

## TAX FLASH NEWS

### Tax is to be deducted on entries relating to provision for expenses passed in the books of account

#### Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of IBM India Private Ltd.<sup>1</sup> (the taxpayer) held that the taxpayer is liable to deduct tax on provision for expenses created in the books of account. The Tribunal rejected the taxpayer's argument that there was no charge under Section 4(1) of the Income-tax Act, 1961 (the Act) and held that statutory provisions dealing with collection and recovery of tax, envisage collection of tax irrespective of charge under Section 4(1) of the Act.

#### Facts of the case

- The taxpayer is a wholly owned Indian subsidiary of a U.S. based company. As per the mercantile system of accounting the taxpayer makes provision for certain expenses in the books of accounts. As per the global group accounting policy, each of the entity of the IBM group worldwide has to quantify its expenses every quarter, within 3 days of the end of every quarter.
- In respect of expenses for which invoices have been submitted or the payments have become due, the same are accounted for and if tax deducted at source (TDS) related provisions are found to be applicable on these expenses, the same are accounted for. However, in respect of expenses of which only service/work has been performed by the vendors, but for which the invoices have not been furnished or in respect of which the payments have not fallen due, a provision for such expenses is also made in the books of account recognising the liability that has been incurred.
- Such expense provisions were created on reliable estimates of the payment that was expected to be made on the settlement dates in the future. In the subsequent financial years, the provision entries were reversed and on receipt of invoices in respect of the respective expenses, the same were recorded as liabilities due to the respective parties and taxes were deducted at source and paid to the government in the due course.
- During the year under consideration, the taxpayer has debited the expenses to the profit and loss account and the provisions are credited to a provision account and not to the vendor accounts as these have not fallen due for payment. While filing return of income, the taxpayer disallowed the amounts in the computation of income in terms of Section 40(a)(i) and Section 40(a)(ia) of the Act.
- The Assessing Officer (AO) held that the above procedure followed by the taxpayer was contrary to the accounting policy because once the expenditure is booked in the profit and loss account, it cannot be reversed. The taxpayer has to deduct tax on the provision so created by the taxpayer in the books of accounts. However, the taxpayer could not produce the details of payment of TDS and therefore, the taxpayer would be treated as an 'assessee in default' under Section 201(1) of the Act in respect of taxes not deducted at source in respect of provision for expenses made in the books of accounts. The AO also levied interest under Section 201(1A) of the Act on taxes not paid to the credit of the Central Government.
- The Commissioner of Income-tax (Appeals) upheld the order of the AO.

<sup>1</sup> IBM India Private Ltd. v. ITO (ITA Nos.749 to 752IBang/2012) – Taxsutra.com

## Tribunal's ruling

- Once there is a disallowance under Section 40(a)(i) and (ia) of the Act, it is not possible to argue that there was no liability under Chapter XVII-B of the Act and therefore the provisions of Section 201(1) of the Act will not be attracted.
  - It is clear from the statutory provisions of TDS that the liability to deduct tax at source exists when the amount is credited to a 'suspense account' or any other account by whatever name called, which will also include a 'provision' created in the books of accounts. Thus, it is not possible for the taxpayer to argue that there was no accrual of expenditure in accordance with the mercantile system of account and therefore the TDS obligations do not get triggered.
  - The Tribunal did not agree with regard to the taxpayer's argument that there is no accrual of expenditure as per the mercantile system of accounting since the payee is not identified. The CIT(A) has correctly held that under the mercantile system of accounting accrual of liability for any expenditure is not dependent of receipt of invoice from the person to whom payment for expenses has to be made.
  - The claim of the taxpayer that it creates provision in the books of account on an estimated basis in some cases, on a historical basis in other and using some sort of arithmetical or geometric progression in some other cases was not acceptable.
  - Section 190(2) of the Act provides that 'Nothing in Section 190 shall prejudice the charge of tax on such income under the provisions of Section 4(1) of the Act.' Therefore, the statutory provisions clearly envisage collection at source *de hors*<sup>2</sup> the charge under Section 4(1) of the Act.
  - Section 195 of the Act uses the expression 'chargeable to tax'. In the present case, it is neither the case of the taxpayer that payments made to non-residents are not chargeable to tax nor has the taxpayer been able to demonstrate as to how payment made to a non-resident is not chargeable to tax. The taxpayer is a person making payment and the simple obligation cast upon him is to deduct a sum specified by the Act from and out of the payment and remit to the credit of the Central Government.
- The argument of the taxpayer that TDS provisions operate on income and not on payment is erroneous. Section 194C, 194J and 195 of the Act, which are the sections applicable in the present case, do not use the expression, 'Income'. The above sections use the expression 'Sum' and tax deduction has to be on the 'sum so paid'.
  - Section 194H and Section 194-I deals with TDS obligation on payment of commission and rental income. These payments by its nature are specific and the entire payment is attributable to commission or rent and therefore the commission and rent paid are treated as 'income'. Therefore, the expression income by way of commission or rent is found in these sections. Moreover, as a person responsible for making payment, it is the duty of the taxpayer to deduct tax at source.
  - Section 194C, 194J, 194H and 194-I do not use the expression 'chargeable to tax'. It has been noted that, it is not the case of the taxpayer that the payments are not chargeable to tax in the hands of the payee.
  - The taxpayer deducted tax on the provision made for various expenses in the subsequent financial years when the provision entries were reversed. The taxpayer therefore cannot take a plea that the payments in question are not chargeable to tax and therefore there was no obligation on its part to deduct tax at source.
  - The CBDT Circular<sup>3</sup> is a specific circular applicable in the case of banks and issued under peculiar circumstances. The taxpayer cannot take shelter under the said circular. Further, various decisions<sup>4</sup> relied on by the taxpayer are distinguishable on the facts of the present case.
  - Accordingly, the levy of interest under Section 201(1A) of the Act has been upheld.

## Our comments

The Bangalore Tribunal in this case dealt with the issue of levy of interest under Section 201(1A) vis-à-vis applicability of TDS provisions on entries relating to provision for expenses passed in the books of account. The Tribunal held that the statutory

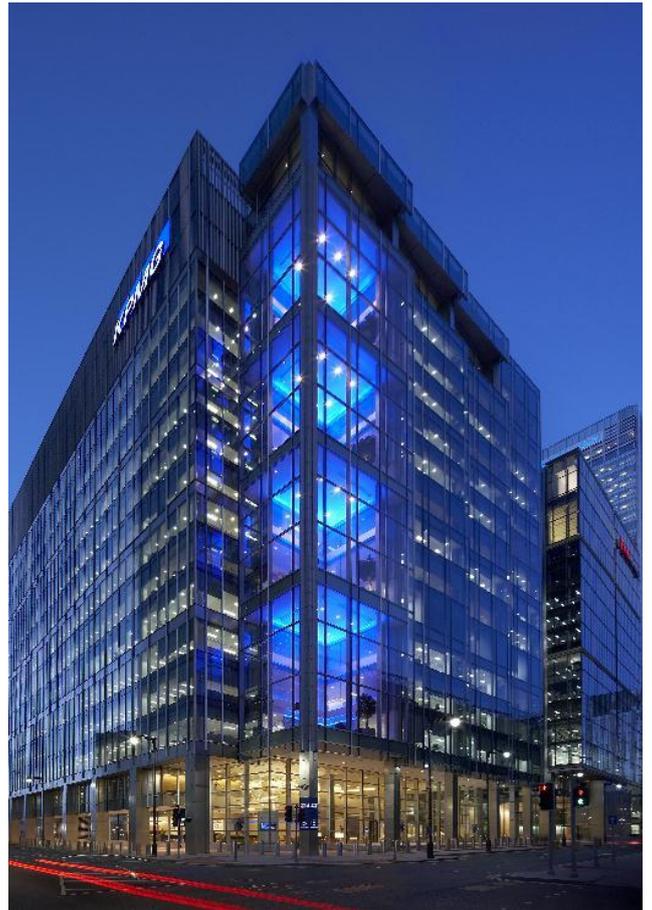
<sup>3</sup> CBDT Circular No.30/2010, dated 2 March 2010

<sup>4</sup> DCIT v. Telco Construction Equipment Co. Ltd. (ITA No.478/Bang/2012), DCIT v. Yeota Merchants Co-op. Bank Ltd. (ITA No. 805/PN/2011), Bovis Lend Lease (I) Pvt. Ltd. v. ITO [2010] 36 SOT 166 (Bang), Bharati Airtel Limited (ITA No.637-644 of 2013), UCO Bank v. UOI & others [2014] 369 ITR 335 (Del)

<sup>2</sup> Out of, without.

provisions of withholding tax clearly envisage deduction of tax at source *de hors* the charge under Section 4(1) of the Act. Further, Section 194C, 194J, 194H and 194-I do not use the expression 'chargeable to tax', and Section 194C, 194J and 195 of the Act, do not use the expression, 'Income'. The above sections use the expression 'Sum' and tax deduction has to be on the sum so paid. Accordingly, the taxpayer was liable to deduct tax at source on entries relating to provision for expenses passed in the books of account.

In some of the cases, the parties with whom the taxpayer is entering into a transaction with may not have been identified when the provision for certain expenses is created. At times, it is difficult to quantify the amount of expenditure which is going to be incurred. In view of these practical difficulties, the deductor could face hardship if he has to comply with the TDS provisions.



**Ahmedabad**

Commerce House V, 9th Floor,  
902 & 903, Near Vodafone House,  
Corporate Road,  
Prahlad Nagar,  
Ahmedabad – 380 051  
Tel: +91 79 4040 2200  
Fax: +91 79 4040 2244

**Bengaluru**

Maruthi Info-Tech Centre  
11-12/1, Inner Ring Road  
Koramangala, Bangalore 560 071  
Tel: +91 80 3980 6000  
Fax: +91 80 3980 6999

**Chandigarh**

SCO 22-23 (1st Floor)  
Sector 8C, Madhya Marg  
Chandigarh 160 009  
Tel: +91 172 393 5777/781  
Fax: +91 172 393 5780

**Chennai**

No.10, Mahatma Gandhi Road  
Nungambakkam  
Chennai 600 034  
Tel: +91 44 3914 5000  
Fax: +91 44 3914 5999

**Delhi**

Building No.10, 8th Floor  
DLF Cyber City, Phase II  
Gurgaon, Haryana 122 002  
Tel: +91 124 307 4000  
Fax: +91 124 254 9101

**Hyderabad**

8-2-618/2  
Reliance Humsafar, 4th Floor  
Road No.11, Banjara Hills  
Hyderabad 500 034  
Tel: +91 40 3046 5000  
Fax: +91 40 3046 5299

**Kochi**

Syama Business Center  
3rd Floor, NH By Pass Road,  
Vytilla, Kochi – 682019  
Tel: +91 484 302 7000  
Fax: +91 484 302 7001

**Kolkata**

Unit No. 603 – 604,  
6th Floor, Tower – 1,  
Godrej Waterside,  
Sector – V, Salt Lake,  
Kolkata 700 091  
Tel: +91 33 44034000  
Fax: +91 33 44034199

**Mumbai**

Lodha Excelus, Apollo Mills  
N. M. Joshi Marg  
Mahalaxmi, Mumbai 400 011  
Tel: +91 22 3989 6000  
Fax: +91 22 3983 6000

**Noida**

6th Floor, Tower A  
Advant Navis Business Park  
Plot No. 07, Sector 142  
Noida Express Way  
Noida 201 305  
Tel: +91 0120 386 8000  
Fax: +91 0120 386 8999

**Pune**

703, Godrej Castlemaine  
Bund Garden  
Pune 411 001  
Tel: +91 20 3050 4000  
Fax: +91 20 3050 4010