Tax is not deductible at source in respect of all payments to non-residents

-By S. K. Tyagi

The ITAT Bench of Chennai has made sweeping observations on TDS in respect of payments to non-residents in the following cases:-

(i) West Asia Maritime Ltd. Vs. I.T.O. [2008] 297 ITR (AT) 202 (Chennai), and
(ii) Poompuhar Shipping Corporation Ltd. Vs. I.T.O. (I.T.) [2008] 297 ITR (AT) 219 (Chennai)

It has been held in the aforesaid judgements that it is not open to a person making payments to a non-resident to take a unilateral decision that the payments made by him are not sums chargeable to tax. To take that view, concurrence of the Assessing Officer as provided in section 195(2) is *sine qua non*. For reaching the aforesaid conclusion, the judgement of the Supreme Court in *Transmission Corporation of A.P. Ltd. Vs. CIT [1999] 239 ITR 587 (S.C.)* has also been invoked.

By laying down the aforesaid requirement for TDS in respect of payments to non-residents, the **Hon. Tribunal has put the cart before the horse**. It has totally lost sight of the current international trends and the very purpose of the Double Taxation Avoidance Agreements (DTAAs) between India and other countries. The ITAT has also not realized that this would lead to collection of enormous amount of refundable tax and thus, create infructuous work all around for the tax department as well as the tax-payers and besides it would put immense pressure on the cash flow of the tax-payers.

In the light of the relevant provisions of the Income-Tax Act, 1961 (the Act), the Circulars of the CBDT and legal precedents, it may be emphatically stated that tax is not required to be deducted at source under section 195 of the Act, in respect of all payments to non-residents. In support of the aforesaid stand, the relevant issues are discussed as follows:-

1. Section 90 of the Income-Tax Act, 1961 – Agreement with foreign countries

In the present context, section 90 of the Income-Tax Act, 1961 (the Act) is relevant and the same is reproduced as follows:-

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Agreement with foreign countries.

90. (1) The Central Government may enter into an agreement with the Government of any country outside India—

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee.

(3) Any term used but not defined in this Act or in the agreement referred to in sub-section (1) shall, unless the context otherwise requires, and is not inconsistent with the provisions of this Act or the agreement, have the same meaning as assigned to it in the notification issued by the Central Government in the Official Gazette in this behalf.

Explanation.—For the removal of doubts, it is hereby declared that the charge of tax in respect of a foreign company at a rate higher than the rate at which a domestic company is chargeable, shall not be regarded as less favourable charge or levy of tax in respect of such foreign company.

From the aforesaid provisions of section 90(1), it may be seen that DTAA is to be entered into–

(a) For granting relief in respect of double taxation.

(b) For the **avoidance of double taxation** of income under this Act and the corresponding law in force in the other country.

(c) For exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or the corresponding law in force in the other country, including investigation of cases of such evasion or avoidance.

(d) Recovery of income-tax under the Act and the corresponding law in force in the other country.

2. Explanatory Notes in respect of the provisions of section 90, as substituted by the Finance Act, 1972

Section 90 was substituted by the Finance Act, 1972, with effect from 1.4.1972. The '*Explanatory Notes,*' in respect of Finance Act, 1972, have been provided, vide Circular No.108, dated 20.3.1973. Para 23 of the aforesaid Circular, provides *Explanatory Notes* on the substitution of section 90, which is reproduced as follows:

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23. *Under section 90, the Central Government is empowered to enter into an agreement with the Government of any foreign country for the avoidance of double taxation of income and to make provisions for implementing the agreement by the issue of a notification in the Official Gazette. Some the of the tax-payers having transactions with outside countries resort to dubious methods for evading their tax liability under the tax laws. Tax evasion is thus closely linked with transactions involving over-invoicing and under-invoicing in import and export business operations through secret foreign bank accounts and smuggling of valuable articles into and out of India. Cases of tax-payers who thwart the attempt of the administration to collect tax dues by either retaining their assets abroad or transferring them secretly outside India are also not unknown. With a view to enabling the tax administration to tackle the problem of tax evasion having international ramifications***, the Finance Act, 1972 has substituted a new section for the existing section 90 in order to empower the Central Government to enter into agreements with foreign countries not only for purposes of avoidance of double taxation of income but also for enabling the tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income or for investigation of cases involving tax evasion or avoidance or for recovery of taxes in foreign countries on a reciprocal basis.**

A consequential change has also been made in the provisions of the Income-Tax Act relating to recovery of arrears of taxes by inserting a new section 228A. Where the tax treaty provides for the recovery of taxes due to the Government of one treaty country in the other and the Government of the foreign country or any authority specified in this behalf in the tax treaty sends to the Central Board of Direct Taxes a certificate for the recovery of any tax due in the foreign country, the Board has been empowered to send the certificate to the Tax Recovery Officer within whose jurisdiction the *property of the defaulter is situated and thereupon the Tax Recovery Officer will proceed to recover the dues in the manner specified in the Income-Tax Act. Likewise, if a taxpayer in India has property in the foreign country, the Income-Tax Officer will be able to send a certificate to the Board certifying the amount of arrears due from the taxpayer and thereupon the Board will take action for the recovery of the dues in the foreign country in accordance with the terms of the tax treaty.*

The Companies (Profits) Surtax Act, the Wealth-tax Act and the Gift-tax Act also contain similar provisions enabling the Central Government to enter into agreements with foreign countries for the avoidance of double taxation with respect to taxes levied under these Acts. The corresponding provisions in these Acts have also been brought in line with the provisions of the Income-Tax Act.

The above modifications have come into force with effect from 1.4.1972. [Emphasis added]

From the aforesaid *Explanatory Notes*, it is abundantly clear that erstwhile section 90 was substituted by the Finance Act, 1972, for the following purposes:-

(i) The avoidance of double taxation

(ii) Enabling the tax authorities to exchange information for the prevention of evasion or avoidance of taxes on income.

(iii) Investigation of cases involving tax evasion or avoidance, and

(iv) Recovery of taxes in foreign countries on a reciprocal basis.

From the aforesaid *Explanatory Notes*, it may also be seen that the main purpose behind the Double Taxation Avoidance Agreements (DTAAs) is to **avoid double taxation** on the basis of source of income and the residence of the tax-payer.

In view of the aforesaid reasons, the deduction of tax at source from all payments non-residents, goes against the very spirit and purpose of DTAAs.

3. Explanatory Notes on Finance (No.2) Act, 1991, in respect of amendments of section 90(2) and section 195

Section 90(2) and section195 were amended by the Finance (No.2) Act, 1991. The '*Explanatory Notes,*' in respect of the same are provided by Circular No.621, dated 19.12.1991. Para 43 of the aforesaid Circular provides comments on '*Taxation of foreign companies and other non-resident tax*-payers'. The relevant part of the same is reproduced as follows:

Taxation of foreign companies and other non-resident tax-payers

43. Tax treaties generally contain provision to the effect that the laws of the two contracting States will govern the taxation of income in the respective State except when express provision to the contrary is made in the treaty. It may so happen that the tax treaty with a foreign country may contain a provision giving concessional treatment to any income as compared to the position under the Indian law existing at that point of time. However, the Indian law may subsequently be amended, reducing the incidence of tax to a level lower than what has been provided in the tax treaty.

43.1 *Since the tax treaties are intended to grant tax relief and not put residents of a contracting country at a disadvantage vis-à-vis other tax-payers, section 90 of the Income-Tax Act has been amended to clarify that any beneficial provision in the law will not be denied to a resident of a contracting country merely because the corresponding provision in the tax treaty is less beneficial.*

43.2 *This amendment takes effect retrospectively from 1st April, 1972.*

43.3 *Under the provisions of section 195 of the Income-Tax Act, any person responsible for paying to a non-resident taxpayer or to a foreign company any sum, other than interest on securities, salary or dividends, chargeable to income-tax in India, is required, to deduct income-tax thereon at the rates in force. Where the person responsible for paying any sum to a non-resident considers that the whole amount would not be income chargeable to tax, he may apply to the Assessing Officer to determine the appropriate proportion of such sum chargeable to tax. In such cases, tax is required to be deducted from the portion as determined by the Assessing Officer.*

43.4 *The facility of deducting tax only from a portion of the sum payable is not available in cases where the payment is by way of interest, royalty or fee for technical services to a foreign company.*

43.5 *In some of the bilateral agreements for the avoidance of double taxation, it has been provided that any or all of the incomes referred to above would be taxed in India on net basis. Further, under certain tax treaties, income by way of royalty or fee for technical service is charged to* *tax on net basis in cases where such income is attributable to any 'permanent establishment' of the foreign enterprise in India.*

43.6 *As a result, in a large number of cases payments of royalty, fee for technical services, etc. to non-residents, tax required to be deducted at source is much larger than the final tax liability.*

43.7 *With a view to avoiding such situations, section 195 of the Income-Tax Act has been amended to empower the Assessing Officer to determine, in all cases of payment of interest, dividends, royalties, fees for technical services, paid to a foreign company or to a non-resident taxpayer, the appropriate proportion of the amount from which tax is to be deducted at source.*

43.8 *This amendment takes effect from 1st October, 1991.*

43.9 *Under the existing scheme of deduction of tax at source, even in cases where a lower rate of tax income is provided in the tax treaty, tax has to be deducted at the rate prescribed in law. As a result, in many cases, the amount of tax deducted from sums remitted to foreign companies is larger than the final tax liability,* **thus requiring filing of claims for refund**.

43.10 *With a view to correcting this position, section 2(37A) of the Income-Tax Act has been amended to secure that tax is deducted at source at the rate applicable in a particular case, for final tax liability.*

43.11 *This amendment taxes effect from 1st October, 1991.*[Emphasis added]

From the aforesaid *Explanatory Notes*, it may be seen that the amendments have laid emphasis on the following points:-

(i) As per para 43.3, under section 195 of the Act, a person responsible for making payment of any sum to a non-resident tax-payer or a foreign company, **which is chargeable to income-tax in India,** is required to deduct tax at source therefrom.

It further lays down that only in case the tax-deductor **considers** that the whole amount would not be income chargeable to tax in India, then he may approach the Assesing Officer (AO) to determine the appropriate proportion of such sum chargeable to tax. In such cases, tax is required to be deducted from that portion as determined by the AO.

From the aforesaid *Explanatory Note*, it is abundantly clear that it could never have been the intention of the Legislature that tax is to be deducted at source for all the payments to non-residents.

(ii) As per para 43.6, in a large number of cases of payments of royalty, fees for technical services, etc. to non-residents, tax required to be deducted at source is much larger than the final tax liability. Further, as per para 43.7, with a view to correcting such situations, section 195 of the Act has been amended to empower the AO to determine the appropriate proportion of the amount from which tax is to be deducted at source.

Thus, section 195(2) has been enacted with a view to providing relief to tax-payers where more than requisite tax is required to be deducted at source under section 195(1) of the Act.

In view of the aforesaid reasons, it would be absolutely absurd to conclude that as per the provisions of section 195(2), tax is required to be deducted at source even in respect of the sums which are not chargeable to tax in India.

(iii) As per para 43.9, under the existing scheme of TDS, even in cases where a lower rate of tax on income is provided in the tax treaty, tax has to be deducted at the rate prescribed in law. As a result in many cases the amount of TDS from sums remitted to foreign companies is larger than the final tax liability, **thus requiring filing of claims for refund.** Further as per para 43.10, with a view to correcting this situation, section 2(37A) of the Act has been amended to secure that tax is deducted at source at the rate applicable in a particular case, for final tax liability.

It is, thus, clear that in a case where the final tax liability is Nil or the sum payable to the non-resident is not chargeable to tax in India, no tax is required to be deducted at source under section 195 of the Act.

It may also be emphasized in this context that if tax is required to be deducted at source from all payments to non-residents, then in respect of sums not liable to tax in India, the non-residents will be required to file claims for refund, whereas the purpose of the DTAA is to avoid such eventualities.

In this regard, another very important aspect which has also to be kept in mind is that most of the non-resident payees do not have a fixed place of business or permanent establishment in India. If tax is also deducted at source in respect of payments which are

not chargeable to tax in India, how would the aforesaid tax-payees be able to file the returns of income in India in order to claim the refund of the tax deducted at source, which should not have been deducted, at all.

4. Role and objectives of tax treaty or DTAA

In the first place, we may refer to the role of tax-treaty. Tax is a barrier to trade and inhibits its growth. International tax basically is a part of the trade which encompasses trade in goods and services and capital and financial markets. Tax treaties play the following roles:-

(i) **Elimination of double taxation**, thus creating a more favourable investment climate in the country.

(ii) Facilitating inward investment flows. These include preventing **discrimination** between the tax-payers.

(iii) Adding fiscal certainty to cross-border operations;

Besides, the general objectives of bilateral tax agreements may be seen to include the **full protection of tax-payers against double taxation** and the prevention or discouragement which taxation may provide for the free flow of international trade and investment and transfer of technology. **They also aim at preventing discrimination between the tax-payers in the international field, and to provide a reasonable element of legal and fiscal certainty as a framework within which international operations are carried out**. The agreements have an objective of co-operation between tax authorities in carrying out their duties. Such agreement is an attempt to invoke the concept of the committee of nations or of rules of international law in interpretation of an agreement that derives legal sanctity from a country's own Income-Tax Act. In India, section 90 is such a provision.

We may now summarise the main objectives of DTAA or Tax Agreement. The Tax Agreement seeks to achieve three basic objectives, viz.:

(i) To eliminate tax barriers to international trade and investment;

(ii) To combat international tax avoidance and evasion.

(iii) To promote mutual economic relations, trade and investment.

In furtherance of these goals, the tax agreement seeks to mediate between competing jurisdictional bases for income taxation (typically between **source** and **residence** states), to develop common frameworks for certain basic concepts necessary to the application of the tax agreements, such as determination of residence and entitlement to benefits; and to establish mechanism for resolving inter governmental disputes as well as **alleviate any remaining instances of potential double taxation of tax-payers covered by the tax agreements**. Cross-border investment would be seriously impeded if there were a danger that the returns are taxed twice, both where money was invested and where the investor is resident. The tax treaty avoids this eventually by providing clear basic rules for taxing income and capital. Double taxation is avoided with respect to investment income by allocating taxing rights between the residence and the source countries. Matters which are covered in a treaty are:-

(i) Imposing liability to tax in one country whilst granting exemption in the other;
(ii) Granting exemption from tax in either or both countries, but having regard nonetheless to the exempted income when computing effective rates of tax on other non-exempted assets;
(iii) Deeming geographical source provisions for particular categories of income to be in one country than in the other;
(iv) Imposing liabilities to tax in the country in which the income is deemed to arise.

Thus, one of the paramount objectives of a tax-treaty or tax agreement is to avoid double taxation of income in the country of source of income and the country of residence of the tax-payer. The provisions of section 195 of the Act, are to be viewed in this context.

5. Purpose of non-discrimination article in all the DTAAs

The objective of non-discrimination article in an DTAA is to prevent discrimination of the Nationals, stateless persons, residents and enterprises of the treaty partners. This article assures nationals of a Contracting State a non-discriminatory treatment. In other words, it means that the nationals of a Contracting State should not be subjected by the other State to any taxation requirement more burdensome than that which the nationals of the other State in the same circumstances are subjected to. It implies that two persons similarly situated must be treated similarly.

We may now look at the interpretation being placed on the provisions of Chapter XVII-B of the Income-Tax Act, 1961. It may be seen from the various sections under Chapter XVII-B of the Act, that in case of residents, tax is required to be deducted at source only if the relevant payment is liable to tax under the Act. Besides, all the payments to residents are not subjected to TDS under the various sections falling under Chapter XVII-B of the Act. Only certain payments are subjected to TDS as per the various sections under the aforesaid Chapter XVII-B.

As per the aforesaid non-discriminatory Article, the non-residents should also be subjected to the same treatment, viz. tax should be deducted at source in respect of non-residents only if the relevant payments are liable to tax in India under the Indian Income-Tax Act, 1961.

It is, thus, clear that the interpretation placed by the Chennai Bench of the Tribunal on the provisions of section 195 also defeats a very important provision of non-discriminatory treatment to non-residents, as contained in the relevant Article of the DTAA.

In this context, it may also be emphasized that the provisions of the DTAA override the provisions of the Indian Income-Tax Act, 1961, including the provisions of section 195 thereof. In this view of the matter, the aforesaid judgements of the Chennai Bench of the Tribunal do not represent the correct legal position.

6. **The provisions of the Income-Tax Act, 1961, have got adequate protection for the revenue as regard to the payments to the non-residents**

There is adequate protection under the Act for the Revenue as regards non-deduction of tax at source, because recovery is possible from the payer under section 201 with interest and possibly penalty. Besides, the right to treat the person as deemed agent of the non-resident is also there under section 163 of the Act. Further, there is also scope for disallowance of payment itself under section 40(a)(i) of the Act.

In addition, under the tax-treaty, there is a provision for the recovery of tax from a non-resident.

Under these circumstances, the view that no "*unilateral decision*" can be taken and that "*concurrence*" of authorities is required for every payment to a non-resident cannot be correct, since there is no such provision in the stature. In fact, even the facility of the Assessing Officer's no objection certificate (NOC) for remittances abroad under the Foreign Exchange Regulations was dispensed with leaving the matter to a chartered accountant in Board's Circular No.759, dated 18.11.1997 and Circular No.767, dated 22.5.1998, along with an indemnity of tax-payer himself, so that the Revenue is further protected.

Reference has also been made to section 195(2), but application under section 195(2) is necessary only where allocation is required to be made between taxable and non-taxable part of payment and not where the payer is advised that there is no tax-liability. Besides, the authorities are not geared for dealing with such requests promptly and in an impartial manner. In fact, they are prone to follow the advice of the Tribunal in these cases to act *ex abundanti cautela*.

7. Provisions of the Act, Circulars and legal precedents in support of the stand that tax need not be deducted at source in respect of all the payments to non-residents

As already pointed out, tax is deductible at source under section 195(1) of the Act, only in respect of sums which are chargeable to tax under the provisions of the Act. In this context, the provisions of the charging section for TDS, viz. section 4(2) of the Act have also to be kept in view. Tax is deductible at source under section 4(2) of the Act only in respect of income or payment which is liable to tax under the provision of the Income-Tax Act, 1961, as per section 4(1) thereof.

It may be clearly understood here that the provisions of section 195(2) are applicable only in cases where such sum is partly taxable in India. The application of sub-section (2) of section 195 pre-supposes that the person responsible for making the payment to the non-resident is in no doubt that the tax is payable in respect of some part of the amount to be remitted to a non-resident, but is not sure what should be the portion so taxable, or the amount of tax to be deducted.

There are Circulars of the CBDT, as also legal precedents which support the aforesaid stand. The same are as follows:-

(i) Circular No.786, dated 7.2.2000 [241 ITR (St.) 132]

As per this Circular, it is advised that no tax should be deducted at source under section 195 in respect of export commission payable to non-resident agents rendering services abroad, as according to this Circular, where the non-resident agent operates outside the country, no part of his income arises in India.

It has also been laid down in the aforesaid Circular that deduction of tax at source under section 195 would arise if the payment of commission to non-resident agent is chargeable to tax in India.

(ii) Circular No.728, dated 30.10.1995 [216 ITR (St.) 141]

Para (3) of the aforesaid Circular is relevant and the same is reproduced as follows:-

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3. It is hereby clarified that in view of the provisions of sub-section (2) of section 90 of the Act, in the case of a remittance to a country with which a Double Taxation Avoidance Agreement is in force, the tax should be deducted at the rate provided in the Finance Act of the relevant year or the rate provided in the DTAA, whichever is more beneficial to the assessee.

It is, thus, clear that in respect of payment of royalty and technical fees, the impact of DTAA may be considered.

(iii) Circular No.734, dated 24.1.1996 [217 ITR (St.) 74]

Paras (2) and (4) of the aforesaid Circular are relevant for our purpose and the same are reproduced as follows:-

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2. *The Board in its Circular No.728 (F.No. 500 / 12 / 95-FTD), dated 30th October, 1995, have already clarified that in case of a remittance to a country with which a Double Taxation Avoidance Agreement is in force, tax should be deducted at the rates provided in the Finance Act of the relevant year or at the rates provided in the Double Taxation Avoidance Agreement, whichever is more beneficial to the assessee.*

4. *It is essential that the above rates which are enshrined in the Double Taxation Avoidance Agreement between India and the United Arab Emirates are strictly adhered to so as* **to avoid unnecessary harassment of the tax-payers.** [Emphasis added]

It is, thus, clear that in respect of payment of interest and dividend, the impact of DTAA may be considered. It is also clear from the aforesaid Circular that the DTAA is meant to avoid unnecessary harassment of the non-resident tax-payers.

(iv) Hyderabad Industries Ltd. Vs. I.T.O. [1991] 188 ITR 749 (Karn.),

It was held in this case that the amounts exempt under section 10 of the Act, do not constitute income for the purposes of section 195 and therefore, tax is not deductible at source in respect of such amounts.

It was also held in this case that the purpose of deduction of tax at source is not to collect a sum which is not tax-levied under the Act; it is to facilitate the collection of the tax lawfully leviable under the Act.

(v) CIT Vs. Superintending Engineer, Upper Sileru [1985] 152 ITR 753 (A.P.)

The Hon. High Court, in this case, was seized of the issue of TDS in respect of payments to non-residents under the provisions of section 195(2) of the Act.

It was held in this case that the safeguard provided under section 195(2) protects the interests of the person receiving such sums, because an application can always be made to the ITO to determine the appropriate proportion of the sum chargeable under the Act, so that tax deduction at source could be confined only to such appropriate proportion and not to the gross amount.

Thus, section 195(2) of the Act, provides a relief to the non-resident payee and it is not meant to add to his burden.

The aforesaid judgement of the A.P. High Court has been affirmed by the Apex Court in the case of *Transmission Corporation of AP Ltd. Vs. C.I.T. [1999] 239 ITR 587 (SC).* It may also be stated in this context that the aforesaid judgement of the Apex Court has not made any difference in this regard. Should the assessee approach the AO in all cases for determination of appropriate proportion of income in the gross amount? He may be sure of the proportion of the chargeable income or he may not get the response from the AO. Since the Supreme Court States in the aforesaid judgement that the provision for determination by the authorities is a safeguard, it follows that where the person responsible for deduction is fairly certain, he can make his own determination.

(vi) ABC Ltd. In Re [2007] 208 CTR 117 (AAR.)

It was held in this case that the consideration for assignment payable under the deed of assignment does not answer the description of '*Royalty*' under *Explanation 2* to section 9(1)(vi) of the Act. Therefore, such consideration is not chargeable to tax under the provisions of the Act and consequently section 195 is not attracted and the assignee is not required to deduct any tax while making remittance to the non-resident.

It may be noted here that the AAR in the aforesaid case has considered the judgement of the Apex Court in the case of *Transmission Corporation of AP Ltd.(Supra)*

(vii) Islamic Investment Co. Vs. Union of India [2002] 176 CTR 46 (Bom.)

It was held in his case that when interest becomes part of a judgement debt, it loses its original character and assumes the character of judgement debt and tax is not liable to be deducted at source under section 195 from the interest component payable under a decree.

(viii) Lufthansa Cargo India Pvt.Ltd. Vs. Dy.CIT [2005] 274 ITR (AT) 20 (Del.)

It was held in this case that overhaul repairs involving routine maintenance repairs do not constitute payment of fees for managerial consultancy or technical services, as defined in *Explanation 2* to section 9(1)(vii).These payments are excluded from fees for technical services under section 9(1)(vii)(b).Therefore, no tax was required to be deducted at source under section 195 and accordingly, the interest under section 201(1A) and penalty under section 271C were held to be invalid.

In the light of the aforesaid discussion, it is clearly established that tax is not deductible at source under section 195 of the Act, in respect of all payments to non-residents.

8. Conclusion

From the discussion in the preceding paragraphs, it is quite clear that-

(i) One of the basic objectives of the DTAAs entered into between India and other countries, as per the provisions of section 90(1) of the Act, is the avoidance of double taxation of income of a tax-payer.

(ii) In view of the *Explanatory Notes* in respect of Finance Act, 1972, vide Circular No.108, dated 20.3.73,the deduction of tax at source from all payments to non-residents goes against the very spirit and purpose of the DTAAs.

(iii) As per *Explanatory Notes* on Finance (No.2) Act, 1991, Circular No.621, dated 19.12.1991-

(a) Under section 195 of the Act, tax is required to be deducted at source only in respect of a sum payable to a non-resident, which is chargeable to tax in India.

(b) If the tax-deductor considers that the whole amount of payment to a non-resident would not be chargeable to tax in India, then he may approach the Assessing Officer (A.O.) to determine the appropriate proportion of such sum chargeable to tax in India.

(c) Section 195(2) has been enacted with a view to providing relief to tax-payers where more than requisite tax is deductible at source under section 195(1) of the Act. Section 195(2) does not override the plain and unambiguous provisions of section 195(1) of the Act.

(d) The purpose of amendment of section 90(2) and section 195, vide Finance (No.2) Act, 1991, was to avoid the requirement of filing of refund claims by non-resident tax-payers where sums payable to them are not chargeable to tax in India.

(e) If tax is required to be deducted at source from all payments to non-residents, it will entail avoidable harassment, inconvenience and waste of time and energy, as regards the non-resident tax-payers.

(iv) The main role of tax-treaty / DTAA is the elimination of double taxation of income on the basis of source of income and residence of the tax-payer.

(v) There is a non-discrimination article in all the DTAAs, the purpose of which is to assure the nationals of the countries party to the tax-treaty to the same tax-treatment. In other words, the non-discrimination article in the DTAA, implies that two persons similarly placed must be treated similarly.

It must be clearly understood in this context that the provisions of the DTAA override the provisions of the Indian Income-Tax Act, 1961.

(vi) The provisions of the Income-Tax Act, 1961, have got adequate protection for the Revenue as regard payments to non-residents. Therefore, it is not imperative to deduct tax at source from all payments to non-residents.

(vii) As per the provisions of the Act, a number of Circulars of the CBDT and numerous legal precedents, tax is not deductible at source under section 195 of the Act, in respect of all payments to non-residents.

In view of the aforesaid reasons, it is clearly established that tax is not deductible at source under section 195 of the Indian Income-Tax Act, 1961, in respect of all payments to non-residents and therefore, the aforesaid judgements of the Chennai Bench of the Tribunal are required to be reconsidered.

Place: Pune

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