

## TAX FLASH NEWS

### Disallowance under Section 40(a)(ia) of the Income-tax Act, 1961 – Law is evolving

#### Background

Recently, the High Court of Punjab and Haryana (High Court) in the case of P.M.S Diesels<sup>1</sup> (the taxpayer) held that consequences under Section 40(a)(ia) of the Income-tax Act, 1961 (the Act) would operate on account of failure to deduct tax where the tax is liable to be deducted at source under Chapter XVII-B of the Act, and the term 'payable' has been used in that sense. The High Court in the present case, did not agree with the decision of the Allahabad High Court in the case of Vector Shipping Services (P) Ltd.<sup>2</sup> wherein the Allahabad High Court had held that when expenditures incurred by the taxpayer were totally paid and did not remain payable at the end of the relevant accounting period, the provisions of Section 40(a)(ia) of the Act are not applicable.

#### Facts of the case

- The taxpayer has been following the mercantile system of accounting. During the scrutiny assessment, the taxpayer admitted that the tax has not been deducted at source in respect of the payments made/deemed to have been made by the taxpayer.
- In view of Section 40(a)(ia) of the Act, the Assessing Officer (AO) disallowed the expenditure relating to the amounts in respect of which tax was liable to be deducted at source and liable to be deposited to the credit of the Central Government, but was not deducted and/or deposited.

#### High Court's ruling

- The Tribunal rightly held that if a taxpayer is liable to deduct tax at source under Section 194C of the Act and the taxpayer fails to do so, the payments are to be disallowed in view of Section 40(a)(ia) of the Act.
- All the Sections in Chapter XVII-B require a person to deduct tax at source at the rates specified therein. The requirement in each of the sections is preceded by the word 'shall'. The provisions are therefore, mandatory. There is nothing in any of the Sections that would warrant reading the word 'shall' as 'may'.
- The point of time at which the deduction is to be made establishes that the provisions are mandatory. For instance, under Section 194C of the Act, a person responsible for paying the sum is required to deduct tax at the time of credit of such source under various provisions of Chapter XVII-B. This view is supported by the judgments of the Calcutta<sup>3</sup> and Madras High Courts<sup>4</sup>.
- The words 'payable' and 'paid' have different connotations. The word 'paid' is an antonym of the word 'payable'. This however, is not significant to the interpretation of Section 40(a)(ia) of the Act.
- The purpose of Section 40(a)(ia) is to ensure the recovery of tax. There is no indication in the said Section that this object was confined to the recovery of tax from a particular type of taxpayer following a certain accounting practice.

<sup>1</sup> P.M.S Diesels v. CIT [ITA No.716 of 2009 (O&M), dated 29 April 2015] (P&H) – Taxsutra.com

<sup>2</sup> CIT v. Vector Shipping Services (P) Ltd. [2013] 262 CTR 545 (All)

<sup>3</sup> CIT v. Crescent Export Syndicate [2013] 216 Taxman 258 (Cal)

<sup>4</sup> Tube Investments of India Ltd. and another v. ACIT (TDS) and others [2010] 325 ITR 610 (Mad)

- If for some reason, the government was interested in ensuring the recovery of taxes only from taxpayers following the mercantile system, it would be expected that the provision stipulate clearly so, if not expressly. It is not suggested that taxpayers following the cash system are not liable to deduct tax at source.
- Adherence to the provisions ensures not only the collection of tax but also enables the authorities to bring within their fold all such persons who are liable to come within the network of taxpayers. The intention was to ensure the collection of tax irrespective of the accounting system followed by the taxpayers.
- Accordingly, Section 40(a)(ia) applies not only to taxpayers following the mercantile system but also to taxpayers following the cash system.
- The term 'payable' only indicates the type or nature of payments by the taxpayers to the persons/payees referred to in Section 40(a)(ia), such as contractors.
- The consequences under Section 40(a)(ia) would operate on account of failure to deduct tax where the tax is liable to be deducted under the provisions of the Act and in particular Chapter XVII-B thereof, and the term 'payable' has been used in that sense.
- The term 'payable' is descriptive of the payments which attract the liability to deduct tax at source. It does not categorise defaults on the basis of when the payments are made to the payees of such amounts, which attract the liability to deduct tax at source.
- If a taxpayer recovers the amount from the payee subsequently, it would still constitute a deduction from the amount payable to the payee. It would only constitute a subsequent deduction.
- The High Court in the present case, did not agree with the decision of the Allahabad High Court in the case of Vector Shipping Services (P) Ltd. wherein the Allahabad High Court had held that when the expenditure incurred by the taxpayer were totally paid and did not remain payable at the end of the relevant accounting period, the provisions of Section 40(a)(ia) are not applicable.
- Subsequently, the Supreme Court dismissed the department's petition for a special leave to appeal. However, the special leave petition was dismissed in limine, without giving any reason, and therefore, the dismissal did not confirm the view of the Allahabad High Court, as held by the Supreme Court in various case laws<sup>5</sup>.

<sup>5</sup> V.M. Salgaocar & Bros. (P) Ltd v. CIT [2000] 243 ITR 383 (SC), Supreme Court Employees Welfare Association v. UOI [1989] 4 SCC 187 (SC)

## Our comments

The issue of disallowance of expenditure under Section 40(a)(ia) of the Act has been a matter of debate before the courts. The question is whether the disallowance under Section 40(a)(ia) could be made only in respect of such amounts which are payable as on 31 March of the year under consideration or not.

The Special Bench of the Visakhapatnam Tribunal in the case of Merilyn Shipping & Transports<sup>6</sup> held that the provisions of Section 40(a)(ia) of the Act are applicable only to the amounts of expenditure remaining unpaid as on 31 March every year and that the said provision would not be attracted in case the amounts have already been paid without deducting tax.

Subsequently, the Calcutta High Court in the case of Crescent Export Syndicates and the Gujarat High Court in the case of Sikandarkhan N Tunvar<sup>7</sup>, have overruled the ratio laid down by the Special Bench Tribunal in the case of Merilyn Shipping. On the other hand, the Allahabad High Court in the case of Vector Shipping Services (P) Ltd, without referring to the decision of the Calcutta High Court and the Gujarat High Court, has held that for disallowance of expenditure on which tax has not been deducted, the amount should be payable and not which has already been paid by the end of the year.

In the present case, the High Court has held that the consequences under Section 40(a)(ia) of the Act would operate on account of failure to deduct tax where the tax is liable to be deducted at source under Chapter XVII-B of the Act and the term 'payable' has been used in that sense. The High Court in the present case, did not agree with the decision of the Allahabad High Court in the case of Vector Shipping Services (P) Ltd. wherein the Allahabad High Court had held that when the expenditure incurred by the taxpayer were totally paid and did not remain payable at the end of the relevant accounting period, the provisions of Section 40(a)(ia) are not applicable.

<sup>6</sup> Merilyn Shipping & Transports v. ACIT [2012] 20 taxmann.com 244 (Vis)

<sup>7</sup> CIT v. Sikandarkhan N Tunvar [2013] 33 taxmann.com 133 (Guj)

**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