

## Tax Alert | Delivering Clarity

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### No disallowance where deduction for expenditure has not been claimed

The Mumbai Bench of the Income-tax Appellate Tribunal (ITAT) gave its decision that amounts could be disallowed (for non-deduction of tax at source) only when deduction for the related expenditure has been claimed. Further, there is no restriction on the revenue authorities to initiate recovery, interest and penalty proceedings in cases where no disallowance is made for non-deduction of tax at source.

#### Background:

- The taxpayer<sup>1</sup> is an internet advertising agency.
- During the Financial Year (FY) 2014-15, corresponding to Assessment Year (AY) 2015-16, the taxpayer made certain payments to a foreign company (F Co), towards the cost of advertisements, carried by F Co, for its clients (i.e. taxpayer's clients). The taxpayer did not deduct tax at source under section 195 of the Income-tax Act, 1961 (ITA) while making payment to F Co towards the cost of advertisements.

Any person responsible for paying to a non-resident any sum (except certain interest and salary) chargeable to tax under the ITA is required to withhold tax at source under section 195 of the ITA.

- The taxpayer had not claimed deduction in respect of the payments made to F Co in its return of income, as its revenue consisted of only commission received in respect of the advertisements so placed.
- The Assessing Officer (AO) during audit proceedings disallowed the payments to F Co under section 40(a)(i) of the ITA for failure to withhold tax at source.

Section 40(a)(i) of the ITA provides for disallowance of any payment made to non-resident (chargeable under the provisions of ITA) without deduction of applicable withholding tax.

- In appeal proceedings, the matter reached the Mumbai Bench of the Income-tax Appellate Tribunal (ITAT).

#### Decision of the ITAT:

- The ITAT noted the following:
  - The taxpayer was an internet advertising agency and as such, advertisements were placed by the taxpayer on behalf of its clients.

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<sup>1</sup>Interactive Avenues private Limited v. DCIT (ITA no 3130/ Mum/19) (Mumbai ITAT).

There was thus ordinarily no occasion for the taxpayer to claim the costs of advertisements as deduction in computation of its business income. Further, the advertisement agency's revenues consisted of only the commission received in respect of the advertisements so placed.

- A disallowance under section 40(a)(i) of the ITA could come into play only when the deduction for the related expenditure was claimed under sections 30 to 38 of the ITA.
- In the case under consideration, the share of the taxpayer, so far as the amount paid to F Co was concerned, was represented by the agency commission of 15% of the net billing amount. It was this agency commission of 15% of the net billing amount which was accounted for in the books of accounts of the taxpayer. Therefore, the taxpayer had not claimed any deduction in respect of expenditure incurred on payments made to F Co.
- In view of the said findings, the ITAT held that unless a claim for deduction in respect of payments made to F Co was made in the computation of business income, there could not be any occasion for invoking section 40(a)(i) of the ITA for its disallowance in computation of business income.

The ITAT remanded the matter back to the AO for factual verification that the taxpayer had not made such claim (i.e. for payment made to F Co) in the computation of business income (i.e. in the profit and loss account filed by the taxpayer along with computation of business income).

- Further, the ITAT observed that the above findings did not restrict the applicability of other consequences for non-deduction of tax at source from payments made to non-residents (for example the revenue authorities may recover, in appropriate cases, the entire tax that the taxpayer failed to deduct at source, along with compensatory interest for delay in its collection of tax by the revenue authorities and the penalty for non-deduction at source).

In view of the above, the ITAT held that where the taxpayer had not claimed deduction of an expenditure under sections 30 to 38 of the ITA, there would be no disallowance under section 40(a)(i) of the ITA.

### **Comment:**

This ruling reiterates the following:

- Amounts could be disallowed under section 40(a)(i) of the ITA only when the deduction for the related expenditure has been claimed under sections 30 to 38 of the ITA.
- There is no restriction on the revenue authorities to initiate recovery, interest and penalty proceedings in cases where no disallowance is made under section 40(a)(i) of the ITA for non-deduction of tax at source.

Withholding tax compliances are onerous and taxpayers may want to evaluate impact of this ruling to the facts of their specific case.



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