
(1984) 07 AP CK 0020

In the Andhra Pradesh High Court

Case No : Reference Case No's. 203 to 205 of 1978

Commissioner of Income Tax

APPELLANT

Vs

Superintending Engineer

RESPONDENT

Date of Decision : 02-07-1984

Acts Referred:

Income Tax Act, 1922 — Section 18(3B)

Income Tax Act, 1961 — Section 174, 18(3B), 192, 193, 194

Citation : (1984) 19 TAXMAN 356

Hon'ble Judges : Jeevan Reddy, J;Anjaneyulu, J

Bench : Division Bench

Advocate : M.S.N. Murthy, for the Appellant; M. Chandrasekhara Rao, for the Respondent

Judgement

Anjaneyulu, J.—At the instance of the Commissioner, these references were made by the Tribunal u/s 256(1) of the income tax Act, 1961 ("the Act"). The question referred in all the three cases is identical and it will be convenient to deal with the same in this common judgment. The Andhra Pradesh State Electricity Board ("the Electricity Board"), the respondent in these references made certain payments to non-residents against purchase of machinery and equipment and also against the work executed by the non-residents in India of erecting and commissioning the machinery and equipment. The question arose whether the Electricity Board was under an obligation to deduct tax at source from these payments u/s 195 of the Act. The payments were made by the Electricity Board without deduction of tax at source. The ITO held that the Electricity Board was under an obligation to deduct tax at source u/s 195. Owing to the failure of the Electricity Board to deduct such tax, the Electricity Board was deemed to be an assessee in default in respect of the tax deductible at source u/s 195. Consequently, the ITO passed orders determining the tax, which, according to him, was deductible at source u/s 195 and required the Electricity Board to pay such amounts. These facts briefly constitute the origin for the subsequent appeals to the AAC and the Tribunal and the present references

before this Court.

2. Reference Case No. 203 of 1978 relates to the payments made by the Electricity Board to Charmilles Engineering Works Ltd., Geneva, Switzerland. Two separate agreements were entered into with the above non-resident. One was for the purchase of No. 95,000 BHP Francis Turbines. Another was for the purchase of 2 Nos. Butterfly Valves. This equipment was for the Upper Sileru Hydro-Electric Scheme, Visakhapatnam district. There were also two more contracts with the same nonresident for the assembly, erection and testing and commissioning of the above equipment at Sileru. It appears, under the contracts for erection and commissioning above referred, the Electricity Board paid the following sums to the non-resident company:

Financial year

Amount paid

Rs.

1966-67

3,65,237

1967-68

8,01,079

1968-69

1,63,602

1969-70

38,832

1970-71

51,001

1971-72

7,700

1972-73

45,000

14,72,450

On the ground that, under these contracts, the amounts were payable to the non-resident free of income tax, the ITO grossed up the net payments. He seems to have arrived at the corresponding gross amounts which, after payment of tax by the non-resident under the provisions of the Act, would yield the net amount paid and treated the difference between the gross amount and the net amount

paid as tax deductible at source u/s 195. The difference between the gross amount and the net amount is held to be the tax deductible at source as apparently, the Finance Act, for the relevant assessment year, authorises such deduction. For instance, in the financial year 1966-67, the net amount paid was Rs. 3,65,237. The ITO arrived at the corresponding gross amount at Rs. 18,25,805. He observed that, under the Finance Act, 1966, the tax deductible at source u/s 195 was 30 per cent income tax and 3 per cent surcharge. Even so, the tax deductible on the gross amount of Rs. 18,25,805 was not determined at the aggregate amount of 33 per cent prescribed by the Finance Act, 1966, but was determined at the difference between the gross amount of Rs. 18,25,805 less the net amount paid of Rs. 3,65,237. By this process, the ITO held that the Electricity Board was under an obligation to deduct tax of Rs. 14,60,568. For the failure to deduct and pay the tax to the Central Government, the ITO had also charged interest u/s 201(1A) of the Act from the date on which such tax was deductible. For instance, the corresponding amount of interest payable on the tax of Rs. 14,60,568 held to be deductible u/s 195 is Rs. 12,77,996. The result has been that, in respect of a net amount of Rs. 3,65,237 paid, the ITO determined the tax deductible at source together with interest thereon at the aggregate figure of Rs. 27,38,564. A very curious result indeed. The ITO determined the tax deductible at source as well as the interest for the subsequent financial years 1967-68 to 1972-73 (both inclusive) in the same manner. It is not necessary to set out the details. It is sufficient to state that, in respect of net payments aggregating to Rs. 14,72,450 made by the Electricity Board during the financial years 1967-68 to 1972-73 (both inclusive), the ITO determined the tax deductible at source u/s 195 at Rs. 58,32,260 and the corresponding interest thereon u/s 201(1A) at Rs. 46,30,034 aggregating to Rs. 1,04,62,294.

3. We shall now briefly refer to the facts in Reference Case No. 205 of 1978, as the orders of the ITO in Reference Case Nos. 203 and 205 of 1978 follow the same pattern. The Electricity Board entered into an agreement with Oerlikon Engineering Co., Zurich, Switzerland, for the purchase of 2 Nos. 60 MW generators and Indoor Switchgear for the Sileru Hydro-Electric Scheme. Another contract was also entered into with the non-resident for the assembly, erection and testing and commissioning of the above equipment at Sileru. It appears that, under the erection contract, the Electricity Board paid the following sums to the non-resident company:

Financial year

Amount paid

Rs.

1966-67

1,95,877

1967-68

13,70,529

1968-69

1,34,378

Total

17,00,784

On the same basis followed in respect of payments made to Charmilles Engineering Works Ltd., in Reference Case No. 203 of 1978, the ITO held that the Electricity Board was under an obligation to deduct tax from the payments made to Oerlikon Engineering Company. On the ground that the payments in this case were also made by the Electricity Board free of income tax, the ITO grossed up the net payments to arrive at the corresponding gross amounts. He accordingly, arrived at the corresponding gross payments which aggregated to Rs. 89,02,338. Deducting therefrom, the aggregate amount of net payments of Rs. 17,00,784, made the ITO arrived at the tax (sic) deductible at source u/s 195 at Rs. 72,01,554. He also determined the interest payable u/s 201(1A) at Rs. 58,55,747. The tax deductible and the interest payable, thus, amounted in all to Rs. 1,30,57,301. The ITO required the Electricity Board to pay the above amount pursuant to his order dated 24-9-1975 u/s 201. It was necessary to state that the ITO followed the same pattern for determination of tax deductible at source in Reference Case Nos. 203 and 205 of 1978.

4. Reference Case No. 204 of 1978 relates to payments made by the Electricity Board to Sacheron Works Ltd., Geneva, Switzerland. It appears, a contract was entered into with aforesaid non-resident for the purchase and erection of 7 Nos. power transformers for the Sileru Hydro-Electric Scheme. Under the contract for the purchase of power transformers, the Electricity Board paid to the non-resident in the financial year 1966-67 a sum of Rs. 27,57,736. Under the contract for erection charges, the Electricity Board paid to the non resident the amounts of Rs 1,19,279, Rs. 48,591 and Rs. 474, respectively, in the financial years 1967-68, 1968-69 and 1969-70. The ITO held that, in respect of payments made towards the price of transformers, net profit to the non resident could be estimated at 5 per cent of the sale price; he also estimated the net profit in respect of payments made to the non-resident on account of erection charges at 25 per cent. The ITO, accordingly, determined the income forming part of the sums paid to the non-resident as above-mentioned. The ITO determined the tax deductible at source u/s 195 at Rs. 2,99,111 in respect of the above payments. The ITO's order does not show whether the net payments were grossed up as was done in Reference Case Nos. 203 and 205 of 1978; it does not also show whether the tax deductible at source was determined at Rs. 29,99,111 with reference to such gross figure. It may be mentioned that the order u/s 201, in respect of the payments made to this non-resident, was passed by the ITO on 10-5-1976.

5. Against the ITO's orders dated 22-9-1975 and 24-9-1975, respectively, in Reference Case Nos. 203 and 205 of 1978, the assessee filed appeals before the AAC and urged that the ITO's orders were illegal. A number of contentions were raised before the AAC challenging the correctness of the orders passed by the ITO. It is not necessary to refer to all these contentions. It may, however, be mentioned that the AAC rejected the various contentions raised by the assessee challenging the correctness of the orders passed, but cancelled the orders accepting one basic contention. That contention was to the effect that the provisions of section 195 are applicable in cases where the sums paid were "pure income profits", that is to say, the sums paid represented wholly income. It was urged that the provisions of section 195 do not come into operation in a case where the non-resident was paid under contracts sums of money, a part of which only may represent income chargeable under the Act. The above contention appealed to the AAC. Accepting the above contention, the AAC held that the words "Any other sum...chargeable under the provisions of this Act", occurring in section 195, do not contemplate inclusion of trading receipts in their ambit. The AAC was of the view that, in terms, section 195 applies only to cases where the sums paid are "pure income profits". Holding the above view the AAC cancelled the orders passed by the ITO u/s 201 which are the subject-matter of consideration in Reference Case Nos. 203 and 205 of 1978. The ITO did not accept the decision of the AAC cancelling the above-mentioned orders on the above ground and filed appeals before the Tribunal. 7. After the AAC cancelled the orders passed by the ITO dated 22-9-1975 and 24-9-1975 in Reference Case Nos. 203 and 205 of 1978 and while the appeals filed by the ITO against the order the AAC (sic) of such orders were pending before the Tribunal, the ITO passed the third order, dated 10-5-1976 u/s 201 in Reference Case No. 204 of 1978. After passing this order, the ITO seems to have pressed for the payment of tax determined whereupon the Electricity Board filed a writ petition in this Court for stay of the tax. While disposing of the writ petition filed by the Electricity Board, this Court directed the AAC to dispose of the appeals within two months from the date of the order of this Court and, consequently, the AAC disposed of the appeal against the ITO's order dated 10-5-1976 in Reference Case No. 204 of 1978, by his order dated 16-8-1976. Although the ITO followed a different pattern for determining the tax deductible at source, the AAC proceeded on the basis that his earlier decision, cancelling the orders of the ITO dated 22-9-1975 and 24-9-1975 in Reference Nos. 203 and 205 of 1978, holds good even in respect of the order dated 10-5-1976 in Reference Case No. 204 of 1978 and, accordingly, cancelled the order of the ITO. The ITO once again filed an appeal to the Tribunal against the order of the AAC.

6. The Tribunal disposed of the three appeals filed by the ITO by its order dated 30-9-1977. Before the Tribunal, the assessee supported the order of the AAC not only on the ground, which appealed to the AAC, but also on the various grounds, which were negated by the AAC. The Tribunal negated the various contentions urged by the assessee, but upheld the order of the AAC on the same ground on

which the AAC cancelled the three orders. Thus, the Tribunal affirmed the order of the AAC cancelling the three orders of the ITO on the ground that the provisions of section 195 are not applicable to payment of sums to a non-resident, which are not "pure income profits". The Tribunal held that there was no sanction to deduct tax from out of gross sums of money, a moiety of which alone represents the income, chargeable under the Act. In the above view, the Tribunal dismissed all the three appeals filed by the ITO against the order of the AAC. Thereupon, the Commissioner filed reference applications u/s 256(1) requiring the Tribunal to refer the cases to this Court for its opinion. That is how the Tribunal made the three references under consideration. It may perhaps be relevant to refer, at this stage, to the question of law referred in each reference for the opinion of this Court u/s 256(1).

Reference Case No. 203 of 1978 :

Whether, on the facts and in the circumstances of the case, the Superintending Engineer, Civil Circle, Upper Sileru, is liable to deduct income tax u/s 195 of the income tax Act, 1961, on the payments made to the nonresident company?

Reference Case No. 204 of 1978 :

Whether, on the facts and in the circumstances of the case, the Superintending Engineer, Civil Services Circle. Upper Sileru, is liable to deduct income tax u/s 195 of the income tax Act, 1961, on the payments made to the nonresident company for the assessment years 1966-67, 1967-68 and 1968-69?

Reference Case No. 205 of 1978 :

Whether, on the facts and in the circumstances of the case, the Superintending Engineer, Civil Circle, Upper Sileru, is liable to deduct income tax u/s 195 of the income tax Act, 1961, on the payments made to the nonresident company for the assessment years 1966-67, 1967-68, 1968-69 and 1969-70?

7. The learned standing counsel for the revenue, Shri M. Suryanarayana Murthy, contended that the Tribunal was in error in holding that the provisions of section 195 were not applicable to cases where sums of money were paid to non-residents, the entirety of which does not represent the income chargeable under the Act. The learned standing counsel points out that the language of section 195 does not lend support to the Tribunal's view that section 195, either expressly or by necessary implication, referred only to sums which are "purely income profits". According to the learned standing counsel, section 195 is applicable even in respect of sums paid during the course of trading operations to a non-resident. It is stated that section 195 does not contain any limitations on its application. The learned counsel also referred to section 195(2) which enables the person responsible for paying the sums to the non-resident to make an application to the ITO to determine the appropriate proportion of the sum chargeable to income tax. The learned standing counsel contends that the power given to the ITO to determine the proportion of the sum chargeable to income

tax, in respect of which only income tax at source is deductible, clearly supports the view that section 195 is applicable to sums paid in the course of trading operations subject only to one condition, that, where the entire sum paid is not income chargeable under the Act, it is open to the assessee to require the ITO to determine the relevant proportion of the sum paid which is chargeable under the Act and deduct tax only in respect of that proportion. The learned standing counsel urged that the Electricity Board failed to make an application u/s 195(2) to the ITO to determine the proportion of the sum chargeable in respect of sums paid to Charmilles Engineering Works Ltd., in Reference Case No. 203 of 1978 and Oerlikon Engineering Co., in Reference Case No. 205 of 1978. In the absence of any application from the Electricity Board, the learned standing counsel contends that the ITO had no option but to enforce deduction of tax at source with reference to the entirety of the sums paid. According to the learned standing counsel, the ITO cannot exercise power to determine the relevant proportion of the sum chargeable unless an application is made by the person responsible for making the payment. If the person responsible for making the payment does not file an application u/s 195, the ITO can enforce deduction of tax at source in respect of the entire sum paid to the non-resident and that is what happened in respect of the payments made by the Electricity Board to the above-referred two companies. The learned standing counsel, therefore, supported the orders passed by the ITO in respect of the payments made to the above-mentioned two concerns. The learned standing counsel also pointed out that, in respect of payments made by the Electricity Board to Sacheron Works Ltd., in Reference Case No. 204 of 1978, the Electricity Board made an application u/s 195 and, consequently, in exercise of his power, the ITO determined only 5 per cent of the price paid for the transformers and 25 per cent of the sum paid in respect of the erection contract as the sum chargeable under the Act. The ITO enforced deduction of tax at source only in respect of that portion of the sum determined by him as chargeable under the Act for purposes of deducting the tax at source u/s 195. The learned standing counsel complained that the AAC as well as the Tribunal failed to notice that, insofar as it concerns the payments made to Sacheron Works Ltd. in Reference Case No. 204 of 1978, the ITO followed a pattern of enforcing tax deduction at source only with reference to that moiety of the sum chargeable under the Act. The learned standing counsel contended that the AAC as well as the Tribunal failed to notice the clear difference in the pattern followed by the ITO in respect of payments made to Sacheron Works Ltd. and proceeded on a mistaken view that, in respect of payments made to Sacheron Works Ltd. also, the ITO enforced tax deduction at source in respect of the entirety of the sums paid to the non-resident, as was done in the case of payments made to Charmilles Engineering Works Ltd. in Reference Case No. 203 of 1978 and Oerlikon Engineering Company in Reference Case No. 205 of 1978. The learned standing counsel pointed out that there can be no grievance on the part of the assessee at least insofar as the ITO's order in respect of payments made to Sacheron Works Ltd. in Reference Case No. 204 of 1978 is concerned.

8. The learned counsel for the revenue relied on the decisions of the Calcutta High Court in *Anglo India Jute Mills Co. Ltd. Vs. S.K. Dutt and Another*, and *P.C. Ray and Co. (India) Private Ltd. Vs. A.C. Mukherjee, Income Tax Officer and Another*, . He also relied on the decision of the Bombay High Court in *Commissioner of Income Tax, Bombay City I Vs. Bhaidas Cursonadas and Co.*, and on the decision of the Allahabad High Court in *MESSRS. RAZA TEXTILES LTD. Vs. Income Tax OFFICER, RAMPUR.*, Reliance was placed on these decisions by the learned standing counsel in support of his propositions that (a) provisions of section 195 are applicable even in respect of sums paid to a non-resident during the course of trading operations, and (b) the sums paid to the nonresident need not represent wholly pure income profits and only a part of such sums paid may represent income chargeable under the Act.

9. Shri M. Chandrasekhara Rao, the learned standing counsel for the Electricity Board, reiterated the submissions made before the lower authorities. It is urged that, taking the entire scheme of the Act into account, the provisions of section 195 apply only to cases where the sums paid to a non-resident represented pure income profits, that is to say, where the entirety of the sum paid represented income. According to the learned counsel, section 195 can have no application in respect of sums paid during the normal course of trading operations, such as payments of purchase price of materials. The learned counsel urged that it is impossible to predicate whether the sum paid consisted of an even a small moiety chargeable under the Act because a trading transaction does not always result in income or profit. The learned counsel, therefore, urged that, because of the inherent difficulty in determining whether any particular sum paid during the course of trading operations to the non-resident consisted of income chargeable under the Act, the provisions of section 195 render themselves inapplicable in cases where sums are paid to the non-residents in the regular course of trading operations. According to the learned counsel, section 195(2) is not a pointer to support that the sum paid to the non-resident need not wholly represent pure income profit. It is urged that the power to determine the proportion of income chargeable under the Act arises only where the sum paid to the non-resident bears income character, and is not wholly chargeable under the provisions of the Act but only a portion of which is chargeable. In such cases, it will be open to the ITO to determine the proportion of the sum chargeable. The learned counsel submits that, in order to apply section 195(2) for purposes of apportionment, the sum paid to the non-resident must basically represent pure income profit and not a trading receipt, a part of which only may be income chargeable or no part of which may be income chargeable. The learned counsel, accordingly, supported the orders of the Tribunal cancelling the orders passed by the ITO in all these references. Without prejudice to the basic contention that section 195 is not at all applicable in respect of trading receipts, the learned counsel further submitted that, in any event, the ITO was under an obligation to ascertain the portion of income chargeable under the Act forming part of the trading receipts and enforce deduction of tax at source u/s 195 only in respect of such portion chargeable to

income tax. The action of the ITO in Reference Case Nos. 203 and 205 of 1978, the learned counsel contended, in enforcing deduction of tax at source on the entirety of the trading receipts, is unsupportable.

10. We have perused the records and considered the submissions of the learned counsel on either side. Two fundamental questions arise for consideration and they are: (a) whether the provisions of section 195 are applicable to cases where the sum paid to the non-resident does not wholly represent income; and (b) if section 195 is applicable in such cases, whether the ITO could enforce deduction of tax at source on the gross amount of trading receipts or only in respect of that portion of the trading receipts which may be chargeable as income under the Act. The question referred to us deals with only the first aspect mentioned above. The second aspect is an integral part of the first aspect and it is necessary to reframe the question in order to bring the real controversy between the parties, which we shall do, before furnishing the required answers. We shall examine both the aspects as they are the subject-matter of consideration by all the authorities below and the counsel for both sides addressed elaborate arguments on these two aspects.

11. Part B of Chapter XVII of the Act enumerates the provisions relating to deduction of tax at source. Section 192 of the Act deals with the obligation of the person responsible for paying income chargeable under the head "Salaries" to deduct tax from the salary. Section 193 of the Act deals with the obligation to deduct tax of the person responsible for paying income chargeable under the head "Interest on securities". Section 194 of the Act deals with the obligation of the principal officer of a company to deduct tax at source from "dividends" paid. Section 194A of the Act deals with the obligation to deduct tax of any person responsible for paying to any person "interest" other than income chargeable under the head "Interest on securities". Section 194B of the Act deals with the obligation to deduct tax of the person responsible for paying to any person income by way of "Winnings from any lottery or crossword puzzles". There is no doubt that the salary, interest on securities, dividend, interest other than interest on securities and winnings from any lottery or crossword puzzles above referred constitute wholly income for the purposes of the Act. It is relevant to examine in this context the provisions contained in section 194C of the Act. Under these provisions, any person responsible for paying any sum to any resident contractor and sub-contractor is under an obligation to deduct tax at 2 per cent of the sums so payable to the contractor or subcontractor. It will at once be seen that the obligation to deduct tax u/s 194C is in respect of the sums paid to the contractors and sub-contractors which do not wholly represent income. The rate at which the tax has to be deducted from out of such sums paid to the contractors and subcontractors, is mentioned in section 194C itself. We are referring to this provision for the purpose of pointing out that the scheme of tax deduction at source applies not only to sums like salaries, dividends, interest on securities, interest other than interest on securities and winnings from any lottery or crossword puzzles, which wholly represent income, but also gross sums

paid to persons. Section 194C brings in this clear intention of the Legislature to enforce tax deduction at source even in respect of gross sums, the whole of which do not represent income chargeable under the Act. Then again, the provisions of section 194D of the Act lay an obligation to deduct tax on the person responsible for paying "insurance commission", the whole of which does not represent income. It must be borne in mind that for the purpose of earning insurance commission, a person may incur expenditure and, therefore, the entire gross commission may not be chargeable. Even so, the provisions of section 194D oblige the person responsible for paying the insurance commission to deduct tax at source from the gross sum of insurance commission. We shall now examine the provisions of section 195, which fall for consideration in these references.

Sub-section (1) of section 195, to the extent it is relevant, lays an obligation on any person responsible for paying to a non-resident any interest, not being "interest on securities", or any other sum, not being dividends, chargeable under the provisions of the Act to deduct tax at source at the rates in force. Sub-section (2) of section 195 provides that, where the person responsible for paying any such sum chargeable under the Act to a non-resident considers that the whole of such sum would not be income chargeable in the case of the recipient, he may make an application to the ITO to determine, by general or special order, the appropriate proportion of such sum so chargeable, and upon such determination, tax shall be deducted under sub-section (1) only on that proportion of the sum which is so chargeable. It is not necessary to refer to the other provisions contained in section 195, as they are not relevant for our purpose. We are unable to find, in the language of section 195, any support for the argument that the expression "any other sum" occurring in the section refers necessarily to sums which represent wholly income or profits. As we have already pointed out, the scheme of tax deduction at source applies not only to amounts paid which wholly bear "income" character, but also to gross sums, the whole of which is not income or profits to the recipient, such as payments to contractors and subcontractors u/s 194C and the payment of insurance commission u/s 194D. That being so, it is not possible to accept the contention of the learned counsel for the Electricity Board that there is no sanction to deduct tax at source from sums which do not represent wholly income or profits. Indeed, the scheme of tax deduction at source makes distinct provisions for deduction of tax from sums which represent wholly income or profit, or other sums, which may not so represent.

In our opinion, the provisions of section 195(2) make the intendment of the Legislature very clear that what was required to be considered for the purposes of tax deduction at source u/s 195(1), is not wholly income or profit. We are not impressed with the argument that section 195 expressly refers to "any other sum chargeable under the provisions of the Act" and, consequently, the whole of such sum must be chargeable as income under the Act. In other words, what is contended is that, where the sum paid to any person is not wholly chargeable

under the provisions of the Act, then the application of section 195 is ousted. If this contention is to be accepted, section 195(2) will be rendered otiose because, if the obligation to deduct tax in respect of "any other sum" attaches only to sums which are wholly chargeable under the Act, then the necessity for the person responsible for paying such sums making an application to the ITO under sub-section (2) to determine the appropriate proportion of such sum so chargeable does not arise. If the entirety of the sum, as contended by the learned counsel for the Electricity Board, should be taxable for section 195 coming into operation, then sub-section (2) of section 195 becomes entirely ineffective. We cannot accept an argument which renders a legislative provision a dead letter. If, on a harmonious construction of the relevant provisions, it is possible to make effective all the provisions contained in a statute, the Courts must always lean in favour of such interpretation. This is an established rule of interpretation. Taking note of the scheme of tax deduction at source, which we have already mentioned above, it would be entirely consistent if the expression "any other sum" occurring in section 195(1) is interpreted as referable not only to a sum which is wholly income chargeable under the Act, but also to a sum, which is not wholly income so chargeable. Then the provisions of sub-section (2) of section 195 will become fully effective. For the aforesaid reasons, we must prefer the interpretation which renders section 195(2) effective without making it a dead letter. We do not also find anything inconsistent in the scheme of the Act or in the exigencies requiring deduction of tax at source to protect the interests of the revenue from out of the sums consisting of only a small moiety of income. The safeguard provided in subsection (2) of section 195 protects the interests of the person receiving such sums because an application can always be made to the ITO to determine the appropriate proportion of the sum chargeable under the Act, so that tax deduction at source can confine only to such appropriate proportion and not to the gross amount. It should also be borne in mind that whatever tax is deducted at source u/s 195 from out of the gross sum, is not irretrievably lost to the recipient. It is only a provisional payment which will be made to the Central Government to the credit of the recipient. The provisions of the Act enable the recipient, whether such recipient is a resident or non-resident, to file a return of income in the regular course and prove to the satisfaction of the ITO the income chargeable under the Act. After such determination, if the tax provisionally deducted at source under any of the provisions contained in Part B of Chapter XVII is in excess of what is required to be paid, the ITO is bound to grant refund of the excess tax deducted at source with interest to the recipient. Thus, the interests of the recipient are fully protected under the scheme of the Act. We do not see any ground for the person responsible for making the payment to object to the deduction of tax at source provisionally either from sums, which represent wholly income or from sums which represent only a part of the income chargeable under the provisions of the Act, so long as the recipient is clearly told that the tax deducted at source from out of the sums paid are liable to be refunded by the income tax department to the recipient, if, by any chance, the tax deducted at source is more than the tax properly chargeable on

the total income of the recipient. We, therefore, uphold the contention of the revenue that the provisions contained in section 195 take in their sweep any sums paid to a nonresident, which do not wholly represent income or profits chargeable under the Act but a portion of which only so represents.

12. It is next contended that the obligation to deduct tax at source u/s 195 cannot be held to extend to sums paid to non-residents during the course of regular trading operations, that is to say, where the sums paid to the nonresidents represented value or cost of goods purchased in the course of regular trade. It is urged that, if the provisions contained in section 195 should be interpreted as sanctioning the deduction of tax at source from out of gross sums paid to non-residents by way of cost of goods, it would lead to serious hardships in the course of international trade. While we agree that some amount of inconvenience and hardship is bound to be felt by the non-residents by reason of deduction of tax at source from sums referable to trading operations, that cannot be a ground for arriving at an interpretation of the provisions of section 195 to excuse sums paid to non-residents during trading operations. The language of the section is very clear and unambiguous and effect must be given to the clear provisions of law irrespective of hardships and inconveniences.

We are conscious of the fact that the process of making regular assessments on non-residents, after deduction of tax at source u/s 195, may take time and the non-residents may not be able to get back refund of excess tax deducted at source, if any, till the regular assessment is completed determining the tax payable by the non-residents on the total income chargeable under the provisions of the Act. We can only express the hope that the CBDT gives instructions to all the ITOs to expedite regular assessments on non-residents, from whom tax is deducted at source, giving top priority and facilitate smooth course of international trade involving a large magnitude of trading operations. The tax authorities will do well to make an accelerated assessment on non-residents u/s 174 of the Act, should circumstances require such a course in order to ensure that the non-residents get back expeditiously excess amounts of tax, if any, deducted at source u/s 195.

13. We may refer to the decision of the Calcutta High Court in *Anglo-Indian Jute Mills Co. Ltd.*'s case (supra). Referring to section 18(3B) of the Indian income tax Act, 1922, which is analogous to section 195 of the 1961 Act, the Calcutta High Court observed that a sum of money paid to a non-resident as the price of the shares was "a sum chargeable under the provisions of the Act" within the meaning of section 18(3B), even though the whole of the price paid was not chargeable to tax and only the profit made by the transaction was so chargeable. There is yet another decision of the Calcutta High Court in *P.C. Ray & Co. India (P.) Ltd.*'s case (supra), which has reiterated the same view. Dealing with section 18(3B), again the Calcutta High Court held that it contemplated not merely amounts the whole of which was taxable without deduction but amounts of a mixed composition, a part of which only might turn out to be taxable income, as

well; and the disbursements, which were of the nature of gross revenue receipts, were yet sums chargeable under the provisions of the 1961 Act and came within the ambit of section 18(3B) of the 1922 Act. We are in respectful agreement with the view expressed by the Calcutta High Court in the above cases. No other decision taking a contrary view has been brought to our notice. The learned counsel for the revenue drew our attention to the decision of the Allahabad High Court in *Raza Textiles Ltd.'s case* (supra). Having perused this decision, we do not think this decision deals with the point under consideration. In that case, the Court was concerned with the obligation to deduct tax from out of commission payable, the whole of which is income chargeable under the Act. This case is, therefore, not relevant. The learned counsel for the revenue also relied on the decision of the Bombay High Court in *Bhaidas Cursonadas & Co.'s case* (supra).

In our opinion, this again is a case where the obligation to deduct tax was in respect of a sum of Rs. 1,40,000 the whole of which represented income. There is a clear finding in the above case that the amount paid to the non-resident represented the profit made on the sale of cotton. This case also does not consider the point with which we are concerned in the present references.

14. For the reasons aforesaid, we are clearly of the opinion that the provisions of section 195 relating to deduction of tax at source come into operation in respect of sums paid to non resident, whether or not such sums represent wholly income or profits and even if such sums are paid to the non-resident during the course of regular trading operations.

15. We now turn to the second aspect of the matter, viz., whether section 195 requires a person responsible for paying any sum to the non-resident chargeable under the Act, to deduct tax on the gross sum of money. The answer is clearly found in the language of section 195 itself. The obligation to deduct tax relates only to the appropriate portion of the gross sum, which would be chargeable as income in the hands of the recipient. We have already referred to the provisions of section 195(2), which affirms the above legal position. We have also noticed earlier that, in the orders passed concerning the payment of sums to Charmilles Engineering Works in Reference Case No. 203 and Oerlikon Engineering Company in Reference Case No. 205 of 1978 the ITO required the company to pay tax on the gross sum of money. The reason was simple. The assessee did not make any application requiring the ITO to determine the appropriate proportion of the sum paid to the non-resident, which is chargeable under the Act. The learned counsel for the revenue contends that, in the absence of any such application, it is not open to the ITO to himself make an apportionment and, consequently, the ITO was helpless and had to call upon the assessee to pay tax in respect of the entire gross sum. The learned counsel relied on the decision of the Calcutta High Court in *Czechoslovak Ocean Shipping International Joint Stock Company and Another Vs. Income Tax Officer, A-Ward and Others*, in support of the above proposition. We have also observed earlier that, in the order passed by the ITO concerning the payments made to Sacheron Works Ltd. in Reference Case No. 204, the ITO

proceeded to determine the tax deductible with reference only to the appropriate portion of the gross sum which, in his opinion, is chargeable under the Act. The ITO held that, in respect of the amount of cost price paid for the power transformers, the profit could be estimated only at 5 per cent of the gross sum and in respect of the erection charges paid, the profit could be estimated at 25 per cent. There is, thus, a clear acceptance by the ITO himself that the obligation of the assessee to deduct tax is only in respect of that proportion of the gross sum which is chargeable as income under the Act and does not extend to the entirety of the gross sum. We are unable to accept the contention of the learned counsel for the revenue that, because the assessee did not file an application u/s 195(2), the ITO is empowered to call upon the assessee to pay tax u/s 195 in respect of the entirety of the gross sum. It should be borne in mind that a person may be honestly under the impression that no part of the gross sum payable to the non-resident is chargeable to tax as income under the Act and, hence, he does not find it necessary to make an application u/s 195(2). The ITO, on the other hand, may be again honestly under the impression that the gross sum of money includes some portion chargeable under the Act. Could it be said that, under such circumstances, the person responsible for making the payment could be punished or penalised by requiring him to pay the tax deductible on the entirety of the gross sum? The answer is clearly in the negative. We cannot accede to the contention of the learned counsel for the revenue that the ITO is entitled to call upon the Electricity Board to pay tax deductible u/s 195 in respect of the entirety of the payments made to Charmilles Engineering Works Ltd. in Reference Case No. 203 of 1978 and Oerlikon Engineering Company in Reference Case No. 205 of 1978. It must be remembered that the order was passed u/s 201. For the purpose of determining the tax in respect of which the person responsible for making the payment could be deemed to be in default, the ITO must determine the tax only on the appropriate proportion of income chargeable under the Act. There is no prohibition in section 201 against the ITO so determining the tax. Indeed, the power to determine the appropriate amount of tax deductible at source u/s 195 is implicit in section 201. In the face of the ITO's own acquiescence that, in respect of erection charges paid to the other companies, the net profit could not exceed 25 per cent. it is not possible to uphold the ITO's action in determining the tax with reference to the gross sums of money in Reference Case Nos. 203 and 205 of 1978. As already mentioned, the power to determine the appropriate amount of tax is referable to section 201 and the fact that the assessee did not file an application u/s 195(2) for determination of such appropriate proportion, is not relevant for the purpose. In any event, this is the only way the provisions contained in section 195 and section 201 can be harmoniously interpreted. We, therefore, hold that the power of the ITO u/s 201 to deem the person responsible for paying any sum to the non-resident u/s 195, as being in default, extends only to the proportion of income chargeable under the Act and forming part of the gross sum of money.

16. We have perused the judgment of the Calcutta High Court in Czechoslovak

Ocean Shipping International Joint Stock Co."s case (supra) relied on by the learned counsel for the revenue, and we do not find in that judgment any support for the view that, in the absence of an application u/s 195(2), the ITO is empowered to enforce deduction of tax from the gross sum of money. That is a case where the person responsible for making the payment required the ITO to furnish a "no objection certificate", required by the Reserve Bank of India for remitting certain sums of money to a non-resident. The ITO treated the application filed for "no objection certificate" as an application u/s 195(2) and proceeded to determine the appropriate proportion of income chargeable under the Act included in the gross sum. The High Court found fault with the order of the ITO on the simple ground that the application filed for a "no objection certificate" could not be treated as an application u/s 195(2) and, consequently, quashed the order passed by the ITO. That case is quite different on facts.

17. All that now remains to be said is that, in respect of the order passed by the ITO, concerning the payments made to Sacheron Works Ltd. in Reference Case No. 204 of 1978, the learned counsel for the revenue is right in his contention that both the AAC and the Tribunal fell into the error of thinking that the ITO's order in this case also followed the same pattern as in the case of Charmilles Engineering Works Ltd. and Oerlikon Engineering Company in Reference Case Nos. 203 and 205 of 1978, respectively. We have already shown that, pursuant to an application made by the Electricity Board, the ITO determined the appropriate proportion of income chargeable in the payments made to Sacheron Works Ltd., and required the Electricity Board to pay tax only in respect of that appropriate portion. Obviously, the ITO's order is in accordance with the provisions of section 195 and the AAC and the Tribunal were in error in cancelling the order of the ITO.

18. A word about the grossing up made by the ITO for purposes of determining the final amount of tax deductible at source u/s 195. The ITO observed that, in all these cases, the Electricity Board agreed to pay all the tax liabilities to the non-resident companies arising on account of the supply of materials and the execution of the erection and the commissioning of the equipment at Sileru. The ITO, therefore, held that the net payments made had to be grossed up to determine the tax following the decision of the Mysore High Court in *Tokyo Shibaura Electric Co. Ltd. (By Agents Radio and Electricals Mfg. Co. Ltd., Mysore) Vs. Commissioner of Income Tax, Mysore*, . The assessee has questioned the correctness of the grossing up in principle and the AAC as well as the Tribunal upheld the view that the payments made had to be grossed up. We have perused the orders in all the three cases to find out on what basis the grossing up has been made. There is no guidance in the orders of the ITO as to how the figure was arrived at. It is not known whether the ITO adopted the system of grossing up by working out tax on tax until he arrived at a round figure. If that was the basis followed, we do not think it is proper. The decision of the Orissa High Court in *Commissioner of Income Tax Vs. American Consulting Corporation*, sets out the correct principle on which grossing up should be done in cases like this. The

Orissa High Court held that, in a case where, under the contract, the tax that would be leviable on the profit in the hands of the non-resident was to be paid by the Indian company, the arrangement entered into between the non-resident and the Indian company did not admit of a system of tax-on-tax. What was available to be added under the contract was addition of that benefit which the non-resident had enjoyed by being free from the liability to income tax. In other words, the value of the benefit or perquisite, which arose to the non-resident by way of its tax liability having been met by the Indian company, had to be limited to the amount of actual tax due and the gross figure determined, accordingly. In the present case, the ITO himself clearly observed that, as per clause 13 of the agreements entered into with the nonresidents, the liability of the non-residents to pay income tax on the profit earned by them has to be discharged by the Electricity Board. Based on this covenant, the ITO would be justified in adding to the net payment made only the amount of tax payable by the nonresident and the tax deductible at source determined with reference to the gross figure arrived at as above. While passing an order conformably to our judgment in Reference Case Nos. 203 and 205 of 1978 the Tribunal will look into this question and determine the figures appropriately.

19. We have earlier stated that the question of law referred to in all these three references does not bring out the real controversy and the question has to be reframed. We, accordingly, reframe the question common to all the three references to bring out the real controversy as under:

Whether, on the facts and in the circumstances of the case, the Superintending Engineer, Civil Circle, Upper Sileru, is liable to deduct income tax u/s 195 of the income tax Act, 1961, in respect of payments made to nonresidents, viz., Charmilles Engineering Works Ltd., Sacheron Works Ltd. and Oerlikon Engineering Company and, if so, whether the tax deductible is liable to be determined on the gross sum of money paid to the non-residents?

Having reframed the question as above, we answer the same to the following effect:

1. The respondent-assessee, who made the payments to the three non-residents above referred, was under an obligation to deduct tax at source u/s 195 in respect of the sums paid to them under the contracts entered into.
2. The obligation of the respondent-assessee to deduct tax u/s 195 is limited only to the appropriate proportion of the income chargeable under the Act forming part of the gross sums of money paid to the three non residents above referred.
3. While the ITO was correct in the determination of tax u/s 195 in respect of the payments made to Sacheron Works Ltd. in Reference Case No. 204 of 1978, he was in error in determining the tax deductible u/s 195 in respect of the gross sums of money paid to Charmilles Engineering Works Ltd. in Reference Case No. 203 of 1978 and Oerlikon Engineering Company in Reference Case No. 205 of

1978.

20. Based on our above answers, we hold that the Tribunal was in error in cancelling the orders passed by the ITO u/s 201. While the order of the ITO passed in Reference Case No. 204 of 1978 concerning the payments made to Sacheron Works Ltd., should be upheld in toto, the orders passed by the ITO in respect of payments made to Charmilles Engineering Works Ltd. in Reference Case No. 203 of 1978 and Oerlikon Engineering Company in Reference Case No. 205 of 1978 have to be modified in the light of our above findings, and the Tribunal shall do necessary modification while passing orders conformably to our judgment u/s 260(1) of the Act.

21. We, accordingly, answer the three references. On the facts and in the circumstances of the case, we direct the parties to bear their own costs. Advocate's fee Rs. 500 in each of the references. The learned counsel for the respondent- assessee makes an oral request for the leave to appeal to the Supreme Court on the ground that the question regarding the deduction of tax at source u/s 195 from out of gross sums of money is a substantial question of law of general importance and this is also a fit case where leave to appeal to the Supreme Court should be granted u/s 261 of the Act. We consider that a substantial question of law of general importance does arise in these references and this is, therefore, a fit case for appeal to the Supreme Court. Leave granted, accordingly.