

EY Tax Alert

Supreme Court rules supplementary commission earned by travel agents from customers on sale of air tickets is subject to withholding taxes

Executive summary

Tax Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

This Tax Alert summarizes recent Supreme Court (SC) ruling ^[1] in the case of Singapore Airlines Ltd., KLM Royal Dutch Airlines and British Airways (collectively called as Taxpayer). The issue before the SC was whether supplementary commission earned by travel agents of the Taxpayer will trigger withholding obligation for Taxpayer under the provisions of the Indian Tax Laws (ITL).

The Taxpayer, an airline operator, sells air tickets to customers through various travel agents. On sale of tickets, the travel agents are entitled to two types of commission viz., (a) standard commission as fixed by International Air Transport Association (IATA) and (b) supplementary commission. The Passenger Sales Agency Agreements (PSA) permits the agents to earn supplementary commission from the customers by selling the air tickets at any price between upper cap of "Base Fare" provided by IATA and "Net Fare" set by the Taxpayer.

To illustrate, Base Fare for air tickets provided by IATA is INR 100. Fare of air tickets charged to customers cannot exceed the Base Fare. The Taxpayer sets out a Net Fare price of INR 60 to travel agents and the travel agents, in turn, may sell the tickets to customers at price of say, INR 80. The excess consideration charged by travel agent (i.e., $80-60=INR\ 20$) from customer over INR 60 is treated as supplementary commission.

¹ Singapore Airlines Ltd [TS-880-SC-2022]

The Taxpayer appropriately withheld taxes on standard commission and there was no dispute on this component. However, the Taxpayer did not withhold taxes on the supplementary commission on the ground that the same was not in the nature of commission income and was earned pursuant to independent transaction between travel agents and customer, where the Taxpayer had no control over and knowledge of actual fare charged by the travel agents to customers. However, the tax authority treated the Taxpayer as “assessee-in-default” for not withholding taxes on supplementary commission earned by travel agent and same was upheld by the High Court.

The SC ruled that the travel agents acted on behalf of the Taxpayer while selling the tickets and the principal-agent relationship between the Taxpayer and travel agents was undisputed. Further, the Taxpayer was responsible towards air transport services to the customers and there was no independent transaction between agent and the customer as the title in the air tickets did not pass to agents. Accordingly, supplementary commission income was incidental and had nexus with agency services rendered by travel agents to the Taxpayer. Furthermore, the definition of “commission” under the ITL is wide and also covers indirect payment of commission to agents. Hence, the Taxpayer was liable to be treated as “assessee-in-default” for not withholding tax on supplementary commission.

However, the SC further held that there can be no recovery of principal amount of tax if the travel agents had paid taxes on supplementary commission, although interest can be levied till the date of payment of taxes by the travel agents. Also, the Taxpayer cannot be penalized for not withholding tax since the issue of withholding on supplementary commission was clearly an arguable and “nascent” legal issue which required resolution by the SC.

Background

- ▶ Under the ITL, a payer of income is under an obligation to withhold tax on “commission or brokerage” payment to residents at the time of credit or payment, whichever is earlier.
- ▶ The term “commission or brokerage” is defined to include any payment received or receivable, **directly or indirectly**, by a person acting on behalf of another person for services rendered (not being professional services) or for any services in the course of buying or selling of goods or in relation to any transaction relating to any asset, valuable article or thing, not being securities.

- ▶ On non-compliance of withholding provisions, the payer is regarded as an “assessee-in-default” which results in initiation of recovery proceedings of taxes required to be withheld, interest and penalty. However, levy of penalty may be defended provided the payer proves that there was reasonable cause for failure to withhold taxes. Further, the default also triggers a disallowance of 30% of corresponding expenditure (in respect of payments to residents) while computing taxable income of the payer.

Facts

- ▶ The Taxpayer is an airline operator and is bound by the regulations set out by IATA. IATA sets the Base Fare of air tickets and the price charged to customers cannot exceed the Base Fare set by the IATA.
- ▶ In order to cater to customers, the Taxpayer enters into standard Passenger Sales Agency Agreements² (PSA) with various travel agents accredited with IATA, where travel agents market and sell the air tickets on Taxpayer’s behalf to the customers.
- ▶ Based on the Base Fare quoted by IATA, the Taxpayer sets a Net Fare of air tickets, a price lower than or equal to Base Fare. However, travel agents may sell air tickets to customers at any fare within the cap of Base Fare set by IATA. The Taxpayer does not exercise any control over the actual fare charged by travel agents to customers.

² PSA is the standard format provided by IATA setting out common terms and conditions including remuneration of travel agents

- ▶ The entire mechanism has been explained by SC by way of below Illustration:

Base Fare set by IATA	Net Fare set by Taxpayer	Actual Fare set by travel agents for customers	Standard commission set by IATA (@7% of Base Fare)	Supplementary Commission (Actual Fare - Net Fare)
INR 1,00,000	INR 60,000	INR 80,000	INR 7,000	INR 20,000
<i>Ceiling Price</i>	<i>Income of the Taxpayer</i>	-	<i>Income of travel agent (subjected to withholding by Taxpayer)</i>	<i>Additional income of the travel agent (not subjected to withholding by Taxpayer)</i>

- ▶ The financial information with regard to sale of air ticket transaction is captured and stored over Billing and Settlement Plan (BSP). BSP consolidates the amounts owed by each agent to various airlines on sale of the tickets by the agents. The information is then transmitted to IATA on consolidated basis and IATA settles the dues to the Taxpayer in single financial transaction without the need of multiple payments.
- ▶ The Taxpayer withheld taxes with reference to standard commission (@7% of Base Fare) earned by travel agents. However, no withholding was made on supplementary commission on the ground that same was not in nature of commission income.
- ▶ The tax authority contended that the Taxpayer ought to have withheld taxes on supplementary commission as it was no different in character from the standard commission earned by travel agents and, accordingly, treated the Taxpayer as "assessee-in-default" under the ITL. The tax authority also invoked recovery proceeding with reference to taxes and interest. Further, the tax authority also invoked penalty proceedings, though it was kept in abeyance pending adjudication of the principle issue.
- ▶ First appellate authority upheld the order of tax authority.
- ▶ The second appellate authority (Tribunal) reversed the order of tax authority and held that supplementary commission was not subject to withholding as supplementary commission was earned by the travel agents independently from customers by selling tickets at Actual Fare above Net Fare set by the Taxpayer.
- ▶ On further appeal by the tax authority, the Delhi High Court (HC) ruled in favor of the tax authority and reimposed the status of 'assessee-in-default' on the Taxpayer and ruled that supplementary commission was in the nature of commission

income subject to withholding provisions for the following brief reasons:

- There exists principal and agent relationship between the Taxpayer and travel agents as the travel agents were acting on behalf of the Taxpayer.
 - Title in the air tickets always remained with the Taxpayer and was never transferred to travel agents.
- ▶ Aggrieved, the Taxpayer filed an appeal before the SC on the issue whether supplementary commission was in the nature of commission income, subject to withholding obligation in the hands of the Taxpayer.

Taxpayer's contentions

- ▶ Standard commission is earned pursuant to principal-agent relationship between the Taxpayer and travel agents as established under PSA. Supplementary commission is earned pursuant to independent transaction between travel agents and the customers over which the Taxpayer has no control. The two transactions are distinct and independent.
- ▶ Supplementary commission amount is paid by the customers directly and hence there cannot be a question of withholding by the Taxpayer as there is no payment by Taxpayer.
- ▶ The nomenclature of "supplementary commission" as used in BSP may not be interpreted to mean that the nature of such income is commission income.
- ▶ Reliance placed on Bombay HC decision in the case of Qatar Airways³ wherein the Bombay HC held that supplementary commission amount is paid by the customers directly to travel agents and in the

³ [2009 SCC OnLine Bom 2179]

absence of any payment by the taxpayer, withholding provisions cannot be made applicable.

- ▶ Even assuming there was default in withholding taxes on supplementary commission, no recovery of principal amount can be made as the travel agents offered supplementary commission as income and paid appropriate taxes on it while filing their returns of income⁴.

Tax authority's contentions

- ▶ Withholding on commission income under the ITL covers direct as well as indirect payments made to agents.
- ▶ It is undisputed that the Taxpayer and travel agents establish a principal-agent relationship under PSA.
- ▶ The transaction of supplementary commission earned by travel agents is not independent of such agency relationship but arises from the same relationship. This is because the PSA states that all the activities of travel agents are carried out on behalf of the Taxpayer.
- ▶ Title in the air tickets is never transferred to travel agents, to make the supplementary commission an independent transaction between travel agent and customer.
- ▶ The Taxpayer has access to BSP and is aware of supplementary commission earned by travel agent apart from standard commission. Hence, it was possible for the Taxpayer to determine supplementary commission amount and withhold taxes under the ITL.
- ▶ Supplementary commission offered to tax by travel agent does not cure the default committed by taxpayer in withholding under ITL. Once withholding tax default is committed, the statutory consequences arise automatically.

SC ruling

The SC ruled in favor of the tax authority and held that the amount of supplementary commission received by the travel agents is in the nature of "commission" and hence withholding provisions are applicable.

A. Whether the Taxpayer can be treated as assessee-in-default for not withholding taxes on supplementary commission:

- ▶ In order to determine principal-agent relationship, the SC referred to the guidance provided by a plethora of SC decisions⁵, wherein distinction between master-servant, principal-agent and an independent contractor is enunciated. The SC

⁴ Reliance placed on earlier SC rulings in *Hindustan Coca Cola Beverages Pvt. Ltd. v. CIT* [(2007) 8 SCC 463] and *CIT v. Eli Lilly & Co. (India)* [22 (2009) 15 SCC 1]

⁵ *Lakshminarayan Ram Gopal and Sons Ltd. vs. The Government of Hyderabad* [15 (1955) 1 SCR 393], *Gordon Woodroffe & Co. v. Sheikh M.A. Majid & Co.* [1966 Supp SCR 1], *Bhopal Sugar Industries Ltd. v. STO, Bhopal* [3 SCC 147]

decisions provide guidance on difference between contract of sale and contract of agency as below:

- A servant is bound to conform to all reasonable orders given to him/her in the course of his/her work. On the contrary, independent contractor works completely independent without any control and interference and provides end results. Whereas an agent receives his/her principal's instructions but is generally free to carry out those instructions according to his/her own discretion.
- An agent, as such is not a servant, but a servant is generally for some purposes his/her master's implied agent, the extent of the agency depending upon the duties or position of the servant.
- A contract of sale involves transfer of title and transferee becomes liable for price to be paid as debtor and not as agent for sale proceeds. However, in a contract of agency, the property in goods is not passed on to the agent and agent merely sells the same as the propperty of principal.
- ▶ In the present case, the travel agents were "acting on behalf of" the Taxpayer as:
 - Title in tickets never passed from the Taxpayer to the travel agents.
 - PSA entered between the Taxpayer and travel agents explicitly provides that title in tickets always remain with the Taxpayer. There is no contract of sale undertaken between the Taxpayer and the travel agent.
 - Under PSA, the travel agents agree that they always act on behalf of the Taxpayer and services are provided with the express prior authorization of the Taxpayer.
 - The Taxpayer remains responsible towards air transport services to the customers and is required to indemnify the travel agents in the event of any loss caused to the travel agents due to deficiency in air transport services and any connected ancillary services to customer.
 - The Taxpayer has the responsibility to provide full and final compensation to the travel agents for the acts they carry out under the PSA.
 - The arrangement between the agent and the customer is not a separate and distinct arrangement but is merely part of the package of activities undertaken pursuant to the PSA. The fact that the travel agent is given an authority to charge more than Net fare but within cap of Base Fare did not dilute the agency relationship.
- ▶ The ITL requires withholding on commission income of agents whether paid directly or indirectly. The fact that supplementary commission is paid by the customers to travel agent and not directly by the

Taxpayer does not relieve withholding obligations under the ITL.

- ▶ On the Taxpayer's contention that supplementary commission amount is paid by the customers directly to travel agents and the Taxpayer has no knowledge of the price charged to the customers, SC noted as below:
 - Bombay HC decision in case of CIT v. Qatar Airways⁶ ruled that it was not possible for taxpayer to withhold taxes and income earned by travel agent over and above the Net Fare can neither be commission nor brokerage in the hands of agent. Whereas Madras HC decision in case of Around the World Travel and Tours P. Ltd. v. Union of India⁷ ruled that withholding is required to be done on supplementary commission also.
 - Demarcation of supplementary commission under separate heading was available through BSP and was feasible for the Taxpayer to withhold taxes basis such information. The SC observed that BSP mechanics were not placed before Bombay HC in case of Qatar Airlines (*supra*) and, hence, the decision was distinguished.
 - Lack of control over the Actual Fare charged by the travel agents does not impact the nature of relationship being of principal and agent and cannot form the legal basis for the Taxpayer to avoid the liability under the ITL. Further, PSA sets out that "all monies" received by the travel agent are held in a fiduciary capacity as a property of the Taxpayer.

B. Even if Taxpayer is treated as assessee-in-default, whether any relief is available to Taxpayer as travel agents paid taxes and filed return of income (RoI):

- ▶ The SC held that where the travel agents have already filed their return of income and paid requisite taxes upon income accruing to them, the Tax Authority cannot proceed against the Taxpayer for recovering the principal amount of tax. However, the Taxpayer will be liable to pay interest from the date of default in withholding till the date on which taxes are actually paid by the travel agents under the ITL. Reliance was placed on earlier SC decisions⁸ in this regard.
- ▶ Furthermore, no penalty can be levied on the Taxpayer since the issue involved was an arguable and "nascent" legal issue and there existed a reasonable cause for the Taxpayer not to have withheld taxes on supplementary commission.

⁶ 9 2009 SCC OnLine Bom 2179

⁷ 2003 SCC OnLine Mad 1027

⁸ Hindustan Coca Cola Beverages Pvt. Ltd. v. CIT [(2007) 8 SCC 463] and CIT v. Eli Lilly & Co. (India) [22 (2009) 15 SCC 1]

Comments

The present SC ruling settles a long-drawn controversy with divergent HC decisions on the issue of withholding taxes on supplementary commission earned by travel agents in airline industry. It draws upon guidance on tests for determining principal-agent relationship from several earlier SC rulings. It supports that an agent can act independently without direction and control from principal to serve the purpose of agency within boundaries set by agency agreement. Once principal-agent relationship is established, even indirect payments received by the agent can be covered within the broad definition of commission under the ITL so long as such payments are received by virtue of and has nexus with such agency relationship. The SC also ruled that any income earned by agent pursuant to principal-agent relationship will be treated as commission income irrespective of the nomenclature used by parties.

The SC also clarified that, where appropriate taxes on income of the payee has been discharged, the tax authority shall not recover the principal tax amount again from the payer. However, the payer will be subject to interest consequences. As per extant law, the SC held that the Taxpayer will be liable to pay interest from the date of default till the date of actual payment of taxes by payee. The provisions of the ITL have since been amended⁹ to specifically provide for relief from recovery of principal tax amount provided the payee has (i) filed the return of income (ii) declared the subject income in the RoI (iii) discharged taxes on the income declared in his/her return of income and this is supported by a Chartered Accountant's certificate in Form 26A. Furthermore, in such case, the interest is computed till the date of filing of RoI by the payee.

⁹ Finance Act 2012

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