# No TDS liability arise on mere passing of book entry which gets reversed subsequently

Case Law Citation- Director of Income Tax Vs. M/s Ericsson Communications Ltd. (Delhi High Court), Income Tax (Appeal) No. 106/2002, Date of Judgment: 04/09/2015

**Brief of the Case**

Delhi High Court held In the case of DIT Vs. M/s Ericsson Communications Ltd. that mere passing of the book entries, which are reversed, would not give rise to an obligation to deduct TDS by the Assessee, as clearly, there is no debt that can be said to be acknowledged by the Assessee. Imposition of an obligation to deduct TDS in these circumstances would amount to enforcing payments from one person towards a tax liability of another, even where the person

does not acknowledge that any sum is payable. This, in our view, is contrary to the scheme of provisions relating to collection of TDS under the Act.

**Facts of the Case**

The Assessee is engaged in the business of installation and commissioning of telecom projects and information technology systems relating thereto. The Assessee is a wholly owned

subsidiary of Telefonaktiebolaget L.M. Ericsson (TLME), which is a company incorporated under the laws of Sweden and has its principal place of business situated in Sweden. The

controversy in the present appeals relates to the obligation of the Assessee to deduct TDS in respect of the amount of Rs.2,24,96,669/- credited to the account of TLME, Sweden

in the books of the Assessee. The said amount was credited on account of royalty payable; however, the said entry was subsequently reversed, as according to the Assessee, the

payment of royalty to TLME was not permissible as per the Industrial policy in force at the material time. Admittedly, no part of the amount in question was ever paid by the Assessee

to TLME.

**Contention of the Assessee**

Senior Counsel appearing on behalf of the Assessee contended that the arguments on behalf of the revenue proceeded on an erroneous assumption that any payment on account of Royalty had been made to TLME. He submitted that the entries passed by the Assessee in its books of accounts had been reversed as the Assessee had been denied the permission to remit any royalty to its holding company. He submitted that at the material time, the industrial policy of the

Government of India did not permit payment of royalty by a wholly owned subsidiary to its holding company. He referred to a letter dated 11th July, 2000 issued by the Government of India to the Assessee, clarifying the above position. He submitted that the aforesaid policy was reviewed and by a Press Note issued by the Government of India, the payment of royalty within the limit specified was permitted with effect from 8th September, 2000. He contended that

in the circumstances, there was no accrual of income and consequently, obligation of withholding tax was not applicable

**Contention of the Revenue**

Learned counsel appearing for the Revenue referred to Section 195 of the Act and submitted that the obligation to deduct TDS is not contingent on the payment being made and the payer is required to deduct TDS even on the amounts being credited in its books of accounts. He emphasised that in the present case, the Assessee had, on 18th August, 1998, credited TLME’s Account for royalty payable to TLME under the agreement dated 1st January, 1997 and on

such entry being passed by the Assessee, its obligation to deduct TAS crystallized. He further submitted that the question whether the amount credited included any element of income or not was not to be determined by the Assessee.

He relied upon the judgment of the Supreme Court in Transmission Corporation of AP Ltd. v. CIT, (1999) 239 ITR 587 in support of his contention.

Further contended that the issue whether the Agreement dated 1st January, 1997 was void or not, was not relevant. He urged that the payment of income tax is not contingent on the validity of agreements and even payments made under void agreements are chargeable to tax under the Act.

**Held by CIT (A)**

CIT (A) confirmed the orders passed by the AO and held that in terms of the agreement entered into between the Assessee and TLME, income had accrued in the hands of TLME and this attracted withholding tax obligations under Section 195 of the Act.

**Held by Tribunal**

The Tribunal upheld the contention of the Assessee and held that there was no accrual of income on account of Royalty in the hands of TLME, which resulted in an obligation on the part of the Assessee to deduct any TDS. The Tribunal accepted the Assessee’s contention that its Agreement with TLME was void under Section 23 of the Contract Act, 1882 and did not result in any enforceable debt in the hands of the TLME.

**Held by High Court**

Section 195 of the Act which is a part of the machinery provisions for collection of tax would, therefore, be applicable only in respect of a total income of a non-resident which falls within the scope of Section 5(2) of the Act. Reading the language of Section 195(1) of the Act in the aforesaid perspective, it is clear that credit of any amount to the account of a non-resident or foreign company, maintained in the books of the payer, would be subject to withholding tax only if credit of such amount reflects accrued income in the hands of the payee, which is chargeable to tax under the Act. The Supreme Court in the case of GE India Technology Centre P. Ltd. v. Commissioner of Income Tax and Another (2010) 327 ITR 456 held that the provisions relating to TDS applies only to those sums which are chargeable to tax under the Income-tax Act.

The obligation of a person to deduct TDS under Section 195(1) of the Act would arise only if the following conditions are met:-

The payer owes a sum to the non-resident (not being a company) or a foreign company on account of interest or any other sum chargeable to tax under the Act; and

Such sum is acknowledged as a debt payable by the person to the non-resident/foreign company by crediting the account of such non-resident/foreign company or is paid to non-resident/ foreign company. Mere passing of the book entries, which are reversed, would not give rise to an obligation to deduct TDS by the Assessee, as clearly, there is no debt that can be said to be acknowledged by the Assessee. Imposition of an obligation to deduct TAS in these circumstances would amount to enforcing payments from one person towards a tax liability of

another, even where the person does not does not acknowledge that any sum is payable. This, in our view, is contrary to the scheme of provisions relating to collection of TAS under the Act.

In the case of Commissioner of Income Tax, Bombay City I v. M/s Shoorji Vallabhdas & Co. 46 ITR 144, the Supreme Court referred to the earlier decision of the Bombay High Court in Commissioner of Income Tax v. Chamanlal Mangaldas & Co. (1956) 29 ITR 987, which was approved by the Supreme Court in Commissioner of Income Tax v. Chamanlal Mangaldas & Co. (1960) 39 ITR 8 and held that *Income tax is a levy on income. No doubt, the Incometax*

*Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in bookkeeping, an entry is made about a “hypothetical income”, which does not materialise. A mere book-keeping entry cannot be income, unless income has actually resulted.*

It is not disputed that TLME had not claimed royalty payable from the Assessee and, concededly, no royalty for the period has been paid either. In the circumstances, we are unable to accept that any income had accrued or arisen or deemed to have accrued or arisen, which is chargeable to tax in the hands of TLME. It is not disputed that the agreement dated 1st January, 1997 was not acted upon at the material time. In the absence of any income chargeable to

tax arising on account of royalty in the hands of TLME at the material time, the question of withholding TAS would not arise.

**Accordingly, appeal of the revenue dismissed.**

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