



## Tax Insights

30 April 2024

### Court rejects higher TDS rate than prior years' as finding on profit attribution was left unquestioned – Delhi High Court

#### In brief

The Delhi High Court<sup>1</sup> held that the Revenue cannot direct a higher rate of tax deducted at source (TDS) than the rate of profit attribution to the permanent establishment (PE) in India it accepted earlier unless the Revenue challenges the same before the appropriate authority.

#### In detail

##### Facts

- The taxpayer, a tax resident of the US, supplies spare parts to various customers in India. It entered into independent contracts with customers for the supply of such parts from outside India.
- The Revenue, in the assessment orders passed for the previous assessment years (AY) 2001–02 to 2008–09, concluded that the taxpayer constitutes a PE in India. The Revenue applied the provisions of section 44BB and 44BBB of the Income-tax Act, 1961 (the Act) and deemed the profitability of 10% of the gross receipts from the supply of spares and offshore repairs; 35% of such profits were attributable to the taxpayer's PE in India.
- For the abovementioned years, Delhi bench of the Income-tax Appellate Tribunal (Tribunal), *vide* a common order concluded that the taxpayer constitutes a PE in India, but it reduced the rate of attribution to 26%. On further appeal, the Delhi High Court affirmed the Tribunal's ruling. Although, the taxpayer preferred a Special Leave Petition (SLP) before the Supreme Court, the taxpayer withdrew the SLP itself since it opted for settlement under the Direct Tax Vivad se Vishwas Act, 2020.
- However, similar orders were passed for AYs 2009–10 to 2015–16 and AY 2017–18 in the taxpayer's case.
- For financial years (FYs) 2010–11 to 2020–21, the taxpayer was granted a lower TDS certificate at the rate of 1.5% of the gross receipts. However, for FY 2021–22, the taxpayer was issued a lower TDS certificate at 4%, which the taxpayer challenged in a writ petition before the Delhi High Court.
- However, at the time of hearing before the Delhi High Court, the taxpayer contended that since the FY 2022 is ending, it is not pressing the writ petition before the Delhi High Court. Moreover, the taxpayer contended

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<sup>1</sup> W.P.(C) 9593/2022

that, for FY 2022–23, it will file a fresh application to obtain a lower TDS certificate from the Revenue.

- Considering the submission made by the taxpayer, the Delhi High Court disposed of the writ petition for FY 2022–23. Delhi High Court further stated that if the rate of attribution of profits to the PE in India is pegged at 26%, then the TDS cannot exceed 1.04%. In addition, if the contentions raised in the writ petitions for FY 2022–23 form part of the fresh application filed for FY 2023–24, including what the Delhi High Court noted regarding the attribution of profits to the PE, the Revenue is directed to deal with the same as per the law.
- On similar lines, the Revenue again issued a certificate directing a 4% TDS for FY 2023–24. Aggrieved, the taxpayer challenged the same in writ petitions before the Delhi High Court. In the interim order, the Delhi High Court stated that the taxpayer will receive income from the concerned remitters after imposition of TDS of 1.5%; however, this includes a caveat that if the taxpayer fails in the writ actions, the balance amount calculated at the differential rate of 2.5% will be deposited with the Revenue.

### Taxpayer's contentions

- Taxpayer had no PE in India, and its income from the supplies was not taxable in India.
- Regarding the rate of taxability, the Tribunal concluded in its ruling (subsequently affirmed by the Delhi High Court) that the profit attribution to the taxpayer's PE in India was reduced to 26%.
- The Dispute Resolution Panel (DRP) also accepted the aforesaid rate of profit attribution. Therefore, it is evident that the Revenue could not direct a TDS higher than 1.04%. This rate was calculated by applying the attribution rate of 26%, 10% profit rate and the domestic tax rate of 40% on the income, i.e.  $26\% \times 10\% \times 40\%$ .
- Instead, the Revenue attributed 100% of the profits to the taxpayer while issuing the lower TDS certificate for FY 2023–24.
- Revenue's allegation of artificial splitting of contracts was baseless, and the customers had paid the requisite tax on their end.

### Revenue's contentions

- The taxpayer has a PE in India, and its income is taxable under section 9(1)(i) of the Act read with the India-USA Double Taxation Avoidance Agreement (DTAA).
- The taxpayer had artificially split its contracts into offshore and onshore supplies to avoid tax liability in India.
- The Revenue relied on the assessment orders passed for AYs 2001–02 to 2008–09, which concluded that the taxpayer had a PE in India. Moreover, the Revenue applied the provisions of sections 44BB and 44BBB of the Act to deem profitability of 10% of the gross receipts from the supply of spares and offshore repairs; 35% of such profits were held as attributable to the PE in India.
- The Revenue also stated that it had filed a rectification application before the DRP against the order. Herein, the DRP had accepted the Tribunal's ruling of attributing 26% of the profits to the taxpayer's PE in India. However, the DRP had missed crucial facts while passing the order, and the profit attribution should be 100%.

### High Court's decision

- The court observed that the Revenue had not disputed the profit attribution rate of 26%, and it could not sustain a TDS of 4% when the same was not seriously questioned.
- Moreover, the Revenue itself, while issuing the TDS certificate, mentioned that the Delhi High Court had upheld the attribution rate of 26%.
- Therefore, the TDS cannot exceed 1.04% as per the Tribunal's ruling and DTAA provisions. The present judgement applies for only FYs 2022–23 and 2023–24; the question of TDS for any other year will have to be decided independently.
- The court further held that all rights and contentions of the parties on merits are kept open to be addressed in regular assessment proceedings.
- Accordingly, the Delhi High Court allowed the taxpayer's writ petitions and quashed the impugned lower TDS certificate for FY 2023–24.

### **The takeaways**

The Delhi High Court held that the Revenue cannot use a different attribution rate in a lower TDS order unless it has challenged the same for earlier years. This is an interesting principle that the High Court has established. However, the facts in this case are unique, and the decision's applicability in other matters will need to be evaluated carefully.

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