Reportable

* **IN THE HIGH COURT OF DELHI AT New Delhi**

ITA No. 439 of 2008

Reserved on : March 04, 2010.
% *Pronounced on : March 15, 2010.*

Van Oord ACZ India (P) Ltd. . . . Appellant

through : Mr. Ajay Vohra with Ms. Kavita Jha and Ms. Akansha Aggarwal, Advocates.

VERSUS

Commissioner of Income Tax . . . Respondent

through: Ms. Sonia Mathur, Advocate.

CORAM :-
THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE SIDDHARTH MRIDUL

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. This appeal was admitted on the following substantial questions of law:

(i) Whether on the facts and in the circumstances of the case the Tribunal erred in holding that the appellant was liable to deduct tax at source under Section 195(1) of the Act in respect of the mobilization and demobilization costs reimbursed by the appellant to VOAMC?

(ii) Whether on the facts and circumstances of the case, the

non-resident and the payee was not required to determine whether the said sum is chargeable to tax or not under the provisions of the Act?

(iii) Whether on the facts and in the circumstances of the case, the Tribunal erred in law in not adjudicating the issue regarding non-applicability of Section 40(a)(i) of the Act in view of the provisions contained in Article 24 of the Indo-Netherlands Double Tax Avoidance Treaty relating to non-discrimination?

2. Counsel for both the parties have made oral arguments, which are supplemented by the written submissions. We have considered the oral as well as written arguments filed by them and proceed to answer to the aforementioned questions of law. However, it would first be apposite to take note of the relevant facts, sans unnecessary details.

3. The appellant/assessee is a company incorporated in India and is a wholly owned subsidiary of Van Oord ACZ Marine Contractors BV, Netherlands, (VOAMC in brief), a company incorporated in the Netherlands. The assessee is engaged in the business of dredging, contracting, reclamation and marine activities. The case relates to the Assessment Year 2003-04. During the relevant previous year, the appellant executed *inter alia* dredging contract at Port Mundra for Gujarat Adani Port Ltd. In terms of the completed contract method, the appellant debited to its profit and loss account, *inter alia*, mobilization and demobilization cost of Rs.8,92,37,645/- reimbursed to VOAMC, out of which Rs.8,65,57,909/- pertained to the aforesaid

related essentially to transportation of dredger, survey equipmen other plant and machinery from countries outside India to the site in India and re-transportation of the same on completion of the contract, including fuel cost incurred on transportation. The aforesaid services were contracted by VOAMC and were provided by various non-resident parties. The appellant reimbursed the cost relating to mobilization and demobilization incurred by VOAMC on the basis of invoices received by VOAMC from the non-resident service providers.

4. The appellant had filed an application with DCIT, Circle 2(2), International Taxation, New Delhi (DCIT) for issuing NIL tax withholding certificate in respect of reimbursement of various costs required to be made by the appellant to VOAMC, on the ground that the amount represented pure reimbursement of expenses and thus, there was no income liable to tax in India in the hands of VOAMC. The DCIT held that the reimbursement of costs to VOAMC were liable to tax in India and determined 11% of the reimbursement amount as the profit arising to VOAMC in India and directed the appellant to deduct tax at source on the above basis. The appellant, in accordance with the aforesaid order, had deducted tax at source in respect of mobilization and demobilization charges of Rs.6,985,26,456/- reimbursed to VOAMC.

5. In the return filed by the appellant, it declared loss of Rs.1,94,87,912/- after claiming certain deductions. It included the deduction for the aforesaid mobilization and demobilization cost of Rs.8,65,57,909/-.

Section 40(a)(i) on the ground that the appellant had defaulte deducting tax at source under Section 195 of the Act, while making payment to VOAMC. Aggrieved by the order of the AO, the appellant preferred an appeal before CIT(A). The CIT(A) upheld the disallowance made by the AO.

6. Still aggrieved, the appellant approached the higher forum, *i.e.*, Income Tax Appellate Tribunal (hereinafter referred to as 'the Tribunal'). The Tribunal upheld, in principle, the disallowance of expenses to VOAMC, made under Section 40(a)(i) of the Act, for alleged non-deduction of tax at source. According to the Tribunal, since payment was made to a non resident, the appellant was mandatorily liable to deduct tax at source under Section 195 of the Act. The Tribunal has further held that it was not necessary to determine whether such payment was chargeable to tax in India in the hands of the non-resident. The Tribunal in detail took note of the nature of transaction in its impugned order. It found that VOAMC was originally awarded contract by Gujarat Adani Port. Subsequently, this contract was assigned to the assessee company on 13.07.2001. The reason for awarding the aforesaid contract to the foreign company was that it suited the contract requirements, technical competence and resources to complete the project, notwithstanding this assignment to the assessee company, *i.e.* VOAMC, which was executing the contract.

7. The AO had recorded the following findings:

(i) The foreign company is executing the contract even after assigning the same to the assessee company, since

resources, technical competence, machinery and financial worth to carry out the aforesaid assignment.

(ii) The assessee company is technically and economically dependent on the holding company inasmuch as the assessee has huge loan outstanding to the holding company.

(iii) Mr. A.P. Srivastava, the Principal Officer of the Indian company, Power of Attorney holder of the foreign company and is empowered to conclude contracts on behalf of the foreign company. The contract with APL was signed by him as a representative of the Van Oord ACZ.

(iv) The assessee company has a very few employees, who are not at all technically competent but are support staff. The manpower for the execution of the contract has been provided by Van Oord ACB BV. Technical details and know-how are also provided by them.

(v) The Tribunal thus recorded the finding of fact to the effect that the assessee company was a dependent agent Permanent Establishment of the foreign company. Therefore, the reassessment of expenses in respect of Mob cost to the above said foreign company was to be subjected to payment of tax.

8. From the reading of the orders of the Tribunal, following discussion

The Tribunal was of the opinion that for resolving the iss was to be determined as to whether the tax authorities below were justified in disallowing a sum of Rs.8,65,57,909/- claimed by the assessee as mobilization and demobilization cost debited by the assessee under Profit & Loss account under Section 40(a)(i) of the Act. It then took note of the fact that the said provision of Section 40(a)(i) of the Act is substituted by the Finance Act 1988 with effect from 01.04.1989, which was relevant to the Assessment Year 2003-04 and concluded that the payment made by the assessee to VOAMC in respect of mobilization and demobilization charges was covered within the provisions of Section 40 (a) (i) of the Act. This provision further provided that if tax is not deducted at source or after deduction, payment is not made to the account of Central Government prescribed under Section 40(a)(i) of the Act, no deduction at source is allowed in computation of income on account of interest, royalty, fees for technical services or other sources, which is payable in India or in India to a non-resident or to a foreign company. For this conclusion, the Tribunal referred to certain case law including the judgment of the Supreme Court in the case of ***Transmission Corporation of AP Ltd. & Another*** Vs. ***Commissioner of Income Tax*** [239 ITR 387] and extensively quoting therefrom. It, then, summed up the legal position under the provisions of Section 195 of the Act by deducing the following principles:

> "a) Section 195deals with the deduction of tax at source by the payer i.e. assessee if the payments are to be made to a non-resident.

c) If the parties feel that either the deduction of tax at sourc by the payer is required to be at a rate lower than th prescribed rate or no deduction is required to be made they are required to file an application before the ITO for obtaining such certificate. In case no such application is filed before Assessing Officer for obtaining such certificate or such application is rejected by Assessing Officer and direction is issued by the Assessing Officer to deduct such tax at a particular rate the payer is duty bound to deduct tax as per the directions of Assessing Officer and in case no such application for obtaining the certificate was filed before the Assessing Officer then the payer is duty bound to deduct tax as per the prescribed rates in force at the relevant time. If the payer still fails to comply with the provisions there is no escape for the payer from suffering the consequences provided under the IT Act.

d) Since the deduction of tax u/s 195 on such payments to non-residents is subject to regular assessments the rights of parties are not adversely affected in any manner whatsoever and is clearly indicative of a fact that such deductions are tentative.

27. From the above discussion we can further deduce that rights and duties of the payer now clearly stand demarcated and limited to the extent as laid down by the Apex Court in their order (Supra) i.e. that the payer/assessee is duty bound to deduct tax at source for the payments made to non-residents at the appropriate rates as provided under these provisions. The payer cannot escape the liability for doing so unless a certificate from ITO is obtained for the deduction of the tax either at a rate lower than the rate as prescribed or for non-deduction of tax at source and that the duty of the payer ends here only and he is not required to examine and look into other aspects beyond this like whether the payer received the services from the non-resident to whom such payments were made or from some other person through the non-resident; whether such receipt in the hands of the recipient non-resident would be his income or part of it would be his income on which he is liable to pay tax. The payer is not expected to step into the shoes of the Assessing Officer for examining whether the receipts in the hands of the recipient is income or not whether he is liable to pay thereon or not."

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33. Thus, in view of our detailed discussions and applying the ratio of the decision of the Apex Court in the case of Transmission Corporation of AP Ltd. (Supra), we conclude that it is not for the assessee/payer to decide the taxability of payments made by it in the hands of non-resident recipient as the machinery for this purpose was provided in sub-section (2) of Section 195 itself, whereby the concerned Assessing Officer could have been approached to decide this aspect. That the chargeability of income in the hands of

> payments made to the concerned non-resident. That th payer/assessee having failed to deduct such tax as require by section – 195 the payments made to the recipient non-resident were liable to be disallowed as per the specific provisions contained in Section 40(a)(i). that while deciding the issue whether for such payments made to non-resident by the payer/assessee deduction u/s 10(a)(i) could be allowed to the payer or not. We are not required to look into whether such payments are income or part of the income in the hands of recipient non-resident taxable in India and many other relevant factors relating to taxability of the payments in the hands of recipient non-resident as its income in India. That having held so the detailed arguments of both the parties on the question of the nature of the payments made by the payer to the payee non-resident and the taxability of such payment as income in the hands of recipient non-resident is thus beyond the scope of provisions of Section 40(a)(i) where we are only required to consider the deduction of such payments claimed by the payer/assessee to the non-resident in case of non-compliance of provisions of section 195 of IT Act i.e. non-deduction of tax at source for the payments made to non-resident.
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> 33.1 Hence for the reasons stated above, we are not considering the arguments of the parties on merits regarding the nature of payments and taxability of the same in the hands of recipient non-resident company as well as the related case laws relied upon by both the parties for deciding the issue u/s 40(a)(i) as being not relevant and so we are also not referring to the same in this order."

9. In nutshell, the view of the Tribunal, while interpreting the provisions of Section 195 of the Act, is that under this provision the assessee is under obligation to deduct the income tax at source if the payments are to be made to a non-resident. In case the assessee feels that no such deduction is required or deduction is required at a rate lower than the prescribed rate, he is under obligation to move an application before the Assessing Officer for obtaining a certificate to this effect. In case such application is rejected or the assessee does not make any such application, he is duty bound to deduct the tax as per the prescribed rates in force at the relevant time. It is not for the assessee to decide the taxability of payments made by it in the hand of the non-

Section 195(2), it is obligatory on the part of the assessee to deduc at source from the payments made to the concerned non-resident. If this is not done, the consequence enlisted under Section 40(a)(i) of the Act shall follow. The authorities would not even be required to look into whether such payments are income or part of income in the hands of the recipient non-resident taxable in India. Thus, in the opinion of the Tribunal, the assessee would be at fault if he did not deduct the tax at source on payments made to non-resident on the dismissal of application under Section 195(2) of the Act and it was of no consequence as to whether the non-resident was liable to pay tax or not on the payments received from the assessee.

On this reasoning, the Tribunal dismissed the appeal of the assessee herein.

10. The basic premise of the submissions of the learned counsel for the assessee, while challenging the aforesaid approach of the learned Tribunal, is that the Tribunal did not deal with the arguments/submissions of the appellant to the effect that since on the facts of the case, the amount reimbursed to VOAMC was not chargeable to tax in India in the hands of VOAMC, the appellant was consequently not liable to deduct tax at source under Section 195 and the disallowance under Section 40(a)(i) of the Act was, therefore, not warranted. The Tribunal also did not deal with the alternate contention of the appellant that no disallowance under Section 40(a)(i) was called for, in view of the non-discrimination provision contained in Article 24 of the Indo-Netherlands Double Tax Avoidance Treaty.

payable by the non-resident on the payments received by the said resident and once it was established that no such tax was payable by the non-resident, the assessee could not be treated to be in breach.

11. We shall take note of the detailed submissions while discussing each of the question of law, which we are required to answer.

12. **Re: Question No. 1:**

Explaining the scheme of tax deduction at source under the Income Tax Act, Mr. Vohra, learned counsel appearing for the appellant submitted that the primary responsibility for payment of tax is on the recipient of income. Obligation is cast under the provisions of Chapter XVII-B of the Act on the remitter/payer of income to deduct tax at source out of the payment made to the recipient. In case of any failure on the part of the remitter to deduct tax at source in accordance with the provisions of the said Chapter, the recipient of income is not absolved from the liability to pay tax on its income chargeable under the provisions of the Act. The various sections in Chapter XVII-B, *viz.*, Sections 192 to 194LA required deduction of tax at source by the payer at the time of making payment to the recipient or at the time of credit of income, whichever is earlier. According to him, the reason for fastening the obligation to deduct tax at source out of payment to non-resident only in a situation where such payment is chargeable to tax in India, is not far to seek. The deduction of tax at source is not an idle formality. It is not the intention of the law to fasten an absolute liability on the remitter to deduct tax at source from the payment made to the non-resident, notwithstanding that the payment is not

of tax deducted at source and (b) assessment on the basis of return. Where the remitter/non-resident is of the opinion that some part of the income may be chargeable to tax in India, the remitter/non-resident can approach the AO in terms of Section 195/197 of the Act to determine the appropriate proportion of the income that would be subject to tax in India and the rate on which the tax needs to be deducted at source. Relying upon the observations of the Supreme Court in ***Transmission Corporation of A.P. Ltd.*** (supra) itself, he argued that it was categorically laid down by the Court that the obligation to deduct tax at source is triggered only when the payment to be made to the non-resident is chargeable to tax in India in the hands of the non-resident recipient and it was so held in the following cases as well:

(i) ***Commissioner of Income Tax*** Vs. ***Estel Communications (P) Ltd.*** [217 CTR 102];

(ii) ***Jindal Thermal Power Company Limited (Earlier Known as Jindal Tranctebel Power Company Ltd.)*** **Vs.** ***Dy. Commissioner of Income Tax, (TDS)*** [182 Taxman 252 (Kar.)];

(iii) ***Commissioner of Income Tax*** Vs. ***ICL Shipping Ltd.*** [315 ITR 165 (Mad.)];

(iv) ***Knowerx Education India Pvt. Ltd., In re*** [301 ITR 207 (ARR)];

(v) ***Cushman & Wakefield (S) Pte Ltd., In re*** [305 ITR 208 (ARR)]; and

(vi) ***Mahindra & Mahindra Ltd.*** Vs. ***Dy. Commissioner of Income Tax*** [313 ITR (AT) 263 (Mum) (SB)].

He thus submitted that as a consequence, the payment must be

the payment was chargeable to tax in India in the hands of resident or not. His further submission was that no mileage could be taken from the fact that order under Section 195(2) of the Act had been passed directing the appellant to deduct the tax at source out of payment made to the VOAMC and failure on the part of the assessee to fully comply with the terms of such order or that the assessee's appeal under Section 249 of the Act against that order had been dismissed *in limini* for non-payment of tax directed to be deducted at source. According to him, this was only a tentative determination directing the remitter to deduct tax in accordance with such order. This tentative determination pales into insignificance in view of the Revenue having held that VOAMC did not have a 'Permanent Establishment' in India and was thus not liable to tax in India and refunding the tax at source on reimbursement of mobilization and demobilization charges, to the extent of Rs.6.98 Crores. He, thus, submitted that once Revenue itself had come to the conclusion that the VOAMC was not liable to tax in India, the effect of order under Section 195(2) of the Act had been washed off.

13. Learned counsel for the respondent, on the other hand, reiterated and relied upon the reasons given by the Tribunal. She further pointed out the following points during the proceedings under Section 195(2):

a) The assessee was asked to produce certain documents, which were absolutely necessary to determine as to whether or not any profit element is embedded in the remittance of the expenses. The DCIT, in absence of any documents proceeded to estimate

statutory obligation of the assessee with regard to deducti tax at source was fully crystallized and, therefore, there was no justification on the part of the assessee not to deduct tax at source particularly when the order passed under Section 195(2) had attained finality.

b) The assessee itself has added block expenditure in respect of payments made and holding company on sister concerns as equipment rent as disallowable under Section 40a(i), as no TDS was deducted therefrom.

c) The assessee deducted tax at source in respect of payment made to Van Oord ACZ Equipments BV at 40.72% on the basis of order under Section 195(2). No details were furnished to show as to how payments against leasing of equipment were different from the payment in issue.

d) Section 195 only determines the proportion of liability. It presupposes existence of liability. The assessee himself had applied for determination of extent of liability. In any case, order under Section 195(2) dated 22.11.2002 partly complied by the assessee.

14. Since both the parties heavily relied upon the judgment of the ***Transmission Corporation of AP Ltd.***(supra) and in fact, the impugned decision of the Tribunal is entirely based on this judgment, it would be appropriate to first examine as to what this case actually decides. A reading of the judgment would indicate that the case issue before the Apex Court in the said judgment was whether the tax at

Section 195 of the Act uses the expression, for the purpos deduction of tax at source, on "any other sum chargeable under the provisions of this Act". The contention of the assessee was that it would mean "sum" on which income tax is leviable and therefore, only on that component which was "pure income profits", tax was to be deducted and not which were trade receipts and therefore, outside the ambit of income. It was in this context the precise question, which was decided was as to whether the tax is leviable to be determined on the gross sum of trading receipts paid to the non-residents or in respect of bad portion of trading receipts, which may be chargeable as income under the Act. The Supreme Court was of the opinion that as per Section 195 of the Act, "any other sum chargeable under the provision of this Act" would include the entire amount paid by the assessee to the non-residents. It is in this context, the observations of the Supreme Court are to be read that it was not for the assessee to look into the aspect as to whether such payments are 'income' or 'the income in the hands of the recipients' inasmuch as how much tax is ultimately payable by the recipients is to be determined in the assessment proceedings of the recipients only.

15. The Court in that case, was not concerned with the situation where no tax at the hands of recipient is payable at all. However, certain observations in that judgment itself, would clearly depict the mind of the Court that liability to deduct at source arises only when the sum paid to the non-recipient is chargeable to tax. Once that is chargeable to tax, it is not for the assessee to find out how much amount of the

recipient. This observation of ours is based on the following ext from the said judgment:

> "… … …
> The scheme of Sub-sections (1), (2) and (3) of Section 195 and Section 197 leaves no doubt that the expression **"any other sum chargeable under the provisions of this Act" would mean 'sum' on which income-tax is leviable.** In other words, the said sum is chargeable to tax and could be assessed to tax under the Act. Consideration would be - whether payment of sum to non-resident is chargeable to tax under the provisions of the Act or not? **That sum may be income or income hidden or otherwise embedded therein. If so, tax is required to be deducted on the said sum.** What would be the income is to be computed on the basis of various provisions of the Act including provisions for computation of the business income, if the payment is trade receipt. However, what is to be deducted is income-tax payable thereon at the rates in force. Under the Act, total income for the previous year would become chargeable to tax under Section 4. Sub-section (2) of Section 4 inter alia, provides that in respect of income chargeable under Sub-section (1), income-tax shall be deducted at source where it is so deductible under any provision of the Act. **If the sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted.**
> … … …" (emphasis supplied)

16. It is clear from the above that the Supreme Court dealt with a situation where the sum paid to the non-resident was chargeable and opined that in such a situation tax at source is to be deducted and entire amount paid and not on the "pure income profits", as it was not for the assessee to determine as to how much of the sum paid by the assessee to the recipient would be taxable at the hands of the recipient. The Court was not confronted with the situation where the amount paid was not chargeable to tax at the hands of non-residents at all.

17. The judgment of the Supreme Court is not to be read as a statute.

18. Plain language of Section 195 of the Act shows that the ta source is to be deducted on the "sum chargeable under the provisions of the Act". This section reads as under:

> "195. (1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest or any other sum chargeable under the provisions of this Act (not being income chargeable under the head "Salaries" shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force:
> … … …
> (2) Where the person responsible for paying any such sum chargeable under this Act to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may made an application to the Officer to determine, the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of the sum which is so chargeable.
> … … …"

19. One can, therefore, reasonably say that the obligation to deduct tax at source is attracted only when the payment is chargeable to tax in India. This position in law further gets strengthened from the reading of some other judgments relied upon by the learned counsel for the assessee. In the case of ***Commissioner of Income Tax*** Vs. ***Estel Communications (P) Ltd.*** [217 CTR 102 (Del.)], this Court, while dismissing the appeal of the Revenue, held that the Tribunal had rightly come to the conclusion that there was no income of the non-resident liable to tax in India, the obligation to deduction of tax at source did not arise. Likewise, the Karnataka High Court in the case of ***Jindal Thermal Power Company Limited (Earlier Known***

the following pertinent observations:

> "The decision however does not lay down that the person is obliged to effect TDS u/s 195 has no right to question the assessment of tax liability. Since in law, if TDS is not effected by the payer (Jindal), the payer would be ultimately responsible to pay the tax liability of the payee (REOL). The conjoint reading of Section 195, 201 read with Section 246(1)(i) and Section 248 makes it clear that the Jindal as a payee has ever right to question the tax liability of its payee to avoid the vicarious consequences. Therefore the contention that Jindal has no right of appeal is to be rejected."
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> [Emphasis supplied]

20. We are also in agreement with the following discussion contained in the decision of the Special Bench of Income Tax Appellate Tribunal in the case of ***Mahindra & Mahindra*** Vs. ***Dy. Commissioner of Income Tax*** [313 ITR (AT) 263]:

> "Section 195(1) provides that any person responsible for paying to a nonresident not being company or to a foreign company any interest or any other sum chargeable under the provisions of this Act, not being income chargeable under the head 'Salaries', shall at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of cheque or draft or by any other mode, whichever is earlier, deduct income tax thereon at the rates in force. Sub-section (2) of Section 195 states that where the person responsible for paying any such sum chargeable under this Act (other than interest on securities and salary) to a non-resident considers that whole of such sum would not be income chargeable in the case of recipient, he may make an application to the Assessing Officer to determine, by general or special order, the appropriate proportion of sum so chargeable and upon such determination, the tax shall be deducted under Sub-section (1) only on that proportion of the sum which is so chargeable. The effect of Sub-section (2) is that where primarily the sum paid or credited to the account of the non-resident is chargeable under the provisions of the Act but the person responsible for paying considers that the entire sum would not be income chargeable in the case of recipient, he may make

within the purview of Sub-section (2) it is imperativ that firstly there should be a sum chargeable under th provisions of this Act which is to be paid to the non-resident and secondly the person responsible should consider that the whole of such sum would not be chargeable to income-tax in the case of the recipient. To put it in simple words if a sum of Rs. 100 is to be paid to the non-resident which is otherwise chargeable to tax, but the person responsible for paying it considers that the entire Rs. 100 would not be taxable in the hands of the recipient but only a sum of, say Rs. 40, will be chargeable to tax because of the availability of certain deductions against such income substantially reducing the amount of chargeable income in the hands of the non-resident, then such person responsible for paying shall apply to the Assessing Officer to make a general or special order to the effect that only a sum of Rs. 40 shall be chargeable to tax. On the determination by the Assessing Officer of such amount chargeable to tax at Rs. 40 or whatever amount, the person responsible shall deduct tax only on the amount so determined and not on Rs. 100.

… … …

From the detailed discussion under the succeeding main head, we will also notice that Where the payee is not liable to pay tax on the amount of income received by him without deduction of tax at source, then also the person responsible cannot be treated as assessee in default. To sum up the liability of the person responsible is dependent upon the deductee failing or otherwise to pay such tax directly. Thus the action Under Section 201(1) is dependent on the outcome of the assessment of the payee and the time limit for passing order Under Section 201(1) has to be viewed in the light of the fate of the assessment in the hands of the recipient.

… … …

From here it follows that Sub-section (2) onwards of Section 195 and Section 197 apply, primarily, in respect of a sum which is chargeable to tax. It is only where the sum is otherwise chargeable to tax but deduction of tax at source is not warranted on the whole or any part of it, depending upon the peculiar circumstances, that the person responsible for paying such sum or the person entitled to receive such sum can apply for no deduction or deduction at lower rate of tax. Thus the pre-requisite condition- for the application of Section 195 and thereafter Section 201 is that the amount paid to the non-resident is otherwise chargeable to tax under the provisions of this Act.

virtue of the provisions Double Taxation Avoidanc Agreement (hereinafter called the DTAA) entered int by India with such other country of which the non-resident is resident, in accordance with Chapter IX, then the provisions of Chapter XVII about the Collection and recovery of tax are ruled out and the person responsible for paying-such sum cannot be fastened with any liability for deduction of tax at source and cannot under any circumstance be treated as assessee in default.

… … …

The underlying principle behind the deduction of tax at source is the presumption that there will be some liability of the payee towards tax on the sum paid to him. If there is no such liability then the entire exercise of firstly getting the amount of tax collected/deducted at source and then refunding to the payee will be futile. If there is no tax liability of the payee then there cannot be any question of treating the person responsible for paying the sum without deducting tax at source as assessee in default. Thus the essence of the provisions of deduction of tax at source is that there is a presumption of liability of the payee to tax on the income. As discussed in an earlier para that if there is no or lower liability of the payee to tax on the income so received without deduction of tax at source, then the payer cannot be treated as assessee in default for the whole or that part of the amount, as the case may be. It is therefore clear that though the duty of deduction of tax at source was there at the time of making the payment or crediting the account of the payee, but its failure will not lead to adverse consequence by treating the person paying the income as assessee in default if eventually either the payee is not liable to tax on such sum or he has already paid the tax due on the amount of income so received. Thus the question of treating the person responsible for paying the income as assessee in default by way of passing the order under Section 201(1) is inter alia, tied with the tax liability of the payee on such sum.

… … …

In the like manner where the payee has not offered such income for taxation and there is no remedy available with the AO for taxing such income in the hands of the payee, i.e., the time-limit for taking action against the payee under any possible provision of the Act has expired, then also the payee cannot be charged on such income nor resultantly the person responsible for paying the income can be treated as assessee in default. The

… … …

We therefore hold that in order to treat the payer as assessee in default it is of the utmost importance that the income so paid or credited to the account of payee is capable of being brought within the purview of tax net and such assessment can be lawfully made on the payee.

… … …

Further these sections do not override Section 195, which in turn, fixes the liability on person responsible for deducting tax at source only if the sum paid or credited to the account of the non-resident is chargeable to tax. The question of deducting tax at source will arise only if the sum payable to the non-resident is chargeable to tax in India. Therefore to argue that the liability to deduct tax at source is de hors the eventual liability of the non-resident and the person responsible for paying or crediting any sum can be treated ass assessee in default even without the possibility of fixing the liability to tax on the non-resident, is fallacious.

Adverting to the facts of the instant case we find that that no assessment has been made in the hands of the payee in respect of the sums received from the assessee in respect of both the Euro issues. Similarly no proceedings have been taken against him till date for assessing such income. We further find that now the time limit for issuing notice Under Section 148 has obviously come to an end since the assessment year under consideration is 1998-99. As the time limit for taking action against the payee Under Section 147 is also not available and there is no course left to the Revenue for making the assessment of the non-resident, ex consequent!, no lawful order can be passed against the assessee either Under Section 201(1) or (1A). We therefore hold that in the facts and circumstances of the present case, the order passed under Section 195 read with Section 201(1) or (1A) of the Income tax Act, 1961 is invalid Resultantly the impugned order, flowing out of such invalid order, will also meet with the same fate which is hereby set aside."

21. In this scenario, what would be the impact of Section 195(2) of the Act? No doubt, sub-Section (2) of Section 195 enables a person responsible for paying any such sum chargeable under the Act to a

only a tentative determination. At that stage, the final view is taken as to whether the recipients of the payments is liable to pay income tax in India or not. We, thus, feel that the scheme of the Act, insofar as it relates to deduction of tax at source is concerned, particularly under Section 195 of the Act, provides that liability of the payee, i.e. the assessee, to deduct tax at source would arise when the payment is made to non-resident, not being a company, or to a foreign company and such payment is chargeable under the provisions of the Act. However, if the payee considers that whole of the said sum would not be income chargeable in the case of the recipient, he may move an application to the Assessing Officer to determine this aspect. Once such an application is moved and it is determined that the payment is income chargeable at the hands of the recipient, the assessee is under obligation to deduct the tax at source. However, in case the assessee does not do so, he runs the risk of attracting the consequences provided under Section 40(a)(i) of the Act. The determination by the AO under Section 195(2) of the Act is tentative in nature. In case it is ultimately found in the assessment proceedings relating to the recipient that he was not liable to pay any tax on the sums received, the assessee cannot be treated in "default" inasmuch as Section 195(1) of the Act casts an obligation to deduct the tax at source on the sum *'chargeable under the provisions of this Act'*.

22. In ***Commissioner of Income Tax*** Vs. ***Samsung Electronic***

24.09.2009, the context was different. The assessees wante show their own assessment proceedings, that amount paid by them was not assessable to tax at the hands of recipient. No doubt, they would be precluded to do so. However, when in the assessment proceedings relating to recipient itself, it is opined by the income tax authorities that the tax is not payable at all on the amounts so received, provision of Section 195 would not be attracted. Even otherwise, because of our analysis of what ***Transmission Corporation of AP Ltd.*** (Supra) decides, we, with due respect, are not in agreement with some of the observations made in the aforesaid judgment of the Karnataka High Court.

23. We hereby summarize the legal position as under:

a) Section 195deals with the deduction of tax at source by the payer i.e. assessee if the payments are to be made to a non-resident.

b) The payer/assessee is required to deduct Income tax on such payments made to non-resident at the specified rates in force.

c) The obligation to deduct the tax at source arises only when the payment is chargeable under the provisions of the Income Tax.

d) If the parties feel that either the deduction of tax at source by the payer is required to be at a rate lower than the prescribed rate or no deduction is required to be made they are required to file an application before the ITO for obtaining such

rejected by Assessing Officer and direction is issued by th Assessing Officer to deduct such tax at a particular rate the payer is duty bound to deduct tax as per the directions of Assessing Officer and in case no such application for obtaining the certificate was filed before the Assessing Officer then the payer is duty bound to deduct tax as per the prescribed rates in force at the relevant time.

e) The order of the Assessing Officer under Section 195(2) of the Act is tentative in nature.

f) In the assessment proceedings relating to the assessee when it is found that the assessee was required to deduct the tax at source in the eventuality contemplated in (d) above, the assessee would not be permitted to argue that the amount paid to the recipient is not chargeable under the provisions of the Act. The assessee may be treated as in default and would suffer the consequences provided under the Income Tax Act. However, in case in the assessment proceedings relating to the recipient, it is ultimately held that the sum received by the recipient was not chargeable to tax, the effect of that would be that it was no obligation on the assessee to deduct tax at source on the sum paid to the said non-resident and in that eventuality, the assessee will not be treated as in default and would be absolved of any consequences for not deduction the tax at source.

24. In the present case, the plea of the VOAMC (the resident/non-resident)

under Section 143(a)(i) of the Act. From this, it was sought to be contended by the learned counsel for the Revenue that there is no determination of the issue involved. Fact remains that by accepting the return as filed, the VOAMC has been refunded tax at source by the assessee herein and the implication that it is not liable to pay tax. In case, higher authority passes any order to the contrary, it would be open to the income tax authorities, in the case of the assessee also, to treat the assessee in "default". However, as of today, the position is that VOAMC is not treated as liable to pay any tax.

25. We, thus, answer the question No. 1 in favour of the appellant/assessee holding that the assessee was not liable to deduct tax at source under Section 195(1) of the Act in respect of the mobilization and demobilization costs reimbursed by the appellant to VOAMC. The assessment proceedings in VOAMC are reopened and the final view taken is that the VOAMC is assessable to tax, the assessee herein would also be treated as assessee in "default", which would attract the consequences provided under Section 40(a)(i).

26. **Re: Question No. 2**

Submission of the learned counsel for the assessee was that on the one hand, the Tribunal opined that it was not necessary to go into this question, whereas on the other hand, Para 35.6 of the impugned judgment, the Tribunal has recorded that it is undisputed that the reassessment of mobilization and demobilization charges are liable to tax in India. His submission was that where sums paid to the

to tax in India in the hands of the non-resident. Therefore question of deduction of tax at source would not arise. This aspect is obviously covered in the discussion contained while answering Question No. 1 above and, therefore, stands answered accordingly.

27. The upshot of the aforesaid discussion would be to set aside the order of the Tribunal and, therefore, it is not necessary to go into the Question No.3 and answer the same, which becomes academic in the present case.

28. We accordingly allow this appeal and set aside the order of the Tribunal on this aspect.

(A.K. SIKRI)
JUDGE

(SIDDHARTH MRIDUL)
JUDGE

March 15, 2010.
pmc