves, technical (e.g. offering online gambling services through the internet).

41. In that respect, it is crucial to determine at what point the special skill or knowledge is used. Special skill or knowledge may be used in developing or creating inputs to a service business. The fee for the provision of a service will not be a technical fee, however, unless that special skill or knowledge is required when the service is provided to the customer. For example, special skill or knowledge will be required to develop software and data used in a computer game that would subsequently be used in carrying on the business of allowing consumers to play this game on the internet for a fee. Similarly, special skill or knowledge is used to create a troubleshooting database that customers will pay to access over the

Internet. In these examples, however, the relevant special skill or knowledge is not used when providing the service for which the fee is paid, i.e. allowing the consumer to play the computer game or consult the troubleshooting database.

42. Many categories of e-commerce transactions similarly involve the provision of the use of, or access to, data and software (see, for example, categories 7, 8, 9, 11, 13, 15, 16, 20 and 21 in annex 2). The service of making such data and software, or functionality of that data or software, available for a fee is not, however, a service of a technical nature. The fact that the development of the necessary data and software might itself require substantial technical skills is irrelevant as the service provided to the client is not the development of that data and software (which may well be done by someone other than the supplier) but rather the service of making the data and software available to that client. For example, the mere provision of access to a troubleshooting database would not require more than having available such a database and the necessary software to access it. A payment relating to the provision of such access would not, therefore, relate to a service of a technical nature.

Managerial services

43. The Group considers that services of a managerial nature are services rendered in performing management functions. The Group did not attempt to give a definition of management for that purpose but noted that this term should receive its normal business meaning. Thus, it would involve functions related to how a business is run as opposed to functions involved in carrying on that business. As an illustration, whilst the functions of hiring and training commercial agents would relate to management, the functions performed by these agents (i.e. selling) would not.

44. The comments in paragraphs 40 to 42 above are also relevant for the purposes of distinguishing managerial services from the service of making data and software (even if related to management), or functionality of that data or software, available for a fee. The fact that this data and software could be used by the customer in performing management functions or that the development of the necessary data and software, and the management of the business of providing it to customers, might itself require substantial management expertise is irrelevant as the service provided to the client is neither managing the client's *business, managing the supplier's business nor developing that data and software (which may well be done by someone other than the supplier) but rather making the software and data available to that client. The mere provision of access to such data and software does not require more than having available such a database and the necessary software. A payment relating to the provision of such access would not, therefore, relate to a service of a managerial nature.*

Consultancy services

45. For the Group, "consultancy services" refer to services constituting in the provision of advice by someone, such as a professional, who has special qualifications allowing him to do so. It was recognised that this type of services overlapped the categories of technical and managerial services to the extent that the latter types of services could well be provided by a consultant.'

We broadly agree with the aforesaid observations. However, in the case of selling agents, we add a note of caution that taxability would depend upon the nature of the character of services rendered and in a given factual matrix, the services rendered may possibly fall in the category of consultancy services. Paragraphs 41 and 42 do not emanate for consideration in the present case, and effect thereof can be examined in an appropriate case [However, see CIT v. Estel Communication (P.) Ltd. [2009] 318 ITR 185 (Del) and Skycell Communications Ltd. (supra)].

***25.** Thus, the technical services consists of services of technical nature, when special skills or knowledge relating to technical field are required for their provision, managerial services are rendered for performing management functions and consultancy services relate to provision of advice by someone having special qualification that allow him to do so. In the present case, the aforesaid requisites and required necessities are not satisfied. Indeed, technical, managerial and consultancy services may overlap and it would not be proper to view them in watertight compartments, but in the present case this issue or differentiation is again not relevant.*

***26.** In view of the aforesaid discussion, the substantial question of law mentioned above has to be answered in favour of the respondent-assessee and against the appellant-Revenue. The appeal is accordingly dismissed. There will be no order as to costs".*

Revenue has to bring on record cogent material to prove that the technical knowledge is made available to the assessee firm which could be used in future . In the absence of cogent material, it could not be said that the foreign brokers have any managerial expertise and the services rendered by them is for their self-use and their own benefit to maximize commission income. Thus in our considered view, no income of these foreign agents have accrued or arisen in India or deemed to have accrued or arisen in India as contemplated u/s 9 of the Act to bring in within the fold of chargeability of tax under the Act and hence the same cannot be brought to tax within the provisions of the Act. As the instant appeal is for assessment year 2010-11 whereby vide circular no 07/2009 dated 22.10.2009, CBDT has withdrawn circular no 23 dated 23-07-1969 and circular no 786 dated 07-02-2000, we have to see the effect in context of withdrawal of earlier circulars. The Hon'ble Hyderabad Tribunal in the case of DCIT v. Divi's Laboratories Limited(2011) 131 ITD 271 (Hyd. Trib.) has discussed the effect of withdrawal of the circulars and held that :

*"**8.** We have considered the submissions of both the parties and perused the relevant material available on record. The moot question that arises out of these appeals is whether the payment of commission made to the overseas agents without deduction of tax is attracted disallowance under section 40(a)(ia) of the Act or not. Whether the payment in dispute made by way of cheque or demand draft by posting the same in India would amount to payment in India and consequently whether mere payment would be said to arise or accrue in India or not? First we will take up the issue whether the payment of commission to overseas agents with out deduction of tax is attracted disallowance under section 40(a)(ia) of the Act or not. We find that the CBDT by its recent Circular No. 7*

dated 22-10-2009 withdrawn its earlier Circular Nos.23 dated 23-7-2009, 163 dated 29-5-1975 and 786 dated 7-2-2000. The earlier circulars issued by the CBDT have clearly demonstrated the illustrations to explain that such commission payments can be paid without deduction of tax. Thus, the main thrust in such a situation is whether the commission made to overseas agents, who are non-resident entities, and who render services only at such particular place, is assessable to tax. Section 195 of the Act very clearly speaks that unless the income is liable to be taxed in India, there is no obligation to deduct tax. Now, in order to determine whether the Income could be deemed to be accrued or arisen in India, section 9 of the Act is the basis. This section, in our opinion, does not provide scope for taxing such payment because the basic criteria provided in the section is about genesis or accruing or arising in India, by virtue of connection with the property in India, control and management vested in India, which are not satisfied in the present cases. Under these circumstances, withdrawal of earlier circulars issued by the CBDT has no assistance to the department, in any way, in disallowing such expenditure. It appears that an overseas agent of Indian exporter operates in his own country and no part of his income arises in India and his commission is usually remitted directly to him by way of TT or posting of cheques/demand drafts in India and therefore the same is not received by him or on his behalf in India and such an overseas agent is not liable to income-tax in India on these commission payments. This view is fortified by the judgment of Apex Court in the case of Toshoku Ltd. (supra).

9. *It is pertinent to note that the section 195 of the Act has to be read along with the charging sections 4, 5 and 9 of the Act. One should not read section 195 to mean that the moment there is a remittance; the obligation to deduct TDS automatically arises. If we were to accept such contention, it would mean that on mere payment in India, income would be said to arise or accrue in India. These are the observations made in the judgment of Apex Court in the case of GE India Technology Centre (P.) Ltd. (supra), relied on by the learned counsel for the assessee, for the proposition that provisions relating to deduction of tax applies only to those sums which are chargeable to tax under the Income-tax Act. If the contentions of the department, are to be taken as correct, that any person making payment to a non-resident is necessarily required to deduct tax, then the consequence would be that the department would be entitled to appropriate the* *monies deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the Income-tax Act by which a payer can obtain refund. As per section 237 read with section 199 of the Act implies that only the recipient of the sum i.e., payee would seek a refund. In view of the above, hence, no tax is deductible under section 195 of the Act on commission payments and consequently the expenditure on export commission payable to non-resident for services rendered outside India becomes allowable expenditure and the same is outside rigors of the section 40(a)(ia) of the Act."*

Section 195 of the Act requires any person responsible for paying to any non-resident, any sum chargeable under the Act, to deduct the applicable tax at source. The Hon'ble Apex Court in the case of Transmission Corporation of AP Ltd. v. CIT (1999) 105 Taxman 742 (SC)and GE India Technology Centre Private Limited v. CIT (2010) 193 Taxman 234 (SC) has held that the obligation to deduct tax at source u/s 195 of the Act arises only when the payment is chargeable to tax under the provisions of the Act, in the hands of non-resident. Thus, determination of taxability of the income of the non-resident is governed by the provisions of the Act, rather than by the circulars issued by the CBDT.

We have also observed that Mumbai Tribunal in the decisions of M/s. Indo Industries Ltd. v. ITO in ITA No. 183/Mum/2014, for the assessment year 2010-11 has allowed the claim of the taxpayer for deduction of commission paid to various non-residents foreign brokers for rendering services outside India in relation to export orders and recovery of sale proceeds, whereby the said foreign brokers did not have place of establishment in India as under:

*"**9**. We have considered rival contentions, carefully gone through the orders of the authorities below and also deliberated on the judicial pronouncements cited before us in the context of factual matrix of the case. From the record we found*

that during the year assessee has paid commission to various non-resident foreign brokers amounting to Rs.92,14,509/- for rendering services outside India in relation to export orders and recovery of the sale proceeds. Nothing was brought on record by the AO to establish that the said non-resident brokers have their place of establishment in India because they were operating in their respective countries. The said non-resident brokers are not liable to any tax in India insofar as it is also not the case of Revenue that services were rendered in India, therefore, neither there was accrual nor receipt of income in India. We found that the non-resident brokers have not rendered any services in India, therefore, commission income neither accrued nor arose in India in view of the decision of the Hon'ble Delhi High Court in the case of ***Eon Technology Pvt. Ltd., 343 ITR 366 (Del)****. There is no dispute to the well settled proposition that provisions of Section 195 does not apply when no income is found to be taxable in India, therefore, there was no reason for making any disallowance under provisions of Section 40(a)(i) in view of decision of the Hon'ble Supreme Court in the case of* ***G.E.India Technology Centre Pvt. Ltd., 327 ITR 456****. There are also judicial pronouncements supporting this proposition, which are reported in* ***10 ITR 501(Trib), 86 ITD 102 and 10 ITR 147(Trib)****.*

10*. Payment of brokerage to the said non-resident brokers for non technical services is the business income of the payee and therefore, not liable to tax in India as was held in the case of* ***Sri Subharaman Subramanian, 30 taxmann.com 236 (Bang.)****. We do not find any merit in the contention of the learned DR that brokerage so paid to the non-resident brokers was fee for technical services. Our view is supported by the decision of the Delhi Bench of the tribunal in the case of* ***Adidas Sourcing Ltd., 28 taxmann.com 267 (Del)****. Even the amended section 9 applies only to technical services and not to brokerage. Accordingly, the payment of brokerage to non-resident did not attract the provisions of Section 9 r.w.s.195 as was held by the Delhi Bench in the case of* ***Angelique International Ltd., 28***

taxmann.com 219 (Del) *and Allahabad Bench of the Tribunal in the case of* ***Model Exims, 42 taxmann.com 446 (All)****.*

11*. In view of the above, we can safely conclude that merely because payments have been made from India, the same cannot be made liable to be taxed in India insofar as payment was made to non-resident for the services rendered outside India as was held in the case of* **Dr. Reddy"s Laboratory, 58 ITD 104 (Hyd.)***.*

12. In the result, appeal of the assessee is allowed."

We have also observed that the similar view have been taken by Delhi-Tribunal in the case of Welspring Universal v. JCIT, (2015) Taxmann.com 174(Del.-Trib.) for assessment year 2011-12 whereby the Tribunal held as under :

"This appeal by the assessee is directed against the order passed by the CIT u/s 263 of the Income-tax Act, 1961 (hereinafter also called 'the Act') on 8.7.14 in relation to the assessment year 2011-12.

2. *Briefly stated, the facts of the case are that the assessee is engaged in manufacturing of engineering items. The AO observed during the course of assessment proceedings that a sum of Rs.23,58,813/- was paid by the assessee as a foreign commission without deduction of tax at source. On being called upon to justify such non-deduction, the assessee tendered explanation which has been reproduced on pages 2-4 of the assessment order. Getting convinced with the assessee's submissions, the AO chose not to make any disallowance u/s 40(a)(i) of the Act. While exercising revisional power u/s 263 of the Act, the ld. CIT opined that in view of the amendment to section 195, the assessee was liable to deduct tax at source on such payment of commission to foreign parties. Having not done so, the ld. CIT held that the assessment order passed by the AO on this score was erroneous and prejudicial to the interests of the Revenue. In support of his conclusion, the ld. CIT also relied on the opinion of the Authority of Advance Ruling in SKF Boilers*

& Driers (P.) Ltd., Inre [2012] 343 ITR 385/206 Taxman 19/18 taxmann.com 325 (AAR - New Delhi) and Rajiv Malhotra, Inre [2006] 284 ITR 564/155 Taxman 101 (AAR - New Delhi). The assessee is aggrieved against the revisional order directing the AO to make disallowance u/s 40(a)(i) of the Act.

***3.** We have heard the rival submissions and perused the relevant material on record. There is no dispute on the factual aspect of the matter that the assessee paid commission to a non-resident for procuring export orders and such commission was paid without deducting tax at source. The assessee pleaded for the correctness of its action in not making such deduction u/s 195 by stating that the non-resident commission agent provided services outside India and, hence, the amount was not chargeable to tax in his hands. It goes without saying that liability for deduction of tax at source arises only when the amount is chargeable to tax in the hands of the payee. If the amount itself is not so chargeable to tax, the liability for deduction of tax at source is also obliterated.*

***4.** Firstly, we will endeavour to determine if the amount of commission is taxable in the hands of the non-resident agent. The scope of total income of a non-resident is governed by section 5(2) of the Act. This section provides that all income of a non-resident from whatever source derived which (a) is received or is deemed to be received in India in such year by or on behalf of such person or (b) accrues or arises or is deemed to accrue or arise to him in India during such year, shall be included in his total income. It is patent that the non-resident did not receive such income in India inasmuch as the assessee made payment for such commission to the non-resident outside India. Section 7 defines 'Income deemed to be received'. It refers to the annual accretion to the balance at the credit of an employee participating in a recognized provident fund; transferred balance in a RPF to some extent; and the contribution made by the Central Government or any other employer to the account of an employee under Pension Scheme referred to in section 80CCD. From the description of the contents of section 7, it can be seen that the commission received by a non-resident cannot be characterized as 'income deemed to be received' in India. The next ingredient of section 5(2) is the income which 'accrues or arises in India.' Since the chargeability to tax under this segment is attracted if the income accrues or arises to the non-resident in India, it becomes crucial to find out the* *place where income from export commission accrues or arises. In this regard, the source of accrual or arising of income cannot be relevant because the incidence of tax is attached with the place of accrual of income and not its source. Ordinarily, there can be several places involved in a transaction, such as, a place where an agreement is entered into or a place where services are actually performed or a place where the services are utilized or a place where entries are made in the books or a place where consideration is paid or received etc. In the context of rendering of services for procuring export orders by a non-resident from the countries outside India, there can be no way for considering the actual export from India as the place for the accrual of commission income of the non-resident. One should keep in mind the distinction between the accrual of income of exporter from exports and that of the foreign agent from commission. As a foreign agent of Indian exporter operates outside India for procuring export orders and further the goods in pursuance to such orders are also sold outside India, no part of his income can be said to accrue or arise in India. The last component of section 5(2) is income which 'is deemed to accrue or arise' in India. The expression - 'Income deemed to accrue or arise in India' - has been defined in section 9(1) of the Act. Sub-section (1) of section 9 has seven clauses. Clause (i) deals with income accruing or arising, whether directly or indirectly, through or from any business connection in India or from any property in India or through or from any asset or source of income in India or through the transfer of the capital asset situated in India. It is quite apparent that the commission income cannot be associated with the later contents of this clause, namely, any property or asset or source of income in India. At the most, it can be considered as having some 'business connection.' Explanation 3 to section 9(1)(i) provides that if business is carried on in India, only so much of the income as is attributable to the operations carried out in India, shall be deemed to accrue or arise in India. Thus, it is clear that in order to bring any income within the ambit of section 9(1)(i), it is sine qua non that the activity resulting into such income should be carried out in India. Notwithstanding the existence of a business connection in India, as even understood in the widest possible amplitude, an income will fall u/s 9(1)(i) only to the extent it results from the operations carried out in India. If no operations for earning such income from business connection are carried out in India, the applicability of clause* *(i) to this extent is ruled out. As, admittedly, the non-resident payee carried out his operations outside India, the command of clause (i) of section 9(1) cannot apply. The other six clauses of section 9(1), namely, clauses (ii) & (iii) dealing with income under the head 'Salaries'; clause (iv) dealing with 'Dividend'; clause (v) dealing with 'Interest'; clause (vi) dealing with 'Royalty'; and clause (vii) dealing with 'Fees for technical services', have no application to the facts and circumstances of the instant case. The amount of commission paid to the non-resident cannot be described as salary or dividend or interest or royalty or fees for technical services.*

***5.** The argument of the ld. DR that Explanation below section 9(2) will bring the instant case within the fold of section 9(1), is devoid of any merit. This Explanation simply states that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clauses (v) or (vi) or (vii) of sub-section (1) and shall be included in the total income of the non-resident whether or not the non-resident has a residence or place of business or business connection in India or the non-resident has rendered services in India. A bare perusal of the Explanation divulges that if there is some income of the non-resident which is in the nature of interest or royalty or fees for technical services, then, such income shall be deemed to accrue or arise in India irrespective of the non-resident rendering services in or outside India etc. The pre-condition for magnetizing this Explanation is that the income of the non-resident should be in the nature of interest or royalty or fees for technical services. It is only in respect of these three categories of incomes that the deeming provision is attracted notwithstanding the non-resident not having a place of business in India or not rendering services in India. As the commission income of non-resident does not fall in any of these three clauses, namely, (v), (vi) or (vii) of section 9(1) of the Act, we hold that Explanation below section 9(2) cannot help the Revenue's case.*

***6.** In view of the foregoing discussion, it is apparent that the commission income in the hands of the non-resident can neither be considered as received or deemed to be received in India or accruing or arising or deemed to accrue or arise to him in India in terms of section 5(2) of the Act. Once it is held that the commission income of a non-resident* *for rendering services outside India does not fall within the scope of his total income, it automatically implies that the same is not chargeable to tax in his hands.*

***7.** Sub-section (1) of section 195 provides that any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest or any other sum chargeable under the provisions of this Act, not being income chargeable under the head 'Salaries' shall, at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, shall deduct income-tax thereon at the rates in force. A circumspection of this provision indicates that in order to attract the withholding of tax on a payment made to a non-resident, it is essential that the sum should be chargeable to tax in the hands of the payee under the provisions of this Act. It is quite natural also because a liability for deduction of tax at source pre-supposes tax liability in the hands of the payee. If there is no tax liability in respect of the payments made to the payee, there can be no question of deducting any income-tax at source from such payment. Only if the amount is chargeable to tax in the hands of the recipient that the question of deducting any tax at source therefrom arises. In an earlier para, we have seen that the export commission is not chargeable to tax in the hands of non-resident in terms of section 5(2) of the Act. The natural outcome, which, therefore, emerges is that there can be no obligation of the assessee-payer to deduct tax at source on such commission payment to the non-resident.*

***8.** Now, we turn to the amendment to section 195, which has been invoked by the ld. CIT to fortify his view that the assessee was required to deduct tax at source before making payment of commission to the non-resident. Before evaluating such a submission, it would be apposite to consider the prescription of the Explanation 2, as under:—*

"Explanation 2. - For the removal of doubts, it is hereby clarified that the obligation to comply with sub-section (1) and to make deduction thereunder applies and shall be deemed to have always applied and extends and shall be deemed to have always extended to all persons, resident or non-resident, whether or not the non-resident person has -

(i) a residence or place of business or business connection in India; or

(ii) any other presence in any manner whatsoever in India."

9. A glance at the above Explanation inserted by the Finance Act, 2012 with retrospective effect from 1.4.1962 reveals that the obligation to comply with sub-section (1), for making deduction of tax at source by the payer, applies and shall be deemed to have always applied to all the persons, resident or non-resident, whether or not the non-resident person has a residence or place of business or business connection in India or any other presence in any manner whatsoever in India. The Explanation simply clarifies that the obligation to deduct tax at source in terms of section 195(1) is not restricted only to the residents, but also extends to the non-residents irrespective of such non-resident not having a place of business or a business connection in India etc. Since the main part of sub-section (1) of section 195 casts obligation for withholding of tax at source on the payer, thus, it becomes axiomatic that the Explanation 2 amplifying the scope of sub-section (1) of section 195 shall also apply to a payer and not a payee. As the extant assessee payer is a resident of India, it is even otherwise obliged to deduct tax at source from the payments made to non-resident in terms of the main sub-section (1), without applicability of the Explanation 2, if the requisite conditions as prescribed in the section are fulfilled. In other words, if a payment is made on account of any sum which is chargeable under the provisions of this Act, then, there will be an obligation to deduct tax at source. Per contra, if the amount is not chargeable to tax in the hands of the payee, then, no liability to deduct tax at source can be fastened on the payer. Thus it is vivid that the insertion of the Explanation 2 has not brought any change to the factual position obtaining before us. The effect of insertion of Explanation to section 195(1) is simply to clarify about liability of deductor. It has not done away with the pre-requisite condition of section 195(1) which mandates that amount should be chargeable to tax in the hands of the payee. In our considered opinion, the ld. CIT erred in invoking Explanation 2 to section 195(1) for treating the assessment order erroneous and prejudicial to the interest of the Revenue on account of non deduction of tax at source from the commission payment to the non-resident and the consequential non-making of disallowance u/s 40(a)(i) of the Act.

10. *The ld. DR vehemently accentuated on Circular no. 7 of 2009 to contend that with the withdrawal of the earlier benevolent circulars on this issue, the instant commission payment has become chargeable to tax in the hands of the payee and in the absence of the assessee having deducted tax at source, the ld. CIT was justified in setting aside the assessment order allowing deduction for such commission payment.*

11. *We do not find any force in this argument. It is relevant to note that* ***Circular no 23 dt. 23/07/1969*** *clarified that no part of the income of a foreign agent of Indian exporter arises in India and hence such an agent is not liable to income-tax in India on the commission. Then* ***circular no. 786 dt. 7/02/2000*** *further elaborated the consequence of Circular no. 23 by stating that since such commission income of foreign agent is not liable to tax in India, no tax is therefore, deductible at source undersection 195 and consequently the export commission payable to a non-resident for services rendered outside India is not disallowable u/s 40(a)(i) of the Act. Thereafter, Circular no. 7 dated 22/10/2009 was issued withdrawing, inter alia, the above two circular nos. 23 and 786. The legal position contained in section 5(2) read with section 9, as discussed above about the scope of total income of a non-resident subsisting before the issuance of circular nos. 23 and 786 or after the issuance of circular no. 786 has not undergone any change. It is not as if the export commission income of a foreign agent for soliciting export orders in countries outside India was earlier chargeable to tax, which was exempted by the CBDT through the above circulars and now with the withdrawal of such circulars, the hitherto income not chargeable to tax, has become taxable. The legal position remains the same de hors any circular in as much as such income of a foreign agent is not chargeable to tax in India because it neither arises in India nor is received by him in India nor any deeming provision of receipt or accrual is attracted. It is further relevant to note that the latter Circular simply withdraws the earlier circular, thereby throwing the issue once again open for consideration and does not state that either the export commission income has now become chargeable to tax in the hands of the foreign residents or the provisions of section 195 read with sec. 40(a)(i) are attracted for the failure of the payer to deduct tax at source on such payments.*

12. *Ex consequenti, we hold that the amount of commission income for rendering services in procuring export orders outside India is not chargeable to tax in the hands of the non-*

resident agent and hence no tax is deductible under section 195 on such payment by the payer. Resultantly, no disallowance is called for u/s 40(a)(i) of the Act.

13. *It can be seen that the ld. CIT relied on two decisions of the Authority of Advance Ruling in SKF Boilers & Driers (P.) Ltd. (supra) and Rajiv Malhotra (supra). It is correct that at least in SKF Boilers (supra),the Authority has held that the payment of commission on export orders is chargeable to tax u/s 5(2)(b) read with section 9(1)(i) of the Act. By an independent evaluation of the matter in the light of the provisions of section 5(2) read with section 9 of the Act, we have held above that the foreign commission is not chargeable to tax in the hands of the non-resident. Be that as it may, it is important to note that it is not a solitary precedent available on the subject. The Hon'ble jurisdictional High Court in DIT v. Panalfa Auto Elektrik Ltd. [2004] 272 CTR (Delhi) 117, has held that the services rendered by non-resident agent for procuring export orders for the assessee cannot be held as fees for technical services u/s 9(1)(vii) of the Act. In this case, the assessee made an application u/s 195(2) for authorization to remit certain amount as commission for arranging export sales and realizing payment to non-resident company. The AO held that the commission payment was taxable as fees for technical services u/s 9(1)(vii) of the Act. That is how, when assailed, the Hon'ble High Court held that the payment of commission cannot be considered as fees for technical services in terms of section 9(1)(vii) so as to call for any deduction of tax at source. The Hon'ble Madras High Court in CIT v. Faizan Shoes (P) Ltd. [2014] 367 ITR 155/226 Taxman 115/48 taxmann.com 48, has also held that no disallowance can be made u/s 40a(i) in respect of commission paid to non-resident agent for providing services outside India.*

14. *At this juncture, it is pertinent to note that we are dealing with an appeal against the order passed u/s 263 of the Act. It is settled legal position that there can be no revision on a debatable issue. The Hon'ble Supreme Court has held so in Malabar Industrial Co. Ltd. v. CIT [2000] 243 ITR 83/109 Taxman 66. This view has been reiterated by the Hon'ble Apex Court in CIT v. Max India Ltd. [2007] 295 ITR 282/[2008] 166 Taxman 188. In this case, the Hon'ble Summit Court held that when two views are possible and the ITO has taken one view with which the CIT does not agree, it cannot be treated as an* *erroneous order prejudicial to the interest of the Revenue, unless the view taken by the ITO is unsustainable in law. Adverting to the facts of the instant case, it can be seen that the AO, after considering certain decisions relied by the assessee favouring non-deduction of tax at source in the present circumstances, accepted the assessee's contention. The fact that the decision of the Authority for Advance Ruling, relied by the ld. CIT, favours the Revenue's case, at the maximum, makes the issue about deduction of tax at source from foreign commission, a debatable one. In view of such a cleavage of opinion, this debatable issue goes outside the purview of section 263 in the light of the above referred two Supreme Court judgments. We, therefore, set aside the impugned order.*

***15.** In the result, the appeal is allowed."*

Based on our above detailed discussions and reasoning, we hold that keeping in view the facts and circumstances of the instant appeal , the assessee firm is entitled for deduction of export commission of Rs.34,18,126/- paid to foreign agents for sourcing of export orders in favour of the assessee firm without deduction of tax at source u/s 195 of the Act , as these export commission payments to the foreign brokers in not a sum chargeable to tax in the hands of the foreign brokers as contemplated u/s 195 of the Act and is neither a fee for technical/managerial services as defined in explanation 2 to Section 9(1)(vii) of the Act to bring it to tax under fiction created by the deeming provisions of Section 9 of the Act. We order accordingly.

20. In the result, the Revenue's appeal is dismissed.

21. In the result, both the assessee firm's and Revenue's appeals are dismissed.

Order pronounced in the open court on Ist February , 2016

Sd/-	sd/-
(Shailendra Kumar Yadav)	(Ramit Kochar)
न्यायिक सदस्य / Judicial Member	लेखा सदस्य / Accountant Member

मुंबई Mumbai;

दिनांक Dated : 01 .02.2016

PS:- Pooja K.

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT – concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)

आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai