

Tax Hotline

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PROCEEDINGS AGAINST BHARTI AIRTEL FOR NON- DEDUCTION OF TAX BARRED BY LIMITATION

- In the absence of any limitation period prescribed in the statute, a reasonable period should be applicable for proceedings against non-deduction of tax for payments made to non-residents.
- Considering that the limitation period prescribed under s. 201(3) of the ITA was not brought about by way of a retrospective amendment, it did not overrule the ratio in *NHK Japan*, which prescribed a limitation period of 4 years for resident and non-resident deductees.
- An unending limitation period with respect to initiating proceedings against non-deduction of taxes would operate harshly on non-residents. Such a limitation period cannot be justified on the basis of easing administrative and revenue collection burdens on the Revenue.

Recently, the Delhi High Court in the case of *Bharti Airtel Ltd. and Anr. v. Union of India and Anr.*¹ held that proceedings in relation to non-deduction of tax at source on payments made to non-resident entities is barred by limitation which should be set at 4 years.

BACKGROUND

Bharti Airtel Limited ("**Taxpayer**"), a resident Indian entity, had engaged non-resident entities for providing services in relation to inter-connections. In doing so, some charges were accrued - which were paid by the Taxpayer to those foreign entities. The Taxpayer did not withhold taxes while making such payment. Accordingly, show cause notices were issued to the Taxpayer from the Revenue Department asking it to show cause as to why it should not be deemed to be an assessee-in-default as it made payments on account of interconnection charges to various foreign entities without deduction of tax under the Income Tax Act, 1961 ("**ITA**"). The show-cause notices were issued to the Taxpayer after considerable time had passed i.e. a notice on March 31, 2011 was issued for the financial years 2002 to 2011 and another notice on March 5, 2012 for the financial years 2002 to 2007.

ISSUE

The Taxpayer challenged these show-cause notices by way of a writ petition in the High Court of Delhi. The issue to be decided by the Court was whether the issuance of the show cause notice by the Revenue Department is barred by limitation.

In this context, it should be noted that prior to 2010, there was no limitation period under the ITA for issuance of show cause notice for non-deduction of taxes. In light of no express time limitation, the Delhi High Court in the case of *Commissioner of Income Tax v. NHK-Japan Broadcasting Ltd*² and *Commissioner of Income Tax v. Hutchison Essar Telecom Ltd*³ had set the limitation period at four years. The Finance Act 2009, however, amended the ITA to provide for a limitation period for residents ("**Amended Provision**") leading to an ambiguity on whether it would also be applicable to non-residents as well. Further, the statement of objects and reasons also did not provide for any explanation in respect of non-residents being left out from the limitation period that was prescribed. However, a circular issued by the Central Board of Direct Taxes stated that no time limit has been prescribed for non-residents "*as it may not be administratively possible to recover the tax from the non-resident*".

ARGUMENTS

The Taxpayer argued that in the absence of a prescribed time limit under the Amended Provision for non-resident deductees, the ratio in the case of *NHK- Japan* (Supra) should apply and initiation of proceeding for non-deduction of tax should be within a reasonable period of time. The Court in this case had come to this conclusion on the basis that the period of limitation for initiating proceedings must be the same as the period for completion of assessment as prescribed under the ITA.⁴ The Taxpayer also argued that the legislature consciously did not provide a limitation period for non-residents as it chose to not disturb the law laid down by the Court in the case of *NHK- Japan* (Supra).

The revenue, however, relied on *Bharat Steel Tubes Ltd. v. State of Haryana*⁵ and stated that the absence of any period of limitation in respect of non-resident remitters meant that the legislature made a conscious distinction between resident and non-resident beneficiaries, based on good reasons. It argued that there is sound rationale for such distinction because in the case of remittances to non-residents, the true nature of the transaction and whether deductions are to be made within the country or not cannot be easily gathered and therefore the legislature did not prescribe any time limit for exercise of powers in respect of such transactions. Further, it argued that *NHK- Japan* (Supra) was decided before the Amended Provision came into effect and therefore the decision did not examine the true import of the amended provisions.

RULING

The Court ruling in favour of the Taxpayer concluded that proceedings for non-deduction of withholding tax under the

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ITA should be initiated within a reasonable time period. While reaching this conclusion, the Court relied on its earlier decision in the case of *Vodafone Essar Mobiles Ltd.*⁶ The Court in the case of Vodafone had held that limitation period of four years as ruled in the case of *NHK Japan* (Supra) would continue to apply even after the amendment was brought into place. This is because if the intent of the legislature was to nullify the effect of the judgment it would have made the amendment retroactive in nature but since the amendment was prospective in nature the reasonable period of 4 years should continue to apply.

Further, the Court noted that the circular relied on by the Revenue which stated that no limitation has been provided for non-residents *as it may not be administratively possible to recover the tax from the non-resident* was outrightly rejected by the Court following the decision in the Supreme Court decision of *G.E. Technologies*,⁷ wherein the Court had held that administrative convenience (for not imposing a time limit) cannot outweigh the harsh nature of the consequences of unlimited period of time within which a proceeding for non-deduction of tax could be initiated. Accordingly, the Court upheld the decision in the cases mentioned above and held that a reasonable period of 4 years should continue to apply in respect of initiation of proceedings for non-deduction of tax under the ITA.

ANALYSIS

Needless to say that the judgment is welcomed so much so that it upholds the decision in the earlier cases on a long standing issue which has been debated time and again. In fact, considering that there are precedents on both sides, by dwelling into the Amended Provisions it provides more clarity to the issue. It needs to be considered that if a payment was made by a resident to a non-resident, there should be some certainty to such resident on the proceedings that may be initiated by the Revenue Department for non-deduction of tax. By not having a time limitation on such proceedings, the fear of proceedings will always loom over the resident taxpayer which will tend to create a regressive environment. Additionally, the question that will also need to be answered is for how long should the resident deductor continue to maintain relevant documents i.e. tax returns, books of accounts etc. in relation to the transaction if no time limitation is specified. This again would cause undue hassle and stress to the resident deductor.

The taxpayers of the country have been rooting for a trust based taxation system. It is imperative that certainty, fairness and stability should continue to serve as guiding principles and not the amount of tax that can be collected. It is necessary to guarantee and enforce internationally recognized taxpayer rights and safeguards to counter excessive discretion and corruption. In that sense, keeping the doors open for scrutiny and not providing for a period of limitation in such cases compromises on the certainty and trust sought by taxpayers.

– Afaan Arshad & Ashish Sodhani
You can direct your queries or comments to the authors

¹ W.P.(C) 2166/2012
² 2008 (305) ITR 137 (Del)
³ [2010] 323 ITR 230 (Delhi)
⁴ Section 147/148 and 153 of the Income Tax Act.
⁵ 70 STC 122 (SC)
⁶ (385) ITR 436 (Del).
⁷ 2010 (10) SCC 29.

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