IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL (IT) NO. 745 OF 2018

The Commissioner of Income Tax (IT) - 4 … Appellant
Versus
M/s. Red Hat India Pvt. Ltd. … Respondent

Ms. Swapna Gokhale for Appellant.
Ms. Fereshte Sethna a/w Mr. Mrunal Parekh and Mr. Abhishek Tilak i/b DMD Advocates for Respondent.

CORAM K. R. SHRIRAM &
DR. N. K. GOKHALE, JJ.
DATED: 6th September 2023

P.C. :

1. Appellant has proposed eight substantial questions of law in the appeal memo, but Ms. Gokhale at the outset stated that the Revenue is only pressing for two of these eight viz. :

> *a) Whether on facts and circumstances of the case and in law, ITAT was correct in holding that the order passed under Section 201(1) within time in case of resident prayer had become invalid just because subsequently there was no assessment made in the hands of the non-resident payee within 6 years, without appreciating that there was no law mandating the passing of assessment order in hands of non-resident payee also within 6 years to validate an order already passed under Section 201(1) ?*
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> *b) Whether on facts and circumstances of the case and in law, ITAT was correct in relying upon the decision of special bench decision in case of Mahindra & Mahindra, without appreciating that the question whether passing of assessment order in the hands of the non-resident payee was mandatory to uphold the validity of the order under Section 201(1) already passed within permitted time in case of payer assessee,*

was never under consideration before the special bench (supra) ?

2. Assessee (M/s. Red Hat India Pvt. Ltd.) during the year under consideration, i.e., Assessment Year 2008-2009 had made foreign remittance to Red Hat Asia Pacific Pte Ltd., Singapore without deducting tax at source. The reason for non-deduction of tax at source under Section 195 of the Income Tax Act, 1961 ("**the Act**") was that payment for purchase of subscription is not taxable as per the provisions of Article 7 read with Article 5 of the India Singapore Double Taxation Avoidance Agreement ("**DTAA**").

3. The Assessing Officer ("**AO**") held that the impugned subscription fees liable to be taxed as ' royalty' within the meaning of Section 9(1)(vi) of the Act as well as Article 12(3) under the DTAA and also taxable as 'fee of technical services' within the meaning of Section 9(1)(vi) of the Act as well as Article 12(4)(a) and Article 12(4)(b) of the DTAA. Accordingly, assessee was treated as an 'assessee-in-default' under Section 201(1) of the Act and the order under Section 201(1) and Section 201(1A) for Assessment Years 2008-2009 and 2007-2008 came to be passed.

4. Against this order, assessee preferred an Appeal before the Commissioner of Income Tax (Appeals) ("**CIT(A)**"). The CIT(A) by an order dated 29th November 2013 partly allowed assessee's Appeal. Aggrieved by the aforesaid order of CIT(A), assessee filed an Appeal before the Income Tax Appellate Tribunal ("**ITAT**"), which allowed the Appeal by the impugned order dated 24th March 2017.

5. We have heard the counsels and also considered the impugned order and the appeal memo.

6. It was the case of assessee before the ITAT that assessee was not an assessee-in-default in respect of the payments made to Red Hat Asia Pacific Pte Ltd., Singapore and therefore, assessee can not be saddled with the tax liability under Section 201(1) of the Act and interest thereon under Section 201(1A) of the Act. It was the case of assessee, relying upon the decision of Special Bench of the ITAT, Mumbai in the case of ***Mahindra & Mahindra Ltd. v. Deputy Commissioner of Income-tax, TDS Range 1(1), Mumbai***[1] that as per the explanation to Section 191 of the Act, two conditions have to be cumulatively satisfied, i.e.,

> **(a)** failure on the part of person to perform his obligation of making TDS and

1. [2009] 122 TTJ 577 (Mumbai) (SB).

(b) non-payment of tax by the payee/recipient directly.

If both these conditions are satisfied only then a person can be treated as an assessee-in-default. If only one condition is satisfied, the person can not be treated as an assessee-in-default.

7. It was the case of assessee that there was no liability of Red Hat Asia Pacific Pte Ltd., Singapore to pay any tax in India and therefore, one of the twin conditions have not been made. In fact, as recorded by the ITAT, it is admitted by AO in his letter dated 21st March 2017 that no assessment in this regard has been made in respect of the tax liability of payee/recipient, Red Hat Asia Pacific Pte Ltd., Singapore for Assessment Years 2007-2008, 2008-2009 and onwards.

8. Paragraph 18.10 of the Special Bench in *Mahindra & Mahindra (Supra)* which has been quoted in the impugned order, reads as under :

> "*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 consequences 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. If no liability of the payee to tax exists at the time when order under section 201(1) is sought to be passed or though the income is chargeable to tax but the liability of the payee to tax has not been determined by passing any order in his hands and further the time-limit for taking action on the payee under any other provision has also passed out, in such a situation again the passing of order under section 201(1) will be mere ritual. It is so because the tax now collected from the payer of income under this order will be incapable of adjustment against the tax liability of the payee either existing or likely to arise on the income so paid to him because in the former case there is no tax liability and in the latter case, such a liability cannot be created as the time-limit for taking action having been run out. Like in an action of search under section 132 or other relevant proceedings under the Act if it comes to the notice of the Department that any income chargeable to tax has escaped assessment, the proceedings are launched against such person and notice is issued under section 148 within the time prescribed under section 149. The present outer limit provided in section 149 is six years from the end of the relevant assessment year within which a notice under section 148 can be issued. If the income so found to have been earned by the assessee and escaped taxation falls within a period of six years from the end of the relevant assessment year, notice under section 148 will be issued and the assessment shall be framed by taxing such income. If however during such proceedings it is conclusively established that the assessee had earned income not disclosed to the Revenue in period prior to the said six years from the end of the relevant assessment year, then such income will escape taxation unless it falls within section 69 or 69A or 69B or 69C and the Revenue will be restrained from recovering tax by making the assessment of such income. The logic behind providing such time-limit for taking action is that the Departmental Authorities should remain vigilant and bring the escaped income to tax at an earlier point of time and further to work against the inaction on the part of the Assessing Officers on one hand and providing certainty to the assessee that after this period no action will be taken against him. Thus it follows that if due to one reason or the other the concealed income of the assessee is unearthed for *a period beyond six years from the end of the relevant assessment year, then no tax can be recovered thereon. By the same logic and turning to the point before us when the payee has paid the tax by offering such income for taxation on which tax was deductible but not deducted, then the person responsible cannot be treated as assessee in default under section 201(1). In the like manner where the payee has not offered such income for taxation and there is no remedy available with the Assessing Officer 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. We have seen above that the provisions for deduction of tax at source pre-suppose the taxability of the sum paid in the hands of the payee and the tax so deducted is finally adjusted against the tax liability of the payee. If tax is collected by way of order under section 201(1) from the person responsible failing in his duty to deduct or paying after deduction of tax at source, but such amount cannot be adjusted against the tax liability of the payee, then this collection of tax would be illegal. The CBDT vide its Circular No. 7 of 2007 dated 23-10-2007 has accepted in para 4 that 'where income has accrued but no tax is due on that income or tax is due at a lesser rate, the amount deposited to the credit of Government to that extent under section 195, cannot be said to be "tax".' From here it follows that unless there is a tax liability capable of being lawfully created and recovered from the deductee, the amount of tax collected by way of deduction of tax at source cannot be characterized as the "tax". In the same Circular, it has been directed that in such cases the refund should be made to the person making payment under section 195, that is the payer. So if tax is recovered in the first instance from the person responsible for paying by virtue of order under section 201(1) but the income cannot be taxed in the hands of the non-resident either due to such income accruing but no tax remaining due thereon or tax not leviable due to the time-limit for taking action under any provisions of the Act having been expired, in such a situation, the amount of tax shall need to be refunded to the person liable to deduct tax who is for the time being considered as assessee in default. 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.*"

(emphasis supplied)

9. An Appeal against the Special Bench's order was dismissed by this Court. We would add, the law laid down by the Special Bench of ITAT on this issue has our approval. Considering the provisions of Section 201 of the Act, one thing, therefore, is certain, in order to treat the payer as an assessee-in-default, it is of utmost importance that 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. The ITAT also came to the conclusion that assessment should be lawfully made by AO on the payee/recipient. Since that has not been done, the order of AO under Section 201(1) read with Section 201(1A) of the Act was unsustainable.

10. We are unable to fault this conclusion arrived at by the ITAT.

11. Appeal dismissed.

(DR. N. K. GOKHALE, J.) **(K. R. SHRIRAM, J.)**

GITALAXMI KRISHNA KOTAWADEKAR

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