IN THE ITAT CHENNAI BENCH 'B'
Deputy Commissioner of Income-tax, Company Circle - III(2)
v.
TVS Electronics Ltd.
ABRAHAM P. GEORGE, ACCOUNTANT MEMBER
AND VIKAS AWASTHY, JUDICIAL MEMBER
IT Appeal NO. 811 (MDS.) of 2010
[ASSESSMENT YEAR 2005-06]
MAY 25, 2012

ORDER

Abraham P. George, Accountant Member - This is an appeal filed by the Revenue against order dated 18.3.2010 of Commissioner of Income Tax (Appeals)-III, Chennai, for the impugned assessment year, in which two core issues have been raised by it. First is on a deletion of an addition made by the A.O. on account of unexpired value of Annual Maintenance Contracts received by the assessee during the relevant previous year. Second issue is regarding deletion of an addition of Rs. 1,04,50,458/- made by the A.O. for non-deduction of tax at source, invoking Section 40(a)(i) of Income-tax Act, 1961 (in short 'the Act').

2. Short facts apropos are that assessee engaged in manufacturing and sale of computer peripherals, had during the relevant previous year, entered into Annual Maintenance Contracts (AMC) with various customers to which it had sold its products. As per such AMCs, assessee was to provide maintenance support for a period of one year from the date of contract. Assessee had shown as income only that part of the revenue pertaining to the AMCs which fell within the relevant previous year. In other words, pro rata revenue for the period falling outside the previous year, was not offered as income. Explanation of the assessee was sought and reply of the assessee was as under:-

"As per accounting policy of the company, the revenue arising out of Annual Maintenance Contracts with customers in our products business (printers, UPS, etc) is recognized on accrual basis. This is determined based on period of contract as agreed while raising the commercial invoice for AMC on customers. For example if Rs. 600 is charged for one printer for a period of 12 months of contract, revenue is recognized at the rate of Rs. 50 per month starting from month 1 of AMC period.

Unexpired Service Contract represents the period falling due after the accounting period for which AMC is already charged in the invoice but for which revenue needs to be recognized in the later period. Hence the invoice value to the extent of unexpired period, is disclosed as current liability since the same is towards providing service to the customer, for a future period. This is in line with the AS 9 for Revenue Recognition and is stated in our notes to accounts."

Assessing Officer was not impressed. According to him, income accrued to the assessee at the time of raising the invoice for the AMC and therefore, assessee was bound to show the full amount as per AMC as its income. Though the assessee relied on the decision of Hon'ble jurisdictional High Court in the case of *CIT* v. *Coral*

Electronics (P) Ltd. (274 ITR 336), A.O. was of the opinion that in that case, there was indefiniteness regarding the service to be rendered, but here in assessee's case, the service to be rendered was defined and definite. He, therefore, made an addition of Rs. 3,68,19,800/- for the unexpired value of AMCs not offered by assessee as its income.

3. In its appeal before CIT (Appeals), argument of the assessee was that when it entered into AMCs, 100% revenue was received only as an advance. The AMCs were for a period of 12 months and a part of the 12 months period would always fall beyond the end of the financial year. The unexpired period of contracts represent liability of the assessee for meeting its maintenance obligations and therefore, corresponding revenue could not be recognized. In any case, as per the assessee, any customer could terminate their AMC agreement before the expiry of the contract and the assessee was bound to refund the amount pertaining to the unexpired period. CIT (Appeals) was appreciative of this contention of the assessee and deleted the addition made by the A.O.

4. Before us, learned D.R. submitted that CIT (Appeals) erroneously relied on the decision of Hon'ble jurisdictional High Court in the case of *Coral Electronics (P) Ltd.* (*supra*). According to him, in the said decision of Hon'ble jurisdictional High Court, the service to be rendered by the concerned assessee was not at all definite, whereas, it was clearly defined in the present case. When the assessee had raised invoices on its customers and received amounts too as per the AMC, assessee was bound to account for such income. Even under mercantile system, the funds which had been received by the assessee, had to be treated as income.

5. Per contra, learned A.R. supported the order of CIT (Appeals).

6. We have perused the orders and heard the rival submissions. There is no dispute that income not offered by the assessee pertained to unexpired period of AMC falling outside the end of the relevant previous year. There is also no dispute that a part of unexpired period always fell outside the relevant previous year, going into the subsequent year. There is also no dispute that assessee had recognized its income on pro rata basis for the duration of the AMC contracts in the relevant previous year. The clients of the assessee could at any point cancel the contract and get a refund for the unexpired period. This itself meant that the amount received by the assessee at the point of time it entered into an AMC was nothing but an advance, which on the progress of each day got converted into revenue. The income was accruing on a day-to-day basis based on the progress of time and it did not accrue on the day of entering into the contract. An obligation was there on the assessee to refund the unexpired value of AMC, if the AMC was cancelled by its customers. So, we cannot say that whole of the income had accrued to the assessee at the point of time it entered into the AMC. The obligation arising out of the contract as well as earning of the income ran side by side and progressed simultaneously. Therefore, contention of the assessee that it could not recognize revenue for the unexpired period of AMC is on strong footing. Principle of matching concept of income and expenses, comes to the aid of the assessee in such a situation. Assessee, in our opinion, was justified in its claim that income relatable to the unexpired period of AMC could be considered only in the subsequent year and not in the relevant previous year. CIT (Appeals), in our opinion, had taken a correct decision which does not require any interference.

7. Ground No.2 stands dismissed.

8. Second issue is regarding deletion of addition made under Section 40(a)(i) of the Act.

9. Facts pertaining to this issue are that assessee had made payment totalling to Rs. 1,04,50,458/- to M/s Rosewell Group Services Ltd. based in Mauritius, for a market survey conducted by them for preparation of project report called "Opportunities in Asia for Electronics". A.O. noted that no tax was deducted at source while making payment to the concerned party. According to him, assessee was obliged to deduct tax at source under Section 195 of the Act. The company being a non-resident, as per the A.O., the payments made fell within the ambit of clause (vii) of Section 9(1) of the Act. It was nothing but fees for technical services, and for reaching this conclusion, A.O. relied on Explanation 2 to Section 9(1)(vii) of the Act. Therefore, he held that assessee had failed to deduct tax at source which it was obliged to do. Relying on the decision of Hon'ble Apex Court in the case of *Transmission Corporation of AP Ltd.* v. *CIT* (239 ITR 587), A.O. held that assessee had violated Section 195 and made a disallowance of Rs. 1,04,50,458/- under Section 40(a)(i) of the Act.

10. In its appeal before CIT (Appeals), argument of the assessee was that the payments were made for market survey, qualitative consumer measurement, retail store site information, etc. and such payments did not attract Section 195 of the Act. According to the assessee, entire services were rendered outside India and the amounts were business income of the concerned non-resident. Relying on the Double Taxation Avoidance Agreement (DTAA) between India and Mauritius, assessee argued that the said non-resident had no permanent establishment in India, and therefore, would not be liable to tax in India. As per the assessee, Chapter III of the DTAA between India and Mauritius did not provide for taxing any fees paid for technical services and therefore, fee for technical services could only be considered as business income in the hands of the recipient and hence taxable only in Mauritius. As per the assessee, provisions of DTAA prevailed over the provisions of the Act and therefore, assessee could not be considered as one in default for not deducting tax. In any case, according to the assessee, market survey expenses could not be considered as fees for technical services or royalty since what was transferred to the assessee was only commercial information. Just because technical services were required for gathering such commercial information would not make such commercial information itself a technical service. CIT (Appeals), after considering the contentions of the assessee and perusing the market survey reports, was of the opinion that the income earned by the said Mauritious company was not taxable in India. According to him, the services were rendered outside India and the said non-resident was not having a permanent establishment in India. He, therefore, held assessee not liable to deduct tax at source under Section 195 of the Act and deleted the disallowance made by the Assessing Officer.

11. Now before us, learned D.R., strongly assailing the order of CIT (Appeals), submitted that none of the agreements placed by the assessee before the CIT (Appeals) were ever made available by the assessee before the A.O. According to him, assessee itself had admitted that expenses paid for market survey was taxable in India. The provisions of DTAA between India and Mauritius was not brought to the

notice of the A.O. and CIT (Appeals) had also not obtained remand report. According to him, the services rendered by the Mauritius company were nothing but technical in nature falling within the ambit of Section 9(1)(vii) of the Act. Assessee was obliged to deduct tax at source thereof irrespective of the citus of receipt of the money or rendering of the service. According to him, in view of the explanation added to Section 9 of the Act by Finance Act, 2007 with retrospective effect from 1.6.1976, it was not necessary that a non-resident should have a permanent business establishment or business connection in India, insofar as fees received for technical services was concerned. He, therefore, submitted that assessee fell in default by not deducting tax at source and attracted the rigours of Section 40(a)(i) of the Act.

12. Per contra, learned A.R. submitted that the non-resident never had any permanent establishment or business connection in India. In any case, according to him, the DTAA provisions prevailed over the Act and therefore, assessee was having every liberty to take advantage of provisions of DTAA. Further, according to him, assessee was under a bonafide belief that in view of the provisions of DTAA, it was not required to deduct any tax at source on the payments effected to a non-resident. Relying on the decision of Special Bench of this Tribunal in the case of *ITO* v. *Prasad Production Ltd.* (125 ITD 263), learned A.R. submitted that the CIT (Appeals) was justified in deleting the disallowance.

13. We have perused the orders and heard the rival submissions. There is no dispute that money paid to the non-resident by the assessee was for a market survey, qualitative consumer measurement, retail store site information and compiling data for identifying opportunities for consumer electronics in the overseas market. Such a "market survey" definitely involved exercise of technical knowledge and skill by the persons doing the survey. We cannot say that the work done by the Mauritius company for the assessee was not a technical service. What assessee paid to Mauritius company was fees for technical services. Explanation 2 to Section 9(1)(vii) of the Act states that "fees for technical services" meant any consideration for rendering any managerial, technical or consultancy services. There is no case for the assessee that payments were made for any construction, assembly, mining or a project undertaken by the recipient which would fall under the head "salaries". Therefore, by virtue of Explanation 2 to Section 9(1)(vii) of the Act, the type of service received by the assessee M/s Rosewell Group Services Ltd., Mauritius was nothing but fees for technical services. A.O. was justified in taking this view. But, nevertheless, argument of the assessee before the CIT (Appeals) was that it had a bonafide belief that DTAA between India and Mauritius saved it from liability to deduct tax at source. According to assessee, the said Mauritius company was not having a permanent establishment in India and technical services not being specifically provided under DTAA, the receipts in the hand of Mauritius company could only be considered as part of its business earnings. This argument was accepted by the CIT (Appeals). However, we find that this line of reasoning was never mentioned by the assessee before the A.O. and the Assessing Officer had no opportunity to express his opinion. When technical service is not mentioned in DTAA between India and Mauritius, whether fee received for such services could be considered as business earning in the hands of recipient has not been analysed by any of the authorities below. Admittedly, Chapter III of DTAA between India and Mauritius did not provide for taxing any fees paid for technical services. Only for a reason that DTAA is silent on a particular type of income, we cannot say that such

income will automatically become business income of the recipient. In our opinion, when DTAA is silent on an aspect, the provisions of the Act has to be considered and applied. This aspect has not been dealt with by the authorities below. We are, therefore, of the opinion that this issue requires a fresh look by the A.O. Orders of lower authorities on payments made for market survey, are set aside and remitted back to A.O. for consideration afresh in accordance with law.

14. Ground No. 3 of the Revenue is allowed for statistical purposes.

15. In the result, appeal filed by the Revenue is partly allowed for statistical purposes.