

## **Whether a Non-resident is liable to deduct Income-tax at source from payments made to persons resident in India ?**

[ (Published in 96 Taxman (Mag.) p.153 (Part-5) ]

- By S.K. Tyagi

Of late the Government of India has been making use of the provisions of Tax Deduction at Source (TDS) for augmenting tax revenues. Vide Finance Act 1995 the scope of TDS has been vastly enlarged. There are certain provisions in the Act wherein a vicarious liability has been cast on persons resident in India in respect of I.T payable on income of non-residents, accruing or arising in India. Such provisions are to be found in Ss. 160(1), 163, 172 and 173 of chapter XV of the Act. All these provisions relate to assessment and recovery of tax in respect of income on non-residents. Similarly there are some provisions in the Act wherein a vicarious liability has been cast on Indian residents for deduction of tax at source from payments to non-residents to be remitted outside India. These provisions are to be found in Ss.194E, 195, 196A and 196D of chapter XVII B of the Act.

As during the recent past the scope of TDS has been vastly enlarged, a question is often being asked whether a non-resident is liable to deduct income-tax source from payments being made to persons resident in India.

In order to answer the aforesaid query one has to examine various provisions of 1961 Act and connected case-law. The same are discussed as follows :

### **1. Basic objective of the IT Act and its Jurisdiction in respect of Non-residents.**

The basic purpose of the IT Act is to determine taxable income of an assessee, levy tax on it and recover the same. All the provisions of the Act are geared for achieving the aforesaid objective. The basic liability in respect of assessment and payment of tax under the Act lies on the person whose income is chargeable under S.4(1) of the IT Act.

A Non-resident may fall within the jurisdiction of the Indian IT Act 1961, only if the source of any part of his income lies within the Indian territory. In other words, an income is taxed in India if India is the country of its source.

A Non-resident may be proceeded against only in respect of assessment and collection / recovery of tax on his income for which India is the source country. A Non-resident is not liable to comply with other provisions of the Indian IT Act.

The IT Act 1961 has got some special provisions in respect of non-residents, viz

- (a) The special provisions relating to certain incomes of non-residents - chapter XII A - Ss. 115 C, 115 D, 115 E, 115 F, 115 G, 115 H, & 115-I.
- (b) Liability in special cases - chapter XV - Ss. 160(1), 163, 172, and 173.

All these provisions relate to assessment and recovery of tax in respect of income of non-residents.

- (c) Deduction of tax at source - chapter XVII - B --- Ss. 194 E, 195, 196 A and 196 D.

All the above provisions are regarding TDS from payments to non-residents to be remitted outside India.

All the aforesaid provisions in sub-paras (a), (b) and (c) relate to assessment of incomes of non-residents or recovery of tax thereon. There is no specific provision in the Act regarding the liability of non-residents in respect of payments made by them to persons resident in India.

In view of the aforesaid reasons the TDS provisions under the Indian IT Act 1961 would not be applicable to non-residents in respect of payments made by them to persons resident in India.

## **2. Extra - territorial operation of the IT Act 1961 does not cover such Non-residents.**

As per S.1(2), the IT Act 1961 is applicable to whole of the Indian territory. As we are concerned with the liability of a non-resident, it would be necessary to look into the scope of extra-territorial operation of the IT Act 1961. There are various provisions under the Act which make certain incomes of non-residents taxable in India. For our purpose we have to examine the extent upto which this extra-territorial jurisdiction may operate.

Under Article 245(1) of the Indian Constitution the Parliament may pass laws for the whole or any part of the Territory of India. Article 245(2) of the constitution enacts “No law made by the Parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation”. An Act is said to have extra-territorial operation if it seeks to regulate, punish or directly deal with any act done beyond its territorial limits or seeks to impose a liability on property situated outside its jurisdiction or on a person resident outside - **Wallace Bros and Co Ltd Vs CIT Bombay 16 ITR p.240 (Privy Council)**. Such would not be the case if there is any connection between an individual and the State, founded either upon residence, or business operation or source of income in that State. This would establish sufficient territorial connection to legislate in regard to such persons or things. A business operation / connection in India also leads to generation of a source of income in India.

Unless nexus with something in India exists, Parliament will have no competence to make the law. The provocation for the law must be found within India itself. Such a law may have extra-territorial operation in order to subserve the object, and that object must be related to something in India. It is inconceivable that a law should be made by Parliament in India which has no relationship with anything in India - **Electronics Corporation of India Ltd Vs CIT 183 ITR p.43(SC)**.

We are dealing with a case where the Non-resident has no business or office in India. As already discussed it would not amount to extra-territorial jurisdiction if there is any connection between an individual and State, founded either upon residence, or business operation or source of income in that State. **For the purpose of this Article the Non-resident has no such connection within the Indian Territory as it has neither a residence nor a business operation, nor a source of income in India.** In view of the aforesaid reasons the I.T. Act 1961 will have no jurisdiction over such a Non-resident. Therefore, the Non-resident will not be under an obligation to deduct tax at source from payments made to persons resident in India for professional or other services.

## **3. Indication from the special provisions in chapter XV “Liability in Special Cases”.**

The IT Act 1961 has made special provisions in chapter XV - Ss.160 (1), 163, 172 and 173; in order to assess and tax the income of a non-resident, chargeable to Indian Income-tax, by placing vicarious liability on persons resident in India, by treating them as agents in respect thereof; primarily because the

persons resident in India are subject to territorial jurisdiction of Indian IT Act 1961, whereas the non-residents are

not. A converse relationship could not have been envisaged under the IT Act 1961. In other words a non-resident could not have been made vicariously liable for deducting and paying tax leviable on a person resident in India in respect of payments made to him by the non-resident, ; particularly when the non-resident has no presence in India either in the form of an office or business operation.

**4. Various provisions of chapter XVII - B go to show that they do not apply to non-residents in respect of payments made by them to persons resident in India.**

**(I) S. 203 A - Allotment of Tax Deduction Account Number (TDA. No)**

U/s 203 A every person deducting tax at source is required to apply to the Assessing Officer (A.O) for allotment of TDA.No. If a non-resident is to deduct tax at source from payments to persons resident in India, in the first place, which would be the A.O in his case?. Secondly if non-resident is making payments to many Indians, staying in different parts of the country which would be the A.O for allotment of TDA.No, in that case ?. There is no provision in the Act covering such a situation. Thus the provisions of S.203A go to show that the TDS provisions under chapter XVII-B, are not applicable in respect of payments by non-residents to persons resident in India.

**(II) Recovery of TDS not paid by a Non-resident to the Government of India**

In case a non-resident deducts tax from payments to a person resident in India but does not pay the same to the Government of India, there would be no one to proceed against in India, for the recovery of such a tax under the provisions of S.201.

Besides, such a tax deducted at source but not paid, cannot also be recovered from the receiver of relevant payments made by the non-resident, in view of the provision S.205 which bars direct demand on the assessee in respect of tax deducted from his income.

Such could never have been the intention of the Legislature. It is obvious that it would be better to levy and collect tax from the Indian resident in respect of such payments made by the non-resident, as the Indian resident is under complete jurisdiction of the IT Act where as the non-resident is not.

**(III) Ss. 191 and 202**

As per S. 202 TDS is only one of the modes of recovery of tax and S.191 provides for a direct levy and assessment of tax on the assessee:

- (i) where no provision has been made for TDS; and
- (ii) where there is such a provision for TDS but no deduction has been made at source.

Thus the provisions of Ss. 202 and 191 provide a better alternative for levy and collection of tax from the Indian residents on their income in respect of payments received from non-residents, as they are under complete jurisdiction of the IT Act and therefore, all the provisions for levy and collection of tax are applicable to them.

**(IV) Exemption from TDS liability for individuals and HUF's in certain cases.**

The vicarious liability for TDS has not been imposed on individuals and HUF's in certain cases in view of practical difficulties e.g Ss. 194, 194 C, 194 H, 194 -I and 194 J. If some persons resident in India could be excluded from the operation of the provisions of chapter XVII - B, on account of practical difficulties, a notion that non - residents could be saddled with such a vicarious

liability would be totally far - fetched, because in their case there would be far more practical difficulties.

#### **(V) Persons deducting tax to furnish prescribed returns - S.206**

The provisions of S.206 require a person responsible for TDS, to furnish certain prescribed returns. Rule 36 A of the IT Rules 1962, is relevant for this purpose. As per rule 36 A the relevant returns are to be furnished to -

- (i) the Assessing Officer so designated by the CCIT or CIT, within whose area of jurisdiction the office of the person responsible for TDS is situated, or
- (ii) in any other case the A.O within whose area of jurisdiction the office of the person responsible for TDS is situated.

In this context the moot question will be regarding the A.O in respect of a non-resident deducting tax at source who has no office in India. There are no guidelines as to who would be the A.O in case of such a non-resident for the purpose of S.206.

#### **(VI) Rule 37 A of IT Rules 1962.**

There is a separate rule 37 A for returns regarding TDS in the case of non-residents.

There is however no rule for non-residents deducting tax at source from payment to residents in India.

#### **(VII) Rule 26 of IT Rules 1962**

There is another Rule 26 in respect of rate of exchange for the purpose of TDS on income payable in foreign currency. This rule applies to income payable to an assessee outside India.

There is, however, no corresponding rule in respect of payments made by non - residents to persons resident in India.

**Thus the aforesaid provisions of various sections of chapter XVII-B make it amply clear that the same are not applicable to non-residents in respect of payments made by them to persons resident in India.**

### **5. Indication from chapter XIX - B “ Advance Rulings ”**

Any non-resident can make application to the Authority for Advance Rulings (AAR), but such application can be made in respect of a “ transaction ” leading to generation of income chargeable to Indian Income-tax ( ref S. 245 S).

There is no provision for approaching the AAR in respect of TDS liability of a non-resident. Thus the provisions of chapter XIX-B, also go to show that provisions of chapter XVII-B regarding TDS are not applicable to non-residents in respect of payments made by them to persons resident in India.

## **6. Broad features of India's Direct Taxation Avoidance Agreements (DTAA)**

For this purpose I have referred "Guide to Double Taxation Avoidance Agreements" by K.Srinivasan, third edition. This book contains "broad features of Indian's DTAA's" p.1.40. On p.1.54 there is a heading "Terms used in treaties and rates of withholding taxes in post - 1986 treaties". In Annexure - 1 p.1.58 the subject of "withholding rate of tax" has been discussed. It has been mentioned therein that TDS rates are prescribed in respect of payments remitted out of India.

Nothing has, however, been mentioned in relation to payments received in India. Thus it also goes to show that TDS or withholding tax provisions are not applicable to non - residents in respect of payments made by them to persons resident in India.

## **7. Practical wisdom regarding the collection and recovery of Income-tax**

The Income-Tax Act has got various provisions in order to ensure that tax in respect of income of non-residents is levied and collected in India itself before the same is remitted outside India. The basic idea behind the scheme in the Act, for this purpose, is to levy, collect/ recover tax in respect of such income as long as it is present within the Indian Territory and accordingly subject to all the provisions of Indian IT Act.

If, on the other hand, a non-resident makes a payment to a person resident in India and he is required to deduct tax at source in respect thereof, then it would mean that he is being authorised to deduct a part of the payment in the form of tax, before the payment is sent to India. Thus it would lead to a situation where a non-resident will have control over a part of payment being sent to India.

If no tax is deducted at source by the non-resident, then whole of the payment is received in India and the recipient thereof is under full and complete jurisdiction of the Indian IT Act. He may accordingly be required to pay advance tax in respect of income embedded in such a payment.

In the light of the aforesaid discussion it would always be prudent and wise to allow the receipt of income in India without any deduction of tax therefrom and thereafter levy, collect or recover tax from the person who is resident in India and therefore liable to comply with all the provisions of the IT Act. Thus the relevant income as well as the tax thereon would both be under the control and jurisdiction of the Indian IT authorities.

## **8. Summary :**

On examination of various provisions of the IT Act and the decisions of various Courts, in the earlier paras, one may reach an unmistakable conclusion that if the source of income lies within the territorial limits of India then all the provisions of the IT Act 1961 are applicable to it; on the other hand if the source of income lies outside the Indian territory then it would not be subject to the jurisdiction of the IT Act 1961, even though such an income is chargeable to tax in India. In this context one may say that the locus of the source of income is synonymous with the locus of the "person responsible for paying", as defined in S.204 of the Act. In other words, it would mean that if the "person responsible for paying"; along with

the source of the payments; is located outside the territorial limits of India, then such a person would not be liable to comply with the provisions of chapter XVII-B of the Act.

## **9. Ratio of the decision of Calcutta High Court in the case of Grindlays Bank Vs ITO 183 ITR p.62.**

This case relates to TDS liability in respect of furlough pay from the London Head Office of the bank. In this respect it is to be seen that the payment of the furlough pay is relatable to the services rendered by the employee of the bank in India and secondly the source of income is also located in India though the payment in respect of the same has been made via the London Head Office of the bank. This decision of the

Calcutta High Court does not, therefore, go against the conclusion derived in para 8 under the head “Summary”.

## **10. Contents of circular No 726 dated 18.10.1995, irrelevant and misleading**

The heading of the aforesaid circular of the CBDT is as follows:

“Deduction of tax at source under section 194 J - payments to persons resident in India by foreign companies or foreign law firms that have no presence in India - clarification - Regarding”.

The aforesaid circular exempts non - residents, who do not have any agent, business connection or permanent establishment in India, from liability of TDS in respect of fees paid to any Chartered Accountant, Lawyer, Advocate or Solicitor who is resident in India. This circular has sought to give exemption from a non - existing liability. It thus creates a wrong impression as if the non-residents will be under a liability for TDS in respect of payments made by them to persons resident in India. As already explained if the source of income or in other words the “person responsible for paying”, is located outside the Indian territory then such a person is under no liability for TDS in respect of payments made to persons resident in India. All the provisions of the IT Act and the case - law discussed in earlier paras, clearly lead to this conclusion.

In view of the aforesaid reasons the contents of circular No 726 are not only ill-conceived but also misleading as they are against the provisions of IT Act 1961. The same, therefore, deserve to be ignored and dis-carded.

## **11. Conclusion**

In view of the reasons discussed in the earlier paras a Non-resident will not to be liable to deduct tax at source from payments made to persons resident in India by way of professional or other fees or charges for advertisement in the Indian Media etc; if the source of the aforesaid payments is located outside the Indian Territory.

M.Sc., LL.B., **Advocate**

Ex-Indian Revenue Service

**Income-Tax Advisor**

Fax : (020) 612 1131

Residence : (020) 668 2032

: (020) 668 2444

E-mail : [sktyagidt@vsnl.com](mailto:sktyagidt@vsnl.com)

Gurudatta Avenue

Popular Heights Road

Koregaon Park

PUNE - 411 001

---