

TAX FLASH NEWS

Disallowance of expenditure due to non-deduction of tax at source – Kerala High Court

Background

Recently, the Kerala High Court (High Court) in the case of Thomas George Muthoot ¹ (the taxpayer) held that a statutory provision unless otherwise expressly stated to be retrospective or by intendment shown to be retrospective, is always prospective in operation. Thus the High Court, while dealing with the second proviso to Section 40(a)(ia) of the Income-tax Act, 1961 (the Act), inserted by the Finance Act 2012, which states that disallowance under this section need not be made if the taxpayer is not an assessee in default under the first proviso² to Section 201(1) of the Act, held that the said proviso is prospective in nature. The reading of the aforesaid second proviso does not show that it was meant or intended to be curative or remedial in nature and by virtue of this proviso, an additional benefit was conferred on the taxpayers.

Further, the High Court held that the language of Section 40(a)(ia) of the Act does not warrant an interpretation that the provisions would be attracted only on such amounts which remain payable on the last day of the financial year.

The High Court also held that the business income of the taxpayer exceeded the limit prescribed under Section 44AB of the Act. Therefore, the taxpayer even though an individual, was liable to deduct tax while paying interest to the firm under Section 194A(1) of the Act.

¹ Shri Thomas George Muthoot v. CIT (ITA No. 278 of 2014) (Kerala) – Taxsutra.com

² Any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident -

(i) has furnished his return of income under section 139 ;
(ii) has taken into account such sum for computing income in such return of income ; and
(iii) has paid the tax due on the income declared by him in such return of income, and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed.

Facts of the case

- The taxpayer was a partner in a partnership firm. During the relevant assessment years, the taxpayer paid interest to the partnership firm without deducting tax at source (TDS) on the belief that Section 194A of the Act, relating to TDS on interest payments, was not applicable to individuals.
- The Assessing Officer (AO) disallowed the said interest expenditure under Section 40(a)(ia) of the Act for non-deduction of taxes under Section 194A of the Act. On an appeal, the order of the AO was upheld by the Commissioner of Income-tax (Appeals) [CIT(A)] and thereafter by the Income-tax Appellate Tribunal (the Tribunal).

High Court's ruling

Whether individuals are excluded from the liability to deduct tax under Section 194A(1) of the Act

- The TDS provisions under Section 194A(1) of the Act applies to any person, not being an individual or a Hindu Undivided Family (HUF). Further, by virtue of the Finance Act 2002, the benefit of exclusion is restricted only to those individuals and HUF, whose total sales, gross receipts or turnover from business and profession do not exceed the monetary limit specified under Section 44AB of the Act during the financial year immediately preceding the financial year in which such interest is credited or paid.

- In the light of the proviso to Section 194A(1), if the taxpayers are claiming the exemption provided in the Section, the burden is on them to establish that they, being individuals, satisfied the conditions specified in the proviso to the Section.
- However, in the present case the taxpayer had not produced any material to contradict specific factual finding made by the Tribunal, wherein it was held that the business income of the taxpayer exceeded the limit prescribed under Section 44AB of the Act and that the taxpayer even though an individual, was liable to deduct tax while paying interest to the firm under Section 194A(1) of the Act.
- Accordingly, the High Court held that the contention of the taxpayer that under Section 194A of the Act, an individual is excluded from the liability to deduct tax and therefore disallowance is without jurisdiction cannot be accepted.

Is the proviso to Section 40(a)(ia) of the Act retrospective in nature

- The other contention raised by the taxpayer was that the second proviso to Section 40(a)(ia) of the Act, which was inserted by the Finance Act 2012, stating that disallowance under this section need not be made if the taxpayer is not an assessee in default under the first proviso to Section 201(1) of the Act, is a remedial and curative clarificatory proviso and hence applies retrospectively.
- The High Court held that, a statutory provision unless otherwise expressly stated to be retrospective or by intendment shown to be retrospective, is always prospective in operation. In addition, it stated that the reading of the second proviso does not show that it was meant or intended to be curative or remedial in nature and by virtue of this proviso, an additional benefit was conferred on the taxpayers; hence such a provision can only be prospective in nature³.
- Further, the taxpayer's reliance on the Supreme Court's judgement in the case of Hindustan Coca Cola⁴ was distinguished on the basis that the said judgement was rendered in the context of Section 201(1) of the Act, the objective of which was compensatory in nature and therefore, the ratio of the said ruling cannot be applied to the provisions of Section 40(a)(ia) of the Act.

Whether disallowance under Section 40(a)(ia) of the Act can be made only in respect of payments outstanding at the end of the year

- The taxpayer, by placing reliance on the case of Vector Shipping Services⁵, contended that the provisions of Section 40(a)(ia) of the Act are applicable only in respect of the amount which remain payable on the last day of the financial year. Since the disputed interest amount in question was not outstanding as at the year end, the provisions of Section 40(a)(ia) of the Act are not attracted.
- The High Court held that the language of the Section 40(a)(ia) of the Act does not warrant an interpretation that it gets attracted only where the interest remains payable on the last day of the financial year. This view has been supported by the decisions of the Calcutta High Court in the case of Crescent Exports Syndicate and another⁶ and the Gujarat High Court in the case of Sikandarkhan N Tunvar⁷.

In view of above, the High Court dismissed the appeal of the taxpayer.

Our comments

The Kerala High Court in the present case held that a statutory provision, unless otherwise expressly stated to be retrospective or by intendment shown to be retrospective, is always prospective in operation. Therefore, the second proviso to Section 40(a)(ia) of the Act shall apply prospectively.

The High Court held that the consequences under Section 40(a)(ia) of the Act would operate on all payments made without deduction of tax during the year, whether or not the same are outstanding at the end of the year. The said decision is in line with the various High Court rulings⁸. However, the Allahabad High Court in the case of Vector Shipping Services (P) Ltd) had taken a contrary view and held that for disallowance of expenditure on which tax has not been deducted, the amount should be outstanding at the end of the year.

Further it was held that the business income of the taxpayer exceeded the limit prescribed under Section 44AB of the Act. Therefore, the taxpayer even though an individual, was liable to deduct tax while paying interest to the firm under Section 194A(1) of the Act.

⁵ CIT v. Vector Shipping Services (P) Ltd. (2013) 262 CTR 545 (Allahabad)

⁶ CIT v. Crescent Exports Syndicate and another [2013] 216 Taxman 258 (Cal)

⁷ CIT v. Sikandarkhan N. Tunvar [2013] 33 taxman.com 133 (Guj)

⁸ CIT v. Crescent Exports Syndicate and another [2013] 216 Taxman 258 (Cal), CIT v. Sikandarkhan Tunvar [2013] 33 taxman.com 133 (Guj), P.M.S. Diesels v CIT [ITA No. No. 716 of 2009 (O&M), dated 29 April 2015] (P&H)

³ Prudential Logistics And Transports v. ITO [2014] 364 ITR 689 (Ker)

⁴ Hindustan Coca Cola Beverages Pvt. Ltd. v. CIT [2007] 293 ITR 226 (SC)

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