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Tax Flash News

3 March 2025

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Limitation period prescribed by a CBDT circular is unsustainable when none existed in the Act

Executive summary

The Income-tax Act, 1961 ('the Act') allows the CBDT[1] to issue instructions or guidelines to relax certain provisions and to accept an application for exemption, deduction, refund even when the specified period under the Act has expired, in certain situations.

In 2007, the CBDT issued a circular outlining the procedure for refund of tax deducted from payment to non-residents in certain situations. This circular also imposed a two-year limitation period for submitting refund claims, despite the absence of such a limitation in the Act.

The Delhi High Court in the case of *Sun Pharmaceutical*[2] held that the CBDT could not impose a limitation period when none existed in the Act and accordingly, the circular was *ultra vires* the Act.

Additionally, the Court held that the interest paid to a non-resident was not taxable in India if the borrowed funds were used exclusively for investment in an overseas subsidiary.

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[1] Central Board of Direct Taxes

[2] *Sun Pharmaceuticals Industries Ltd v.* ITO [2025] 171 taxmann.com 469 (Delhi)

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Facts of the case

An Indian company had borrowed funds from outside India which were used for the purposes of equity infusion in its overseas wholly owned subsidiary and to expand the global business operations.

During the financial years 2010-11 to 2012-13, the Indian company paid interest to various bondholders and banks without deducting tax at source (TDS). However, out of abundant caution, it deposited the TDS amount with the government after grossing up the interest paid, thereby absorbing the TDS cost.[3]

Subsequently, in 2014, the Indian company took the position that the payments were not chargeable to tax in India by virtue of specific exclusion in the relevant section of the Act and thus, no tax was required to be deducted from such payments.

Accordingly, the Indian company filed revised TDS returns, claiming a refund for the tax deposited. Formal applications were also filed before the tax officer seeking a refund of the tax deducted.

In 2018, the tax officer rejected the refund claim on the grounds that:

(a) the payment did not qualify for the exclusion and thus, was chargeable to tax in India.

(b) The applications were barred by the limitation period of two years as prescribed in the CBDT circular.[4]

The Indian company challenged the rejection order through a writ petition, arguing that the time limitation imposed by the CBDT circular was *ultra vires* the Act.

Relevant provisions

<u>Chargeability of interest payment</u>

Interest payable by an Indian resident to a non-resident is taxable in India. However, there is an exclusion which provides that such interest is not taxable if it is payable in respect of debt incurred, or money borrowed and used for the business carried out by that resident outside India or for earning an income from any source outside India.[5]

[3] Under section 195 of the Act

[4] Paragraph 9 of CBDT Circular No. 7/2007, dated 23 October 2007

[5] Section 9(1)(v)(b) of the Act

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Period of limitation

In 2007, the CBDT issued a circular outlining the procedure for refund of tax deducted from payment to non-residents, in certain situations to the person deducting the tax at source. It also stipulates that claims for such refunds must be made within two years from the end of the financial year in which the tax was deducted at source.

Taxpayer's contention

Chargeability of interest payment

The investment and infusion of funds in the overseas subsidiary was unquestionably connected with the business which the Indian company undertook overseas in the expectation of deriving income in the shape of dividend or profits from those ventures.

Relying on the Supreme Court decision in the case of *S.A. Builders*[6], the Indian company argued that the phrase 'for the purposes of business' should be interpreted through the lens of commercial expediency, acknowledging the significant interest a parent company may have in its subsidiary.

No part of the borrowed funds was used in connection with the operations of the Indian company in India. Accordingly, the interest paid should fall within the exclusion clause, making it non-taxable in India.

Period of limitation

The limitation set by the circular is unsustainable absent any such limitation in the Act and thus, is *ultra vires* the Act itself. The period of limitation introduced by the CBDT is beyond its jurisdiction.

Previous circulars[7] issued before the 2007 circular did not impose any limitation period. The basic intent of the 2007 circular was to establish a procedure, based on the representations received, for the refund of taxes which had been wrongly or incorrectly deducted and to facilitate the refund of all amounts which did not represent tax.

Previously, sub-section 2 of section 239 specified the time limit within which the refund of excess TDS can be claimed. The omission of that sub-section from the Act (by the Finance (No. 2) Act, 2019)[8] reflects the legislative intent to eliminate rigid timelines for refund claims.

[6] *S.A. Builders Ltd*. v. *CIT* [2007] 288 ITR 1 (SC)

[7] Circular Nos. 769/1998 and 790/2000

[8] W.e.f. 1 September 2019

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Revenue's contentions

Chargeability of interest payment

The Indian company was engaged in the business of manufacturing and trading of pharmaceuticals and was not an investment company. The interest cannot be viewed as incurred for a business carried on outside India and thus did not qualify for the exclusion.

The Revenue relied on the decision in the case of *Havells India*[9] to argue that since the business entity was based in India, the interest should be taxable in India.

Period of limitation

The refund applications were time-barred as per the CBDT circular, which prescribes a two-year limitation for refund claims.

Decision

The High Court quashed the tax officer's rejection order and directed to process the refund applications..

Chargeability of interest payment

The interest payments were incurred for business carried on outside India and fell within the exclusion clause.

Referring to the Supreme Court decision in *S.A. Builders*, the High Court held that a holding entity has a vested interest in the business prospects and performance of a related entity. Advances or liabilities undertaken are considered commercially expedient unless they involve illegal fund diversion.

In the instant case, the money borrowed was used solely for the benefit of an overseas subsidiary. The income is anticipated to arise from activities of the overseas subsidiary, indicating that the investment was driven by the expectation of earning income from a source outside India.

Period of limitation

In the absence of a specific provision in the Act, the two-year limitation period prescribed under the circular *was ultra vires* the Act and beyond the CBDT's powers which the Act confers upon it, making the circular's restriction unsustainable.

[9] *CIT v. Havells India Ltd* [2012] 21 taxmann.com 476 (Delhi)

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Section 119 of the Act empowers the CBDT to facilitate the management of tax assessment and collection. The Act enable the CBDT to relax or extend statutory periods and requirements, emphasising flexibility rather than imposing restrictions. The language of section 119 highlights the CBDT's power to adapt statutory prescriptions to aid taxpayers and not to extinguish a claim or a right.

A circular made in exercise of powers conferred by section 119 could have neither curtailed nor erased a right for refund or extinguish a claim for refund of tax erroneously deposited and that too by prescribing periods of limitation when none existed in the statute.

The omission of section 239(2) is demonstrative of the clear legislative intent to avoid prescribing strict limitation periods within which refund applications may be preferred. This is particularly relevant considering various CBDT circulars providing that tax mistakenly deducted should not be regarded as a lawful collection of a levy authorised by law.

The High Court, after examining the provisions of indirect tax laws[10] that explicitly set a time limit for filing refund applications, determined that when these laws are compared with the provisions of the Act, which does not specify any time restriction for such claims, it becomes evident that the Act does not intend to impose specific constraints on the timeframe for submitting a TDS refund application.

Prescribing a period of limitation is a legislative function. In the case of *Bharat Barrel,*[11] the Supreme Court held that unless the statute itself were to fix a period within which an action may be initiated or instituted, there is no general law which governs the issue of limitation.

Applying the decision in the case of *Vikram Singh*[12], the Court reaffirmed that the CBDT lacks the authority to establish mandates or instructions that conflict with the boundaries of the relevant statutory provision.

Our comments

This decision reaffirms that while administrative circulars are allowed to relax or extend statutory periods and requirements, they must not impose any restrictions that are not explicitly defined in the Act. This distinction is crucial in protecting the integrity of legislative intent and ensuring fair administrative practices.

[10] Central Goods and Services Tax Act, 2017 and Central Excise Act, 1944

[11] *Bharat Barrel and Drum MFG. Co. Ltd. And Another* v. *The Employees State Insurance Corporation* (1971) 2 SCC 360

[12] *Vikram Singh* v. *UOI* [2017] 394 ITR 746 (Del)

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