Controversies

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Disallowance of Expenditure under Section 40(a)(ia) for Short deduction of TDS

Issue :

When TDS is made at a rate which is lower than the prescribed rate the question arises whether 30% disallowance is required or only proportionate disallowance is required or no disallowance is called for.

Section 40 (a)(ia) of the Income Tax Act, 1961, provides for disallowance of 30% of any sum payable to a resident on which tax is deductible at source under chapter XVII-B, where such tax has not been deducted or after deduction has not been paid on or before the due date specified in section 139(1). Till assessment year 2014-15, the whole of such sum payable was disallowed.

The question which arises for consideration, under the circumstances is, whether the tax authorities can disallow the whole or part of the expenditure on such grounds that tax not been deducted at source on such expenditure ignoring altogether the fact that the tax was in fact deducted though under a different provision of the Act.

Proposition:

It is proposed that when TDS has been made from the payments made then even if there is a short fall no disallowance can be made under section 40(a)(ia).

View Against The Proposition:

As per Section 40(a)(ia) tax has to be deducted at source as per Chapter XVII-B otherwise 30% of the expenditure in question has to be disallowed. It is further submitted that it is provided in the section that where in respect of any sum as referred in this section tax has not been deducted or after deduction has not been paid then 30% of such sum shall be disallowed as a deduction while computing the income of the assessee for the previous year relevant to assessment year under consideration. It is further submitted that not only failure to deduct tax at source will attract disallowance but the tax at source at a rate lower than the prescribed rate will also attract the disallowance. Whether the expenditure in question is genuine or not is irrelevant. It is further submitted that Supreme Court in the case of *GurusahaiSaigal vs. CIT 48 ITR 1* had observed that the provision in taxing Statute dealing with machinery for assessment have to be construed by the ordinary rules of construction, that was to say, in accordance with the clear intention of the Legislature, which was to make effective a charge that was levied.

It is further submitted that it cannot be the defense of the assessee that since TDS has been made though at a lesser rate there is no question of any disallowance because TDS has been made and at the most the assessee may be visited with penalty under section 201 but the question of disallowance does not arise. Say for example assessee has paid Professional Fees of Rupees one Lac to a lawyer but he contends that it is only contractual payment and hence the rate of TDS is only 2%. This stand of the assessee is not correct and hence 30% of the expenditure in question has to be disallowed or in the alternative proportionate expenditure must be disallowed.

The provision of Section 40(a)(ia) of the Act uses the words "…..on which tax is deductible at source under chapter XVII-B and such tax has not been deducted or after deduction has not been paid." The use of words "Such tax" clearly denoted that the tax has to be deducted as per rate prescribed under the appropriate section in chapter XVII-B of the Act which is applicable to sums under consideration. The expression "on which tax is deductible at source under chapter XVII-B and on which such tax has not been deducted" clearly indicates that the disallowance provisions get attracted when such tax is not deducted i.e. tax deductible under chapter XVII-B so even if part of

tax deductible is not deducted, the disallowance under section 40(a)(ia) kicks in.

The said proposition of law gets further fortified from the proviso inserted by the Finance Act 2012 which provides that "where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of chapter XVII-B on any such sums". The use of words "whole or any part of the tax" makes it evident that the TDS not only need to be deducted but the same needs to be deducted at appropriate rate under applicable section in chapter XVII-B of the Act.

View in Favor Proposition:

There are number of authorities available which have clearly held that in case of short deduction no disallowance is called for under section 40(a)(ia). Few of such cases are as under:

1. *ACIT Circle-2 Ghaziabad vs. PankajBhargava [2013] 33 taxmann.com 484*
2. *UE Trade India Corporation Ltd. vs. DCIT 28 Taxmann.com 77 Delhi*
3. *ITO vs. Premire Medical Supplies*
4. *DCIT vs. Chandabhai&Jasabhai*

Let me now refer in detail the decision of Calcutta High Court in the case of *S. K. Tekriwal, 361 ITR 432*. In this case the Tribunal noted that section 40(a)(ia) had 2 limbs - one requiring deduction of tax and the second requiring payment of tax into the government account. There was nothing in that section, treating the assessee as a defaulter where there was a shortfall in deduction. According to the Tribunal, it could be assumed that on account of the shortfall, there was a default in deduction. If there was any shortfall due to any difference of opinion as to the taxability of any item or the nature of payments falling under various TDS provisions, the assessee could be declared to be an assessee in default u/s 201, and no disallowance could be made by invoking the provisions of section 40(a)(ia).

The High Court concurred with the findings recorded by the Tribunal and dismissed the appeal of the tax department. The High Court affirmed the order of the Tribunal that disallowance cannot be invoked under Section 40(a)(ia) of the Act in the case of short-deduction of tax.

Summation:

Recently their Lordships of Kerala High Court in *CIT v. PVS Memorial Hospital Ltd, 60 taxmann.com 69 on* examination of the provisions of section 40(a)(ia) expressed the view that the section was not a charging section but was a machinery section, and that such a provision should be understood in a manner that it was made workable. According to Kerala High Court, if section 40(a)(ia) was to be understood in the manner as laid down by the Supreme Court, the Expression " tax deductible at source under Chapter XVII-B" had to be understood as a tax deductible at source under the appropriate provision of chapter XVII-B. Therefore, it was deductible u/s 194J but was deducted u/s 194C, according to Kerala High Court, such a deduction did not satisfy the requirement of section 40(a)(ia).

In the case of *GurusahaiSaigal vs. CIT 48 ITR 1* had observed that the provision in taxing Statute dealing with machinery for assessment have to be construed by the ordinary rules of construction, that was to say, in accordance with the clear intention of the Legislature, which was to make effective a charge that was levied.

The Kerala High Court held that a cumulative reading of provision showed that deduction under a wrong provision of law would not save an assessee from disallowance u/s 40(a)(ia) expressly dissenting from Calcutta High Court's decision in S.K. Tekriwal's case and confirmed disallowance u/s 40(a)(ia).

The provisions of section 40(a)(ia) require a disallowance in case of failure to deduct tax at source, where it was deductible or after deduction the same has not been paid on or before due date specified u/s 139(1). It does not cover cases of partial or non-deduction of TDS.

Section 201 by express language using the specific term "wholly or partly" seeks to rope in the case of partial or complete failure of deduction of TDS and makes assessee liable for the consequences.

As the term "wholly or partially" is not included in section 40(a)(ia) it covers the cases of absolute failure to deduct tax and not the cases of partial failure to deduct tax.

Further, section 201 of the Income Tax Act, 1961, clearly brings out the failure in whole or in part, would result in an assessee being treated as in default. Similarly, section 271C clearly specifies that the penalty can be levied for failure to deduct whole or any part of the tax as required by chapter XVII-B. Unlike both the sections, section 40(a)(ia) uses the term "not been deducted", without specifying whether it applies to deduction in whole or in part.

Secondly, even in cases of acknowledged failure, the Andhra Pradesh High Court, followed by many High Courts in the case of *P.V. Rajagopal vs. Union of India 99 Taxman 475*, held, in the context of provision of section 201 as it then stood, that if there was any shortfall due to any difference of opinion as to the taxability of any item, the employer could not be declared to be an assessee in default. The Tribunal in the case of *DCIT V. Chandabhoy & Jasabhoy 49 SOT 448 (Bom), Apolo Tyres vs. DCIT 60 SOT 1 (Coch) and Three Star Granites (P) Ltd vs. ACIT32 ITR (Trib)398,* held that the provision of section 40(a)(ia) would be attracted only in case of total failure to deduct tax at source, and where the tax had been partly deducted at source, it could not be said that tax had not been deducted at source. In all these cases the Tribunal noted the decision of *P.V. Rajagopal vs. Union of India(supra)* with approval.

In situation where tax deductor has taken a bonafide view in respect of tax deductible from a particular type of payment, adopting one of the two possible views on the matter, should he be penalized by disallowance of the expenditure, besides being asked to pay the tax short deducted, as well as interest on such short deduction?

In the case for penalty for concealment, the Supreme Court in the case of CIT vs. Reliance Petroproducts (P) Ltd. 322 ITR 58 held that where a tax payer based on a possible view of the matter, claimed a deduction, a penalty for concealment could not be levied on him even where his claim for deduction of such payments was disallowed in assessment of his total income.

The disallowance u/s 40(a)(ia) is a form of penalty on a tax deductor for non deduction of TDS under Chapter XVII-B or after deduction for non-payment of TDS to the government on or before the due date specified u/s 139(1). Therefore if a taxpayer makes a genuine mistake, taking a possible interpretation of the provision under which the tax is to be deducted, he should not be penalized.

The intention of the Legislature is to ensure that the deductor deducts TDS from the payments on which the provision of Chapter XVII-B is applicable and in doing so he should use the TDS rates applicable under the specific provision which in his bona fide belief is the provision that is applicable to such payments. The intention of Legislature could not be to penalize the actions taken under a bona fide belief of a deductor particularly when the view taken by him is a possible one.

Therefore the view taken by Calcutta High Court can be considered a better one which states that no disallowance can be made u/s 40(a)(ia) for short deduction of TDS, particularly in cases where there is a genuine dispute as to the appropriate section under which the tax is deductible at source. As held by the Apex Court in the case of *Hindustan Steels Ltd. 83 ITR 26 (SC)*in case of any mistake made by deductor in deducting tax under a wrong provision of law which is based on bona fide belief, is a case of trivial mistake and should not lead to hold the assessee in default.

Where the assessee is advised that there is no duty to deduct tax on which the assessing officer takes a contrary view

1. One possible defense in such a case is where two provisions are applicable or there are two views as to the deductibility, the one favorable to the tax payer as understood by him should be acceptable of the purpose of tax deduction at source.
2. An alternate defense may be in case, where the tax is paid by the deductee accounting the amounts failed to be deducted or short deducted. There is an abatement of liability to deductor for tax failed to be deducted in such cases in the light of the decision of Supreme Court in Hindustan Coco Cola Beverages Ltd. Vs. CIT [2007] 293 ITR 266.

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