IN THE HIGH COURT OF JUDICATURE AT MADRAS

DATED: 27.08.2024

CORAM :

THE HONOURABLE DR.JUSTICE ANITA SUMANTH
and
THE HONOURABLE MR.JUSTICE G. ARUL MURUGAN

TC (Appeal) No.1003 of 2007
and TC (Appeal) No.264 of 2011
M.P.Nos.1 & 2 of 2007

TC (A) No.1003 of 2007

M/s.Frontier Offshore Exploration
(India) Limited,
(Formerly known as Frontier Aban
Drilling (India) Limited),
No.113, Janpriya Chest,
Pantheon Road,
Egmore, Chennai – 600 008. .. Appellant

vs

The Deputy CIT,
Company Circle II (1),
Chennai – 600 034. .. Respondent

Prayer in T.C.No.1003 of 2007: Appeal filed under Section 260A of the Income Tax Act, 1961 against order dated 28.02.2007 made in ITA No.2037/Mds/2006.

TC (A) No.264 of 2011

Commissioner of Income Tax-I,
Chennai. .. Appellant

vs

M/s.Frontier Offshore Exploration
(India) Limited,
(Formerly known as Frontier Aban
Drilling (India) Limited),

No.113, Janpriya Chest,
Pantheon Road,
Egmore, Chennai – 600 008. .. Respondent

Prayer in T.C.A.No.264 of 2011: Appeal filed under Section 260A of the Income Tax Act, 1961 against order dated 04.02.2011 made in ITA No.200/Mds/2009.

For Appellant	:	Mr.C.J.Yeswanthram for M/s.K.Vaitheeswaran (in T.C.No.1003/07)
For Respondent	:	Mr.Avinash Krishnan Ravi (in T.C.No.1003/07) Ms.Abbirami M for Mr.R.Meenakshisundaram (in T.C.A.No.264/2011)

COMMON JUDGMENT
(Delivered by Dr.ANITA SUMANTH.,J)

The Assessee, (appellant in TC(A) No.1003 of 2007, and hereinafter referred to as 'Assessee') had suffered orders of assessment effecting disallowances under Section 40(a)(i) of the Income-Tax Act, 1961 (hereinafter referred to as 'Act') for non-deduction of tax at source in respect of remittances made to two foreign entities, by name Frontier Drilling ASA Bergen Norway and Frontier Inc AS, Bergen, Norway (hereinafter referred to as 'non-residents') for assessment years (AY) 03-04 & 04-05.

2. The Assessee had entered into agreements with Oil and Natural Gas Corporation (ONGC) and Hardy Exploration and Production (India) (HEPI) for drilling of oil wells in Indian waters of the coast of India. It had, in turn, entered into agreements with the non-residents for hiring of

drilling units and rigs for specified periods on bareboat charter basis for which payments had been made in foreign currency.

3. The substantial questions admitted for each year are as follows:-

T.C.(Appeal) No. 1003 of 2007 (AY 03-04)

(i) Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that payments made to the non-resident should be disallowed under Section 40(a)(i) of the Income Tax Act, even though tax has been deducted at source on the income of the non-resident computed in accordance with Section 44.BB?
(ii) Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the gross payment to the non-resident should have been considered for tax deduction and not the income computed in accordance with Section 44.BB, even though Section 44.BB has a non-obstante clause and a deeming provision?
(iii) Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that the non-application to the assessing authority in terms of Section 195(2) would mean that the entire payment should be subject to tax deduction at source?
(iv)Whether on the facts and circumstances of the case, the Tribunal was right in law in holding that in the absence of the expression 'the whole or any part of the tax' used in Section 201 is applicable to Section 40(a)(i)?

T.C.(Appeal) No.264 of 2011(AY 04-05)

1. Whether on the facts and circumstances of the case, the Income Tax Appellate Tribunal was right in holding that the Assessing Officer was not justified in making a disallowance under Section 40(a)(i) to the tune of Rs.28,64,40,818/- on account of the assessee's failure to deduct tax on the payment by way of Bare boat charges and Ex-pat crew paid to non-resident companies without deducting tax @ 30% plus surcharge at 5% prescribed by the Finance Act?
2. Whether on the facts and in the circumstances of

> *the case, the Income Tax Appellate Tribunal was right in holding that the assessee was justified in not deducting tax at source even though the income was chargeable to India by wrongly applying the decision of the Supreme Court in the case of G.E.India Technology Centre Ltd v C.I.T reported in 327 ITR 456?*

4. Both Mr.C.J.Yeswanthram appearing for the Assessee as well as Ms.Abbirami, and Mr.Avinash Krishnan Ravi appearing for the Income tax Department, would accede to the identity of facts in respect of both years. Co-ordinate Benches of the Income-Tax Appellate Tribunal (ITAT/Tribunal) have however come to diametrically opposed conclusions in law on the issues arising for resolution in respect of the two assessment years.

5. In the course of the assessments, the assessing officer had initiated a proposal for disallowance of the remittances made to the foreign entities for non-deduction of tax under Section 195 of the Act. The defence of the petitioner was that the non-residents were liable to tax only in terms of Section 44BB of the Act, which provides for a presumptive assessment on the incomes earned by them in India and hence there would be no necessity for deduction of tax in respect of those remittances over and above the tax deducted by it in terms of Section 44BB of the Act.

6. The submission was negated for AY 2003-04 by the assessing authority who was of the view that the provisions of Section 44BB would not be applicable to the non-residents as they were not 'eligible assesses' under that provision. The assessing officer had proceeded on the basis that the non-residents are in receipt of business income that is taxable at

higher rates. As a consequence, the Assessee was required to deduct tax at the rates applicable for business income as against which it has deducted tax at the rate applicable to receipts covered under Section 44BB of the Act taxable presumptively at the rate of 10% only, which order has been confirmed by the Tribunal on 28.02.2007. For AY 03–04, while the order of assessment and first appeal were adverse to the petitioner, the Tribunal reversed the aforesaid orders, vide order dated 04.02.2011 holding that the provisions of Section 44BB were indeed applicable to non-residents. Hence, the necessity to deduct tax at source over and above the deduction already made stood obviated as did the question of effecting any disallowance under Section 40 (a)(i) of the Act.

7. There is a finding in the order of the Tribunal relating to AY 03-04 that a decision on the issue of tax deduction would involve an assessment having been made on the non-resident, which has not transpired, for the reason that the Income tax Department has not chosen to issue notices to the non-residents calling for their participation in an assessment. Hence no assessments had come to be made.

8. We had called for the original records to ensure that all relevant factual particulars were available before the authorities. The records for AY 03-04 have been produced and we find from the order-sheet notings that relevant documents have been produced before the Assessing officer, including agreement dated 10 June 2002 inter se the parties. Thus, the authorities have been in full possession of all materials to examine the nature of the transaction, and come to a conclusion as to whether

presumptive rate of tax was available to the non-resident.

9. We have heard learned counsel and perused the material records. The scheme of tax deduction under the Act in respect of remittances made to non-residents is set out under Section 195 of the Act that states *'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 tax thereon at the rates in force'.*

10. In *Transmission Corporation of A.P.Ltd v Commissioner of Income-Tax* [239 ITR 587], a case that travelled to the Supreme Court from the Andhra Pradesh High Court, the question was whether a taxable amount could be embedded within the ambit of the expression *'any other sum chargeable under the provisions of this Act'.* The Supreme Court answered in the affirmative holding that any assessee which makes a payment to a non-resident under contract is under an obligation to deduct tax at source under Section 195.

11. In *G.E. India Technology Centre Pvt Ltd v Commissioner of Income-Tax and another* [(2010) 327 ITR 456] the issue was amplified and clarified to state that the obligation to deduct tax at source would arise only in those cases where there arose such liability. Where there is, in the view of the assessee, no component of taxable income in a remittance made to a non-resident, there would arise no necessity to deduct tax at source. Thus, with this pronouncement, liberty was available

to an assessee to take a calculated risk as to whether to deduct tax in respect of remittances to non-residents or desist. Needless to say, if the decision of the assessee not to deduct in a particular case was found to be erroneous by the Income tax Department, consequences would follow such as levy of penalty under section 201 of the Act and disallowance under section 40(a)(i).

12. The settled position is thus, that an option is extended to the assessee to ensure that the amount deducted is tax appropriate. For this purpose, an assessee may approach an assessing officer under Section 197 seeking clarity as to the quantum of income embedded in the remittance and/or, the rate of deduction at NIL or lower rate, where it believes that there is ambiguity about the quantum of, or rate at which deduction is to be effected. If the assessee chooses to make those decisions itself, without seeking the advice of the Assessing Officer (TDS), it carries the burden of such decision making, with all attendant consequences thereof.

13. By way of a separate line of judgments, the Supreme Court in the case of *Hindustan Coca Cola Beverage Pvt. Ltd. v. CIT,* [(2007) 293 ITR 226 (SC)] considered a case of non-deduction by the remitter where the recipient had made good the tax demand in respect of that remittance. In such cases the Supreme Court held that there was no liability upon the assessee to effect deduction, though, if the demand had been settled by the payee belatedly, there would still be liability for the levy of penalty/interest under Section 201.

14. Chapter IV contains a series of provisions providing for the determination of tax on the basis of gross receipts where liberty is granted to the assessee not to maintain books of accounts. Section 44B is a special provision for computing profits and gains in connection with the business of exploration of minerals, oils etc. In the interest of clarity, we extract the provision below:-

> *"**Special provision for computing profits and gains of foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects.**—*
>
> *Notwithstanding anything to the contrary contained in sections 28 to 44AA, in the case of an assessee, being a foreign company, engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government in this behalf a sum equal to ten per cent. of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account of such civil construction, erection, testing or commissioning shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".*

15. The remittance in this case is to non-residents and the assessee has taken it upon itself to decide that the relevant provision under which tax would have been payable by the recipients is Section 44BB. The objection raised by the Income tax Department is that non-residents are not '*existing assessees*'. The term '*existing*' does not figure in Section 44BB and the term used is 'assessee'.

16. In the present case, the non-residents are assessees, as tax

has been deducted by the Assessee at the rate 10% from the remittances made to them, and deposited with the Income tax Department. Hence, the non-residents cannot be stated not to be 'assessees'. According to the Department however, is that the receipts ought to be taxed as business profits without the benefit of presumptive taxation.

17. However, section 44BB applies to a foreign entity engaged in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government. Records have been produced before the authorities to establish the aforesaid position including a copy of agreement dated 27.07.2001 inter se the Frontier Ice AS Bergen, Norway and Frontier Aban Drilling (India) Pvt Ltd.

18. The Tribunal, in order dated 04.02.2011 for AY 2004-05 has taken note of the documentation, the nature of business and the status of the parties to come to the conclusion that the provisions of section 44BB are applicable. Procedurally, we agree that the proper approach would have been for the Bench passing order dated 04.02.2011 to have made a reference to the President of the Income tax Appellate Tribunal for constitution of a larger Bench in view of the earlier order of the Tribunal taking a different view.

19. However, since the assessment years in question are 2003-04 and 2004-05, more than two decades ago, we do not propose to set right the procedure now and would rather decide the matter on the merits. Both learned counsel also request that we follow this approach.

20. Section 40 (a)(i) applies to those situations where a sum chargeable to tax under the Act has been remitted to the credit of a non-resident without the deduction of tax. In such circumstances, the assessee/payer is deemed to be in default. In order to proceed with the consequences of non-deduction, an assessing authority is required to determine the appropriate proportion of the sum chargeable to tax as mentioned in Section 195(1).

21. In this regard, useful reference may be made to two Circulars issued by the Central Board of Direct Taxes, Circular No.2 of 2014 dated 26.02.2014 and Circular No. 3/2015 dated 12.02.2015. The Circulars read thus:

Circular No.2 of 2014 dated 26.02.2014

INSTRUCTION NO. 2/2014 [F.NO. 500/33/2013-FTD-1]
SECTION 119 OF THE INCOME-TAX ACT, 1961 - INCOME-TAX AUTHORITIES - INSTRUCTIONS TO SUBORDINATE AUTHORITIES

INSTRUCTION NO. 2/2014 [F.NO. 500/33/2013-FTD-1], DATED 26-2-2014

Section 195 of the Income-tax Act (hereafter referred to as 'the Act') provides that any person, responsible for paying to a non-resident not being a company or to a foreign company, any sum chargeable under the provisions of this Act, shall at the time of credit of such income to the account of the payee or at the time of payment thereof, whichever is earlier, deduct income-tax thereon at the rates in force. Section 201 of the Act inter alia provides that any person who is required to deduct tax in accordance with the provisions of the Act, does not do so, shall be deemed to be an assessee in default and shall also be liable to pay simple interest at the specified rate.

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 (P.) Ltd. v. CIT (2010) 7 taxmann.com 18/193 Taxman 234/327 ITR 156 (SC) and Transmission Corporation of AP Ltd. and another v. CIT [1999] 105 Taxman 742/239 ITR 587 (SC) and the decision of the Madras High Court in CIT v. Chennai Metropolitan Water Tax Cases Appeals Nos.500-501 of 2005, [2011]14 taxmann.com 73/202 Taxman 454/[2012] 348 ITR 530 (Mad.) with a request for clarification as to whether the tax is to be deducted under sub-section (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 undo sub-section (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 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, 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.

4. The undersigned is directed to state that the above position may be brought to the notice of all officers concerned."

Circular No.3 of 2015 dated 12.02.2014

Government of India
Ministry of Finance
Department of Revenue
Central Board of Direct Taxes
North Block, New Delhi
Dated the 12th of February, 2015

Subject :- Clarification regarding 'Amounts not deductible' under sub-clause (i) of clause (a) of section 40 of Income-tax Act, 1961 ('Act') -regarding.

Section 40(a)(i) of the Act stipulates that in computing the income chargeable under the head "Profits or gains of business or profession" any interest, royalty, fees for technical services or other sum chargeable under this Act either payable in India to a non-resident (not being a company)/a foreign company or payable outside India, shall not be allowed as a deduction, if there has been a failure in deduction or in payment of tax deducted in respect of such amounts under Chapter XVII-B of the Act.

2. Disallowance regarding 'other sum chargeable' under section 40(a)(i) is triggered when the deductor fails to withhold tax as per provisions of section 195 of the Act. Doubs have been raised about the interpretation of the term 'other sum chargeable' i.e. whether this term refers to the whole sum being remitted or only the portion representing the sum chargeable to income-tax under relevant provisions of the Act.

3. Central Board of Direct Taxes has already issued Instruction No. 02/2014 dated 26.02.2014 (F.No. 500/33/2013-FTD-I) regarding deduction of tax at source under subsection (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. It has been further clarified that such appropriate portion of the said sum will depend on the facts and circumstances of each case taking into account the nature of remittances, income component therein or any other fact relevant to determine such appropriate proportion.

4. As disallowance of amount under section 40(a)(i) of the Act in case of a deductor is interlinked with the <u>sum chargeable under the Act</u> as mentioned in section 195 of the Act for the purposes of tax deduction at source, the Central

Board of Direct Taxes, in exercise of powers conferred under section 119 of the Act, hereby clarifies that for the purpose of making disallowance of 'other sum chargeable' under section 40(a)(i) of the Act, the appropriate portion of the sum which is chargeable to tax under the Act shall form the basis of such disallowance and shall be the same as determined by the Assessing Officer having jurisdiction for the purpose of sub-section (1) of section 195 of the Act as per Instruction No. 2/2014 dated 26.02.2014 of CBDT. Further, where determination of 'other sum chargeable' has been made under sub-sections (2), (3) or (7) of section 195 of the Act, such a determination will form the basis for disallowance, if any, under section 40(a)(i) of the Act.

5. This may be brought to the notice of all concerned.

6. Hindi version to follow.

(Rohit Garg)
Deputy Secretary to the Government of India

22. Section 40(a)(i) provides that if an assessee has made a remittance without deduction of the appropriate amount representing tax on remittance, then a disallowance would be made of an equal amount from the income of that assessee. Being a disallowance, there has to be certainty and exactitude in regard to the exact amount to be deducted, based upon which the disallowance is made.

23. In the present case, the Department has not taken any steps to determine what the income of the non-residents will be such that a corresponding disallowance may be made under Section 40(a)(i) of the Act. While the Assessee states that the non-residents will be liable to presumptive taxation, Revenue would, contend that the rate applicable will be that for business income.

24. We are of the considered view that an assessment of an

entity cannot be made on an oral statement of the assessing officer and such assessment has to be based on relevant materials proper procedure and applicable provisions of law. If at all the Revenue was of the view that the receipts by the non-residents are taxable as business income, necessary steps should have been taken to initiate an assessment, analyse the records and frame an assessment in accordance with law. This has not been done.

25. In such circumstances, we find nothing untoward in the deduction of tax at the rate applicable to Section 44BB by the Assessee, particularly since the transaction, prima facie fits into the contours of Section 44BB on all parameters. This is not a case where the Assessee has not made a deduction at all, but one where it has consciously and cautiously analysed the transaction, the applicable provisions and then come to a decision that the tax liability would be at presumptive rates under Section 44BB. The efforts put in by the Assessee to determine the tax liability of the non-residents are far more than what the revenue has and the onerous burden cast by Section 40(a)(i) cannot visit the Assessee in such circumstances.

26. In *Chennai Petroleum Corporation Limited v The Joint Commissioner of Income-Tax, Larger Tax Payer Unit*, Chennai [TCA No.291 of 2019 dated 08.03.2021] involving a similar question as in the present matter, the assessments have been remitted for fresh decision after verification of the records, leaving the substantial questions of law open. Since the records have been produced before the authorities and

also before us, and there is no dispute on any of the factual aspects, we do not see any reason to remand these matters, particularly at this distance of time.

27. We specifically record the position that learned Revenue counsel was not in a position to either dislodge the application of Section 44BB to the facts of the subject transaction or to support the assumption that the receipts of the non-residents constitute business income in its hands. In such circumstances, we see no infirmity in the conclusion of the Tribunal in its order dated 04.02.2011.

28. The substantial questions of law are answered in favour of Assessee. As a result, TC No.1003 of 2007 is allowed and TCA No.264 of 2011 is dismissed. No costs. Connected miscellaneous petitions are closed.

[A.S.M., J] [G.A.M., J]
27.08.2024

Index:Yes
Neutral Citation:Yes
ssm

To

The Deputy CIT,
Company Circle II (1),
Chennai – 600 034.

DR. ANITA SUMANTH,J.
and
G. ARUL MURUGAN.,J

ssm

T.C.No.1003 of 2007
and
T.C.A.No.264 of 2011

27.08.2024