IN THE INCOME TAX APPELLATE TRIBUNAL
"H" Bench, Mumbai

Before Shri G. Manjunatha, Accountant Member
and Shri Ravish Sood, Judicial Member

ITA No.2842/Mum/2017
(Assessment Year: 2012-13)

M/s Knight Frank (India) Pvt. Ltd. C/o Kalyaniwalla & Mistry LLP, 2nd Floor, Esplanade House No. 29, Hazarimal Somani Marg, Fort, Mumbai 400 001	Vs.	Asst. Commissioner of Income Tax-2(2)(1), Room No. 548, 5th Floor, Aayakar Bhavan, M.K. Marg, Mumbai.
PAN – AAACK1544J		
(Appellant)		**(Respondent)**

Appellant by: Shri M.M. Golvala &
Shri Amey Wagle, A.Rs
Respondent by: Shri Manoj Kumar Singh, D.R

Date of Hearing: 06.06.2019
Date of Pronouncement: 12.06.2019

O R D E R

PER RAVISH SOOD, JM

The present appeal filed by the assessee is directed against the order passed by the CIT(A)-5, Mumbai, dated 16.12.2016, which in turn arises from the order passed by the A.O under Sec. 143(3) of the Income Tax Act, 1961 (for short 'I-T Act'), dated 12.03.2015. The assessee has assailed the order of the CIT(A) on the following amended grounds of appeal:

> "This Appeal is against the Order passed by Commissioner of Income-tax (Appeals) - 5, Mumbai and relates to the Assessment year 2012-2013.

1. The learned Commissioner of Income Tax (Appeals) erred in disallowing commission paid to Newmark Knight Frank under section 40(a)(i) Rs. 24,62,367/-.
2. The learned Commissioner of Income Tax (Appeals) erred in holding that the appellant had failed to demonstrate how the commission was not taxable under the Double Taxation Avoidance Agreement between India and USA. The said finding is perverse.
3. Having regard to the facts and circumstances, the appellant submits the disallowance of Rs. 24,62,367/- is unjustified and is required to be deleted.

The Appellant craves leave to add to, amend, alter, modify or withdraw any or all the Grounds of Appeal before or at the time of hearing of the Appeal, as they may be advised from time to time."

2. Briefly stated, the assessee company which is engaged in the business of rendering international real estate advisory and property management services had filed its return of income for A.Y. 2012-13 on 29.11.2012, declaring total income of Rs.7,23,59,570/-. The return of income filed by the assessee was processed as such under Sec. 143(1) of the I-T Act. Subsequently, the case of the assessee was selected for scrutiny assessment under Sec. 143(2).

3. During the course of the assessment proceedings it was observed by the A.O that the assessee had paid a referral fees of Rs. 24,62,367/- to a foreign concern, namely Newmark & Company Real Estate Inc., New York, USA, for introducing clients to the assessee. Observing, that no tax was deducted at source by the assessee at the time of making the aforesaid payment, therefore, the A.O called upon it to explain as to why the said payment which was claimed as an expense in the profit & loss account may not be disallowed under Sec. 40(a)(i) of the I-T Act. In reply, it was submitted by the assessee that no obligation was cast upon it to deduct tax at source on the aforesaid amount, for the reason viz. (i) that, as the services rendered by the foreign concern for introducing a client did not "make available" any technical knowledge, experience, skill, know-how or processes to the assessee, therefore, the same did not fall within the realm of "Fees for included services" as envisaged in Article 12 of the India-USA, DTAA;

and (ii). that, as the payment made to the foreign concern for the services which were rendered entirely in USA, constituted its business profits within the meaning of Article 7 of the India-USA DTAA, therefore, in the absence of any Permanent Establishment (for short 'PE') of the said foreign concern in India, the said amount could only be brought to tax in USA. In sum and substance, the assessee tried to impress upon the A.O that as it was not obligated to deduct any tax at source on the payment made to the foreign concern towards referral fees, therefore, no disallowance u/s 40(a)(i) was called for in its hands. However, the A.O was not persuaded to accept the explanation of the assessee. It was observed by the A.O, that a similar payment was disallowed by his predecessor under Sec. 40(a)(i) while framing the assessment in the case of the assessee for A.Y. 2009-10. The A.O relied on the view taken by his predecessor, wherein he had after referring to the 'Explanation' to Section 9(2) that was made available on the statute by the Finance Act, 2010 w.r.e.f 01.06.1976 observed, that the income of a non-resident was deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1), and was to be included in the total income of the non-resident, whether or not, (i) the non-resident has a residence or place of business or business connection in India; or (ii) the non-resident has rendered services in India. It was noticed by the A.O that his predecessor on the basis of the aforesaid retrospective amendment had concluded, that irrespective of the fact that the foreign concern to which referral fees was paid by the assessee had a residence or place of business or business connection in India, or had rendered services in India, or not, the amount of referral fees would be taxable in the hands of the said foreign concern in India. Apart there from, it was also observed by the A.O that the assessee had failed to demonstrate as to how the aforesaid amount was not taxable in India as per the

India-USA DTAA. On the basis of his aforesaid deliberations, the A.O being of the view that the assessee who was obligated to deduct tax at source on the referral fees of Rs. 24,62,367/-, however, had failed to comply with the said statutory obligation, thus, disallowed the said amount under Sec. 40(a)(i) of the I-T Act.

4. Aggrieved, the assessee carried the matter in appeal before the CIT(A). However, the CIT(A) following the view taken by his predecessor who had upheld the said disallowance while disposing off the appeal in the case of the assessee for A.Y. 2009-10, dismissed the appeal.

5. The assessee being aggrieved with the order of the CIT(A) has carried the matter in appeal before us. The ld. Authorised Representative (for short 'A.R') for the assessee, at the very outset of the hearing of the appeal submitted, that there was a delay of 17 days in filing of the present appeal before the Tribunal. The ld. A.R explaining the reason which had led to the delay in filing of the appeal submitted, that the same had occasioned on account of an inadvertent omission on the part of the tax consultant of the assessee company, namely M/s Kalyaniwalla & Mistry LLP. It was submitted by the ld. A.R that as the tax consultant of the assessee at the relevant point of time i.e 25.03.2017 till 10.04.2017, was engrossed in shifting of its office to a new premises, therefore, on account of a bonafide omission the filing of the appeal with the Tribunal had skipped from the mind of the concerned person and, the same had resulted to the delay of 17 days in filing of the present appeal. In order to drive home his aforesaid contention, the ld. A.R took us through the "affidavit" of the assessee, wherein the latter had deposed the aforesaid facts. Per contra, the ld. D.R objected to the admission of the appeal which was filed beyond the stipulated time period.

6. We have considered the aforesaid reasons which had led to the delay in filing of the appeal by the assessee company. We find that as per the facts discernible from the application filed by the assessee for condonation of delay in filing of the present appeal, which is further supported by its affidavit, the delay had occasioned on account of a bonafide omission on the part of its tax consultant, who at the relevant point of time is stated to have been pre-occupied in shifting its office. As the delay in filing of the appeal cannot be attributed to the assessee, which as observed by us hereinabove, was on account of a bonafide omission on the part of its tax consultant, therefore, we are of the considered view that the application filed by the assessee seeking condonation of delay of 17 days in filing of the appeal merits acceptance. Accordingly, we condone the delay of 17 days in filing of the present appeal.

7. We shall now advert to the merits of the case. As observed by us hereinabove, the A.O holding a conviction that the assessee had defaulted in deducting tax at source u/s 195 on the referral fees of Rs. 24,62,367/- that was paid to a foreign concern viz. Newmark & Company Real Estate Inc., New York, USA, had thus disallowed the claim of the said amount as an expenditure under Sec. 40(a)(i). As is discernible from the assessment order, the A.O had subscribed to the view that was taken by his predecessor in the case of the assessee for A.Y. 2009-10, and had observed, that as the referral commission paid by the assessee to the aforementioned foreign concern was covered by the Explanation to Sec. 9(2) that was made available on the statute by the Finance Act, 2010 w.r.e.f from 01.06.1976, therefore, the same was taxable in India. Accordingly, the A.O holding the assessee as being in default for not deducting tax at source u/s 195, thus disallowed the aforesaid payment of referral fees of Rs. 24,62,367/-

u/s 40(a)(i) of the I-T Act. We find that the A.O while concluding that the referral fees paid by the assessee to the foreign concern fell within the realm of 'Explanation' to Sec. 9(2), and was thus taxable in the hands of the said foreign concern in India, had however, failed to point out the basis for bringing the same within the sweep of the said 'Explanation', viz. (i). that, as to whether the same was income in the nature of 'interest' as set out in Sec. 9(1)(v) of the Act; or (ii) that, the same was income in the nature of 'royalty' as set out in Sec. 9(1)(vi) of the Act; or (iii). that, the same was income by way of 'fees for technical services' as set out in Sec. 9(1)(vii) of the Act. In our considered view, the A.O without demonstrating that as to how the referral fees paid by the assessee to the foreign company could be brought within the realm of the incomes envisaged in 'Explanation 2' of Sec. 9(2) viz. (i). Interest income; or (ii). royalty income; or (iii). fees for technical fees, had bypassed the said basic statutory requirement and, therein by way of a non-speaking order concluded that pursuant to the retrospective insertion of 'Explanation 2' of Sec. 9(2), the referral fees was liable to be included in the total income of the foreign concern in India. We are afraid that such cryptic observation of the A.O, which is not backed by any reasoning for bracketing the referral fees in the 'Explanation' to Sec. 9(2), cannot be subscribed on our part. In fact, we are of a strong conviction that the view taken by the lower authorities which is shorn of any reasoning can justifiably be vacated on the said count itself, however, in all fairness, we shall deliberate on the aspect as to whether the referral fees paid by the assessee to the aforesaid foreign concern was liable to be subjected to deduction of any tax at source, or not.

8. Before adverting any further, we may herein observe that the reliance drawn by the lower authorities on the order passed in the

case of the assessee for A.Y 2009-10, wherein it was observed by the A.O/CIT(A) that the referral fees paid by the assessee to the foreign concern without deduction of tax at source was liable to be disallowed u/s 40(a)(i), had been vacated by the ITAT, "A" bench, Mumbai in M/s Knight Frank (I) Pvt. Ltd. Vs. Addl. CIT-2(2), Mumbai (ITA No. 2410/Mum/2013; dated 18.03.2019). However, we find that the disallowance u/s 40(a)(i) was vacated by the Tribunal by drawing support from the CBDT Circular No. 786, dated 07.02.2009 and CBDT Circular No. 23, dated 23.07.1969. As per the said benevolent circulars, it was clarified that no TDS was liable to be deducted from the commission and other related charges payable to a non-resident for services rendered outside. However, as the aforesaid circulars had thereafter been withdrawn by the CBDT, vide its Circular No. 7/2009, dated 22.10.2009, therefore, the same cannot be pressed into service for arriving at a similar conclusion while disposing off the present appeal of the assessee. At this stage, we may herein observe that the ld. A.R had fairly brought to our notice the distinction in the facts involved in the case of the assessee for A.Y 2009-10, as against that for the year under consideration. Be that as it may, we find that both the aforesaid CBDT circulars viz. (i). Circular No. 786, dated 07.02.2009; and (ii). Circular No. 23, dated 23.07.1969, were clarificatory in nature and, therein clearly provided that as per Sec. 5(2) and Sec. 9 of the I-T Act, no tax was deductible on export commission and other related charges payable to a non-resident for services rendered outside India. Admittedly, though the aforesaid circulars do not hold the ground any more, however, as per the mandate of law, as was therein clarified in both of the said respective circulars, the payment of commission or related charges to a non-resident for services rendered outside India would not be taxable in India.

9. We shall now deliberate upon the scope of taxability of the referral fees that was received by the foreign concern, namely Newmark & Company Real Estate Inc., New York, USA from the assessee during the year under consideration. As per Sec. 5(2) of the Act, the total income of a non-resident includes income from whatever source derived which viz. (i). is received or is deemed to be received in India in such year by or on behalf of such person; or (ii). accrues or arises or is deemed to accrue or arise to him in India during such year. Admittedly, as the assessee had made the payment of referral fees to the foreign concern outside India, therefore, the said amount cannot be said to have been "received" in India. Insofar, the "income deemed to be received in India" is concerned, we find that the same is defined in Sec. 7 of the Act. As per Sec. 7, the income 'deemed to be received' takes within its sweep viz. (i). the annual accretion in the previous year to the balance at the credit of an employee participating in a recognized provident fund, to the extent provided in rule 6 of Part A of the Fourth Schedule; (ii). the transferred balance in a recognized provident fund, to the extent provided in sub-rule (4) of rule 11 of Part A of the Fourth Schedule; and (iii). the contribution made, by the Central government or any other employer in the previous year, to the account of an employee under a pension scheme referred to in Sec. 80CCD. Accordingly, the payment of referral fees by the assessee to the foreign concern cannot be "deemed to be received" in India. As regards the income which "accrues or arises in India", the place of accrual of income, and not its source would be relevant for determining the same. As the referral fees was received by the foreign concern for rendering of its services abroad for referring or introducing a customer to the assessee, therefore, the same cannot be characterised as income accrued or arisen to the assessee in India. Now, we come to the last limb of Sec. 5(2) i.e "income deemed to

accrue or arise in India". We find that the "income deemed to accrue or arise in India" is defined in Sec. 9(1) of the Act, which is spread over seven clauses viz. clause (i) to clause (vii). A perusal of clause (i) of Sec. 9(1) provides, that 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 from any asset or source of income in India, or through the transfer of a capital asset situate in India, shall be deemed to accrue or arise in India. On a scrutiny of clause (i), the only relevant aspect of the said clause which could have any bearing on determining the 'deemed accrual or arising' of the referral fees in the hands of the foreign concern in the case before us, is the ".....direct or indirect business connection in India". A perusal of "Explanation 1(a)" of clause (1) to Sec. 9(1) reveals, that 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. Now, in the case before us, as the referral fees was earned by the foreign concern, viz. Newmark & Company Real Estate Inc., New York, USA, for their services or operations which were fully carried out outside India, therefore, no part of the said fees received could be attributed or held as having been "deemed to have accrued or arisen" to the said foreign concern in India. Our aforesaid view is supported by the judgment of the **Hon'ble Supreme Court** in the case of **CIT Vs. Toshoku Ltd. (1980) 125 ITR 525 (SC)**. In the aforesaid judgment, the Hon'ble Apex Court after deliberating on the scope of clause (a) of the Explanation to Sec. 9(1)(i), while adjudicating the issue pertaining to taxability of commission income that was paid by an Indian exporter to a foreign agent, had observed as under:

> 8. The second aspect of the same question is whether the commission amounts credited in the books of the statutory agent can be treated as incomes accrued, arisen, or deemed to have accrued or arisen in India to the non-resident assessees during the relevant year. This takes us to s. 9 of the Act. It is urged that the commission amounts should be treated as incomes deemed to have accrued or arisen in India as they, according to the Department, had either accrued or arisen through and from the business connection in India that existed between the non- resident assessees and the statutory agent. This contention overlooks the effect of cl. (a) of the Explanation to cl. (i) of sub-s. (1) of s. 9 of the Act which provides that in the case of a business of which all the operations are not carried out in India, the income of the business deemed under that 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. If all such operations are out in India, the entire income accruing therefrom shall be deemed to have accrued in India. If, however, all the operations are not carried out in the taxable territories, the profits and gains of business deemed to accrue in India through and from business connection in India shall be only such profits and gains as are reasonably attributable to that part of the operations carried out in the taxable territories. If no operations of business are carried out in the taxable territories, it follows that the income accruing or arising abroad through or from any business connection in India cannot be deemed to accrue or arise in India [See CIT vs. R.D. Aggarwal & Co. (1965) 56 ITR 20 (SC) and Carborandum Co. vs. CIT (1977) 108 ITR 335 (SC) which are decided on the basis of s. 42 of the Indian IT Act, 1922, which corresponds to s. 9(1)(i) of the Act].
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> 9. In the instant case, the non-resident assessees did not carry on any business operations in the taxable territories. They acted as selling agents outside India. The receipt in India of the sale proceeds of tobacco remitted or caused to be remitted by the purchasers from abroad does not amount to an operation carried out by the assessees in India as contemplated by cl. (a) of the Explanation to s. 9(1)(i) of the Act. The commission amounts which were earned by the non-resident assessees for services rendered outside India cannot, therefore, be deemed to be incomes which have either accrued or arisen in India. The High Court was, therefore, right in answering the question against the Department."

As the facts involved in the case before us i.e pertaining to taxability of referral fees paid by the assessee to the foreign concern, for the services rendered by it abroad, are more or less similar to the facts as were there in the case before the Hon'ble Apex Court, therefore, we respectfully follow the same and conclude that the referral fees received by the foreign concern in the case before us, cannot in so far clause (i) to Sec. 9(1) is concerned, be held, to have 'deemed to accrued or arisen in India'. As regards clause (ii), clause (iii) and clause (iv) of Sec. 9(1), it is observed that as the same are in context of income by way of (i). salaries earned in India; (ii) income by way of salary payable by the government; and (iii). dividend paid by an Indian company,

respectively, therefore, the same are not relevant in the backdrop of the facts involved in the case before us.

10. We shall now advert to the remaining three clauses of Sec. 9(1) viz. clause (v); clause (vi); and clause (vii). As the "Explanation" to Sec. 9(2) of the Act, as had been relied upon by the A.O/CIT(A) for concluding that the referral fees received by the foreign concern was liable to be included in the income of the foreign concern in India, therefore, we have purposively segregated the said clauses for necessary deliberations. At this stage, we may herein observe, that in case if the referral fees received by the foreign concern is found to fall within either of the aforementioned three clauses i.e clause (v), clause (vi) or clause (vii), then the 'Explanation' to Sec. 9(2) would come into play, and the income of the foreign concern shall be deemed to have accrued or arisen in India, irrespective of the fact viz. (i). the foreign concern had a residence or place of business or business connection in India, or not; or (ii). the foreign concern had rendered services in India, or not. As regards clause (v) to Sec. 9(1), we find that as the same refers to income by way of "interest income", which is not the case before us, therefore, the same would not be relevant. Insofar clause (vi) to Sec. 9(1) is concerned, again we find that as the same deals with income by way of "royalty", which again is not the case before us, therefore, the same also will have no bearing on the adjudication of the lis before us. Now, we come to the last clause i.e clause (vii) to Sec. 9(1), which we find is in regard to income by way of "fees for technical fees". As the definition of "fees for technical fees" as envisaged in "Explanation 2" of Sec. 9(1)(vii) takes within its sweep consideration received by an assessee for rendering of certain services viz. (i). managerial services; (ii). technical services; and (iii). consultancy services, therefore, in the backdrop of the same, the

nature of services rendered by the foreign concern to the assessee would require some deliberation, for deciding, as to whether the referral fees received by the foreign concern from the assessee would fall within the realm of either of the aforementioned three services, or not :

(A). Managerial services :

(i). We are of the considered view that referral services rendered by the foreign concern viz. Newmark & Company Real Estate Inc., New York, USA, abroad for referring/introducing a customer to the assessee, cannot be bracketed as management services provided by the said foreign concern to the assessee. Admittedly, as the foreign concern was neither acting as a manager or dealing with the administration, nor controlling the policies or scrutinising the effectiveness of the policies, therefore, it did not perform any supervising function whatsoever. Accordingly, as the foreign concern was only rendering its services abroad for referring or introducing customers to the assessee, and was not rendering managerial advice or management services, therefore, the referral income received by the said foreign agency from the assessee cannot be held to have been received by it for rendering any managerial services.

(ii). Technical services :

(a). As the foreign agency viz. Newmark & Company Real Estate Inc., New York, USA, was only rendering referral services to the assessee, and was not undertaking or performing any “technical services” where special skills or knowledge relating to a technical field were required, therefore, it can safely be concluded that the referral fees received by the foreign agency from the assessee was not towards technical fees.

(iii). <u>Consultancy fees</u> :

(a). As the foreign agency by using its skill, business acumen and knowledge which was acquired by it for its own benefit, was only referring customers to the assessee, therefore, it cannot be said that it was providing any consultancy services to the assessee. In fact, the term 'consultant' refers to a person, who is consulted and who advises or from whom information is sought. In our considered view, the foreign concern had not provided any consultation or advise to the assessee, but in fact was only referring or introducing customers to it. Accordingly, we are of the considered view, that as the foreign concern was not providing any consultancy services to the assessee, therefore, the referral fees received by the assessee cannot be held as consultancy fees.

11. On the basis of our aforesaid observations, we are of the considered view, that as the referral fees received by the foreign concern viz. Newmark & Company Real Estate Inc., New York, USA, from the assessee, was neither towards managerial, technical or consultancy services, hence the same cannot be characterised as receipt of income towards 'fees for technical services' by the said foreign concern.

12. We thus are of the considered view, that as the income received by the foreign concern viz. Newmark & Company Real Estate Inc., New York, USA, from the assessee was neither income in the nature of 'interest' as set out in Sec. 9(1)(v) of the Act; or income in the nature of 'royalty' as set out in Sec. 9(1)(vi) of the Act; or income by way of 'fees for technical services' as set out in Sec. 9(1)(vii) of the Act, therefore, the "Explanation" to Sec. 9(2), as had been made available on the

statute vide the Finance Act, 2010, w.r.e.f 01.06.1976, would not come into play. Accordingly, we are of the considered view that as the referral fees received by the foreign concern from the assessee does not fall within the realm of the scope of "total income" of the said foreign concern viz. Newmark & Company Real Estate Inc., New York, USA, as envisaged in Sec. 5(2) of the Act, therefore, no obligation u/s 195 was cast upon the assessee to have deducted tax at source on the referral fees of Rs. 24,62,367/- that was paid to the said foreign concern.

13. Alternatively, we find that no obligation was cast upon the assessee to deduct tax at source on the amount of Rs. 24,62,357/- that was paid to the foreign concern viz. Newmark & Company Real Estate Inc., New York, USA, towards referral fees, for the reason viz. (i) that, as the services rendered by the foreign concern for introducing a client did not did not "make available" any technical knowledge, experience, skill, know-how or processes to the assessee, therefore, the same did not fall within the realm of "Fees for included services" as envisaged in Article 12 of the India-USA, DTAA; and (ii). that, as the aforesaid payment made to the foreign concern for the services which were rendered entirely in USA, constituted its business profits within the meaning of Article 7 of the India-USA DTAA, therefore, in the absence of any Permanent Establishment (for short 'PE') of the said foreign concern in India, the said amount could only be brought to tax in USA. As such, we are of the considered view, that even as per Sec. 90(2) of the Act, in pursuance of the beneficial provisions of the India-USA DTAA, as the referral fees received by the foreign concern was not taxable in India, therefore, no obligation was cast upon the assessee to have deducted any tax at source on the said payment. Accordingly, for

the said reason also no disallowance u/s 40(a)(i) of the referral fees of Rs. 24,62,357/- was called for in the hands of the assessee.

14. Accordingly, in terms of our aforesaid observations the order of the CIT(A) is set aside and, the disallowance of Rs. 24,62,357/- made by the A.O is vacated.

15. As a result, the appeal of the assessee merits acceptance and is allowed.

Order pronounced in the open court on 12/06/2019.

Sd/- Sd/-

(G. MANJUNATHA) (RAVISH SOOD)
ACCOUNTANT MEMBER JUDICIAL MEMBER

मुंबई Mumbai; दिनांक 12.06.2019
Ps. Rohit

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
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

सत्यापित प्रति //True Copy//

आदेशानुसार/ BY ORDER,

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

आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**