

IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED : 08.03.2021

CORAM

THE HONOURABLE MR.JUSTICE T.S.SIVAGNANAM
and
THE HONOURABLE MS.JUSTICE R.N.MANJULA

T.C.A.No.291 of 2018
and
C.M.P.No.5832 of 2018

M/s.Chennai Petroleum Corporation Limited,
536, Anna Salai, Teynampet,
Chennai-600 018.
PAN: AAACM4392C ... Appellant

-vs-

The Joint Commissioner of Income-tax,
Large Tax Payer Unit,
Chennai-600 034. ... Respondent

Appeal under Section 260A of the Income Tax Act, 1961 against the order dated 07.12.2017 made in I.T.A.No.687/Mds/2013 on the file of the Income Tax Appellate Tribunal 'B' Bench, Chennai for the assessment year 2006-07, against the order of the Office of the Commissioner of Income Tax (Appeals) Large Tax Payer Unit, Chennai made in ITA No.66/11-12 for Assessment Year 2006-2007 dated 08/01/2013 against the order of the Joint Commissioner of Income Tax, LTU, Chennai made in Q1 No./PA No.AACM 4392C dated of order 30/11/2011 for the Assessment Year 2006-2007.

For Appellant : Mr.Vikram Vijayaraghavan
For M/s.Subbaraya Aiyar,
Padmanabhan & Ramamani

For Respondent : Mr.T.Ravikumar,
Senior Standing Counsel

JUDGMENT

(Judgment of the Court was delivered by T.S.Sivagnanam, J.)

This appeal, filed under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as "the Act"), by the assessee, a

Public Sector Corporation, is directed against the order dated 07.12.2017, passed by the Income Tax Appellate Tribunal 'B' Bench, Chennai (for brevity "the Tribunal") in I.T.A.No.687/Mds/2013 for the assessment year 2006-07.

2.The revised substantial questions of law, which are to be decided, are as hereunder:-

"(i) Whether the Tribunal was right in law in upholding disallowance u/s.40(a)(i) of the Act, for non-deduction of tax under Section 195(1) of the Act, the total Gross Payments made for purchase of crude oil from the Indian PE of the non-resident M/s.Hardy Exploration and Production India Inc (HEPI) and not the profit chargeable to tax?

(ii) Whether the Tribunal erred in law in not considering the provisions of Article 7 of the DTAA between India and USA, the ratio of the decision of the Apex Court in the case of G.E.Technology Centre P ltd vs. CIT 327 ITR 456 and the clarification issued by the CBDT vide Instruction No.02/2014 dated 26.02.2014 read with CBDT Circular No.3/2015 dated 12.02.2015 and in not directing the Assessing Officer to first determine the income chargeable to tax under the Indian Income Tax Act, 1961 on which tax has to be deducted and then compute the amount to be disallowed, if any, u/s. 40(a) even though the assessee has not applied u/s.195(2)?

(iii) The Tribunal erred in law in not holding that, when the recipient M/s.Hardy Exploration and Production India Inc has paid the requisite tax taking into account the amount received from the appellant, further disallowance of the same amount in the hands of the appellant would amount to double taxation of that amount?

(iv) The Tribunal erred in law in not holding that as per provisions of Section 191, once the payee has paid the tax, the TDS cannot be recovered from the assessee payer and hence the amount cannot be disallowed in the hands of the assessee u/s.40(a)(i).

(v) The Tribunal erred in law in not applying the provisions of Non Discrimination as per Article 26(3) of the DTAA between India and USA, whereby, the payment by an Indian resident to a resident of USA should be allowed in computing the taxable income of the Indian payer as if such

payments have been made to an Indian resident. As payments to an Indian Residence for purchase of oil does not require deduction of tax, payment to HEPI cannot be disallowed for non deduction of tax as per Article 26(3) of the DTAA.

(vi) The Tribunal erred in law in not applying the provisions of Article 26(3) of the DTAA between India and USA which provides that allowability, in the hands of the resident Payer of the amount paid to a Non Resident of USA should be on the same conditions as if the payment was made to an Indian resident. Tribunal erred in law in not holding that as per proviso to Section 40(a)(ia) read with proviso to Section 201(1) and in the light of the decision of the Delhi High Court in the case of CIT vs. Ansal Land Mark Township Pvt Ltd read with Article 26 (3) of the DTAA between India and USA, no disallowance can be made in the hands of the payer once the recipient has paid the tax.

(vii) In any event the Tribunal erred in law in not directing that disallowance u/s.40(a)(i) should be restricted to the amount of income which is found to be chargeable to tax in the hands of the recipient."

3. We have heard Mr. Vikram Vijayaraghavan, learned counsel for the appellant/assessee and Mr. T. Ravikumar, learned Senior Standing Counsel appearing for the respondent/Revenue.

4. The assessee is engaged in the business of refining crude into petroleum products. For the assessment year under consideration, 2006-07, the assessee filed its return of income. The case was selected for scrutiny and notice under Section 143 (2) of the Act was issued on 15.10.2007, and subsequently, the scrutiny assessment was completed under Section 143(3) of the Act on 26.12.2008, determining the total income at Rs. 678,35,51,967/-. Subsequently, the assessment was reopened under Section 147 of the Act to disallow certain aspects and in this appeal, we are concerned about the disallowance under Section 40(a)(i) for non-deduction of tax under Section 195 of the Act on the payments made to Hardy Exploration and Production India Inc (HEPI).

5. With regard to the said issue, the assessee in his reply stated that payment was made for purchase of crude oil during the assessment year 2006-07; Section 195 of the Act is applicable in case of payment to non-resident of any interest or any other sum chargeable under the provisions of the Act; the assessee making payment to a non-resident is not obliged to

deduct tax at source, if such sum is not chargeable to tax under the Act; the purchases are not the sum chargeable under the Act; and Section 195 contemplates that in the case of composite payments made to non-resident, which have an element of income embedded or incorporated in them, the payer is under no obligation to deduct TDS in respect of such income attributable to the composite payments. Further, the assessee stated that purchases of indigenous crude oil, the price payable is determined based on international markets and hence, it would not be possible to determine the profit element embedded in the total payment made towards the purchase. Apart from the price of crude oil, being subject to daily fluctuations and they are independent of cost associated for exploration and production of crude oil and because of the nature of business transaction, it is impracticable to determine the profit/loss in respect of each crude purchase transaction due to daily fluctuation in the prices. Further, the assessee contended that the provisions of Section 40(a)(i) is applicable only in respect of any sum chargeable under the Act, which is payable and on which, tax had not been deducted at source and hence will not apply to the purchase of crude oil from HEPI.

6. The Assessing Officer did not agree with the said submission and completed the assessment by order dated 30.11.2011 and while doing so, the Assessing Officer made disallowance under Section 40(a)(i) of the Act by relying on the decision of the Hon'ble Supreme Court in the case of Transmission Corporation of AP Ltd. vs. CIT [(1999) 239 ITR 0587 (SC)] and held that a trading receipt which may or may not include pure income is liable for deduction of tax under Section 195 of the Act. Further, the Assessing Officer relied on the decision in the case of G.E. Technology Centre P Ltd. vs. CIT [(2010) 327 ITR 0456 (SC)] and held that the assessee is liable to deduct tax at source under Section 195(2) on the sum paid to the non-resident (HEPI).

7. Aggrieved by such order, the assessee preferred appeal before the Commissioner of Income Tax (Appeals), Large Taxpayer Unit, Chennai (for brevity "the CIT(A)"). By order dated 08.01.2013, the CIT(A) upheld the disallowance made by the Assessing Officer on the ground that payment made to HEPI for purchase of crude oil is clearly covered by the provisions of Section 195(1) and Section 195(2) of the Act. Aggrieved by the same, the assessee preferred appeal before the Tribunal, which has been dismissed by the impugned order.

8. On a careful reading of the scrutiny assessment order, the order passed by the CIT(A) and the Tribunal, it is seen that the authorities as well as the Tribunal did not address the core issue as to whether the transaction done by the assessee

requires tax to be deducted at source and whether the payments effected were sums chargeable to tax so as to attract Section 195(1) of the Act. In fact, the assessee has to be partially blamed for having placed certain decisions in the forefront before the Assessing Officer, rather than to first clarify the factual position. The Assessing Officer while deciding the issue, framed two questions for consideration, viz., (i) whether the provisions of Section 195 of the Act are attracted in the case of payment made to a non-resident for purchase; (ii) whether a certificate obtained under Section 197(1) of the Act by the non-resident recipient of the sum absolve the payer from the statutory obligation of deduction of tax under Section 195 of the Act.

9. In our view, the first question, which was framed by the Assessing Officer should have been slightly differently worded and had it been done, the result would have been rightly arrived at. The question, which should have been framed for consideration is whether Section 195(1) of the Act requires tax to be deducted at source for payment to non-resident only, if the amount is chargeable to tax. This appears to have been the stand taken by the assessee. Nevertheless, the Assessing Officer proceeded to take note of paragraph 10 of the judgment in Transmission Corporation of AP Ltd. (supra) and paragraph 10 of the decision in G.E. Technology Centre P Ltd. (supra) and proceeded to hold that the assessee has not deducted tax on the payment made to HEPI and after holding so, the Assessing Officer proceeded to decide the second question on the effect of the certificate obtained under Section 197 of the Act. In fact, had the Assessing Officer read the entire decision in G.E. Technology Centre P Ltd. (supra), which has explained all the earlier decisions and clarified all issues, probably the error might not have occurred. In fact, in paragraph 10 of the judgment, the applicability of the judgment in the case of Transmission Corporation of AP Ltd. (supra) has been dealt with. At this stage, it would be beneficial to refer to paragraph 10 of the decision in G.E. Technology Centre P Ltd. (supra), which reads as follows:-

"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 exigible 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." (emphasis supplied)

10. It has been pointed out by the observations of the Hon'ble Supreme Court that the words "such sum" clearly indicate that the observation refers to 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. Therefore, the Assessing Officer fell in error in not addressing the question as to when an application under Section 195(2) of the Act is required to be made by the assessee. The above decision clearly clarifies the position and in fact, has taken note of the earlier decision as well, viz., the decision in the case of CIT vs. Eli Lilly & Co. (India) (P) Ltd., [(2009) 312 ITR 0225].

11. On a perusal of the grounds of appeal filed before the CIT(A), we find that the assessee had raised the following grounds:-

11.1. The Joint Commissioner of Income tax, LTU erred in disallowing Rs.95,07,58,118/- under Section 40(a)(i) on the ground that the appellant had not deducted TDS from the payments made to Hadry Exploration and production India Inc u/s. 195.

11.2. The Joint Commissioner of Income tax ought to have appreciated that payment made to HEPI was for the purchase of crude oil and hence payment is not subject to tax in India.

11.3. The Joint Commissioner of Income tax, LTU ought to have appreciated that Section 195 requires that tax is to be deducted at source from payment to a non-resident only if the amount is chargeable to tax.

11.4. The Hon'ble Supreme Court in G.E. Technology Centre vs. CIT (327 ITR 256) has held that if there is no income chargeable to tax in India then there is no requirement for deducting tax at source under the Income Tax Act, 1961.

12. Though the above grounds were raised, the first appellate authority proceeded on a different angle. In fact, the CIT(A) has extracted the findings of the Assessing Officer and the grounds raised by the assessee and the decision, which was relied on by the assessee in the case of CIT vs. Estel Communications (P) Ltd., [(2008) 217 CTR 102 (Delhi)] and proceeded to decide the issue as to whether Section 40(a)(i) is applicable only in respect of amounts payable or would also cover amounts, which were paid and concluded that the assessee has made payments to HEPI for purchase of crude oil and it is

covered by the provisions of Section 195(1) and Section 195(2) of the Act.

13. In our considered view, the CIT(A) proceeded on a tangent probably due to the contentions, which were advanced by the assessee when the case was heard by the first appellate authority. We say so because in the grounds, which were raised before the CIT(A), this issue was not one of the grounds, which was highlighted. The core issue that should have been decided is whether Section 195 requires that tax is to be deducted at source for the payment made to HEPI, as the assessee contended that such deduction would be required only if the amount is chargeable to tax.

14. The assessee also referred to the decision in G.E. Technology Centre P Ltd. (supra), to support their contention that if there is no income chargeable to tax in India, then there is no requirement for deduction of tax at source under the Act. Though such was the ground raised, the arguments, which were made before the CIT(A) appear to have proceeded on different lines thus, derailing the entire proceedings resulting in an order without taking a decision on the core issue. The assessee carried the matter on appeal to the Tribunal. Once again before the Tribunal, the assessee proceeded on a different footing and the Tribunal concluded that the assessee having not obtained necessary certificate under Section 197(2) of the Act, the disallowance by the Assessing Officer has to be sustained. Thus, we find that the main and the core issue was never agitated/adjudicated before the authorities or before the Tribunal.

15. Mr. T. Ravikumar, learned Senior Standing Counsel is right in his submission by contending that the Assessing Officer, nor the CIT(A), nor the Tribunal could be blamed and it is the assessee alone who has to be blamed because what was passing in the minds of the assessee was not reflected by way of submissions before the authorities or before the Tribunal. In fact, the grounds raised before the CIT(A) were not canvassed. Thus, the entire proceedings got derailed.

16. The learned counsel for the assessee had referred to the circulars issued by the CBDT dated 26.02.2014, 12.02.2015 and 26.10.2016. Admittedly, all the circulars were much after the order of assessment and the order passed by the CIT(A). Therefore, the correctness of those two orders cannot be tested based on the circulars. Nevertheless, the circulars were much prior to the impugned order passed by the Tribunal. Therefore, had the assessee been vigilant, they would have placed the circular dated 26.02.2014 before the Tribunal, but they failed to do so. In any event, we would see what is the purport and

intent which necessitated the issuance of the circular. The circular dated 26.02.2014 pertains to deduction of tax at source under Section 195 read with Section 201 of the Act relating to payment made to a non-resident. The following portion of the circular would be relevant:-

"2. References were received from field officers on the issue of deduction of tax at source under section 195 of the Income-tax Act, 1961 in the light of the decisions of the Supreme Court of India in the case of GE India Technology Private Limited Vs. CIT 327 (ITR) 456 and Transmission Corporation of AP Limited and another Vs. CIT (1999) 299 (ITR) 587, and the decision of the Madras High Court in CIT Vs. Chennai Metropolitan Water Tax Cases Appeals Nos.500-501 of 2005, with a request for clarification as to whether the tax is to be deducted under subsection (1) of section 195 on the whole sum being remitted to a non-resident or only the portion representing the sum chargeable to tax, particularly if no application has been made under subsection 2) of section 195 of the Act to determine the sum.

3. The matter has been examined in the Board and accordingly, in exercise of powers vested under Section 119 of the Act, the Board hereby directs that in a case where the assessee fails to deduct tax under section 195 of the Act, the Assessing Officer shall determine the appropriate proportion of the sum chargeable to tax as mentioned in subsection (1) of section 195 to ascertain the tax liability on which the deductor shall be deemed to be an assessee in default under section 201 of the Act, and the appropriate proportion of the sum will depend on the facts and circumstances of each case taking into account nature of remittances, income component therein or any other fact relevant to determine such appropriate proportion."

17. It appears that despite the circulars, still issues were lingering which necessitated a clarification to be issued by the CBDT dated 12.02.2015, the operative portion of which reads as follows:-

"3. Central Board of Direct Taxes has already issued Instruction No.02/2014 dated 26.02.2014 (F.No.500/33/2013-FTD-1) regarding deduction of tax at source under sub-Section (1) of Section

195 read with Section 201 of the Act relating to payments made to non-residents in cases where no application is filed by the deductor for determining the sum so chargeable under sub-Section (2) of Section 195 of the Act. Vide this Instruction, Board has clarified that in cases where tax is not deducted at source under Section 195 of the Act, the Assessing Officer shall determine the appropriate portion of the sum chargeable to tax, as mentioned in sub-Section (1) of Section 195, to ascertain the tax-liability on which the deductor shall be deemed to be an assessee in default under Section 201 of the Act."

18.The effect of both the circulars were once again reiterated by circular dated 26.10.2016. Though the circulars will not bind the Court, yet the circulars would be binding upon the Revenue, as it would serve as a guidance to the Assessing Officers to take a decision in the matter. Therefore, we are of the view that the assessment requires to be redone. Firstly, to examine the facts and take a decision qua, the claim made by the assessee that when there is no income chargeable to tax in India, then there is no requirement for deducting tax at source under the provisions of the Act. Therefore, this core issue needs to be decided by the Assessing Officer for which a thorough factual examination has to be done and it is only thereafter the law on the subject should be applied to the facts and not vice versa.

19.For all the above reasons, this appeal is allowed, the impugned orders are set aside, insofar as it relates to the issue regarding the disallowance under Section 40(a)(i) of the Act and the matter is remanded to the Assessing Officer for a fresh decision on merits and in accordance with law. It would be well open to the assessee to place additional material in support of their contention as well as the decisions to support their factual contentions. Consequently, the substantial questions of law are left open. No costs. Consequently, connected miscellaneous petition is closed.

Sd/-
Assistant Registrar(CS IV)

//True Copy//

Sub Assistant Registrar

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To

1.The Income Tax Appellate Tribunal 'B' Bench,
Chennai.

2.The Joint Commissioner of Income-tax,
Large Tax Payer Unit, Chennai-600 034.

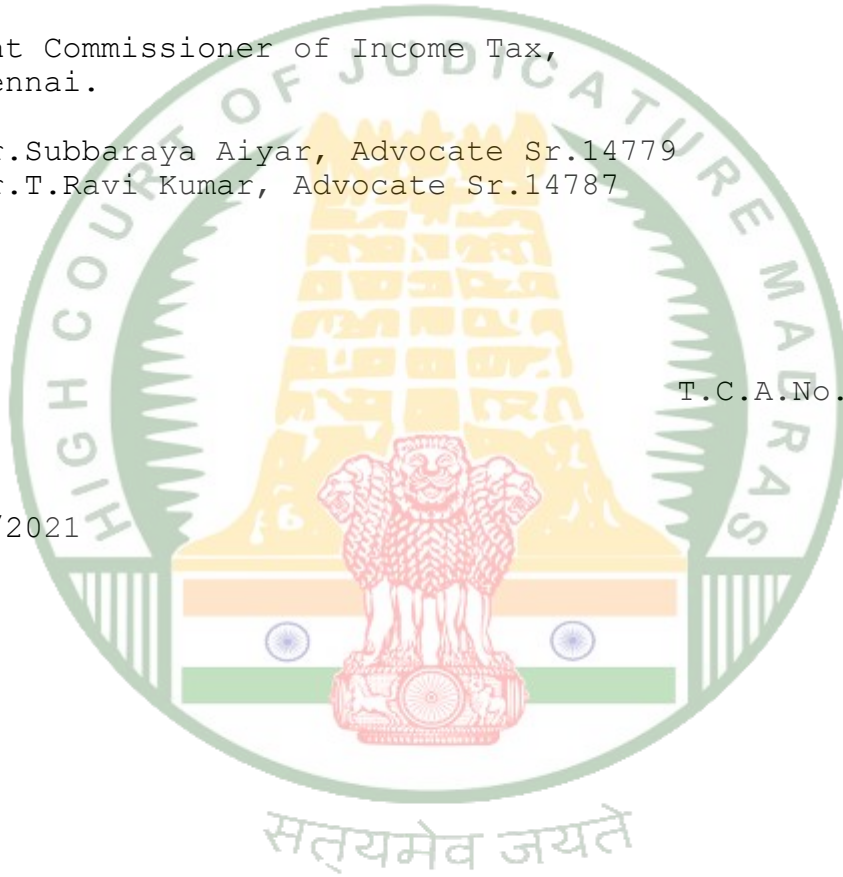
3.The Commissioner of Income Tax (Appeals)
Large Tax Payer Unit, Chennai.

4.The Joint Commissioner of Income Tax,
LTU, Chennai.

+lcc to Mr.Subbaraya Aiyar, Advocate Sr.14779
+lcc to Mr.T.Ravi Kumar, Advocate Sr.14787

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