IN THE INCOME TAX APPELLATE TRIBUNAL
"L" BENCH: MUMBAI

BEFORE SHRI R. S. PADVEKAR, JUDICIAL MEMBER
AND SHRI R.K. PANDA, ACCOUNTANT MEMBER

ITA No.442/Mum/2009
(Assessment year: 2005-06)

M/s. Goldcrest Exports,
Devidas Mansion, 3rd Floor,
Merewather Road,
Colaba,
Mumbai -400 039 .... Assessee

Vs

ITO – 12(2),
Aayakar Bhavan,
Mumbai -400 020 ....Revenue
PAN: **AAAFT 1304 Q**

Assessee by: Shri K. Shivaram
Revenue by: Shri Aarsi Prasad

O R D E R

PER R. S. PADVEKAR, JM

The Assessee has filed this appeal challenging impugned order of the Learned CIT (A)-XII Mumbai for the assessment year 2005-06 dated 3.11.2008.

2. The first issue is disallowance of Rs.38,41,257/- u/s.40(a) of the Income-tax Act, which was in respect of the payment of compensation

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under the arbitration award to non-resident company. The facts pertaining to the issue which reveal from the record are as under.

3. The assessee firm is engaged in the business of export & import as well as trading in different commodities. The assessee had made the provision of Rs.38,41,257/- in respect of the compensation to be paid to foreign company namely M/S. Swissgen NV of London (UK) and claimed the same as an expenditure in the profit and loss account. The assessee has entered into a contract for supply of Indian Natural Whitish Sesame Seeds to M/s. Swissgen NV London, UK (in short foreign buyer). Two different contracts were entered into; One for 95 MT and another for 190 MT. One M/S. Radhasons International was broker through whom the contracts for sale were entered into by the assessee with the foreign buyer at the price of US $ 540/- per M.T. The assessee repudiated the contract on the ground that the seller did not obtain the export contract duly signed by the buyer and contract was merely signed by the broker. There was sum correspondence between foreign buyer and assessee-firm. The foreign buyer invoking arbitration clause and proceeded with FOSFA arbitration. The foreign buyer appointed an Arbitrator namely Mr. Derek Marshal and also asked the assessee to appoint the Arbitrator within 14 days. The Assessee did not opt to appoint Arbitrator. The foreign buyer claimed the compensation from the assessee through the arbitration proceedings to the extent of US $ 81,937.50. The Arbitrator passed the award determining the claim of the foreign buyer against the assessee of US $ 81,225, payable with interest @ 5% per annum from 3.11.2003 till the date of payment of awarded amount. The claim of the damages was base on the ruling rate of specified dates minus the contract price. The assessee contended that damages were nothing but difference in price ruling on the date of non-fulfilment of the contracts and contract prices. The Assessee, therefore, claimed the same u/s.37(1) of the Act. The

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Assessing Officer rejected the claim of the assessee by giving the following reasons:-

> *"(i) The act of compensation receivable for breach of contract can not be equated with 'operations which are confined to the purchase of goods in India for the purpose of export'.*
>
> *(ii) DTAA between India and UK does not define the term 'Business Profits' which is the subject matter of taxability under Article-7. The assessee has not brought any material on record to demonstrate that in the hands of foreign buyer the compensation amount would be business profits so that recourse to Article-7 may be allowed.*
>
> *(iii) DTAA between U.K. and India will apply only to the Resident of one or more country. Nothing is brought on record to suggest that M/s. Swissgen N.V. London, UK is a Resident of U.K.*
>
> *(iv) The compensation is taxable in India u/s.9(1)(i) since it is an income deemed to accrue or arise in India.*
>
> *(v) The assessee was required to deduct TDS u/s.195 on provision for compensation made in the Books for A.Y. 2005-06, which it has not done."*

4. Assessee challenged the disallowance before the Learned CIT (A) but without success who confirmed the same by giving following reasons

> *"2.3 I have considered the submission of the Appellant as well as the Asstt. order. The perusal of the Arbitration Award shows that the foreign buyer had contracted to purchase through Radhasons International. From the submissions made by the Appellant it could be seen that the Appellant was to pay 1% commission to Radhasons International in Mumbai. The Appellant is conveniently silent about the role played by Radhasons International. The status of Radhasons International as to its being a resident or a non-resident had not been clarified as to determine whether or not the foreign buyer had a permanent establishment through its agent Radhasons International. In view of the above, the Appellant's proposition that compensation paid cannot be held to accrue or arise in India is not acceptable. The compensation paid cannot be equated with the purchase of goods in India for the purpose of export as in the instant case there was no actual purchase of goods. The compensation*

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> *does not fall in the exception provided under explanation 1(b). Regarding the residential status of the foreign party, just filing a downloaded copy of a Web page does not establish the same and as such the reliance placed in the DTAA between India and UK becomes meaningless. Considering the above, the Appellant was liable to deduct tax u/s.195 on the compensation payable to the foreign party, which has been debited to the P&L A/c. The Assessing Officer is very much justified in disallowing the compensation of ₹ 38,41,257/- u/s 40(a). Accordingly, this ground of appeal is dismissed."*

5. Now, the assessee is in appeal before us.

6. We have heard the rival submissions of the parties and also perused the records as well as the paper book filed by the assessee. We have also considered the precedents cited by both the parties. The Learned Counsel argues that compensation paid by the assessee was in respect of its trading contract with M/s. Swissgen NV London, UK. It is argued that the arbitration award was passed in financial year 2004-05 more particularly on 13th August 2004 and the same was communicated to the assessee. The assessee challenged the said award in the Hon'ble High Court without success. The Learned Counsel also referred to the copy of the Arbitration award which is placed at page no.19 to 28 of the paper book. It is argued that, at the first instance, provisions of section 195(1) are not applicable for deducting the tax at source as the arbitration award was passed in UK and it cannot be said that the income has accrued to the foreign buyer to whom the payment was made. The Learned Counsel further argued that as per the provisions of DTAA between the India & UK, the compensation payable otherwise is also not taxable for the reason that the foreign company has not Permanent Establishment (in short PE) in India. He further submitted that as per Article 7.1 of the DTAA between India & UK, the compensation in the nature of the business profit and M/s. Swissgen NV

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London, UK which is a non-resident company has no PE in India as per Article 5 of the DTAA. It is argued that M/s. Radhasons International is an 'independent broker. He further pleaded that obligation to deduct tax at source u/s.195(1) arise only when the income of the non-resident is chargeable to tax in India. The Learned Counsel relied on the following precedents / decisions:-

(i) VAN OORD ACZ India (P) Ltd. vs. CIT 36 DTR 425 (Del)
(ii) ITO vs. Proceed Petition Ltd. 3 ITR 58 (Trib)(SB)(Del)
(iii) Mahindra & Mahindra vs. Dy. CIT (SB) 313 ITR 263 (AT)(Mum)
(iv) Royal Airways Ltd. vs. DDIT 98 ITD 259 (Del).

7. The Learned Counsel further argued that the Hon'ble Special Bench has already considered the decision of the Hon'ble High Court of Karnataka in the case of CIT vs. Samsung Electronics Ltd. 320 ITR 209. It is argued that, so far as the interest element in the compensation is concerned the same is merged with the compensation and it looses its original character and assumes the character of judgment debt. For the said proposition, he relied on the decision of Hon'ble High Court of Bombay in the case of Islamic Investment Co. vs. UOI 265 ITR 254. *Per contra*, the Learned D.R. supported the order of the A.O. as well as the Learned CIT (A) and submitted that in the case of Samsung Electronics Ltd.(supra) it is held that whether the income of the non-resident made taxable in India or not cannot be determined by the assessee as the said authority has vested with the A.O. u/s.197 of the Act. He further argued that so far as the present assessment year is concerned, the nature of the liability was the contingent one and it was not the ascertained liability.

8. We have already elaborately discussed the facts pertaining to the issue in controversy before us. The A.O. made a disallowance mainly on the reason that the assessee has not deducted the tax at source u/s.195

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of the Act, when the provision for compensation was made in the books of account and he made the disallowance u/s.40(a) of the Act. It is clear from the reasons given by both the authorities that the nature of the liability to pay compensation whether it is a contingent or ascertained was not any of the reasons for disallowing the claim of the assessee. The disallowance is made only on the reason that as per the provisions of section 40(a) of the Act the assessee failed to deduct tax. As per the copy of the Arbitration Award filed on record, it is seen that the M/s. Swissgen NV London, UK is shown as foreign company in the arbitration award dated 13.8.2004. The arbitration award has not disputed by both the parties. As per the arguments of the Learned Counsel, M/s. Swissgen NV London, UK is a non-resident and has no PE in India. In this case, one broker namely M/s. Radhasosns International was involved in the deal and it was an independent broker. The only reference of the DTAA in the assessment year is on the two point (i) assessee has not brought anything on record to demonstrate that the amount of the compensation would be the business profit within the meaning of article 7 of the DTAA between India & UK; and (ii) nothing is brought on record to suggest or prove that the foreign party is a Resident of UK and apart from that there is no discussion in the assessment order. The Learned CIT (A) was of the opinion that the status of the buyer namely M/s. Radhasons International whether it was a resident or non-resident had not been clarified. In our opinion, both the parties have not understood the issue in a proper prospective. So far as character of the compensation is concerned, in our opinion, it is a business profit and is covered under Article 7 of DTAA of UK and India as it is arising out of the trading contract entered into by the assessee and M/s. Swissgen NV London, UK. It appears that the said contract was through one broker M/s. Radhasons International, Mumbai.

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9. The next issue is to be determined whether there is any PE as per Article 5 of DTAA between India and UK. Nowhere it is a case of the A.O. as well as CIT (A) that Radhasons International was dependent broker. As per the facts on record, a contract was only supply of goods in India and nothing is there on record to suggest that M/s. Radhasons International was the dependent agent of the foreign buyer. The foreign buyer has no PE in India. As per Article 5(5) of DTAA, even if any business is carried out through a broker or general commission agent or any other agent of an independent status, then it cannot be said that the non-resident has PE in India. We, therefore, hold that as M/s. Swissgen NV London, UK has no PE in India and hence the compensation awarded under arbitration award was not taxable in India. So far as the decision of Samsung Electronics Ltd. (supra) is concerned, contrary view is taken by Hon'ble Delhi High Court in case of VAN OORD ACZ India (P) Ltd. (supra). Moreover, the Special Bench of the Tribunal in the case of Prasad Production Ltd. (Supra) has considered the decision of the Hon'ble Karnataka High Court in the case of Samsung Electronics Ltd. (supra). We, therefore, hold that there is no obligation on the assessee to deduct the tax u/s.195(1) of the Act. It is true that there is an element of the interest in the amount awarded, but this issue is also covered in favour of the assessee by the decision of Hon'ble jurisdictional High Court in the case of Islamic Investment Co. vs. UOI 265 ITR 254 (Bom). In the said case the Hon'ble High Court has held that the amount payable to the non-resident in view of the decree or arbitration award looses its original character and assumes the character of a judgment debt. In sum and substance, interest partake the character of the compensation. We, therefore, hold that for the reasons given hereinabove, there was no justification for disallowing amount of the compensation claimed by the assessee on the reason for non-deduction of the tax. We, therefore, delete the addition and allow the ground taken by the assessee.

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10. The next issue is disallowance of the telephone expenditure of Rs.60,790/-.

11. The assessee has debited telephone expenses of Rs.4,44,179/- to the profit and loss account. It was noticed by the A.O. that telephone expenses to the extent of Rs.47,004/- pertains to the telephones installed at the residence of the partners. The sum of Rs.1,96,160/- were pertaining to the mobile expenses of the partners & managers of the Firm. The A.O., therefore, made an *ad-hoc* disallowance of the 1/4th of Rs.2,43,164/-, which was in respect of the mobile expenditure + telephone installed at residence of the partners.

12. We have heard the parties. We have also perused the reasons given by both the parties. It is seen that nothing is there on record to show that the telephone was used for non-business purposes. If the assessee has claimed any expenditure and A.O. desires to make the disallowance then the proper way is to identify the element, which does not relate to the business of the assessee. In our opinion, the ad-hoc disallowance is not justified, hence, the same is deleted.

13. The Learned Counsel submitted that as per the instructions of the assessee, he has not claiming ground no.3 & ground no.4 that is in respect of business promotion expenses and legal and professional fees. As both the grounds are not pressed the same are dismissed as not pressed.

14. In the result, the assessee's appeal is partly allowed.

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Order pronounced in the open court on 7th day of September 2010.

Sd/-	Sd/-
(R.K. PANDA)	**(R. S. PADVEKAR)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Mumbai, Date: **7th September 2010**

Copy to:-

1) The Appellant.
2) The Respondent.
3) The CIT (A) –XII, Mumbai.
4) The CIT - XII, Mumbai.
5) The D.R. "L" Bench, ITAT, Mumbai.

By Order

/ / True Copy / /

Asstt. Registrar
I.T.A.T., Mumbai

*Chavan

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Sr.N.	Episode of an order	Date	Initials	Concerned
1	Draft dictated on	03.09.2010		Sr.PS
2	Draft placed before author	06.09.2010		Sr.PS
3	Draft proposed & placed before the second Member			JM/AM
4	Draft discussed/approved by Second Member			JM/AM
5	Approved Draft comes to the Sr.PS			Sr.PS
6	Kept for pronouncement on			Sr.PS
7	File sent to the Bench Clerk			Sr.PS
8	Date on which file goes to the Head Clerk			
9	Date of dispatch of Order			

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