IN THE HIGH COURT OF JUDICATURE AT BOMBAY

O. O. C. J.

WRIT PETITION NO.404 OF 2010

Dedicated Health Care Services TPA
(India) Pvt. Ltd. and others ..Petitioners.

Vs.

Assistant Commissioner of Income Tax and
others ..Respondents.

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Mr. R.A. Dada, Senior Advocate with Mr. Jitendra Jain, Ms. M. Dada and Ms. Farnuaz Karbhari i/b RES Legal for the Petitioners.

Mr. B.M. Chatterji with Mr. Yogesh Patki i/b Mr. Suresh Kumar for the Respondents.

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CORAM : DR. D.Y.CHANDRACHUD &
J.P. DEVADHAR, JJ.

3 May, 2010.

ORAL JUDGMENT (Per DR.D.Y.CHANDRACHUD, J.):

1. Rule, by consent returnable forthwith. With the consent of Counsel and at their request the Petition is taken up for hearing and final disposal.

2. The issue which falls for determination in these proceedings

relates to the construction of the provisions of Section 194-J of the Income Tax Act, 1961. Petitioners 1 to 5 are companies registered under the Companies Act, 1956 and provide services to holders of health insurance policies issued by insurance companies licensed by the Insurance Regulatory and Development Authority of India (IRDA). Petitioners 1 to 5 are registered with IRDA under the Third Party Administrator Health Services Regulations 2001 framed under the provisions of Sections 14 and 26 of the Insurance Regulatory and Development Act read with Section 114 A of the Insurance Act. The Sixth Petitioner is a trust registered under the Indian Trust Act 1882 and has been constituted by Third Party Administrators (TPAs). TPAs enter into agreements, described as service level agreements, with insurance companies. The insurance companies issue health insurance policies which are serviced by the TPAs who act as facilitators. Under the service level agreements, the TPA is obligated to perform various services for policyholders. A specimen of a service level agreement which is relied upon in the proceedings contains a recital to the effect that the TPA is engaged in making available health

and support services and that the insurer and the TPA have agreed that the latter shall provide to customers of the insurer health care services for a fee. The services which are provided inter alia include hospitalization services, cashless access services, billing services and call center services. Each TPA as a facilitator of the insurance company provides services in connection with the settlement of claims, processing of claims received from policyholders / hospitals and making payment thereafter, after allowing for cashless hospitalization. All claims payable by the insurance company to the policyholder are paid through the TPA from a Claim Float Account (CFA) provided by the insurance company. In order to facilitate cashless hospitalization, the TPA enters into a memorandum of understanding with individual hospitals and medical aid providers.

3. The issue which arises in the present case is whether, while making payments to hospitals TPAs are required to deduct tax at source under the provisions of Section 194-J. The relief that has been sought in these proceedings is (i) A declaration that the provisions of

Section 194-J are not applicable to payments made by the Petitioners to hospitals under the cashless hospitalization scheme; (ii) Setting aside of a circular dated 24 November 2009 (circular 8/ 2009) issued by the Central Board of Direct Taxes; (iii) A mandamus directing the Respondents to drop all proceedings initiated for non deduction of tax at source under Section 194-J on payments made to hospitals under the cashless hospitalization scheme, and reliefs ancillary thereto.

4. An affidavit in reply has been filed in these proceedings by the Assistant Commissioner of Income Tax, TDS-2(2) in which it has been stated that in pursuance of notices that were issued to Petitioners 1 to 5 the First Respondent has passed orders under Section 201(1) of the Act holding them liable to deduct tax at source under Section 194-J. The Revenue has submitted that these orders are subject to an appeal before the Commissioner (Appeals) under Section 246-A. It has also been stated before the Court that various hospitals have applied under Section 197 seeking a certificate for a

lower deduction of tax in respect of different types of income earned by the hospitals. In one such instance, the Jaslok Hospital and Research Center is stated to have applied under Section 197 and in Schedule 11 furnished a list of persons, including the name of the First Petitioner. On this basis, it has been urged that the hospitals are treating payments made by the TPAs to them as professional fees and are seeking a certificate for a deduction of tax at a lower rate. In response to the submission of the Revenue, it has been stated on behalf of the Petitioners during the course of the hearing that against the orders passed under Section 201, appeals have been filed before the Commissioner (Appeals). However, the Petitioners have pressed their challenge in these proceedings since they seek a resolution of the issue of interpretation of Section 194-J and since, according to them, the issuance of a circular by the Central Board of Direct Taxes amounts to an interference with the quasi judicial powers of assessing authorities under the Act.

5. Counsel appearing on behalf of the Petitioners submits that

(i) Section 190 forms a part of Chapter 17 which deals with the collection and recovery of tax. Sub section (1) of Section 190 provides that tax on income shall be payable by deduction or collection at source or by advance payment, in accordance with the provisions of the Chapter, notwithstanding that the regular assessment in respect of any income is to be made in a later assessment year ; (ii) Section 194-J applies where any person (not being an an individual or a Hindu Undivided Family) is responsible for paying to a resident any sum by way of fees for professional services. The expression "professional services" is defined by the Explanation to mean services rendered by a person in the course of carrying on inter alia the medical profession; (iii) Under Section 194-J the payee must carry on the medical profession or any of the other professions as stipulated therein; (iv) The hospital to whom payments are made by the TPAs does not carry on the medical profession. For Section 194-J to apply, the payee must render service in the course of carrying out the medical profession and must receive a fee in that regard; (v) The provisions of Section 44 AA, Section 80-IB (11B) and

Section 88A are pressed in aid in support of the interpretation that the payee who is in receipt of the payment must be rendering services in the course of carrying on the medical profession. The submission is that the hospitals to whom payments are made by TPAs do not carry on the medical profession which only an individual can carry on and that consequently such payments are not subject to a deduction of tax at source under Section 194-J.

6. On the other hand, counsel appearing on behalf of the Revenue urges that (i) The Petitioners provide services within the meaning of Section 194-J under their own service level agreements and agreements with hospitals under the Health Service Regulations 2001 framed under Sections 14 and 26 of the Insurance Regulatory Development Authority Act read with Section 114 of the Insurance Act 1938; (ii) The expression "person" in Section 194-J include entities such as the Petitioners who make payments to hospitals on behalf of insurance companies; (iii) The hospitals have applied for a no deduction certificate under Section 197; and (iv) The hospitals

provide medical services and any interpretation to the contrary would result in absurd consequences; (v) Parliament excluded individuals and Hindu Undivided Families from the responsibility of deducting tax at source while making payments. However, in defining the character of the payee, Parliament used the expression "person" which in Section 2(31) includes an artificial entity. Hence to hold that Section 194-J would apply only to payments received by an individual or a firm as a payee would be to restrict the ambit of the Section by adding words of restriction. This would be impermissible.

7. Sub section (1) of Section 194-J provides as follows :

> 194J. (1) Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way of -
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> (a) fees for professional services, or
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> (b) fees for technical services, or
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> (c) royalty, or
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> (d) any sum referred to in clause (va) of section 28.
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> shall, at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to ten percent of such sum as income tax on income comprised therein.

Explanation (a) to the provision is as follows :-

> "(a) "professional services" means services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the Board for the purposes of section 44AA or of this section."

8. The substantive part of Section 194-J requires a deduction of an amount equal to 10% where any person, not being an individual or a Hindu Undivided Family is responsible for paying to a resident any sum inter alia by way of fees for professional services. The deduction has to be made at the time of the credit of such sum to the account of the payee, or at the time of payment whichever is earlier. Sub section (1) of Section 194-J uses three expressions viz. (i) person; (ii) individual; and (iii) resident. Parliament having used three separate expressions in the same provision, this must be construed as being done with a sense of deliberateness. In defining the character of the payer Parliament has referred to any person not being an individual or a Hindu Undivided Family. The liability to make a deduction is not attracted where the payer is either an individual or a Hindu Undivided Family. The character of the payee is, on the other

hand, referred to as a resident to whom the payer is responsible for paying any sum by way of fees for professional services.

9. The expression "person" is defined in Section 2(31) to include (i) an individual; (ii) a Hindu Undivided Family; (iii) a company; (iv) a firm; (v) an association of persons or a body of individuals whether incorporated or not; (vi) a local authority and (vii) every artificial juridical person not covered in the previous clauses. The expression "resident" is defined in Section 2(42) to mean a person who is resident in India within the meaning of Section 6. Section 6 prescribes the conditions subject to which an individual under sub section (1); a Hindu Undivided Family under sub section (2); a company under sub section (3); and every other person under sub section (4) can be treated as being a resident of India in any previous year. Consequently, by virtue of the definition of the expression "resident" in Section 2(42) read with Section 6 it is evident that the expression is not confined to a natural person.

10. The Explanation to Section 194-J stipulates that for the purposes of the Section professional services means services rendered by a person in the course of carrying on inter alia the medical profession. Conscious as it was of the use of the expressions person, individual and resident in sub section (1) of Section 194-J, Parliament has not used the expression "individual" in clause (a) of the explanation, but has used the expression "a person". Professional services are defined to mean services rendered by a person in the course of carrying on the medical or other professions.

11. The submission which has been urged on behalf of the Petitioners is that the medical profession or, for that matter, any other profession that is adverted to in Clause (a) of the Explanation can only be carried on by an individual. Consequently, it has been urged that a hospital cannot be regarded as carrying on the medical profession and hence, payments made by TPAs to a hospital cannot be treated as fees for professional services. Now it needs to be emphasised that while defining the expression "professional services"

Parliament has not defined the expression to mean services rendered by an individual who carries on the legal, medical, engineering or architectural profession or any of the other professions listed in the clause. If Parliament intended to restrict the ambit of Explanation (a) only to fees received by an individual in the discharge of his or her duties as a professional, it was open to Parliament to use words that would be indicative of that position. In fact as noted earlier, while defining the character of the payer Parliament specifically excluded an individual and a Hindu Undivided Family from the purview of the expression of the person who is liable to deduct tax at source and a portion of the payment which is made to the payee. Hence, there are three circumstances, while construing the provisions of Section 194-J, that would weigh in determining the interpretation of the provision. Firstly, in defining the character of the person who is to make the payment and whose obligation it is to deduct tax at source, Parliament has excluded from the ambit of the expression "any person" an individual and a Hindu Undivided Family. Secondly, in defining the character of the payee under the substantive part of

Section 194-J Parliament has used the wider expression "resident". Thirdly, in terms of explanation (a), the words "services rendered by a person in the course of carrying on" have to be given a meaning. These words include service rendered which is incidental to the carrying out of a profession which is listed therein. The consequence of the submission which has been urged on behalf of the Petitioners would now have to be tested. Following the submission to its logical conclusion, when a doctor runs a nursing home, Section 194-J would apply in respect of payments made by any person who is not an individual or a Hindu Undivided Family for professional services. However, Section 194-J would, as a consequence of that submission, have no application where a corporate body runs the hospital. As a matter of interpretation, there is no reason to postulate that Parliament would have intended such a result. There can be no gain saying the fact that a hospital provides medical services. As a matter of fact, a hospital provides an umbrella of services and for making those services available engages the services of doctors and qualified medical professionals. The fact that the services are institutionalized

at a hospital which provides medical services should make no difference to the applicability of the provision of Section 194-J. The services which are provided continue to be services rendered in the course of carrying on the medical profession. These are medical services institutionally provided by the hospital, in the course of the carrying on of the medical profession.

12. Now undoubtedly a hospital by itself, being an artificial entity, or a corporate enterprise which conducts the hospital is not a medical professional. In **Dr. Devendra M. Surti v. The State of Gujarat**[1] the Supreme Court held that "a professional activity must be an activity carried on by an individual by his personal skill and intelligence". The Supreme Court in that case was construing the provisions of Section 2(4) of the Bombay Shops and Establishments Act, 1948 which defined the expression "commercial establishment". In that case, a doctor who was running a dispensary was convicted for an offence under Section 52(e) read with Section 62 of the Act and of the Rules. The Supreme Court while allowing the appeal

1 AIR 1969 SC 63. (at paragraph 7 page 67)

against the order of conviction held that the case of the appellant did not fall within the purview of the Act, more specifically Section 2(4). The Gujarat High Court similarly had occasion to follow this principle in its decision in **Commissioner of Income Tax v. Dr. K.K. Shah**[2] while holding that where both spouses were doctors, lawyers or architects, and form a partnership for the purpose of carrying on a professional activity, their income would not be liable to be clubbed together under Section 64(1)(i). The Gujarat High Court held that for this purpose, if the spouses were to carry on the activity of a nursing home as part of their professional activity for treating their own patients, the income from the nursing home could be treated as their professional income which was not liable therefore to be clubbed. However, if a business activity was carried on by the firm such as the running of a drug store, such income would partake of a business activity and would hence be liable to be clubbed. While applying the principle enunciated in **Dr. Shah**'s case, it is necessary to note that the Explanation to Section 194-J provides a definition of the expression "professional services" only for the purposes of the Section.

2 (1982) 135 ITR 146.

Parliament must be attributed to be cognizant of the fact that the pursuit of a profession is, as noted by the Supreme Court, an activity carried on by an individual through the application of personal skill and intelligence. Despite this, when it imposed an obligation under Section 194-J to deduct tax, Parliament imposed that obligation on any person (not being an individual or a Hindu Undivided Family) who is responsible for paying to a resident any sum by way of fees for professional services and the expression "professional services" has been defined to mean services rendered by a person in the course of carrying on inter alia the medical profession. Where the provision of medical services takes place within the institutional framework of a hospital, services are rendered as part of an umbrella of services provided by the hospital which engages qualified medical professionals who practise the medical profession. These are services rendered in the course of the carrying on of the medical profession. Hence, it is not possible to accept the submission that TPAs, when they make payments to hospitals are not liable to deduct tax at source under the provisions of Section 194-J. Section 197(1) of the Act

provides that where in the case of any income of any person or sum payable to any person income tax is required to be deducted at the time of credit or, as the case may be, at the time of payment at the rates in force under the provisions inter alia of Section 194-J and the Assessing Officer is satisfied that the total income of the recipient justifies a deduction of income tax at lower rates or no deduction of income tax, the Assessing Officer shall on application made by the assessee in this behalf give to him such certificate as may be appropriate. Where a certificate to that effect is given, then under sub section (2) the person responsible for paying the income tax shall so long as the certificate remains valid deduct income tax at the rates specified in the certificate or deduct no tax, as the case may be. It would be open to any hospital, if it is so advised, to make an application under the provisions of Section 197 for the deduction of tax at a lower rate or, as the case may be, for no deduction of tax as for instance when the hospital itself is exempted under the provisions of Section 10(23C) of the Act. Such applications, as the affidavit in reply discloses, have already been made.

13. The Petitioners have also called into question the validity of a circular issued by the Central Board of Direct Taxes, being Circular 8/2009 dated 24 November 2009. Paragraphs 3, 3.1 and 4 of the circular are to the following effect :

> "3. The services rendered by hospitals to various patients are primarily medical services and, therefore, provisions of 194-J are applicable on payments made by TPAs to hospitals etc. Further for invoking provisions of 194-J, there is no stipulation that the professional services have to be necessarily rendered to the person who makes payment to hospital. Therefore TPAs who are making payment on behalf of insurance companies to hospitals for settlement of medical /insurance claims etc. under various schemes including cashless schemes are liable to deduct tax at source under section 194-J on all such payments to hospitals etc.
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> 3.1 In view of above, all such past transactions between TPAs and hospitals fall within provisions of Section 194-J and consequence of failure to deduct tax or after deducting tax failure to pay on all such transactions would make the deductor (TPAs) deemed to be an assessee in default in respect of such tax and also liable for charging of interest under Section 201(1A) and penalty under Section 271C.
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> 4. Considering the facts and circumstances of the cases of TPAs and insurance companies, the Board has decided that no proceedings u/s 201 may be initiated after

> the expiry of six years from the end of financial year in which such payment have been made without deducting tax at source etc. by the TPAs. The Board is also of the view that tax demand arising out of Section 201(1) in situations arising above, may not be enforced if the deductor (TPA) satisfies the officer in charge of TDS that the relevant taxes have been paid by the deductee assessee (hospitals etc.). A certificate from the auditor of the deductee assessee stating that the tax and interest due from deductee assessee has been paid for the assessment year concerned would be sufficient compliance for the above purpose. However, this will not alter the liability to charge interest under Section 201 (1A) of the Income Tax Act till payment of taxes by the deductee assessee or liability for penalty under Section 271C of the Income Tax Act as the case may be."

14. Section 119 of the Act provides that the Board may, from time to time issue such orders, instructions and directions to other income tax authorities as it may deem fit for the proper administration of the Act and that such authorities and all other persons employed in the execution of the Act shall observe and follow such orders, instructions and directions of the Board. The proviso to sub section (1) however stipulates that no such orders, instructions or directions shall be issued (a) so as to require any income tax authority to make a particular assessment or to dispose of a particular

case in a particular manner; or (b) so as to interfere with the discretion of the Commissioner (Appeals) in the exercise of his appellate functions. The Board has by the circular taken the view that payments which are made by TPAs to hospitals fall within the purview of Section 194-J. No exception can be taken to the circular to that extent, consistent with the interpretation placed on the provisions of Section 194-J in the course of this judgment. However, the grievance of the Petitioners is that the circular proceeds to postulate that a liability to pay a penalty under Section 271-C will be attracted for a failure to make a deduction under Section 194-J. Section 273-B of the Act provides that notwithstanding anything contained in the provisions inter alia of Section 271-C no penalty shall be impossible on the person or the assessee, as the case may be, for any failure referred to in the provision if he proves that there was a reasonable cause for the failure. The vice in the circular that has been issued by the Central Board of Direct Taxes lies in the determination which has been made by the Board that a failure to deduct tax on payments made by TPAs to hospitals under Section

194-J will necessarily attract a penalty under Section 271-C. Besides interfering with the quasi judicial discretion of the Assessing Officer or, as the case may be, the appellate authority the direction which has been issued by the Board would foreclose the defence which is open to the assessee under Section 273-B. By foreclosing a recourse to the defence statutorily available to the assessee under Section 273-B, the Board has by issuing such a direction acted in violation of the restraints imposed upon it by the provisions of sub section (1) of Section 119. To that extent, therefore the circular that was issued by the Board would have to be set aside and is accordingly set aside. We also clarify that in making assessments or, as the case may be, in passing orders on appeals filed under the Act, the Assessing Officers and the Commissioner (Appeals) shall do so independently and shall not regard the exercise of their quasi judicial powers as being foreclosed by the issuance of the circular.

15. For the aforesaid reasons, rule is made absolute partly in the aforesaid terms and to the extend noted herein above.

16. In the circumstances of the case, there shall be no order as to costs.

At the conclusion of the judgment, learned senior counsel appearing on behalf of the Petitioners has requested the Court to stay the operation of the judgment to enable the Petitioners to seek recourse to their remedies in appeal. There shall be a direction to the effect that no coercive steps shall be taken to enforce the outstanding dues, if any, against the Petitioners for a period of eight weeks from today.

(Dr. D.Y.Chandrachud, J.)

(J.P. Devadhar, J.)