

COMMISSIONER OF INCOME TAX vs. ELI LILLY & COMPANY (INDIA) (P) LTD. & ORS.

SUPREME COURT OF INDIA

S.H. Kapadia & Aftab Alam, JJ.

Civil Appeal Nos. 5152 of 2005; 1769, 1775, 1776, 1778, 1780, 1782, 1783 to 1787, 1789, 1791 to 1796, 1920, 2187, 2210, 2211, 2480, 5263, 5646 of 2006; 107, 156, 159, 161, 342 to 347, 349, 352, 428, 434, 816, 1343, 1345, 1346, 1348, 1351, 1352, 1354, 1355, 1357, 1634, 1939, 1943, 1948, 1956, 1961, 2121, 2292 to 2295, **3124**, **3126**, 3212, 3523, 3616, 4082, 4173, 4477, 4516, 4517, 5110, 5111*, 5114, 5288, 5295, 5742, 5749, 5986 of 2007; 264, 292, 293, 1037, 1462, 3587 of 2008; 1890 to 1908 of 2009

25th March, 2009

(2009) 77 CCH 0310 ISCC

(2009) 223 CTR 0020 : (2009) 21 DTR 0074 : (2009) **312 ITR 0225** : (2009) 178 TAXMAN 0505

Legislation Referred to

Section 4, 5(2), 9(1)(ii), 40(a)(iii), 192, 201(1), 201(1A), 271C, 273B

Case pertains to

Asst. Year -

Decision in favour of:

Revenue (partly), Assessee

***From the judgment and order dt. 8th Nov., 2006 of the Delhi High Court in IT Appeal No. 1034 of 2006, reported as CIT vs. Eli Lilly & Co. (India) (P) Ltd. (2008) 297 ITR 300 (Del)**

TDS—Under s. 192—Home salary/special allowances paid by foreign company/head office to expatriate employees outside India—Sec. 9(1)(ii) lays down that income which falls under the head "Salaries", if earned in India, shall be deemed to accrue or arise in India—IT Act, 1961, is an integrated code and s. 9(1) integrates the charging section, the computation provisions as well as the machinery provisions—Sec. 192(1) has to be read with s. 9(1)(ii) and Explanation thereto—Consequently, it cannot be said that the TDS provisions which are in the nature of machinery provisions to enable collection and recovery of tax are independent of the charging provisions which determine the assessability in the hands of the employee—In the instant case, no work was found to have been performed by the expatriates for the foreign company—Thus, the payment of home salary/special allowance made by the foreign company abroad is for rendition of services in India and the assessee was statutorily obliged to deduct tax under s. 192(1)—Interest under s. 201(1A) is compensatory measure for withholding the tax which ought to have gone to the exchequer—Levy of interest is mandatory and the absence of liability for tax

will not dilute the default—As far as the period of default is concerned, the period starts from the date of deductibility till the date of actual payment of tax—Date of payment by the concerned employee can be treated as the date of actual payment—Sec. 271C cannot be held to be mandatory or compensatory or automatic because s. 273B states that penalty shall not be imposed in case falling thereunder—In the instant cases, non-deduction of tax at source took place on account of the controversial addition—Further, in most of the cases, the assessee has not claimed deduction under s. 40(a)(iii)—In some cases, the expatriate employees have directly paid the taxes due on foreign salary by way of advance tax/self assessment tax—Assessee was under genuine and bona fide belief that there was no obligation to deduct tax at source from the home salary paid by the foreign company/head office—Consequently, penalty under s. 271C is not leviable in any case

Held :

Sec. 192(1) falls in the machinery provisions. It deals with collection and recovery of tax. That provision is referred to in s. 4(2). Therefore, if a sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted. The sum which is to be paid may be income out of different heads of income mentioned in s. 14, that is to say, income from salaries, income from house property, profits and gains of business, capital gains and income from other sources. The scheme of the TDS provisions applies not only to the amount paid, which bears the character of "income" such as salaries, dividends, interest on securities etc. but the said provisions also apply to gross sums, the whole of which may not be income or profits in the hands of the recipient, such as payment to contractors and sub-contractors. The purpose of TDS provisions in Chapter XVII-B is to see that the sum which is chargeable under s. 4 for levy and collection of income-tax, the payer should deduct tax thereon at the rates in force, if the amount is to be paid to a non-resident. The said TDS provisions are meant for tentative deduction of income-tax subject to regular assessment.—[Transmission Corporation of A.P. Ltd. & Anr. vs. CIT \(1999\) 155 CTR \(SC\) 489 : \(1999\) 239 ITR 587 \(SC\) applied.](#)

(Para 21)

If the payments of home salary abroad by the foreign company to the expatriate has any connection or nexus with his rendition of service in India then such payment would constitute income which is deemed to accrue or arise to the recipient in India as salary earned in India in terms of s. 9(1)(ii) (which is one of the heads of income). Sec. 9(1)(ii) lays down that income which falls under the head "Salaries", if it is earned in India, shall be deemed to accrue or arise in India. The 1961 Act has extraterritorial operation in respect of the subject-matters and the subjects which is permissible under Art. 245 of the Constitution and the provisions are enforceable within the area where the 1961 Act extends through the machinery provided under it. The 1961 Act is an integrated code and s. 9(1) integrates the charging section, the computation provisions as well as the machinery provisions [see s. 9(1)(i) r/w ss. 160, 161, 162 and 163]. Non-residents who are not assessable in respect of income accruing and received abroad are rendered chargeable under s. 5(2)(b) in respect of income deemed by s. 9 to accrue in India. Sec. 9 deems certain categories/heads of income to accrue in India has no application in cases where income actually accrues in India. Likewise, s. 9 does not apply in cases where income is received in India. Therefore, if the income is not received in India, a non-resident would not be chargeable to tax upon it unless it accrues or is deemed to accrue in India. Thus, a general charge of income-tax is imposed by ss. 4 and 5, and that general charge is given a particular application in respect of non-residents by s. 9 which enlarges the ambit of taxation by deeming income to arise in India in certain circumstances. Under s. 9(1), income is deemed to accrue in India if it accrues directly or indirectly under five circumstances mentioned therein.—[A.H. Wadia vs. CIT \(1949\) 17](#)

ITR 63 (FC) and [CIT vs. B.C. Srinivasa Setty](#) (1981) 21 CTR (SC) 138 : (1981) 128 **ITR** 294 (SC) **applied**.

(Paras 26 to 29)

Sec. 192 inter alia provides that any person responsible for payment of any income chargeable under the head "Salaries" shall at the time of payment deduct income-tax on the basis of the rates in force for the financial year. It is true that the word "aggregate" does not precede the word "income" in s. 192(1). However, in s. 192(1), the words used are "any income chargeable under the head 'Salaries'" shall at the time of payment, deduct income-tax on the amount payable. There is a marked similarity between s. 192(1) and s. 40(a)(iii). The word(s) used in s. 192 is not merely "salaries". The words used in s. 192(1) are "any income chargeable under the head 'Salaries'". This aspect is very important. Under the 1961 Act, as stated hereinabove, there are different categories of income enumerated in s. 9(1). One such income falls under the head "Salaries" if earned in India [see s. 9(1)(ii)]. Once an income falls under s. 9 (1), it comes in the category of income deemed to accrue or arise in India in terms of s. 5(2)(b). This is one more example of the 1961 Act being an integrated Code. At this stage two aspects need to be highlighted. Firstly, in s. 192(1), tax at source has to be deducted on the amount payable. This is where the tax-deductor-assessee has to estimate the income of the assessee employee under the head "Salaries". This word "payable" also finds place in s. 40(a)(iii). Secondly, one has to note the effect of the Explanation to s. 9(1)(ii). Sec. 9(1)(ii) enacts that income chargeable under the head "Salaries" under s. 15 shall be deemed to accrue or arise in India if it is earned in India, i.e., if the services under the agreement of employment are or were rendered in India, the place of receipt or actual accrual of the salary being immaterial. Thus, s. 192(1) has to be read with s. 9(1)(ii). This is one more illustration to show that the 1961 Act is an integrated code. In fact, if s. 192(1) is to be segregated from s. 9(1)(ii) or from s. 40(a)(iii) then the very purpose of shifting the "accrual test" to the "earning test" by reason of insertion of Explanation, would stand defeated. In this connection one more aspect may be noted. Sec. 192(1) is the only section in Chapter XVII-B, unlike other sections in that chapter, which requires deduction of tax at source on estimation of income chargeable under the head "Salary". The act of "estimation" is similar to computation of income. As stated above, the 1961 Act is an integrated Code in which chargeability and computation goes hand in hand. Thus, s. 192(1), which is a stand-alone section in Chapter XVII-B, has to be read with s. 9(1)(ii). From the above analyses two conclusions flow. Firstly, it cannot be stated as a broad proposition that the TDS provisions which are in the nature of machinery provisions to enable collection and recovery of tax are independent of the charging provisions which determines the assessability in the hands of the employee-assessee. Secondly, whether the home salary payment made by the foreign company in foreign currency abroad can be held to be "deemed to accrue or arise in India" would depend upon the in- depth examination of the facts in each case. If the home salary/special allowance payment made by the foreign company abroad is for rendition of services in India and if as in the present case no work was found to have been performed for EL Inc. Netherlands then such payment would certainly come under s. 192(1) r/w s. 9(1)(ii). The post-survey operations revealed that no work stood performed for the foreign company by the four expatriates to the joint venture company in India and that the total remuneration paid was only for services rendered in India. In such a case the tax-deductor-assessee was statutorily obliged to deduct tax under s. 192(1).—[CIT vs. Eli Lilly & Co. \(India\)\(P\) Ltd.](#) (2008) 297 **ITR** 300 (Del) and [CIT vs. Woodward Governor India \(P\) Ltd.](#) (2007) 295 **ITR** 1 (Del) **overruled**.

(Paras 32 & 33)

A perusal of s. 201(1) and s. 201(1A) shows that both these provisions are without

prejudice to each other. It means that the provisions of both the sub-sections are to be considered independently without affecting the rights mentioned in either of the sub-sections. Further, interest under s. 201(1A) is compensatory measure for withholding the tax which ought to have gone to the exchequer. The levy of interest is mandatory and the absence of liability for tax will not dilute the default. The liability of deducting tax at source is in the nature of a vicarious liability, which pre-supposes existence of primary liability. The said liability is a vicarious liability and the principal liability is of the person who is taxable. A bare reading of s. 201(1) shows that interest under s. 201(1A) r/w s. 201(1) can only be levied when a person is declared as an assessee-in-default. For computation of interest under s. 201(1A), there are three elements. One is the quantum on which interest has to be levied. Second is the rate at which interest has to be charged. Third is the period for which interest has to be charged. The rate of interest is provided in the 1961 Act. The quantum on which interest has to be paid is indicated by s. 201(1A) itself. Sub-s. (1A) specifies "on the amount of such tax" which is mentioned in sub-s. (1) wherein, it is the amount of tax in respect of which the assessee has been declared in default. The object underlying s. 201(1) is to recover the tax. In the case of short deduction, the object is to recover the shortfall. As far as the period of default is concerned, the period starts from the date of deductibility till the date of actual payment of tax. Therefore, the levy of interest has to be restricted for the above stated period only. It may be clarified that the date of payment by the concerned employee can be treated as the date of actual payment.

(Para 34)

Sec. 271C inter alia states that if any person fails to deduct the whole or any part of the tax as required by the provisions of Chapter XVII-B then such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to deduct. Thus s. 271C(1)(a) makes it clear that the penalty leviable shall be equal to the amount of tax which such person failed to deduct. This provision cannot be held to be mandatory or compensatory or automatic because under s. 273B Parliament has enacted that penalty shall not be imposed in cases falling thereunder. Sec. 271C falls in the category of such cases. Therefore, the liability to levy of penalty can be fastened only on the persons who do not have good and sufficient reason for not deducting tax at source. Only those persons will be liable to penalty who do not have good and sufficient reason for not deducting the tax. The burden, of course, is on the person to prove such good and sufficient reason. In the instant cases non-deduction of tax at source took place on account of controversial addition. The concept of aggregation or consolidation of the entire income chargeable under the head "Salaries" being exigible to deduction of tax at source under s. 192 was a nascent issue. It has not been considered by this Court before. Further, in most of these cases, the tax-deductor-assessee has not claimed deduction under s. 40(a)(iii) in computation of its business income. This is one more reason for not imposing penalty under s. 271C because by not claiming deduction under s. 40(a)(iii), in some cases, higher corporate tax has been paid to the extent of Rs. 906.52 lacs. In some of the cases, it is undisputed that each of the expatriate employees have paid directly the taxes due on the foreign salary by way of advance tax/self-assessment tax. The tax-deductor-assessee was under a genuine and bona fide belief that it was not under any obligation to deduct tax at source from the home salary paid by the foreign company/head office and, consequently, in none of the cases penalty was leviable under s. 271C as the respondent in each case has discharged its burden of showing reasonable cause for failure to deduct tax at source.—[CIT vs. Mitsui & Company Ltd. & Anr.](#) (2004) 190 CTR (Del) 38, [CIT vs. Lurgi Oil Gas Chemie GmbH](#) (2004) 141 Taxman 348 (Del), [CIT vs. Sencma SA, France](#) (2006) 203 CTR (Del) 96 and [CIT vs. Japan Radio Co. Ltd.](#) (2006) 203 CTR (Del) 145 **affirmed**.

(Para 35)

The AO is directed to examine each case to ascertain whether the employee-assessee (recipient) has paid the tax due on the home salary/special allowance(s) received from the foreign company. In case taxes due on home salary/special allowance(s) stands paid off then the AO shall not proceed under s. 201(1). In cases where the tax has not been paid, the AO shall proceed under s. 201(1) to recover the shortfall in the payment of tax. Similarly, the AO shall examine and find out whether interest has been paid/recovered for the period between the date on which tax was deductible till the date on which the tax was actually paid. If, in any case, interest accrues for the aforesaid period and if it is not paid then the adjudicating authority shall take steps to recover interest for the aforesaid period under s. 201(1A).

(Paras 36 & 37)

Conclusion :

Sec. 192(1) has to be read with s. 9(1)(ii) read with the Explanation thereto; assessee was duty-bound to deduct tax at source under s. 192(1) from the home salary/special allowance(s) paid abroad to expatriate employees by the foreign company, particularly when no work stood performed for the foreign company and the total remuneration was paid only on account of services rendered in India during the period in question.

In favour of :

Revenue (partly)

TDS—Assessee in default—Interest under s. 201(1A)—Interest under s. 201(1A) is compensatory measure for withholding the tax which ought to have gone to the exchequer—Levy of interest is mandatory and the absence of liability for tax will not dilute the default—As far as the period of default is concerned, the period starts from the date of deductibility till the date of actual payment of tax—Date of payment by the concerned employee can be treated as the date of actual payment

(Para 34)

Conclusion :

Interest under s. 201(1A) is compensatory measure for withholding the tax which ought to have gone to the exchequer, levy of interest is mandatory and the absence of liability for tax will not dilute the default; as far as the period of default is concerned, the period starts from the date of deductibility till the date of actual payment of tax; date of payment by the concerned employee can be treated as the date of actual payment.

Penalty under s. 271C—Failure to deduct tax at source—Reasonable cause—Sec. 271C cannot be held to be mandatory or compensatory or automatic because s. 273B states that penalty shall not be imposed in case falling thereunder—In the instant cases, non-deduction of tax at source took place on account of the controversial addition—Further, in most of the cases, the assessee have not claimed deduction under s. 40(a)(iii)—In some cases, the expatriate employees have directly paid the taxes due on foreign salary by way of advance tax/self assessment tax—Assessee were under genuine and bona fide belief that there was no obligation to deduct tax at source from the home salary paid by the foreign company/head office—Consequently, penalty under s. 271C is not leviable in any case

Conclusion :

Assesseees were under genuine and bona fide belief that there was no obligation to deduct tax at source from the home salary paid by the foreign company/head office; consequently, penalty under s. 271C is not leviable in any case.

In favour of :

Assessee

Cases referred:

CIT vs. S.G. Pgnatale (1980) 16 CTR (Guj) 337 : (1980) 124 **ITR** 391 (Guj)

Circular referred to

Circular No. 719, dt. 22nd Aug., 1995

Counsel appeared:

Parag P. Tripathi with Ms. Arti Gupta, Ms. Vismai Rao & R.V. Balram Das, for the Revenue : S. Ganesh, M.S. Syali & C.S. Agarwal with Ajay Vohra, Kanan Kapoor, Salil Kapoor, Ms. Kavita Jha, Sandeep S. Karhail, Ms. Mahua Kalra, R.S. Suri, Jogjit Singh Chhabra, Kamal Mohan Gupta, P.V. Yogeswaran, Bhargava V. Desai, Vikas Mehta, N. Ganpathy, Dhruv Mehta, K.L. Menta & Co., Amboj Kumar Sinha, S. Prasad, Rajinder Mathur, P.N. Gupta, Chandra Prakash Pandey, Anuvrat Sharma & O.P. Khaitan, for the Assesseees

S.H. KAPADIA, J.

JUDGMENT

Delay condoned.

2. Leave granted.

3. In this batch of civil appeals, the question which arises for determination is-whether TDS provisions in Chapter XVII-B, which are in the nature of machinery provisions to enable collection and recovery of taxes, are independent of the charging provisions which determines the assessability of income chargeable under the head "Salaries" in the hands of the recipient ? Broadly stated, we have cases in which the tax-deductor-assessee(s) has not deducted tax at source on the home salary/special allowance(s) (education allowance or retention) payments made by the foreign company/HO to its employees (expatriates to India) outside India in foreign currency.

I. Facts in Civil Appeal No. 5114 of 2007 :

[CIT vs. Eli Lilly & Co. (I) (P) Ltd.]

4. Assessee was engaged in manufacturing and selling pharmaceutical products during the financial years 1992-93 to 1999-2000. In the course of survey under s. 133A of the IT Act, 1961 ("1961 Act" for short), the AO noticed that the foreign company had seconded four expatriates to the joint venture in India; that, the tax-deductor-assessee was a joint venture company; that, the appointment of the four expatriates was routed through the joint venture Board comprising of the Indian partner, viz., M/s Ranbaxy Ltd. and that only part of their aggregate remuneration was paid in India by the tax-deductor-assessee. The post-survey operations revealed that no work stood performed for M/s Eli Lilly Inc., Netherlands ("foreign company" for short). The AO further found that the total remuneration paid was only on account of services rendered in India and therefore in terms of s. 9(1)(ii) the income derived by the expatriates was taxable in India and subject to s. 192(1) of the 1961 Act. Consequently, the tax-deductor-assessee was asked to explain why it should not be declared as "assessee in default" under s. 201(1) as it had failed to deduct tax at source on the aggregate salary received by the four expatriates.

5. In reply, the tax-deductor-assessee submitted that the four expatriates were seconded by the foreign company to the joint venture company in India; they were employed by the joint venture; they continued to be on the rolls of the said foreign company and they received home salary outside India in foreign currency from the said foreign company. It was further submitted that the joint venture company deducted tax at source under s. 192(1) in respect of the salary paid to the expatriates in India and that no tax stood deducted in respect of the home salary paid by the foreign company to the expatriates outside India, de hors the contract of employment in India.

6. The AO held that the respondent herein, viz., the tax-deductor-assessee, was an "assessee-in-default" under s. 201 for failure to deduct tax at source from out of home salary paid by the said foreign company outside India and levied interest under s. 201(1A).

7. The Tribunal and the High Court, however, held that the tax-deductor-assessee was not under statutory obligation to deduct tax at source on the home salary paid by the said foreign company under s. 192 as it was not paid by the joint venture company in India and consequently the said joint venture was not an "assessee in default" under s. 201(1) of the 1961 Act. Hence, the Department has come to this Court by way of these civil appeals.

8. To complete the chronology of events, we may state that in some of the cases herein the Department has levied penalty under s. 271C of the 1961 Act for failure to deduct tax under s. 192(1) from out of home salary paid outside India by the head office ("HO") to the expatriates deputed to the branch office(s) in India which penalty was set aside on the ground that the expatriates exercised dual employment and that there was no obligation on the branch office to deduct tax under s. 192(1) on the home salary paid by the HO outside India. It was further held that the said home salary paid by the HO was not on account of or on behalf of the branch office since no deduction was claimed for the salaries paid outside India in computing the income of the employer and accordingly it was held that no penalty was leviable under s. 271C of the 1961 Act. Against deletion of penalty under s. 271C, the Department has come to this Court by way of these civil appeals.

II. Contentions

9. Shri Parag P. Tripathi, learned Addl. Solicitor General on behalf of the appellants, on interpretation of s. 192 submitted that the said section comprises of four elements :

(i) It imposes an obligation of 'deducting' tax on "any person" responsible for paying any income chargeable under the head "Salary",

(ii) Clarifies that this obligation attaches itself "at the time of payment", which is the temporal time frame,

(iii) The rate is to be determined on the basis of the average rate of income-tax for the financial year, and

(iv) Most importantly, the rate is to be applied "on the estimated income of the assessee under this head for that financial year", i.e., for the totality of the assessable salary income of the assessee employee.

10. According to the learned senior counsel, the expression "any person" in s. 192 would include any person, responsible for making salary payment to an assessee employee, whether the employee is in India or outside India or whether the payment is made in India or outside India. According to the learned counsel, the only requirement is that the assessee employee must be paid in respect of services rendered in India. In this connection, learned counsel submitted that s. 192(2) advisedly uses the expression "making the payment". The said sub-section does not use the expression "making the deduction". These very two expressions, according to the learned counsel, find place also in s. 192(1), however, the said two expressions are used in that sub-section in different context. The expression "payment" is used in respect of payment of salary income to the assessee employee and the expression "deduction" is used in respect of deduction of tax. According to the learned counsel, the very fact that s. 192(2) authorizes the assessee employee to choose one of the several persons "making the payment" and not "making the deduction" is an indication that the obligation under s. 192(1) attaches to "any" person, who is responsible for making payment of any salary income and is not limited to a person, who is under an obligation to deduct tax at source. This analyses was advanced by the learned counsel to counter the arguments of one of the assessees that s. 192(1) is in two parts, namely, one part relating to the "obligation" to deduct the tax and the other relating to the "quantum". According to the learned counsel, on a proper construction of s. 192(1), the expression "deduct income-tax on the amount payable" only qualifies the quantum of tax to be deducted at source and not the identity of the person obliged to make the payment. Therefore, according to the learned counsel, under s. 192 there is a clear obligation to deduct tax on "any" and every person responsible for paying any salary income to an assessee employee in India so long as the said income is exigible to income-tax in India. Sec. 192(2), according to the learned counsel, mitigates the rigours of s. 192(1). In conclusion, learned counsel submitted that s. 192 imposes a joint and several obligation on all the persons, who are responsible for paying any income chargeable under the head "Salaries" to an assessee employee in India. In the alternative, learned counsel submitted that even if it were to be held that it is only the Indian employer who is obliged to deduct tax at source and not the foreign employer (who is directly paying to the foreign account of the expatriate employee outside India), particularly in view of the amendment to s. 9(1)(ii), the obligation of the Indian employer has to be interpreted co-extensively and in respect to the entire salary income of the expatriate employee so long as the salary income of such an employee arises or accrues in India or is in respect of "services rendered in India".

11. On the penalty issue, learned Addl. Solicitor General submitted that the imposition of penalty under s. 271C r/w s. 273B is in the nature of a civil liability. According to the learned senior counsel the burden of bringing the case within the exception, namely, showing the "reasonable cause" is squarely on the assessee. On facts, in the context of

penalty, learned counsel submitted that in each of these civil appeals the respondent assessee has pleaded bona fide misunderstanding of law, which explanation, according to the learned senior counsel, does not satisfy the test of "reasonable cause" and therefore merits rejection.

12. Shri Ajay Vohra, learned counsel appearing on behalf of the respondent-M/s Eli Lilly & Co. (India) (P) Ltd., submitted as follows.

13. M/s Eli Lilly & Co. (India) (P) Ltd. was incorporated in India under the Companies Act, 1956. It was a joint venture between M/s Eli Lilly, Netherlands B.V. and Ranbaxy Laboratories Ltd. The foreign partner had seconded four expatriate(s) to the joint venture in India. They were employee (s) by the joint venture. They, however, continued to remain on the rolls of the foreign company. They received home salary outside India from the foreign partner. The joint venture company deducted tax under s. 192(1) in respect of the salary paid by it to the expatriate(s) in India, however, no tax stood deducted in respect of the said home salary paid by the foreign company. In the circumstances, learned counsel contended that the assessee herein was under no obligation to deduct tax under s. 192(1) of the 1961 Act from the "home salary", which admittedly was not paid by the assessee herein. According to the learned counsel, s. 192 enjoins upon the person responsible for paying salary to deduct tax out of the estimated income chargeable under the head "Salaries", at the time of making payment thereof. The employer is thus expected to make an honest and bona fide estimate at the beginning of the year of the income of the employee chargeable under the head "Salaries" and deduct tax at the average rate at the time of payment of salary on month-to-month basis. Thus, s. 192 requires an estimate of income, inter alia, for the reason that the salary is liable to change during the year on account of increment, pay revision, payment of bonus, DA etc. and also on account of valuation of perquisites in kind. Sec. 192 of the 1961 Act, according to the learned counsel, unlike other sections in Chapter XVII-B, regulating deduction of tax at source, requires such deduction to be made on estimated income chargeable under the head "Salaries" and at the time of payment of salary. The obligation under s. 192(1) is on the person responsible for paying, to deduct tax at source on the income of the employee chargeable under the head "Salaries". Therefore, according to the learned counsel, the obligation of the assessee herein (employer) is to deduct tax at source qua the amounts actually paid by the employer or paid on his behalf or on his account. This question as to whether payment has been made on behalf of or on account of the employer has to be decided on facts of each case. According to the learned counsel, the 1961 Act and the rules framed thereunder recognize deduction of tax by different units of the same employer by treating each unit as a separate and independent deductor. In this connection, reliance was placed on r. 114A of the Rules and Circular No. 719, dt. 22nd Aug., 1995 [(1995) 127 CTR (St) 57]. According to the learned counsel, where an employee is simultaneously employed with more than one employer, the employee has an option to file with one employer (the chosen employer), a declaration of the salary earned by him in Form 12B. In this connection, learned counsel placed reliance on s. 192(2). According to the learned counsel, the chosen employer, in such circumstances, would be liable to deduct tax on the total income taxable under the head "Salaries". In the absence of exercise of option under s. 192(2), the obligation of each employer, according to the learned counsel, is confined to the amounts of salary actually paid and there is no statutory obligation on one employer to take into account the salary paid by the other employer and deduct tax from the gross salary. Therefore, according to the learned counsel, there is nothing in s. 192(1) to suggest that the aggregate salary received by an employee from various employers needs to be taken into account by each employer while deducting tax at source. According to the learned counsel, the TDS provisions are in the nature of machinery provisions which enables easy collection and recovery of tax. The said provisions are independent of the charging provisions which are applicable to the recipient of income whereas the TDS provisions are applicable to the payer of income. According to the learned counsel, therefore, the obligation to deduct tax at

source is on the deductor, which is independent of the assessment of income in the hands of the expatriate employee(s); the deductor is obliged to deduct tax at source only from the payment made by the deductor or payment made on his behalf or on his account. Therefore, according to the learned counsel, each employer is required to comply with and deduct tax from out of the salaries paid by such employer. The obligation does not extend to deduction of tax out of salaries paid by any other person, which is not on account of or on behalf of such employer, notwithstanding that such salaries may have nexus with the service of the employee with that employer and may be assessable to tax in India in the hands of the recipient employee. According to the learned counsel, on facts, the payment of salary by the foreign company in Netherlands was not on behalf of or on account of the tax-deductor-assessee herein and, consequently, it was not under statutory obligation to deduct tax from the entire salary including the home salary, particularly when the expatriate(s) did not exercise the option under s. 192(2) requiring the tax-deductor-assessee herein to deduct tax from their aggregate salary income. Lastly, learned counsel submitted that each of the expatriate employee(s) had paid directly the taxes due on the home salary by way of advance tax/self-assessment tax from time to time. They had filed also the return of income. In such circumstances, according to the learned counsel, there was no loss to Revenue occasioned on account of the alleged default by the assessee herein in not deducting tax from the entire salary or on account of short deduction of tax at source. According to the learned counsel, even if the assessee herein is to be regarded as an assessee-in-default in terms of s. 201 of the Act, the tax alleged to be in default cannot be once again recovered from the assessee herein since the same stood paid by the expatriate(s).

14. Shri S. Ganesh, learned senior counsel appearing on behalf of M/s Ericsson Communications (P) Ltd. (Civil Appeal No. 4082 of 2007), submitted that the TDS provisions have no extra-territorial operation. In this connection, learned counsel urged that there is no provision in the 1961 Act which says that TDS provisions shall apply to payment made abroad by a person who is located outside India. Learned counsel next contended that breach of such provisions results in severe penal and criminal sanctions and therefore penal and criminal liability imposition by a statute on foreigners in respect of acts and omissions committed outside the country should not be inferred unless there is a clear cut provision in the said 1961 Act. In this connection, learned counsel placed reliance on the provisions of ss. 200, 201, 203, 203A, 206, 271C (penalty) and 276B (prosecution). The learned counsel next contended that the issue as to whether the TDS provisions are applicable to payments made abroad has nothing to do with assessability of such amounts in the hands of the recipient. In this connection, learned counsel stated that there are several payments which do not attract TDS provisions, but which are assessable to tax in the hands of the recipient, e.g., salary paid by a foreign employer to his employee in India or professional fees paid by a client from abroad to his lawyer/chartered accountant/technical consultant in India. These payments, according to the learned counsel, are undoubtedly taxable in India in the hands of the recipient. Nevertheless, no tax would be deductible at source thereon as they are made outside India and are not subject to the TDS provisions.

15. On the point of interpretation of s. 192(1), learned counsel submitted that the said section can be divided into two distinct parts, the first part consisting of the words "any person responsible for paying any income chargeable under the head salaries shall, at the time of payment deduct income-tax on the amount payable" and the second part consisting of the following words :

"at the average rate of income-tax, computed on the basis of the rates in force in the financial year in which the payment is made, on the estimated income of the assessee under this head for the financial year."

The submission made by the learned counsel was that the first part of s. 192(1) creates

the legal liability to deduct tax at source whereas the second part provides for the computation of the amount of tax to be deducted. According to the learned counsel, the first part of s. 192(1) makes it clear that the tax has to be deducted on the amount payable by the person concerned. According to the learned counsel, on a plain and correct reading of s. 192(1), tax is deductible from the amount paid or payable by the person concerned and he is not at all required to deduct tax in respect of an amount which is paid by any other person. He is also not required to take into account the amount received by the employee from other sources or to deduct tax taking into account such other amounts. Learned counsel further submitted that in the second part of s. 192(1) the words used are "estimated income of the assessee". According to the learned counsel, the second part of s. 192(1), therefore, refers only to the estimated income of the recipient employee for the whole financial year on the basis of the payments made to him by the person responsible for deducting the tax at source. According to the learned counsel, the only reason why such words occur in s. 192(1) and not in any other sections dealing with deduction of tax on other items of income is that there is no fixed rate of tax to be applied for determining tax at source on salaries. In this connection, learned counsel pointed out that salary is paid on a monthly basis and the tax has to be deducted therefrom at the applied rate of income-tax which is arrived at by considering the employee's estimated salary income received from the person concerned for the entire financial year. That is why, according to the learned counsel, even in s. 192(2) a provision is made to the effect that it is only in special and extraordinary circumstances mentioned therein that a particular employer is required to consider the payments made to the employee by another employer. As a corollary, according to the learned counsel, if the extraordinary circumstances mentioned in s. 192(2) do not exist, as in ordinary cases covered by s. 192(1), then the employer, who has to deduct tax at source, is required to consider only the payments made by him and not payments received by the employee from any other sources. According to the learned counsel, the present cases are not governed by s. 192(2). Therefore, in Ericsson Communications (P) Ltd. case, according to the learned counsel, the employer was not liable in law to deduct tax at source in respect of the "child education payments" made by a Swedish company to its expatriate employee(s) in Sweden. In the alternative, learned counsel urged that the assessee was under the bona fide impression that it was not required to deduct such tax at source in respect of the said expatriate employee(s), which bona fide impression constituted "reasonable cause" and therefore, in any event, no penalty could be imposed on the assessee under s. 271C r/w s. 273B of the 1961 Act.

16. Shri M.S. Syali, learned senior counsel appearing on behalf of M/s Mitsui & Company Ltd. (Civil Appeal No. 5152 of 2005) submitted that the sole issue in his case was whether the Tribunal/High Court were correct in law in cancelling the penalty imposed under s. 271C of the 1961 Act. It was submitted that the retention/continuation payment(s) to expatriates in Japan by the HO was not taxable in India and/or the provisions of Chapter XVII-B requiring deduction of tax at source were not applicable to such payment. It was further submitted that the respondent is a foreign company having its HO in Tokyo. It had, in the relevant financial years in India, a project office and a liaison office. The Japanese expatriates were deputed to the said establishments as employees. As per the terms of deputation, the said expatriates were to be paid "salaries" for the services rendered in India, by the respective establishment, in addition, a retention/continuation was paid in Japan by the HO to ensure continuity in service. Tax at source was deducted by the respective establishment, however, on the retention/continuation paid in Japan by HO, it was not deducted under Chapter XVII-B of the 1961 Act. On facts, learned counsel pointed out that the tax-deductor-assessee presented its case before the Department. Its stand was not accepted by the Department. However, after consultation with the CBDT, the tax-deductor-assessee agreed and deposited the tax and interest on the understanding that there will not be any penalty proceedings. According to the learned counsel, contrary to its promise, Department commenced penalty proceedings under s. 271C against the project office and the liaison office in India for the alleged default of the HO in Japan. Therefore,

according to the learned counsel, both, in law and on facts, the Department had erred in initiating penalty proceedings under s. 271C.

17. On the legal issue, learned counsel contended that the Department was not right in its submission that after the amendment of s. 9(1)(ii) made to the Act after the decision in the case of CIT vs. S.G. Pgnatale (1980) 16 CTR (Guj) 337 : (1980) 124 ITR 391 (Guj), retention/continuation dues can be construed as income under the head "Salaries". According to the learned counsel, the Gujarat High Court (supra) had held that amounts paid outside India by the French company for rendering services in India though referred to as "retention remuneration" was not liable to tax in India because the word "earned" has a narrow as well as wider meaning. In view of the difference in the language in cls. (ii) and (iii) of s. 9(1), salaries earned in India shall be governed by the narrower meaning. Accordingly, the Gujarat High Court in the above judgment equated the words "salaries earned in India" to "arising/accruing in India". According to the Gujarat High Court, therefore, although the amount payable was for rendering services in India but having been paid by a person responsible outside India, the said earning of salaries cannot be treated as having accrued or arisen in India. In order to nullify the effect of the judgment of the Gujarat High Court, according to the learned counsel, an amendment was brought in s. 9(1)(ii) adding an Explanation thereto by which the above decision of the Gujarat High Court stood overruled. By the said amendment, it was stipulated that income which falls under the head "Salaries" if earned in India will include such income payable for services rendered in India. According to the learned counsel, the insertion with retrospective effect from 1st April, 1979 by the Finance Act, 1983, however, was not all inclusive. According to the learned counsel, despite the said amendment, amounts paid to foreign technicians for "off period" could not be taxed as "salary". Being aware that the Explanation, as it stood at that time, did not include within its purview the salary paid for the "off period", the legislature once again amended the Explanation to s. 9(1)(ii), explaining its scope to include therein the salary paid for the rest period or leave period, but, only such, which is preceded or succeeded by services rendered in India and which forms part of the service contract of employment. However, such Explanation of the scope of s. 9(1)(ii) only took effect from 1st April, 2000 and it applied only in relation to the asst. yr. 2000-01 and subsequent years thereto. The Explanation was made expressly prospective. Therefore, according to the learned counsel, any and everything paid to an employee does not fall within the scope of s. 9(1)(ii). According to the learned counsel, it is only when rendition of service takes place, that the amount is liable to be taxed in India and not otherwise. The mere fact that the amount flows from the employer does not render it taxable even under the amended s. 9(1)(ii) read with the Explanation.

18. According to the learned counsel, s. 192 does not have extra- territorial operation. On this point, we find that the arguments advanced by Shri M.S. Syali, learned senior counsel appearing for M/s Mitsui & Co. Ltd. are similar to the submissions made by Shri S. Ganesh, learned senior counsel appearing for M/s Ericsson Communications (P) Ltd., which submissions are stated hereinabove. Hence, we need not repeat such submission and burden this judgment. Lastly, Shri Syali, learned senior counsel, submitted that s. 192 mandates deduction of tax at source by "any" person responsible for paying "any" income chargeable under the head "Salaries". The deduction from the said income, according to the learned counsel, is stipulated to be "on the amount payable". According to the learned counsel, therefore, there is no basis for reading s. 192 as imposing a liability on "any" person responsible for paying such income to deduct tax from the entire income chargeable under the said head. According to the learned counsel, the words "on the amount payable" and "any income" clearly mandate that the person responsible for paying is concerned only with the amount that is payable by him. According to the learned counsel, the person responsible is not obliged under s. 192 to deduct tax on the entire "amount payable". According to the learned counsel, s. 192 inter alia stipulates that within the amount payable, he has to arrive at the "estimated income" of the assessee under the head "Salaries" for the financial year. The words "estimated income"

is the net figure calculated under the relevant provisions on estimate basis from the amount payable. The entire salary is not paid in one go and, therefore, out of the estimated amount payable for that financial year, income for the month under the said head is to be ascertained and accordingly one has to determine the appropriate average rate. According to the learned counsel, each establishment, i.e., the project office and the liaison office (in this case) has to be treated as separate and independent entities for the purpose of applicability of s. 192 and for compliance with other provisions in Chapter XVII-B and consequently the assessee has not erred therefore in treating the HO a distinct and separate person responsible for paying. Therefore, according to the learned counsel, no default could be attributed merely because the assessee agreed with the Department's understanding of the said provisions. In this connection, learned counsel placed reliance on ss. 159A, 203, r. 114A and Form 49B. He also relied upon r. 36A and r. 37 of the IT Rules, 1962. Learned counsel next contended that under s. 204(i), the person responsible for paying would cover either the employer himself or if the employer is a company the company itself including its principal officer. According to the learned counsel, the definition contemplates two situations-where the branch is the person responsible, it acts as the employer, and where centralized compliance is made, the company is treated as the employer. According to the learned counsel, in cases where the liaison office and the project office are separate employers distinct from the company, as the company itself is not an assessee paying taxes on its global income, then the employer is not the company. In such cases, the persons who need to comply with the provisions is either the project office or the liaison office. In this connection, learned counsel placed reliance also on s. 192(2) which stipulates that in case of successive or simultaneous employers, the sub-section enables the employee to furnish particulars in respect of salaries due or received by him from one employer to the other. These particulars are required to be taken into account by the chosen employer to examine its impact upon the average rate of tax and the quantum of tax that is to be deducted by the chosen employer. According to the learned counsel, the sub-section does not cast vicarious liability of one employer upon the other. Each employer, be it successive or simultaneous, is independently liable to comply with the TDS provisions in respect of the amount it pays. Therefore, according to the learned counsel, the said sub-section belies the concept of aggregation or consolidation of the entire amount under the head "Salaries" being exigible to deduction of tax at source under s. 192 in the hands of one person responsible for paying a part thereof. Lastly, learned counsel submitted that the issue involved in these civil appeals is nascent. It involves a moot point. It has not been considered by the apex Court earlier. Therefore, in any event, this case is not a fit case for imposing penal consequences.

19. Shri C.S. Agarwal, learned senior counsel, Shri Kannan Kapoor, and Shri Salil Kapoor, learned counsel appearing for various other assessees have adopted the arguments mentioned hereinabove.

III. Relevant Provisions of the IT Act, 1961

Sec. 2—Definitions.

"2.(37A) 'Rate or rates in force' or 'rates in force', in relation to an assessment year or financial year, mean—

(i) for the purposes of calculating income-tax under the first proviso to sub-s. (5) of s. 132, or computing the income-tax chargeable under sub-s. (4) of s. 172 or sub-s. (2) of s. 174 or s. 175 or sub-s. (2) of s. 176 or deducting income-tax under s. 192 from income chargeable under the head "Salaries" or computation of the "advance tax" payable under Chapter XVII-C in a case not falling under s. 115A or s. 115B or s. 115BB or s. 115BBB or s. 115E or s. 164 or s. 164A or s. 167B, the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year and for the purposes of

computation or of the "advance tax" payable under Chapter XVII-C, in a case falling under s. 115A or s. 115B or s. 115BB or s. 115BBB or s. 115E or s. 164 or s. 164A or s. 167B, the rate or rates specified in s. 115A or s. 115B or s. 115BB or s. 115BBB or s. 115E or s. 164 or s. 164A or s. 167B, as the case may be, or the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year, whichever is applicable.

(ii) for the purposes of deduction of tax under ss. 193, 194, 194A, 194B, 194BB and 194D the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year;

(iii) for the purposes of deduction of tax under s. 195, the rate or rates of income-tax specified in this behalf in the Finance Act of the relevant year or the rate or rates of income-tax specified in an agreement entered into by the Central Government under s. 90, or an agreement notified by the Central Government under s. 90A, whichever is applicable by virtue of the provisions of s. 90, or s. 90A, as the case may be."

"Sec. 9 Income deemed to accrue or arise in India.—(1) The following incomes shall be deemed to accrue or arise in India—

(i).....

(ii) Income which falls under the head "Salaries", if it is earned in India.

Explanation : (Inserted by the Finance Act, 1983, with retrospective effect from 1st April, 1979)—For the removal of doubts, it is hereby declared that income of the nature referred to in this clause payable for service rendered in India shall be regarded as income earned in India.

Explanation : (Substituted by the Finance Act, 1999, w.e.f. 1st April, 2000)—For the removal of doubts, it is hereby declared that the income of the nature referred to in this clause payable for—

(a) service rendered in India; and

(b) the rest period or leave period which is preceded and succeeded by services rendered in India and forms part of the service contract of employment, shall be regarded as income earned in India."

"Sec. 40 Amounts not Deductible.—Notwithstanding anything to the contrary in ss. 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—

(a) In the case of any assessee—

(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year

before the expiry of the time prescribed under sub-s. (1) of s. 200."

.....

"(iii) any payment which is chargeable under the head "Salaries", if it is payable—

(A) outside India; or

(B) to a non-resident,

and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B;"

"Sec. 190 Deduction at source and advance payment.—(1) Notwithstanding that the regular assessment in respect of any income is to be made in a later assessment year, the tax on such income shall be payable by deduction or collection at source or by advance payment or by payment under sub-s. (1A) of s. 192, as the case may be, in accordance with the provisions of this chapter.

(2) Nothing in this section shall prejudice the charge of tax on such income under the provisions of sub-s. (1) of s. 4."

"Sec. 191 Direct Payment—In the case of income in respect of which provision is not made under this chapter for deducting income-tax at the time of payment, and in any case where income-tax has not been deducted in accordance with the provisions of this chapter, income-tax shall be payable by the assessee direct.

Explanation. : For the removal of doubts, it is hereby declared that if any person referred to in s. 200 and in the cases referred to in s. 194, the principal officer and the company of which he is the principal officer does not deduct the whole or any part of the tax and such tax has not been paid by the assessee direct, then, such person, the principal officer and the company shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default as referred to in sub-s. (1) of s. 201 in respect of such tax."

"Sec. 192 Salary.—(1) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made, on the estimated income of the assessee under this head for that financial year."

"Sec. 201 Consequences of failure to deduct or pay—(1) If any such person referred to in s. 200 and in the cases referred to in s. 194, the principal officer and the company of which he is the principal officer does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by or under this Act, he or it shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default in respect of the tax :

Provided that no penalty shall be charged under s. 221 from such person, principal officer or company unless the AO is satisfied that such person or principal officer or company, as the case may be, has without good and sufficient reasons failed to deduct and pay the tax.

(1A) Without prejudice to the provisions of sub-s. (1), if any such person, principal officer or company as is referred to in that sub-section does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by or under this Act, he

or it shall be liable to pay simple interest at one per cent for every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is actually paid and such interest shall be paid before furnishing the quarterly statement for each quarter in accordance with the provisions of sub-s. (3) of s. 200."

"Sec. 271C Penalty for failure to deduct tax at source—(1) If any person fails to—

(a) Deduct the whole or any part of the tax as required by or under the provisions of Chapter XVII-B; or

(b) Pay the whole or any part of the tax as required by or under,—

(i) Sub-s. (2) of s. 115-O; or

(ii) Second proviso to s. 194B,

then, such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to deduct or pay as aforesaid.

(2) Any penalty imposable under sub-s. (1) shall be imposed by the Jt. CIT."

"Sec. 273B Penalty not to be imposed in certain cases—Notwithstanding anything contained in the provisions of cl. (b) of sub-s. (1) of s. 271, s. 271A, s. 271AA, s. 271B, s. 271BA, s. 271BB, s. 271C, s. 271CA, s. 271D, s. 271E, s. 271F, s. 271FA, s. 271FB, s. 271G, cl. (c) or cl. (d) of sub-s. (1) or sub-s. (2) of s. 272A, sub-s. (1) of s. 272AA, or sub-s. (1) of s. 272BB or sub-s. (1A) of s. 272BB or sub-s. (1) of s. 272BBB or cl. (b) of sub-s. (1) or cl. (b) or cl. (c) of sub-s. (2) of s. 273, no penalty shall be imposable on the person or the assessee, as the case may be, for any failure referred to in the said provisions if he proves that there was reasonable cause for the said failure."

IV. Issue :

20. Whether TDS provisions which are in the nature of machinery provisions enabling collection and recovery of tax are independent of the charging provision which determines the assessability in the hands of the employee assessee (recipient) ? In other words, whether TDS provisions under the IT Act, 1961 are applicable to payments made abroad by the foreign company, which payments are for income chargeable under the head "Salaries" and which are made to expatriates who had rendered services in India ?

V. Our decision

(i) Whether TDS provisions which are in the nature of machinery provisions are independent of the charging provisions ?

21. At the outset, we wish to clarify that our judgment is confined strictly to the question of deductibility of tax from the "income chargeable under the head 'Salaries' under s. 192(1). This introduction is important for the reason that unlike other sections in Chapter XVII-B regulating deduction of tax at source out of other payments, s. 192 requires such deduction on "estimated income" chargeable under the head "Salary" and at the time of payment of salary. Chapter XVII is divided into various parts as 'A' to 'F'. Part 'A' deals with deduction at source and advance payment. Sec. 190, inter alia, provides that notwithstanding the regular assessment in respect of any income, the tax on such income shall be payable by deduction or collection at source or by advance payment in accordance with the provisions of the chapter. Hence, before a regular

assessment is made, tax on income becomes payable by deduction or collection at source or by advance payment in accordance with the provisions of the chapter. Sec. 191 provides for direct payment of income-tax by the assessee in cases where provision for deduction of tax at source is not made under the chapter. Part 'B' of Chapter XVII contains a group of sections which provides for "deduction of tax" at source. Sec. 192 provides for deduction of tax on the income chargeable under the head "Salaries" by any person responsible for paying such salaries. Sec. 193 provides for deduction of income-tax by the person responsible for paying any income by way of "interest on securities". Sec. 194 provides for deduction of tax at source by the company paying "dividends". Sec. 194A, s. 194B, s. 194BB inter alia provides for deduction of tax at source from the income of interest other than interest on securities, winnings from lotteries, winnings from horse race respectively. Even with regard to payment to contractors and sub-contractors, specific provision is made for deducting tax at source on the basis of payment of such sum as the income-tax on income comprised therein. Under the 1961 Act, total income for the previous year is chargeable to tax under s. 4. Sec. 4(2) inter alia provides that in respect of income chargeable under s. 4(1), income-tax shall be deducted at source where it is so deductible under any provision of the 1961 Act. Sec. 192(1) falls in the machinery provisions. It deals with collection and recovery of tax. That provision is referred to in s. 4(2). Therefore, if a sum that is to be paid to the non-resident is chargeable to tax, tax is required to be deducted. The sum which is to be paid may be income out of different heads of income mentioned in s. 14, that is to say, income from salaries, income from house property, profits and gains of business, capital gains and income from other sources. The scheme of the TDS provisions applies not only to the amount paid, which bears the character of "income" such as salaries, dividends, interest on securities etc. but the said provisions also apply to gross sums, the whole of which may not be income or profits in the hands of the recipient, such as payment to contractors and sub-contractors. The purpose of TDS provisions in Chapter XVII-B is to see that the sum which is chargeable under s. 4 for levy and collection of income-tax, the payer should deduct tax thereon at the rates in force, if the amount is to be paid to a non-resident. The said TDS provisions are meant for tentative deduction of income-tax subject to regular assessment. [see *Transmission Corporation of A.P. Ltd. & Anr. vs. CIT* (1999) 155 CTR (SC) 489 : (1999) 239 **ITR** 587 (SC) at p. 594].

22. As stated above, the question which arises for determination is : whether TDS provisions in Chapter XVII-B, which are in the nature of machinery provisions enabling collection and recovery of tax are at all applicable to payments made abroad by the foreign company/HO who had seconded the expatriate(s) for rendering services in India to the tax-deductor-assessee (employer) ?

23. To answer the above question one needs to examine the issue-whether TDS provisions have extra-territorial operations as also the inter-linking of various provisions in the 1961 Act dealing with chargeability, liability, collection and recovery of taxes.

24. On the question of extraterritorial operation of the 1961 Act the general concept as to the scope of income-tax is that, given a sufficient territorial connection or nexus between the person sought to be charged and the country seeking to tax him, income-tax may extend to that person in respect of his foreign income. The connection can be based on the residence of the person or business connection within the territory of the taxing State; and the situation within the State of the money or property from which the taxable income is derived (see *The Law and Practice of Income-tax* by Kanga and Palkhivala, Seventh Edition, at p. 10).

25. In the case of *A.H. Wadia vs. CIT* (1949) 17 **ITR** 63 (FC) the Federal Court held that so long as the statute (IT Act, 1922) selected some fact or circumstance which provided some connection or nexus between the person who is subject to the tax and the country imposing the tax, its validity would not be open to challenge on the ground that it is

extraterritorial in operation. In that case, the question which arose for determination before the Federal Court was whether s. 42(1) of the 1922 Act, which brought within the scope of the charging section "interest" earned out of money lent outside British India, but brought into British India as ultra vires the Indian legislature on the ground that it had extraterritorial operation. It may be stated that s. 9 of the 1961 Act gathers in one place various provisions (which stood scattered in the 1922 Act) under which income actually accruing to an assessee abroad is deemed to accrue in India. Sec. 42(1) of the 1922 Act is similar to s. 9(1)(i) of the 1961 Act. It was held by the Federal Court that s. 42(1) brings within the ambit of the charging section (s. 4 of the 1922 Act) income accruing or arising, directly or indirectly, under the four categories of income, viz., from business connection or property or asset/ source of income in India or through transfer of capital asset in India or through moneys lent. It was held that since the money lent was brought by the assessee into British India, the transaction fell under one of the categories of income in s. 42(1), consequently the income therefrom was deemed to accrue or arise in British India. It was held that once an income came within one of the categories of income in s. 42(1), the income arising out of the transaction came under s. 42(1) as there existed a territorial connection between the person receiving income under the particular head and India. It may be mentioned that s. 42(1) of the 1922 Act is similar to s. 9(1) of the 1961 Act which deems certain categories of income to accrue in India.

26. Applying the above test, we are of the view that if the payments of home salary abroad by the foreign company to the expatriate has any connection or nexus with his rendition of service in India then such payment would constitute income which is deemed to accrue or arise to the recipient in India as salary earned in India in terms of s. 9(1)(ii) (which is one of the heads of income). Sec. 9(1)(ii) lays down that income which falls under the head "Salaries", if it is earned in India, shall be deemed to accrue or arise in India. In fact, s. 9 explains the expression "is deemed to accrue or arise to him in India" used in s. 5(2)(b). Sec. 9 is not only a machinery section, it has the effect of rendering a person liable to tax on income which do not accrue or arise or are not received in India but which are deemed to be taxable by virtue of s. 9 which applies to residents and non-residents. Sec. 9 is, therefore, a typical example of a combination of a machinery provision which also provides for chargeability.

27. Lastly, on the question of extraterritorial operation of the IT Act, 1961, it may be noted that the 1961 Act has extraterritorial operation in respect of the subject-matters and the subjects which is permissible under Art. 245 of the Constitution and the provisions are enforceable within the area where the 1961 Act extends through the machinery provided under it.

28. On the question as to whether there is any inter-linking of the charging provisions and the machinery provisions under the 1961 Act, we may, at the very outset, point out that in the case of CIT vs. B.C. Srinivasa Setty (1981) 21 CTR (SC) 138 : (1981) 128 **ITR** 294 (SC) this Court has held that the charging section and the computation provisions together constitute an integrated code. When there is a case to which computation provisions cannot apply at all, it is evident that such a case was not intended to fall within the charging section. We may add that, the 1961 Act is an integrated code and, as stated hereinabove, s. 9(1) integrates the charging section, the computation provisions as well as the machinery provisions [see s. 9(1)(i) r/w ss. 160, 161, 162 and 163].

29. In the present case, it has been vehemently urged that TDS provisions being machinery provisions are independent of the charging provisions whereas as held by this Court in the case of B.C. Srinivasa Setty (supra), the 1961 Act is an integrated Code. To answer the contention herein we need to examine briefly the scheme of the 1961 Act. Sec. 4 is the charging section. Under s. 4(1), total income for the previous year is

chargeable to tax. Sec. 4(2) inter alia provides that in respect of income chargeable under sub-s. (1), income-tax shall be deducted at source whether (where) it is so deductible under any provision of the 1961 Act which inter alia brings in the TDS provisions contained in Chapter XVII-B. In fact, if a particular income falls outside s. 4(1) then TDS provisions cannot come in. Under s. 5, all residents and non-residents are chargeable in respect of income which accrues or is deemed to accrue in India or is received in India. Non-residents who are not assessable in respect of income accruing and received abroad are rendered chargeable under s. 5(2)(b) in respect of income deemed by s. 9 to accrue in India. Sec. 9 deems certain categories/heads of income to accrue in India has no application in cases where income actually accrues in India. Likewise, s. 9 does not apply in cases where income is received in India. Therefore, if the income is not received in India, a non-resident would not be chargeable to tax upon it unless it accrues or is deemed to accrue in India. Thus, a general charge of income-tax is imposed by ss. 4 and 5, and that general charge is given a particular application in respect of non-residents by s. 9 which enlarges the ambit of taxation by deeming income to arise in India in certain circumstances. Under s. 9(1), income is deemed to accrue in India if it accrues directly or indirectly under five circumstances mentioned therein. To give an example of as to how the 1961 Act is an integrated Code we may state that s. 9(1) explains the meaning of the words "deemed to accrue or arise in India" in s. 5(2)(b). Sec. 9(1)(i) performs two functions :

I. It deems the above five categories of income to accrue in India. The deeming provisions of this clause

(a) apply to residents and non-residents alike;

(b) have no application where income actually accrues in India or is received in India.

Both these points have been noted above in dealing with this section generally.

II. It specifies the categories of income in respect of which a vicarious liability is imposed by ss. 160 and 161 on an agent to be assessed in respect of a non-resident's income. In performing this function, the clause

(a) applies to the income of non-residents alone;

(b) specifies the categories of income in respect of which the agent is vicariously liable even if the income actually accrues in India or is received in India.

Examples showing inter-linking of various provisions of the 1961 Act :

(a) It may be noted that ss. 160(1)(i), 161, 162 and 163 are machinery sections. They do not affect the incidence of taxation under ss. 4 and 5 which are the charging sections. Secs. 160 and 161 provide a machinery for collection of a charge which is imposed in general terms elsewhere and yet ss. 160 and 161 are the sections which like s. 201(1) imposes a vicarious liability on an agent to be assessed in respect of the income of the principal. The liability is imposed under ss. 160 and 161 in respect of the income of non-resident principal and it is only in respect of the income falling within s. 9(1) and not any other income. Therefore, one has to read s. 9(1) with s. 160 and s. 161 which are machinery sections (see *The Law and Practice of Income Tax* by Kanga & Palkhivala, Eighth Edition., at pp. 1268 and 1269).

(b) Similarly, s. 40(a)(iii), quoted above, which finds place in Chapter IV (computation of business income) inter alia states that any payment which is chargeable under the head "Salaries", if it is payable outside India or to a non-resident and if the tax thereon

is not deducted from such payment under Chapter XVII-B then notwithstanding the entitlement of the assessee to claim deduction, the same will be disallowed for such non-deduction of tax at source.

30. The above examples show that the 1961 Act is an integrated Code in which one cannot segregate the computation machinery from the collection and recovery machinery.

(ii) On the scope of s. 192(1) :

31. On behalf of the tax-deductor-assessee the basic contention before us was that s. 192(1) was not applicable as the home salary was paid by the foreign company outside India de hors the contract between the respondent herein and the expatriate(s). That, the contract under which the home salary was paid in foreign currency stood executed outside India. That, the payment of home salary by the foreign company abroad was not on behalf of or on account of the tax-deductor-assessee (who has not claimed deduction for such salary in computation of its business income in India under the 1961 Act), therefore, it was urged that there was no obligation on the tax-deductor-assessee to deduct tax from the home salary/special allowance(s) paid in foreign currency abroad.

32. To resolve the controversy, we need to analyse s. 192(1). After going through the relevant provisions of s. 192 and s. 9(1)(ii) with the Explanation thereto we are of the view that s. 192 inter alia provides that any person responsible for payment of any income chargeable under the head "Salaries" shall at the time of payment deduct income-tax on the basis of the rates in force for the financial year. It is true that the word "aggregate" does not precede the word "income" in s. 192(1). However, in s. 192(1), the words used are "any income chargeable under the head 'Salaries'" shall at the time of payment, deduct income-tax on the amount payable. There is a marked similarity between s. 192(1) and s. 40(a)(iii). The word(s) used in s. 192 is not merely "salaries". The words used in s. 192(1) are "any income chargeable under the head 'Salaries'". This aspect is very important. Under the 1961 Act, as stated hereinabove, there are different categories of income enumerated in s. 9(1). One such income falls under the head "Salaries" if earned in India [see s. 9(1)(ii)]. Once an income falls under s. 9(1), it comes in the category of income deemed to accrue or arise in India in terms of s. 5(2)(b). This is one more example of the 1961 Act being an integrated Code. At this stage two aspects need to be highlighted. Firstly, in s. 192(1), tax at source has to be deducted on the amount payable. This is where the tax-deductor-assessee has to estimate the income of the assessee employee under the head "Salaries". This word "payable" also finds place in s. 40(a)(iii). Secondly, one has to note the effect of the Explanation to s. 9(1)(ii). Prior to the insertion of the Explanation, the Gujarat High Court had held in the case of Pgnatale (supra) that the words "earned in India" in s. 9(1)(ii) must be interpreted as "arising or accruing in India" and not as "from services rendered in India". Therefore, according to the Gujarat High Court, if the liability to pay arose outside India and the amount became payable outside India, s. 9(1)(ii) was not invocable. To offset the effect of the judgment of the Gujarat High Court, an Explanation was inserted by which the expression "earned in India" stood equated to "services rendered in India". Thus, according to Kanga and Palkhivala on the The Law and Practice of Income-tax, s. 9(1)(ii) inter alia provides for an artificial place of accrual for income taxable under the head "Salaries" (see Seventh Edition at p. 207). Sec. 9(1)(ii) thus enacts that income chargeable under the head "Salaries" under s. 15 shall be deemed to accrue or arise in India if it is earned in India, i.e., if the services under the agreement of employment are or were rendered in India, the place of receipt or actual accrual of the salary being immaterial. Thus, s. 192(1) has to be read with s. 9(1)(ii). This is one more illustration to show that the 1961 Act is an integrated Code. In fact, if s. 192(1) is to be segregated from s. 9(1)(ii) or from s. 40(a)(iii) then the very purpose of shifting the "accrual test" to the "earning test" by reason of insertion of Explanation, would stand

defeated. In this connection one more aspect may be noted. Sec. 192(1) is the only section in Chapter XVII-B, unlike other sections in that chapter, which requires deduction of tax at source on estimation of income chargeable under the head "Salary". The act of "estimation" is similar to computation of income. As stated above, the 1961 Act is an integrated Code in which chargeability and computation goes hand in hand. Thus, s. 192(1), which is a stand-alone section in Chapter XVII-B, has to be read with s. 9(1)(ii).

33. From the above analyses two conclusions flow. Firstly, it cannot be stated as a broad proposition that the TDS provisions which are in the nature of machinery provisions to enable collection and recovery of tax are independent of the charging provisions which determines the assessability in the hands of the employee-assessee. Secondly, whether the home salary payment made by the foreign company in foreign currency abroad can be held to be "deemed to accrue or arise in India" would depend upon the in-depth examination of the facts in each case. If the home salary/special allowance payment made by the foreign company abroad is for rendition of services in India and if as in the present case of M/s Eli Lilly & Company (India) Pvt. Ltd. no work was found to have been performed for M/s Eli Lilly Inc. Netherlands then such payment would certainly come under s. 192(1) r/w s. 9(1)(ii). As stated above, the post-survey operations revealed that no work stood performed for the foreign company by the four expatriates to the joint venture company in India and that the total remuneration paid was only for services rendered in India. In such a case the tax-deductor-assessee was statutorily obliged to deduct tax under s. 192(1) of the 1961 Act.

(iii) On the scope of s. 201(1) and s. 201(1A) :

34. A perusal of s. 201(1) and s. 201(1A) shows that both these provisions are without prejudice to each other. It means that the provisions of both the sub-sections are to be considered independently without affecting the rights mentioned in either of the sub-sections. Further, interest under s. 201(1A) is compensatory measure for withholding the tax which ought to have gone to the exchequer. The levy of interest is mandatory and the absence of liability for tax will not dilute the default. The liability of deducting tax at source is in the nature of a vicarious liability, which presupposes existence of primary liability. The said liability is a vicarious liability and the principal liability is of the person who is taxable. A bare reading of s. 201(1) shows that interest under s. 201(1A) r/w s. 201(1) can only be levied when a person is declared as an assessee-in-default. For computation of interest under s. 201(1A), there are three elements. One is the quantum on which interest has to be levied. Second is the rate at which interest has to be charged. Third is the period for which interest has to be charged. The rate of interest is provided in the 1961 Act. The quantum on which interest has to be paid is indicated by s. 201(1A) itself. Sub-s. (1A) specifies "on the amount of such tax" which is mentioned in sub-s. (1) wherein, it is the amount of tax in respect of which the assessee has been declared in default. The object underlying s. 201(1) is to recover the tax. In the case of short deduction, the object is to recover the shortfall. As far as the period of default is concerned, the period starts from the date of deductibility till the date of actual payment of tax. Therefore, the levy of interest has to be restricted for the above stated period only. It may be clarified that the date of payment by the concerned employee can be treated as the date of actual payment.

(iv) On the scope of s. 271C r/w s. 273B :

35. Sec. 271C inter alia states that if any person fails to deduct the whole or any part of the tax as required by the provisions of Chapter XVII-B then such person shall be liable to pay, by way of penalty, a sum equal to the amount of tax which such person failed to deduct. In these cases we are concerned with s. 271C(1)(a). Thus s. 271C(1)(a) makes it clear that the penalty leviable shall be equal to the amount of tax which such person failed to deduct. We cannot hold this provision to be mandatory or compensatory or

automatic because under s. 273B Parliament has enacted that penalty shall not be imposed in cases falling thereunder. Sec. 271C falls in the category of such cases. Sec. 273B states that notwithstanding anything contained in s. 271C, no penalty shall be imposed on the person or the assessee for failure to deduct tax at source if such person or the assessee proves that there was a reasonable cause for the said failure. Therefore, the liability to levy of penalty can be fastened only on the person who do not have good and sufficient reason for not deducting tax at source. Only those persons will be liable to penalty who do not have good and sufficient reason for not deducting the tax. The burden, of course, is on the person to prove such good and sufficient reason. In each of the 104 cases before us, we find that non-deduction of tax at source took place on account of controversial addition. The concept of aggregation or consolidation of the entire income chargeable under the head "Salaries" being exigible to deduction of tax at source under s. 192 was a nascent issue. It has not been considered by this Court before. Further, in most of these cases, the tax-deductor-assessee has not claimed deduction under s. 40(a)(iii) in computation of its business income. This is one more reason for not imposing penalty under s. 271C because by not claiming deduction under s. 40(a)(iii), in some cases, higher corporate tax has been paid to the extent of Rs. 906.52 lacs [see Civil Appeal No. 1778 of 2006 entitled CIT vs. The Bank of Tokyo-Mitsubishi Ltd.]. In some of the cases, it is undisputed that each of the expatriate employees have paid directly the taxes due on the foreign salary by way of advance tax/self-assessment tax. The tax-deductor-assessee was under a genuine and bona fide belief that it was not under any obligation to deduct tax at source from the home salary paid by the foreign company/HO and, consequently, we are of the view that in none of the 104 cases penalty was leviable under s. 271C as the respondent in each case has discharged its burden of showing reasonable cause for failure to deduct tax at source.
