IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NOs.7541-7542 OF 2010
(Arising out of SLP(C) No. 34306-34307 of 2009)

GE India Technology Centre Private Ltd. .... Appellant(s)

Versus

Commissioner of Income Tax & Anr. ....Respondent(s)

With

Civil Appeal Nos.7543-7544/2010 @ S.L.P. (C) Nos.34310-34311/2009,
Civil Appeal Nos.7545-7548/2010 @ S.L.P. (C) Nos.35340-35343/2009,
Civil Appeal Nos.7549-7758/2010 @ S.L.P. (C) Nos.1392-1601/2010,
Civil Appeal Nos.7759-7764/2010 @ S.L.P. (C) Nos.1620-1625/2010,
Civil Appeal Nos.7765-7767/2010 @ S.L.P. (C) Nos.4230-4232/2010,
Civil Appeal No.7768/2010 @ S.L.P. (C) No.4239/2010,
Civil Appeal No.7769/2010 @ S.L.P. (C) No.3329/2010,
Civil Appeal No.7770/2010 @ S.L.P. (C) No.5174/2010,
Civil Appeal Nos.7771-7772/2010 @ S.L.P. (C) Nos.7821-7822/2010,
Civil Appeal No.7773/2010 @ S.L.P. (C) No.8410/2010,
Civil Appeal No.7774/2010 @ S.L.P. (C) No.9701/2010,
Civil Appeal Nos.7775-7776/2010 @ S.L.P. (C) Nos.13440-13441/2010,
Civil Appeal No.7777/2010 @ S.L.P. (C) No.13442/2010 and

J U D G M E N T

S.H. KAPADIA, CJI.

1. Leave granted.

2. The short question which arises for determination in this batch of cases is – whether the High Court was right in holding that the moment there is remittance the obligation to deduct tax at source (TAS) arises? Whether merely on account of such remittance to the non-resident abroad by an Indian company per se, could it be said that income chargeable to tax under the Income Tax Act, 1961 (for short "I.T. Act") arises in India?

Facts in the leading case of Sonata Information Technology Ltd.

3. Appellant(s) are the distributors of imported pre-packaged shrink wrapped standardized software from Microsoft and other Suppliers outside India. During the relevant assessment year(s) appellant(s) made payments to the said software Suppliers which according to the

appellant(s) represented the purchase price of the abovementioned software. The ITO(TDS) held that since the sale of software included a license to use the same, payments made by the appellant(s) to the foreign Suppliers constituted royalty, which was deemed to accrue or arise in India. Therefore, TAS was liable to be deducted under Section 195 of the I.T. Act. The said finding of the ITO(TDS) was upheld by the Commissioner (A). In second appeal, the ITAT, however, held that the amount paid by appellant(s) to the foreign software Suppliers was not "royalty" and the same did not give rise to any income taxable in India, and therefore, the appellant(s) was not liable to deduct TAS.

4. The Department appealed to the Karnataka High Court. Before the High Court, the Department for the first time raised the contention that unless the payer makes an application to the ITO(TDS) under Section 195(2) and has obtained a permission for non-deduction of the TAS, it was not permissible for the payer to contend that the payment made to the non-resident did not give rise to "income" taxable in India and that, therefore, there was no need to

deduct any TAS. This argument of the Department was accepted by the High Court vide the impugned judgment. For reaching this conclusion, the High Court placed strong reliance on the judgment of this Court in **Transmission Corporation of A.P. Ltd. Vs. C.I.T.** [239 ITR 587(SC)]. Aggrieved by the said decision, the appellant(s) has come to this Court by way of civil appeal(s).

Analysis of Section 195

5. At the outset, we quote hereinbelow the relevant provisions of Section 195, as it stood at the relevant time.

"**195.** (1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest on securities) 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 (other than interest on securities and salary) to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the Assessing Officer to determine, by general or special order, 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.

(3) Subject to rules made under sub-section (5), any

person entitled to receive any interest or other sum on which income-tax has to be deducted under sub-section (1) may make an application in the prescribed form to the Assessing Officer for the grant of a certificate authorizing him to receive such interest or other sum without deduction of tax under that sub-section, and where any such certificate is granted, every person responsible for paying such interest or other sum to the person to whom such certificate is granted shall, so long as the certificate is in force, make payment of such interest or other sum without deducting tax thereon under sub-section(1)."

6. At this stage we may also quote hereinbelow Section 195 (6) as inserted by Finance Act, 2008 w.e.f. 1.4.2008.

"**195(6)** The person referred to in sub-section (1) shall furnish the information relating to payment of any sum in such form and manner as may be prescribed by the Board."

7. Under Section 195(1), the tax has to be deducted at source from interest (other than interest on securities) or any other sum (not being salaries) chargeable under the I.T. Act in the case of non-residents only and not in the case of residents. Failure to deduct the tax under this Section may disentitle the payer to any allowance apart from prosecution under Section 276B. Thus, Section 195 imposes a statutory obligation on any person responsible for paying to a non-resident, any interest (not being interest on securities) or any other sum (not being dividend) chargeable under the

provisions of the I.T. Act, to deduct income tax at the rates in force unless he is liable to pay income tax thereon as an agent. Payment to non-residents by way of royalty and payment for technical services rendered in India are common examples of sums chargeable under the provisions of the I.T. Act to which the aforestated requirement of tax deduction at source applies. The tax so collected and deducted is required to be paid to the credit of Central Government in terms of Section 200 of the I.T. Act read with Rule 30 of the I.T. Rules 1962. Failure to deduct tax or failure to pay tax would also render a person liable to penalty under Section 201 read with Section 221 of the I.T. Act. In addition, he would also be liable under Section 201(1A) to pay simple interest at 12 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid. The most important expression in Section 195(1) consists of the words "**chargeable under the provisions of the Act**". A person paying interest or any other sum to a non-resident is not liable to deduct tax if such sum is not

chargeable to tax under the I.T. Act. For instance, where there is no obligation on the part of the payer and no right to receive the sum by the recipient and that the payment does not arise out of any contract or obligation between the payer and the recipient but is made voluntarily, such payments cannot be regarded as income under the I.T. Act. It may be noted that Section 195 contemplates not merely amounts, the whole of which are pure income payments, it also covers composite payments which has an element of income embedded or incorporated in them. Thus, where an amount is payable to a non-resident, the payer is under an obligation to deduct TAS in respect of such composite payments. The obligation to deduct TAS is, however, limited to the appropriate proportion of income chargeable under the Act forming part of the gross sum of money payable to the non-resident. This obligation being limited to the appropriate proportion of income flows from the words used in Section 195(1), namely, "chargeable under the provisions of the Act". It is for this reason that vide Circular No. 728 dated October 30, 1995 the CBDT has clarified that the tax

deductor can take into consideration the effect of DTAA in respect of payment of royalties and technical fees while deducting TAS. It may also be noted that Section 195(1) is in identical terms with Section 18(3B) of the 1922 Act. In **CIT Vs. Cooper Engineering** [68 ITR 457] it was pointed out that if the payment made by the resident to the non-resident was an amount which was not chargeable to tax in India, then no tax is deductible at source even though the assessee had not made an application under Section 18(3B) (now Section 195(2) of the I.T. Act). The application of Section 195(2) pre-supposes that the person responsible for making the payment to the non-resident is in no doubt that tax is payable in respect of some part of the amount to be remitted to a non-resident but is not sure as to what should be the portion so taxable or is not sure as to the amount of tax to be deducted. In such a situation, he is required to make an application to the ITO(TDS) for determining the amount. It is only when these conditions are satisfied and an application is made to the ITO(TDS) that the question of making an order under Section 195(2) will arise. In fact, at

one point of time, there was a provision in the I.T. Act to obtain a NOC from the Department that no tax was due. That certificate was required to be given to RBI for making remittance. It was held in the case of **Czechoslovak Ocean Shipping International Joint Stock Company Vs. ITO** [81 ITR 162(Calcutta)] that an application for NOC cannot be said to be an application under Section 195(2) of the Act. While deciding the scope of Section 195(2) it is important to note that the tax which is required to be deducted at source is deductible only out of the chargeable sum. This is the underlying principle of Section 195. Hence, apart from Section 9(1), Sections 4, 5, 9, 90, 91 as well as the provisions of DTAA are also relevant, while applying tax deduction at source provisions. Reference to ITO(TDS) under Section 195(2) or 195(3) either by the non-resident or by the resident payer is to avoid any future hassles for both resident as well as non-resident. In our view, Sections 195(2) and 195(3) are safeguards. The said provisions are of practical importance. This reasoning of ours is based on the decision of this Court in **Transmission Corporation**

(supra) in which this Court has observed that the provision of Section 195(2) is a safeguard. From this it follows that where a person responsible for deduction is fairly certain then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof.

Submissions and findings thereon

8. If the contention of the Department that the moment there is remittance the obligation to deduct TAS arises is to be accepted then we are obliterating the words "chargeable under the provisions of the Act" in Section 195(1). The said expression in Section 195(1) shows that the remittance has got to be of a trading receipt, the whole or part of which is liable to tax in India. The payer is bound to deduct TAS only if the tax is assessable in India. If tax is not so assessable, there is no question of TAS being deducted. [**See : Vijay Ship Breaking Corporation and Others Vs. CIT** 314 ITR 309]

9. One more aspect needs to be highlighted. Section 195 falls in Chapter XVII which deals with collection and

recovery. Chapter XVII-B deals with deduction at source by the payer. On analysis of various provisions of Chapter XVII one finds use of different expressions, however, the expression "sum chargeable under the provisions of the Act" is used only in Section 195. For example, Section 194C casts an obligation to deduct TAS in respect of "any sum paid to any resident". Similarly, Sections 194EE and 194F inter alia provide for deduction of tax in respect of "any amount" referred to in the specified provisions. In none of the provisions we find the expression "sum chargeable under the provisions of the Act", which as stated above, is an expression used only in Section 195(1). Therefore, this Court is required to give meaning and effect to the said expression. It follows, therefore, that the obligation to deduct TAS arises only when there is a sum chargeable under the Act. Section 195(2) is not merely a provision to provide information to the ITO(TDS). It is a provision requiring tax to be deducted at source to be paid to the Revenue by the payer who makes payment to a non-resident. Therefore, Section 195 has to be read in

conformity with the charging provisions, i.e., Sections 4, 5 and 9. This reasoning flows from the words "sum chargeable under the provisions of the Act" in Section 195(1). The fact that the Revenue has not obtained any information per se cannot be a ground to construe Section 195 widely so as to require deduction of TAS even in a case where an amount paid is not chargeable to tax in India at all. We cannot read Section 195, as suggested by the Department, namely, that the moment there is remittance the obligation to deduct TAS arises. If we were to accept such a contention it would mean that on mere payment income would be said to arise or accrue in India. Therefore, as stated earlier, if the contention of the Department was accepted it would mean obliteration of the expression "sum chargeable under the provisions of the Act" from Section 195(1). While interpreting a Section one has to give weightage to every word used in that section. While interpreting the provisions of the Income Tax Act one cannot read the charging Sections of that Act de hors the machinery Sections. The Act is to be read as an integrated

Code. Section 195 appears in Chapter XVII which deals with collection and recovery. As held in the case of **C.I.T. Vs. Eli Lilly & Co. (India) (P.) Ltd.** [312 ITR 225] the provisions for deduction of TAS which is in Chapter XVII dealing with collection of taxes and the charging provisions of the I.T. Act form one single integral, inseparable Code and, therefore, the provisions relating to TDS applies only to those sums which are "chargeable to tax" under the I.T. Act. It is true that the judgment in **Eli Lilly** (supra) was confined to Section 192 of the I.T. Act. However, there is some similarity between the two. If one looks at Section 192 one finds that it imposes statutory obligation on the payer to deduct TAS when he pays any income "chargeable under the head salaries". Similarly, Section 195 imposes a statutory obligation on any person responsible for paying to a non-resident any sum "chargeable under the provisions of the Act", which expression, as stated above, do not find place in other Sections of Chapter XVII. It is in this sense that we hold that the I.T. Act constitutes one single integral inseparable Code. Hence, the provisions relating to TDS

applies only to those sums which are chargeable to tax under the I.T. Act. If the contention of the Department that any person making payment to a non-resident is necessarily required to deduct TAS then the consequence would be that the Department would be entitled to appropriate the moneys deposited by the payer even if the sum paid is not chargeable to tax because there is no provision in the I.T. Act by which a payer can obtain refund. Section 237 read with Section 199 implies that only the recipient of the sum, i.e., the payee could seek a refund. It must therefore follow, if the Department is right, that the law requires tax to be deducted on all payments. The payer, therefore, has to deduct and pay tax, even if the so-called deduction comes out of his own pocket and he has no remedy whatsoever, even where the sum paid by him is not a sum chargeable under the Act. The interpretation of the Department, therefore, not only requires the words "chargeable under the provisions of the Act" to be omitted, it also leads to an absurd consequence. The interpretation placed by the Department would result in a situation where even when

the income has no territorial nexus with India or is not chargeable in India, the Government would nonetheless collect tax. In our view, Section 195(2) provides a remedy by which a person may seek a determination of the "appropriate proportion of such sum so chargeable" where a proportion of the sum so chargeable is liable to tax. The entire basis of the Department's contention is based on administrative convenience in support of its interpretation. According to the Department huge seepage of revenue can take place if persons making payments to non-residents are free to deduct TAS or not to deduct TAS. It is the case of the Department that Section 195(2), as interpreted by the High Court, would plug the loophole as the said interpretation requires the payer to make a declaration before the ITO(TDS) of payments made to non-residents. In other words, according to the Department Section 195(2) is a provision by which payer is required to inform the Department of the remittances he makes to the non-residents by which the Department is able to keep track of the remittances being made to non-residents outside India.

We find no merit in these contentions. As stated hereinabove, Section 195(1) uses the expression "sum chargeable under the provisions of the Act." We need to give weightage to those words. Further, Section 195 uses the word 'payer' and not the word "assessee". The payer is not an assessee. The payer becomes an assessee-in-default only when he fails to fulfill the statutory obligation under Section 195(1). If the payment does not contain the element of income the payer cannot be made liable. He cannot be declared to be an assessee-in-default. The abovementioned contention of the Department is based on an apprehension which is ill founded. The payer is also an assessee under the ordinary provisions of the I.T. Act. When the payer remits an amount to a non-resident out of India he claims deduction or allowances under the Income Tax Act for the said sum as an "expenditure". Under Section 40(a)(i), inserted vide Finance Act, 1988 w.e.f. 1.4.89, payment in respect of royalty, fees for technical services or other sums chargeable under the Income Tax Act would not get the benefit of deduction if the assessee fails to deduct TAS in

respect of payments outside India which are chargeable under the I.T. Act. This provision ensures effective compliance of Section 195 of the I.T. Act relating to tax deduction at source in respect of payments outside India in respect of royalties, fees or other sums chargeable under the I.T. Act. In a given case where the payer is an assessee he will definitely claim deduction under the I.T. Act for such remittance and on inquiry if the AO finds that the sums remitted outside India comes within the definition of royalty or fees for technical service or other sums chargeable under the I.T. Act then it would be open to the AO to disallow such claim for deduction. Similarly, vide Finance Act, 2008, w.e.f. 1.4.2008 sub-Section (6) has been inserted in Section 195 which requires the payer to furnish information relating to payment of any sum in such form and manner as may be prescribed by the Board. This provision is brought into force only from 1.4.2008. It will not apply for the period with which we are concerned in these cases before us. Therefore, in our view, there are adequate safeguards in the Act which would prevent revenue leakage.

Applicability of the judgment in the case of Transmission Corporation (supra)

10. In **Transmission Corporation** case (supra) a non-resident had entered into a composite contract with the resident party making the payments. The said composite contract not only comprised supply of plant, machinery and equipment in India, but also comprised the installation and commissioning of the same in India. It was admitted that the erection and commissioning of plant and machinery in India gave rise to income taxable in India. It was, therefore, clear even to the payer that payments required to be made by him to the non-resident included an element of income which was exigilble to tax in India. The only issue raised in that case was whether TDS was applicable only to pure income payments and not to composite payments which had an element of income embedded or incorporated in them. The controversy before us in this batch of cases is, therefore, quite different. In **Transmission Corporation** case (supra) it was held that TAS was liable to be deducted

by the payer on the gross amount if such payment included in it an amount which was exigible to tax in India. It was held that if the payer wanted to deduct TAS not on the gross amount but on the lesser amount, on the footing that only a portion of the payment made represented "income chargeable to tax in India", then it was necessary for him to make an application under Section 195(2) of the Act to the ITO(TDS) and obtain his permission for deducting TAS at lesser amount. Thus, it was held by this Court that if the payer had a doubt as to the amount to be deducted as TAS he could approach the ITO(TDS) to compute the amount which was liable to be deducted at source. In our view, Section 195(2) is based on the "principle of proportionality". The said sub-Section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court stated, "*If no such application is filed, income-tax on* ***such sum*** *is to be deducted and it is the statutory obligation of the person responsible for paying* ***such***

'sum' *to deduct tax thereon before making payment. He has to discharge the obligation to TDS".* If one reads the observation of the Supreme Court, the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India. In our view, the above observations of this Court in **Transmission Corporation** case (supra) which is put in italics has been completely, with respect, misunderstood by the Karnataka High Court to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TAS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of the plain words of Section 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the I.T. Act, i.e., chargeable under Sections 4, 5 and 9 of the I.T. Act.

11. Before concluding we may clarify that in the present case on facts the ITO (TDS) had taken the view that since

the sale of the concerned software, included a license to use the same, the payment made by appellant(s) to foreign Suppliers constituted “royalty” which was deemed to accrue or arise in India and, therefore, TAS was liable to be deducted under Section 195(1) of the Act. The said finding of the ITO(TDS) was upheld by the CIT(A). However, in second appeal, the ITAT held that such sum paid by the appellant(s) to the foreign software Supplier was not a “royalty” and that the same did not give rise to any “income” taxable in India and, therefore, the appellant(s) was not liable to deduct TAS. However, the High Court did not go into the merits of the case and it went straight to conclude that the moment there is remittance an obligation to deduct TAS arises, which view stands hereby overruled.

12. Since the High Court did not go into the merits of the case on the question of payment of royalty, we hereby set aside the impugned judgments of the High Court and remit these cases to the High Court for de novo consideration of the cases on merits. The question which the High Court will answer is –whether on facts and

circumstances of the case the ITAT was justified in holding that the amount(s) paid by the appellant(s) to the foreign software Suppliers was not "royalty" and that the same did not give rise to any "income" taxable in India and, therefore, the appellant(s) was not liable to deduct any tax at source?

13. Subject to what is stated hereinabove, we set aside the impugned judgment(s) and remit these cases to the High Court to answer the question framed hereinabove. Accordingly, the appeal(s) filed by the appellant(s) stands allowed with no order as to costs.

.....CJI
(S. H. Kapadia)

.....J.
(K.S. Radhakrishnan)

New Delhi;
September 09, 2010