Karnataka HC ruling in Samsung Electronics case: Significant Spin-offs!

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ALARMED by the implications arising out of the judgment of the Hon'ble Karnataka High Court in the Samsung Electronics case2009-TIOL-629-HC-KAR-IT, I was one of the first to write a piece on this, in the national tax press. This second piece is a rather cooler attempt, to take a deeper look at this judgment and its implications.

Before we get into a full fledged discussion, let's understand, very briefly, what the High Court had actually held, in this case…

The judgment dealt with a series of petitions filed by the Income tax Department against the various orders of the Income Tax Appellate Tribunal, including in a case involving Samsung Electronics, on whether tax is to be deducted at source, under Section 195 of the Income tax Act, in respect of payments made to non-residents, on import of software. Instead of directly addressing this question on whether software imports are covered under the TDS provisions contained in Section 195, the High Court has held that every payment to a non-resident must be subject to deduction of tax at source or else must be pre-authorized/ pre-validated by the Assessing Officer for any concession either for rate deduction or for appropriate value chargeable on an application under Section 195(2). In a 'non-taxing' language, the High Court's judgment states that, Indian residents effecting remittances to Non-Residents are bound to either deduct tax at source, or apply to the Income tax Officer for a certificate under Section 195(2). As is known, this judgement of the Karnataka High Court is largely based on the decision of the Supreme Court in the

With due respects to the Karnataka High Court, a discussion on the implications arising out of the Samsung decision can be attempted, as under……

1. Will this judgment affect imports of raw materials, components and other goods?

Payments to Non-Residents could be classified into three categories, viz.

++ those which are exempt from the levy of tax in India

++ those which are fully taxable in India

++ those which are partially taxable in India

It appears that the Karnataka HC has solely relied upon the decision of the Supreme Court, rendered in Transmission Corporation of A.P. Ltd v. CIT (2002-TIOL-471-SC-IT), disregarding the

subsequent developments in this area including the subsequent binding decisions of the Supreme Court including in Vijay Ship Breaking Corporation v. CIT, Ahmedabad 2008-TIOL-197-SC-IT, wherein the Apex Court has categorically held that, the resident is not required to deduct tax at source under Section 195(1) of the Income tax Act, if the income of the non-resident recipient is not taxable in India. Given this binding precedent, my view is that, the decision in the Samsung Electronics case would not apply to cases where the non-resident recipient is not taxable in India.

Hence, a clear view can be taken that cases involving imports of raw materials, components, etc. are still not covered by Section 195, given the binding precedent of the law laid down in the Vijay Ship Breaking Corporation case, notwithstanding the decision in the Samsung Electronics case.

2. Will this judgment affect import of services rendered outside India?

We can now discuss whether, payments effected for import of services, which are rendered outside India can be said to be covered under Section 195, in the light of the Samsung decision. We can recall that the Government had issued Circulars bearing Nos 23 dated 23-7-2009 and 786 dated 7-2-2000, wherein, a clear view had been taken that no income arises or accrues in respect of services rendered overseas. Though these circulars talk about overseas selling agents, the view of the CBDT is equally applicable for all services, which are rendered outside of India.

In a recent development, the CBDT has chosen to withdraw Circular Nos 23 and 786 by issuing Circular No.7/2009 dated October 22, 2009. But, in my view, this 'disowning' of Circular No, 23, which has stood the test of time and law for over four long decades, will not any significant impact in terms of the TDS issues covering payments for services rendered outside India. After all, the action of the CBDT in withdrawing this 40 year old Circular, cannot result in the levy of tax on remittances to non-residents, which are not chargeable to tax in India.

Reference may be drawn here, to the decision of the Supreme Court in Ishikawajma-Harima Heavy Industries Ltd v. Director of Income tax reported in 288 ITR 408 (SC), wherein, it had been held that for Section 195 to be attracted, the services rendered by the non-resident should have been rendered in India and also, the services should have been used in India and that, this twin test has to be satisfied for Section 195 to be attracted. As is known, the Government had tried to overcome the impact of this judgment by retrospectively introducing the following Explanation to Section 9(2) of the Income tax Act, with effect from 1-6-1976, thro' Finance Act, 2007:

"Explanation.— For the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of

sub-section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India.

Despite this attempt to overcome the implications arising out of the Supreme Court's judgment, the Karnataka High Court has, in a land mark case, viz. Jindal Thermal Power v. DCIT (2009-TIOL-302-HC-KAR-IT) held that the law laid down by the Supreme Court in the Ishikawajma case still holds good, despite the retrospective amendment to Section 9.

It does appears that, the decision of the Karnataka HC in the Samsung case conflicts with the decision in the Jindal Thermal Power case.

Consequently, in my view, the requirement of the services of the non-resident being rendered in India and being utilized in India, is still valid, despite the Samsung decision. Hence, there is no need for tax to be deducted at source, in respect of payments effected by residents to non-residents for export agency commission, marketing services, selling services and other similar services like organizing trade fairs and exhibitions abroad, consultancy rendered outside of India etc. which are all rendered outside India, though, it may be said that these services are utilized in India.

3. Will this judgment affect payments for import of software?

In terms of the impact of the Samsung decision for deduction of tax at source on software imports, we must bear in mind that this question of law has not been directly answered by the Karnataka High Court. Instead, the High Court has held that an application to the Assessing Officer has to be made under Section 195(2) in respect of all payments to non-residents. As we know, the Samsung case and other cases which came up before the Karnataka High Court pertained to the issue involving deduction of tax at source in respect of payments made for import of readily available off the shelf software. It was contended by the Indian importers that these payments were for import of goods being in the nature of copyrighted software, while the Department kept arguing that the payments were in the nature of royalty. The importers had further contended that the definition of 'royalty' in the Double Taxation Avoidance Agreement ('DTAA') covered payment for use of the copyright and not the copyrighted material itself and that, in the absence of the of permanent establishment in India of the non-resident, no taxable income arose, vis-a-vis the non-residents. The Department, of course, took the view that these payments for import of software were in the nature of royalties and therefore, constituted income chargeable to tax under Section 9(1)(vi) of the Income tax Act, read with the relevant articles of the DTAA and consequently attracting Section 195.

On appeal, the Tribunal had held that the importer had only acquired a readymade off-the-shelf computer programs for being used in its business, that no right had been granted by the non-resident to the importer to utilize the copyright of the computer program, that the non-

resident had merely sold a copy of the copyrighted article being the computer program and that the definition of 'royalty' as provided in the DTAA did not apply to the facts of the case and that the remittance made by the importer for purchase of software was not an 'income' in India and consequently, no tax was to be deducted in India under Section 195 on the payment effected by the importer to the non-resident.

Without directly addressing the issue related to the taxability of import of software licenses directly, the Karnataka High Court had held, interalia, that all payments to non-residents would either have to suffer TDS at the rates prescribed in the Act or the importer will have to get a certificate from the Assessing Officer under Section 195(2).

In my view, this could be a case wherein, the sub silentio doctrine is attracted, in as much as, with due regards to the Karnataka High Court, the law which has arisen due to the binding precedents of the Supreme Court has not been considered by the High Court, while rendering this judgment. As we know, the doctrine of sub silentio is an exception to the rule of precedents.

The Supreme Court and the High Courts have held in several cases that, software licenses are 'goods' in no uncertain terms. The law on the taxation of software is clearly progressing towards the direction of involving treating software as goods. In a very recent landmark judgment, viz . CIT, New Delhi v. Oracle Corporation India Ltd reported in 2010-TIOL-04-SC-IT, the Supreme Court has held that duplication of the master copy of the software imported in a master CD, into blank CDs, amounts to manufacture and that the assessee is entitled to deduction under Section 80-IA of the Income tax Act.

In the light of these developments, it seems that the Samsung decision will not require deduction of tax at source even in respect of import of software, despite the fact that this was the subject matter before the Karnataka High Court.

Very interestingly, in a very recent landmark ruling dated January 29, 2010, the Authority for Advance Rulings has held, in the case of M/s Dassault Systems K.K., Japan (AAR No. 821/2009) has held that no taxable income accrues to the Japan based software product developer, on payments received from Indian Value Added Resellers, on the import of software product licenses sold to the end customers, in the absence of a permanent establishment. This case will be relevant for all other imports of software products, as well. Coming, as it does, in the aftermath of the decision rendered in the Samsung Electronics case, this advance ruling assumes a lot of importance.

4. Will this judgment affect importers outside of or inside Karnataka?

In my view, this decision will not become a binding precedent in the light of the Supreme Court decisions. As regards importers outside of Karnataka, the decision will not have a binding effect due to binding nature of the decisions of the respective jurisdictional High Courts.

Even for importers within the state of Karnataka, whose jurisdictional High Court has delivered this judgment, the rule of precedent arising out of this case, would get badly affected, in my view, on account of the operation of the doctrines of per incuriam and sub-silentio.

The expression per incuriam means 'resulting from ignorance of'. If a decision is rendered per incuriam a statute or binding authority, the same maybe ignored. [A-One Granites v State of U.P. (2001)3SCC 537; AIR2001 SC 1203; Salmond on Jurisprudence, 12 th Edn. Page 167].

With due respects to the Karnataka High Court, this decision suffers from the doctrines of per incuriam and sub silentio and hence, may not constitute a binding precedent.

5. How can practising CAs handle issues vis-a-vis Form 15CBs?

In my view, practising CAs can still rely on the binding precedents arising out of the judgements of the Supreme Court and especially, its judgements in the Ishikawajma and Vijay Ship Breaking cases and the relevant judgements of the jurisdictional High Courts, including, of course, the decision in the Jindal Thermal Power case.

I don't think that the law related to deduction of tax at source under Section 195 has changed consequent to the Samsung decision or for that matter, the withdrawal of Circular Nos 23 and 786 by the CBDT.

Practising CAs, issuing 15CB certificates would be advised to quote all relevant judgments from the Supreme Court as well as the relevant advance rulings to justify their opinion on the TDS issue covering the payments by the Indian importers.

Before concluding…….

The Supreme Court has temporarily stayed the collection of tax, arising out of the Samsung decision, by the Department from the appellants, who had filed an SLP. We need to wait for the final outcome of the case.

This decision, as we have seen, has been rendered solely on the basis of the Supreme Court decision in the Transmission Corporation of A.P. case. As far as my knowledge goes, the Supreme Court has held that in this case that Section 195 gets attracted only when the amount paid by the resident to the non-resident wholly bears the character of 'income' (such as salaries, dividends, interest on securities, etc) but also to gross sums the whole of which may not be income or profits of the recipient, such as payments to contractors and sub-contractors,

insurance commission, etc. Nowhere has it been stated in this decision of the Supreme Court that Section 195 gets attracted even in cases where there is no 'income' arising or accruing to the non-resident. That Section 195 is not attracted in cases where no income arises or accrues to the non-resident becomes very clear when one goes thro' the recent judgment of the Apex Court in the Vijay Ship Breaking case. Given this clarity, a clear view can be taken that the Karnataka High Court has only re-iterated the decision of the Supreme Court rendered in the Transmission Corporation of A.P. case and consequently, its impact would be restricted to cases wherein the payment to the non-resident is chargeable to tax in India, either wholly or partly and definitely not to cases to payments which are wholly not taxable in India.

That the provisions of the Double Taxation Avoidance Agreements would prevail over the provisions of the Indian Income tax Act, would seem to have been completely overlooked by the Karnataka High Court, while rendering the decision in the Samsung case. Even the CBDT has not objected to this view, in terms of its Circular dated 12th April, 1982.

From a practical point of view, one wonders as to how the Income tax Department could possibly handle the innumerable applications under Section 195 which could flood the Department, if the Karnataka High Court's decision in the Samsung case is to be implemented. Perhaps, the Departmental officers would need to give up their other tasks including assessments and dedicate themselves exclusively to the task of providing certificates under Section 195 to the applicants, if this decision is to be implemented by the Department.

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