

Controversies

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Whether interest paid u/s 234B is allowable as business expenditure?

Issue:

XYZ Ltd. did not pay advance tax and hence it was required to pay interest u/s 234B of the Income Tax Act 1961. XYZ Ltd. claims that such interest is compensatory in nature and hence it is required to be allowed as business expenditure.

Proposition:

It is proposed that interest paid u/s 234B can not be called penal interest and hence it can not be disallowed either u/s 40(a)(ii) or u/s 37, The levy of interest can not be regarded as a penalty in as much as the same is by way of compensation and not by way of penalty.

View Against the Proposition:

It is submitted that interest paid u/s 234B is certainly penal interest and the same has to be disallowed while computing the business income, the interest is nothing but part and parcel of liability to pay Income Tax. Since Income Tax paid by the assessee is not a permissible deduction in view of section 40(a)(ii) the interest paid for delay in payment of tax would also not be permissible deduction as the interest would take the color of the original amount liable to be paid as Income Tax.

Let me now refer to section 40(a)(ii).....

“Section 40- Amounts not deductible “

Not with standing Section 30 to 38, the following amounts are not allowed as deduction in computing the income under the head “Profit and gain of business or profession”.....

- (ii) “Any sum paid on account of any rate or tax levied on the profit or assessed in relation to such profit.”

It is submitted that Interest u/s. 234A, 234B and 234C being regarded as accretion to Income Tax, are not deductible. Reference may be made to decision of Gauhati High Court in case of Assam Forest Products (P)Ltd. vs. CIT (180 ITR 478). Even Foreign Income Tax would

not be allowed as deduction. Reference may be made to the decision of Madras High court in case of CIT vs. Indian Overseas Bank Ltd. (50 ITR 725). However interest tax would be allowed as deduction.

Let me further submit as under:

- a) The payment of interest under section 139,215 and 217 are payments out of profits and not expenditure for earning profit;
- b) Such interest is not trading loss which could be taken into account under section 28 under ordinary commercial principles; and
- c) Such interest is—
 - (i) Not incurred for reducing liability to tax but, in fact, increased it,
 - (ii) Not incurred for preserving the business.
 - (iii) Not incurred as interest on capital borrowed for the business.
 - (iv) Not incidental to business as they related to a liability to which all assesses were exposed whether they did business or not, and
 - (v) Is penal in nature.

It is submitted that:

Payment of income-tax is not deductible as business expenditure under the provisions of section 40(a)(ii) of the Income tax Act, 1961. It is clear from the language of section 139(8) of the Act that the interest charged under this provision is an accretion to the amount of tax found payable on the total income as determined on regular assessment. Due to failure to file return in time, the Revenue lose the amount of tax due as per the return and so by charging interest, it enlarges its receipt, i.e., augments the amount of tax. In so far as interest levied by sections 215 and 217 of the Income-tax Act,1961, is concerned, that has a direct connection with the amount payable as advance tax by charging interest on which the corpus of the tax amount is enlarged. So, in all these three cases, interest paid has to be regarded as part and parcel of the liability to pay tax. Since any sum paid on account of tax is not



deductible under section 40(a)(ii), interest paid under sections 139,215 and 217 are also not deductible as business expenditure.

It is important to refer to the decision of their lordships of Gauhati high court in the case of ASSAM FOREST PRODUCTS (P.) LTD. V/s COMMISSIONER OF INCOME TAX. Reported in 180 ITR 479. It is held by their lordships as under:

“We may add that though from what has been stated in Mahalakshmi’s case [1980] 123 ITR 429 (SC) it is not explicit whether payment of cess itself was a deductible expenditure but the same being an expenditure laid out by the mill wholly and exclusively for the purpose of business was definitely covered by section 37 of the Act. Now, if cess is a deductible expenditure, as we think to be, interest paid on arrear of cess under section 3(3) of the relevant act has also to be regarded as a deductible expenditure in the context of the view taken about the interest payable on arrear of cess under section 3(3) of the relevant Act. But as the amount of income-tax paid is not deductible under the Act in view of what has been stated in section 40(a)(ii), interest on it would also not be deductible.

ShriBhattacharjee has also referred in this connection to Rajasthan central Stores (P) ltd. v. CIT[1985] 156 ITR 90 (raj) in which payment of interest on the failure of the assessee to remit the sales tax to the government account within time was held to be permissible deduction. This view was taken following, inter alia, the decision in mahalakshmi Sugar Mills Co.’s case [1980] 123 ITR 429 (SC). The bench deciding the case regarded the interest payable under the relevant Sales tax Act as not much different from the interest payable under section 3(3) of the U.P. Sugarcane Cess Act which had come for consideration in Mahalakshmi Sugar Mills co’s case [1980] 123 ITR 429 (SC), which was followed in balrampur Sugar Co. Ltd v. CIT [1982] 135 ITR 227 (Cal) and Triveni Engineering Works Ltd. v. CIT [1983] 144 ITR 732 (All) [FB]. As the payment of sales tax which was under consideration in rajasthan’s case [1985] 156 ITR 90 (Raj) and for that matter, other taxes coming up for consideration in the Calcutta and Allahabad cases were held as deductible expenditure, the interest paid on the same was also regarded as revenue expenditure deductible under section 37(1) of the Act. But these decision cannot

assist the assessee as payment of income tax is not deductible as per section 40(a)(ii) of the Act and so interest under sections 139,215 and 217 which have to be regarded, for reasons given, as accretion to tax, cannot also be allowed to be deducted.”

View in favour of the Proposition:

It is submitted under the advance tax scheme, an assessee who earns income in a particular year is required to pay tax in that financial year. Section 234B applies to situations where there is a default in payment of advance tax. But it would only apply where there is a liability upon the assessee to pay the advance tax in that year and if he has failed to do so. Section 208 of the said Act clearly stipulates that advance tax is payable during the financial year. Section 209 also indicates that it must be paid in that year.

Let me refer to the decision of Supreme Court in the case of CIT v. Pranoy Roy and Another “The assessee, being further aggrieved, filed a writ petition in the High Court of Delhi which has been disposed of by the impugned order. The High Court, while accepting the writ petition and setting aside the interest charged under section 234A of the Act, has come to the conclusion that interest is not a penalty and that the interest is levied by way of compensation to compensate the revenue in order to avoid it from being deprived of the payment of tax on the due date.”

The Honorable Karnataka High Court in the matter of CIT vs. Oriental Insurance Co. Ltd. 183 Taxman 186 has held that section 201 [1A] is a provision to levy interest for delayed payment for TDS and hence it is compensatory in the nature. Similarly, for refunds, the revenue pays interest to the assessee. Therefore, the levy of interest under section 201(1A) cannot, at any rate, be construed as penalty. Hence, it will be of immense use to rely on this case regarding the allowance of the interest on the late payment of TDS. Hence interest on late payment of TDS is allowed. No provision in act says interest under 201(1A) is disallowed.

Summation:

It is interesting to refer to the direct Judgment on the issue of Deduction of interest U/s 234B as Business Expenditure. The reference is CIT vs. AnandPrakash reported in 316 ITR 141 (dehli). The Lordships of Delhi High Court held as under.

“We Have examined the decisions cited by the counsel on both sides and after considering the submissions made by them, we agree with the learned counsel for the revenue that the levy under section 234B of the said Act is compensatory in nature and is not in the nature of penalty. We may also note the decision of the Bombay High Court in case of CIT v. Kotak Mahendra Finance Ltd: 265 ITR 119(Bom), wherein the Bombay High Court observed that it was well settled that interest under section 234B was compensatory in Character and that it was not penal in nature. Another Decision which would be relevant is of a Division Bench of this court in the case of Dr. Prannov Roy vs. Commissioner of Income-tax and another : 254 ITR 755 (Del.). In that case, the provisions of Section 234A were in issue. The Question before the court was whether interest could be charged under Section 234A when, though the return had not been filed in time, the tax had been paid. The argument raised on behalf of the Revenue that such payment of tax did not strictly comply with the meaning of advance tax and would therefore, have to be disregarded for the purposes of charging interest under section 234A, was rejected. The *Court also held that interest under section 234A was compensatory in nature and unless any loss was caused to the Revenue, the same could not be charged from the assessee. It may be relevant to point out that the matter was taken up in appeal before the Supreme Court and By Its decision dated 17.09.2008 in CIT vs. Prannov Roy /Civil ‘Appeal No.448/2003L the Supreme Court noted that; “ the High Court, while accepting the writ petition and Setting aside the interest charged under section 234A of the Act, has come to conclusion that interest is not a penalty and that the interest is levied by way of compensation to compensate the revenue in order to avoid it from being deprived of the payment of tax on the due date.

“Having heard counsel on both the sides we entirely agree with the finding recorded by the High Court as also the interpretation of Section 234’A of the Act as it stood at the relevant time.”

12. Coming back to the present appeals, we are of the view that Section 234A, Section 234B and Section 234C are of the same class. On going through these provisions, it is clear that interest’ is sought to be charged on account of the fact that the

Government is deprived of its revenue. Under Section 234A, interest is charged if tax whichever to be paid at the time of filling of the return is not paid at that point of time, Section 234B provides for levy of interest for default in payment of advance tax on the appointed dates of payment. It is Clear that under the said Act tax is payable at different dates and through different models. Where Specific dated of payment of tax are not adhered to, it can be said that the Government is deprived of tax on those dates. Interest is chargeable under the provisions the Act such a Sections 234A, 234B And 234C in order to compensate the Government for such deprivation. It is clear from the scheme of the Act and the nature of these provisions that they are compensatory and not penal. We, Therefore, conclude that the levy of interest under section 234B of the Income Tax Act is Compensatory in nature. The Tribunal, having taken a contrary view has clearly erred.”

It is submitted that levy of interest under section 234B is compensatory in nature and is not in the nature of penalty. “Section 234B and section 234C are of the same class. On going through these provisions, it is clear that interest is sought to be charged on account of the fact that the Government is deprived of its revenue. Under Section 234A, interest is charged if tax, whichever to be paid at the time of filing of the return, is not paid at that point of time; section 234B provides for levy of interest for default in payment of advance tax; and section 234C stipulates the charging of interest for default in the payments of advance tax on the appointed dates of payment. It is clear that under the Act, tax is payable on different dates and through different modes. Where specific dates of payment of tax are not adhered to. It can be said that the Government is deprived of tax on those dates. Interest is chargeable under the provisions of the Act, such as sections 234A, 234B, and 234C in order to compensate the Government for such Deprivation. It is clear from the scheme of the Act and the nature of these provisions that they are compensatory and not penal, and hence interest paid under section 234B is to be allowed as deduction while computing business income.
