

Proceedings under section 201 of the Act to be initiated within a reasonable time even in the case of non-residents

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In brief

The Delhi High Court (HC) held in a recent case that for passing an order under section 201(1) of the Income-tax Act, 1961 (the Act) deeming a taxpayer as a “taxpayer in default” for non-withholding of tax from payments to non-residents, a show cause notice needed to be issued within a reasonable time, in absence of stipulation of any time limit in section 201 of the Act.

In detail

Background

- In this case¹, the deductor was a non-resident telecommunication provider, engaged in providing interconnection services to its users.
- The deductor engaged with non-resident entities for interconnections, for which it made payments to such non-residents.
- The tax officer (TO) issued several show cause notices to the deductor for various periods, asking it to show cause as to why it should not be deemed a taxpayer in default, as it made payments on account of interconnection charges to various foreign entities without deduction of tax

under section 195 of the Act, and consequently, why tax should not be charged from the deductor under section 201(1A) of the Act on account of failure to deduct tax at source on payments for interconnect charges to non-resident operators.

- Aggrieved, the deductor filed a writ petition before the HC.

Issues before the HC

- Would section 201 of the Act also apply to payments made to non-residents?
- Were the impugned show cause notices issued by the TO barred by limitation?

Deductor's contentions

- The deductor contended that section 201 did not expressly mention “non-

residents”, and prescribed a time limitation for deeming one to be a taxpayer in default for residents. Accordingly, in the absence of express provision of time limitation, the reasoning in earlier HC decisions² would set the limitation period at four years, i.e., within a reasonable time.

- The deductor also contended that the amendment made in 2010 only reiterated that the power to issue show cause notice was to be exercised within a defined time limit, and therefore, the reasoning in the aforesaid decisions has not been disturbed.
- The deductor further contended that if the court were not to accept the construction given by the

¹ [2016] 76 taxmann.com 256 (Delhi)

² CIT v. NHK-Japan Broadcasting Limited 2008 (305) ITR 137 (Delhi)

CIT v. Hutchison Essar Telecom Limited [2010] 323 ITR 230 (Delhi)
CIT v. CJ International Hotel (P) Limited [2015] 372 ITR 684 (Delhi)

Vodafone Essar Mobile Services Limited v. Union of India [2016] 385 ITR 436 (Delhi)

deductors, the result would be an invalidation of the provision itself, because it sought to treat one class of deductees or recipients more favourably than others. To an extent, this interpretation would lead to an artificial distinction between domestic deductees and foreign deductees, whereas in reality, they belonged to one class and had always remained so. For purposes of treatment under section 201, the distinction was invidious, and amounted to impermissible classification, and was thus a violation of Article 14 of the Constitution of India.

- The deductor also placed reliance on the HC ruling that earlier held that if there was a time limit for completing the assessment, then the time limit for initiating the proceedings must be the same, if not less.

Revenue's contentions

- The revenue contended that Parliament made a conscious distinction between resident and non-resident beneficiaries, based on good reasons.
- There was a sound rationale for such distinction because in remittances to non-residents, the true nature of the transactions, and whether deductions were to be made because income arises within the country or outside, could not be easily gathered.
- It further said that when earlier HC rulings² were

decided, the amendment had not been brought about, and therefore, the issue of existence of a period of limitation, did not arise. The court therefore considered, on the basis of available authority, that a four-year period was a reasonable period as the outer limit for issuance of notice under section 201. However, in the present case, Parliament had consciously amended the Act. In doing so, it prescribed a limitation only for residents. Instead of actively barring the applicability of the provision to non-residents, did the Parliament choose to passively do so by remaining silent on non-residents and only amending the provision, for residents?

High Court's ruling

- The HC relied on the decision of the apex court³, wherein the court considering the absence of any limitation period in respect of payments to non-residents for the purpose of section 195 read with section 201, and held that proceedings could be initiated within a reasonable time.
- The CBDT Circular relied on by the Revenue, furnishing a rationale for not providing limitation, had been decisively rejected in another HC ruling⁴.
- The HC accepted the deductor's contention, holding that reasonable period had been read into the Act, in relation to the exercise of powers (although in a different

context). It concluded that administrative convenience could not outweigh the harsh nature of the consequences. This would expose resident payers to the onerous responsibility of maintaining books and documents for an uncertain period of time.

The takeaways

The Finance Act, 2010 had introduced section 201(3)(i) in the Act, which provided for completion of proceedings within two years from the end of the financial year (where withholding tax statements have been filed), in the case of non-deduction of taxes from payments to residents.

Further, the Finance Act, 2014 deleted section 201(3)(i) of the Act, and provided that any order treating a person as a taxpayer in default for not withholding tax on payments made to a resident, could be passed at any time within seven years from the end of the financial year in which the payment is made, or credit given.

Both the above provisions however have been silent on applicability to non-residents.

As there is no time limit prescribed in case of payments made to non-residents specifically, this ruling, in line with earlier court rulings would come in handy as a guidance on time limitation in case of non-residents.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

³ Vodafone Essar Mobile Services Limited v. Union of India [2016] (385) ITR 436 (Delhi)

⁴ GE India Technology Centre v. CIT [2010] (10) SCC 29

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