

TDS provisions are mere machinery provisions. They shift the administrative burden of tax collection on to payers of incomes chargeable to tax, and were introduced with the intention of creating administrative convenience. Attaching this administrative burden to non-residents seems to have thrown up questions, not only pertaining to the recovery of tax liability, but also the very efficacy of TDS provisions as applicable to non-residents. While there is nothing unconstitutional about TDS provisions in their applicability to non-residents, this article seeks to examine the desirability and enforceability or otherwise of these provisions in certain circumstances. The present scheme of TDS provisions not only causes administrative inconvenience, but also seems to leave room, if not invite, tax evasion. There may be a degree of justification for having TDS provisions for transactions between non-residents; however, they seem to be much convoluted when the recipient is a resident.

international **taxation** COVER STORY

TDS WOES OF NON-RESIDENTS



INTRODUCTION

1. Withholding tax-'TDS' provisions-provide for shifting of administrative burden of income-tax collection from the payee to the payer of income. There are various provisions in the Income-tax Act, 1961 which obligate a non-resident liable to deduct tax at source from payments made to other non-residents and surprisingly in certain cases, on payments made to residents of India. Inevitably, questions arise as to the validity of such provisions that seek an extra-territorial shift of administrative burden and more importantly their practical feasibility or desirability.

Under the Constitution of India, the Legislature is competent to pass laws having extra-territorial operation¹ insofar as there is a nexus with the territory of India.² However, the general principle flowing from the sovereignty of States is that laws made by one State can have no operation in another State. This raises questions as regards the enforceability of laws, which seek extra-territorial application. This conflict has been reconciled by the Privy Council in *British Columbia Electric Railway Co. Ltd. v. King*³ wherein it was held that :

"A Legislature which passes a law having extra-territorial operation may find that what it has enacted cannot be directly enforced, but the Act is not invalid on that account, and the courts of its country must enforce the law with the machinery available to them."

There may be situations wherein the person liable to deduct tax at source will have no presence, either in person or in property, in India, making it extremely difficult for tax authorities to enforce TDS provisions and recover the dues.

Hence, while there is nothing unconstitutional about TDS provisions in their applicability to non-residents, this article seeks to examine the desirability and enforceability or otherwise of these provisions in certain circumstances.⁴

SCENARIOS

2. Before examining the enforceability of TDS and other related provisions on non-residents, it is important to determine the various liabilities that accrue to the payer in the following four scenarios :

2.1 *When the payer deducts tax at source and fails to pay, but does not refuse to pay* - When the payer of taxable income deducts tax at source and fails to pay without intending to evade its liability, he will be liable to a three-fold penalty⁵ - firstly, the payer will be treated as an 'assessee in default' and would hence be liable to pay a penalty under the relevant provisions of the Act;⁶ secondly, the payer will be liable to pay interest at the rate of 12 per cent per annum on the amount of such tax from the date on which such tax was deductible to the date on which tax is actually paid; and thirdly, such a default creates a statutory charge upon all assets of the defaulter for the amount of tax deducted and not paid.⁷ However, where the assessee proves to the satisfaction of the Tax Officer that the default was for good and sufficient reasons, no penalty will be imposed.⁸ However, payment of interest on the liability is mandatory and cannot be waived on the basis that the default was not intentional or on any other basis.⁹

1. Article 245(2), Constitution of India: 'No law made by Parliament shall be deemed to be invalid on the ground that it would have extra-territorial operation.'

2. *State of Bombay v. RMD Chamarbaugwala* AIR 1957 SC 699; *Electronics Corpn. of India Ltd. v. CIT* AIR 1989 SC 1707.

3. (1946) AC 527.

4. The analysis is based on the fundamental assumption that the payer is a non-resident with no assets/presence in India.

5. *Martin & Harris v. CIT* 73 Taxman 555.

6. Section 221.

7. Section 201.

8. Second proviso, section 221.

9. *Bennet Coleman & Co. v. V.P. Damle, Third ITO* [1986] 157 ITR 812/[1985] 21 Taxman 131 (Bom.).

2.2 The payer fails to deduct tax at source but the payee pays tax - The power to recover tax by deduction at source does not prejudice any other mode of recovery.¹⁰ Thus, the general power to levy tax on the payee remains in spite of provisions for deduction of tax at source.¹¹ However, as per the Act, the primary onus to withhold tax (on the income of the payee) rests with the payer and it is immaterial whether or not the payee has paid the tax. In other words, the fact that the payee has paid taxes on the relevant income does not prejudice the tax authorities' power to penalize the payer, for failure to deduct tax at source.

The payer may, in spite of recovery of taxes from the payee, be held liable to penalty to the extent of 100 per cent of TDS liability.¹² However, this penalty is not automatic and cannot be levied without reasonable cause to do so. Before levying penalty, the concerned officer is required to find out whether the failure to deduct tax at source was without a reasonable cause. The initial burden is on the payer to show that there existed reasonable cause which was the reason for the failure referred to in the concerned provision. Thereafter, the officer dealing with the matter has to consider the explanation offered by the assessee or the person, as the case may be. The expression 'reasonable cause' should be construed as applied to human action is that which would constrain a person of average intelligence and ordinary prudence. It can be described as a probable cause. It means an honest belief founded upon reasonable grounds, of the existence of a state of circumstances, which

assuming them to be true, would reasonably lead any ordinary prudent and cautious person, placed in the position of the person concerned, to come to the conclusion that the same was the right thing to do. The cause shown has to be considered and only if it is found to be frivolous, without substance or foundation, the prescribed consequences follow.¹³ No such penalty may be impossible once the payer proves that there was a reasonable cause for the said failure.¹⁴

A failure to deduct tax at source also attracts liability under section 221 read along with section 201, as discussed earlier.

2.3 The payer fails to deduct tax and the non-resident payee refuses to pay - The Act makes non-resident payers liable to deduct tax at source from taxable income paid to other non-residents.¹⁵ There may be situations wherein, on failure to deduct tax at source, the non-resident payee may refuse to pay the same when one does not have any presence/assets in India and does not face the direct risk of prosecution of person or attachment of property. As seen above, the Act provides for penalty on payers failing to deduct tax at source to the extent of 100 per cent of TDS liability, irrespective of whether or not tax has been recovered through any other media, since the primary onus to collect tax lies with the payer. Further, should it be held that the payer has wilfully attempted to evade tax and such person shall be liable to rigorous imprisonment for a term which may extend to seven years and an unlimited fine.¹⁶

2.4 The payer deducts tax at source and refuses to pay - While it is true that recovery of TDS

10. Section 202.

11. *British Airways v. CIT* [1992] 193 ITR 439/[1991] 54 Taxman 470.

12. Section 271C.

13. *Woodward Governor India (P.) Ltd. v. CIT* [2002] 253 ITR 745/[2001] 118 Taxman 433.

14. Section 273B.

15. Section 195.

16. Section 276C.

is only one mode of recovery and without prejudice to any other mode of recovery,¹⁷ once tax has actually been deducted at source it will not be open to the tax authorities to demand tax from the payee even if the payer refuses to pay.¹⁸ This is true even in case of a resident payee and it is immaterial whether or not a TDS certificate has been issued - the only criterion being the conclusion of the fact that tax was indeed deducted at source.¹⁹ The only way for the authorities to recover tax is at the hands of the non-resident payer.

The payer will be subject to penal provisions of the Act for wilful attempt to evade tax,²⁰ and persons in breach would be liable to unlimited fine and rigorous imprisonment, which may extend to seven years.

Thus, a non-resident payer is subject to TDS liabilities and in case of default, penalties thereon. However, under the assumption that the payer does not have any presence/assets in India, one may refuse to meet these penal obligations. This throws up questions pertaining to the enforceability of relevant tax provisions and the recovery of taxes.

REPRESENTATIVE ASSESSEE

3. An interesting observation and comment was made by the Authority for Advance Rulings in the case of *ABC, In re* [1997] Advance Ruling P. No. 13 of 1995²¹ :

"... It is generally true that tax deductions at source envisaged in respect of certain types of payments made by residents to other residents and particularly non-residents as a convenient mode of collection when the moneys pass hands rather than await an assessment on, and recovery from, the payee in due course. But the language of the relevant provisions comprehensively covers 'any person' responsible for paying any sums

chargeable to income-tax. Foreign or non-resident companies and persons cannot, therefore, be considered outside the scope of these provisions of the Act, though it is true that there may be some practical difficulties in enforcing these obligations on such persons, unless they have a representative or agent who can be made vicariously liable in this regard. . . ." (p. 509)

The question that craves examination in light of the above observation and comment of the tax authority is whether there can be representative assessment for a non-resident's TDS liability.

The expression 'representative assessee' has been defined in the Act to mean—

"in respect of a non-resident specified in sub-section (1) of section 9, the agent of the non-resident, including a person who is treated as an agent under section 163".²²

Under the Act, a representative assessee is subject to the same duties, responsibilities and liabilities as the assessee and shall be liable to assessment in his own name as regards the income in respect of which he is a representative assessee.²³

As can be seen from the language of the above provisions, which make it abundantly clear, that an agent can be held as a representative assessee only insofar as the liability concerns a non-resident's income. Nowhere in the Act has it been mentioned that an agent shall be liable, as representative assessee, for all tax liabilities of the non-resident, whose representative assessee he is, in India. It is only as regards the income in respect of which the agent is a representative assessee that one shall be subject to the same duties, responsibilities and liabilities as the non-resident. Thus, with due respect, the comment of the Authority needs to be interpreted in a narrow and limited sense, and *prima facie* may not hold good in most cases.

17. Section 202.

18. Section 205.

19. *Yashpal Sahni v. Rekha Hajarnavis, Asstt. CIT* [Writ Petition No. 950 (Bom.) of 2006, the Bombay High Court].

20. *Supra*.

21. 228 ITR 487/94 Taxman 171.

22. Section 160(1)(i).

23. Section 161(1).

ILLEGAL INCOME

4. Any refusal to pay for liabilities, either in the form of tax liabilities or penalties, will amount to an illegal gain, and hence income²⁴ in the hands of the person to whom the said liabilities attach. Illegal income is also a taxable income.²⁵

The important question that arises is whether a representative assessee can be made liable for any of the 'illegal incomes' that accrue to the payer in the above variable circumstances, as

suggested by the authority? Again it must be borne in mind that a representative assessee is assessed only for those incomes in respect of which he is representative assessee, and shall be subject to the same duties, responsibilities and liabilities arising only from such incomes.²⁶ Thus, the contention that the payer's agent be made liable as representative assessee for this illegal income may hold good only if it is proved that one had connived along with the payer towards the generation of such income.



tion treaty between USA and India specifically provides for offences relating to taxation or revenue or one of a purely fiscal character to be regarded as an extraditable offence.²⁸ India could, in cases where wilful tax evasion is alleged, seek extradition of such non-resident payers refusing to meet their respective liabilities. Physical extradition may not be possible in case of a company. However, India could negotiate through the diplomatic channel to freeze assets of such a non-resident company in order to retrieve the liability.

Extradition may, however, not be feasible in every case - not only economically, but also technically. India can seek extradition of a fugitive²⁹ only for extraditable offences³⁰ as agreed in the respective treaty. Offences under the Act may or may not fall under this category under a treaty. Further,

EXTRADITION

5. There have been instances, when tax evaders have been held as fugitive criminals and have been sought to be extradited to the country where the evasion of tax has taken place.²⁷ The extradi-

24. Section 2(24): 'income' includes - (i) profits and gains;...

25. *Maddi Venkatraman & Co. v. CIT* [1997] 2 SCC 95; *CIT v. Pira Singh* AIR 1980 SC 1271; *CIT v. Smt. Prabhavati Bausali* [1983] 141 ITR 419/[1982] 9 Taxman 444 (Cal.); *Bharat Bhushan Jain v. ITO* [2004] 91 TJ 888.

26. Section 161(1).

27. <http://www.nytimes.com/2007/06/29/nyregion/29tollman.html>; <http://www.accountancyage.com/accountancyage/news/2164841/tax-extradition-halted-abuse>; <http://query.nytimes.com/gst/fullpage.html?res=9C01E7D6103FF935A15752C0A9609C8B63>, last visited on October 10, 2007.

28. Article 2(3)(c), Extradition Treaty between the Government of USA and the Government of the Republic of India.

29. Section 2(f), The Extradition Act, 1962: 'fugitive criminal' means a person who is accused or convicted of an extradition offence within the jurisdiction of a foreign State and includes a person.

30. Section 2(3)(i), The Extradition Act, 1962: 'Extradition offence' means - in relation to a foreign State, being a treaty State, an offence provided for in the extradition treaty with that State.



at present, India has extradition treaties with only twenty-five countries.³¹ In absence of a treaty provision to the contrary, the Extradition Act, 1962 does not empower the Government of India to seek extradition of any person for an offence, which is punishable with imprisonment for a term less than one year.³² Hence, it will not be possible to extradite an offender for the offences considered in this article, in absence of a treaty with a contrary provision.

CONCLUSION

6. TDS provisions are mere machinery provisions. They shift the administrative burden of tax collection on to payers of incomes chargeable to tax, and were introduced with the intention of creating administrative convenience. These provisions were created to provide for easy collection of taxes and to avoid tax evasion.³³ However, attaching this administrative burden to non-residents seems to have thrown up questions, not only pertaining to the recovery of tax liability, but also the very efficacy of TDS provisions as applicable to non-residents. It may be possible for the tax authorities to freeze foreign assets or seek extradition of such defaulting non-residents through the diplomatic channel in certain cases; however this may not be feasible in each instance of tax evasion or 'tax refusal' by a non-resident. Even if it were so feasible, the same would continue to be in the teeth of the *raison d'être* of TDS provisions, which is administrative convenience.

It can only be hoped that with the new tax code coming into force from next year, the Legislature fixes these provisions, thereby providing administrative ease in payments and collection eventually protecting revenue loss to the treasury.

The present scheme of TDS provisions not only causes administrative inconvenience, but also seems to leave room, if not invite, tax evasion. There may be a degree of justification for having TDS provisions for transactions between non-residents; however they seem to be much convoluted when the recipient is a resident.

31. <http://www.cbi.gov.in/interpol/extradition.php#et> last visited on October 10, 2007.

32. Section 3(1)(c)(ii).

33. *United Breweries v. Asstt. CIT* [1995] 211 ITR 256/83 Taxman 263 (Kar.).