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Article

Disallowance for non-deduction of TDS - Supreme Court interprets 'amount payable'

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The Honorable Supreme Court of India in a recent Judgment in the case of *Palam Gas Agencies ltd.* set at rest a controversy which had been raging in the Income Tax circles from 2012. The moot question before the Hon'ble Supreme Court was whether the expression "payable" used in Section 40(a)(ia) means payable at the end of the year or payable at any time during the year though paid during the year itself.

Background

Section 40(a)(ia) was introduced in the Income Tax Act, by the Finance Act, 2004 with effect from 1-4-2005 with a view to augment the revenue through the mechanism of deduction of Tax at source. This provision was brought on the statute to disallow the claim of even genuine and admissible expenses of the assessee under the head 'Income from Business and Profession' in case the assessee does not deduct Tax at Source [TDS] on such expenses. The default in deduction of TDS would result in disallowance of expenditure on which such TDS was deductible.

While enacting the above provision the legislature stated that it proposed to extend the provisions of section 40(a)(i) to payments of interest, commission or brokerage, fees for professional services or fees for technical services to residents, and payments to a resident contractor or sub-contractor for carrying out any work (including supply of labour for carrying out any work), on which tax has not been deducted or after deduction, has not been paid before the expiry of the time prescribed under sub-section(1) of section 200 and in accordance with the other provisions of Chapter XVII-B. ...in order to ensure compliance with the TDS provisions.

In 2012, the majority view of a Special Bench of the Income Tax Appellate Tribunal[1] had given a conclusion that provisions of section 40(a)(ia) are applicable only to the amounts of expenditure which are payable as on the date 31st March of every year and it cannot be invoked to disallow expenditure which has been actually paid during the previous year, without deduction of TDS.

This view was overruled by the High Court of Calcutta in the case of Crescent Export Syndicate[2]. A view similar to that of the Calcutta High Court was taken by the Punjab

1 [2012] 136 ITD 23 (*Visakhapatnam*)*Merilyn Shipping & Transports* v. *Addnl CIT Visakhapatnam*

2 [2013] 216 Taxman 258 (Calcutta)

& Haryana High Court as well as the Madras High Court[3].

The Allahabad High Court in the case of *Vector Shipping Services Pvt. Ltd*[4] however approved the decision of the Special Bench in the case of *Merilyn Shipping & Transports.*

The case of Palam Gas Agencies before the Supreme Court

The assessee in the case on hand had made a sub-contract with three persons towards freight within the meaning of Section 194C of the Act and, therefore, he was liable to deduct tax at source from the payment of Rs.20,97,689/-. On account of his failure to do so the said freight expenses were disallowed by the Assessing Officer as per the provisions of Section 40(a)(ia) of the Act. The assessee argued that that since the amounts had already been paid, it can straightaway be concluded, that such amounts would not be covered within the mischief of Section 40(a)(ia), that Section 40(a)(ia) would apply only when the amount remains *'payable'* at the end of the year.

Against the order of the Assessing Officer, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals), Shimla who *vide* order dated August 17, 2012 upheld the order dated November 30, 2011. The matter thereafter came up in appeal before the Income Tax Appellate Tribunal (for short 'ITAT') which too met with the same fate. In further appeal to the High Court under Section 260A of the Income Tax Act, the outcome remained unchanged as the High Court of Himachal Pradesh also dismissed the appeal affirming the order of the ITAT.

Observations of Supreme Court

The Supreme Court was of the view that when the entire scheme of obligation to deduct the Tax at Source and paying it over to the Central Government is read holistically, it cannot be held that the word *'payable'* occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. If the provision is interpreted in the manner suggested by the appellant , then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIB (or specifically Sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences. Insofar as judgment of the Allahabad High Court is concerned, a reading thereof would reflect that the High Court, after noticing the fact that since the amounts had already been

3 *Tube Investments of India Ltd.* V. *Assistant Commissioner of Income-Tax (TDS),* [2010] 325 ITR 610 (Mad).

4 *CIT* vs *Vector Shipping Services Pvt. Ltd.* [2013] 357 ITR 642(All)

paid, it straightaway concluded, without any discussion, that Section 40(a)(ia) would apply only when the amount is '*payable*' and dismissed the appeal of the Department stating that the question of law framed did not arise for consideration. Thus, though, the Special Leave Petition there against was dismissed in *limine*, it would not amount to confirming the view of the Allahabad High Court

In view of the aforesaid discussion, the Honorable Supreme Court held that the view taken by the High Courts of Punjab & Haryana, Madras and Calcutta is the correct view and the judgment of the Allahabad High Court in *CIT* v. *Vector Shipping Services (P) Ltd.*, [2013] 357 ITR 642 did not decide the question of law correctly.

To conclude,

The elaborate judgment of the Supreme Court has in this decision analyzed the provisions of section 40 (a)(ia) and set at rest a controversy caused by the judgement of the Special Bench of the Income Tax Appellate Tribunal at Vishakhapatnam in the case of *Merlyn Shipping & Transports Pvt. Ltd* which had opened a Pandora's Box as it were and which should not have existed in the first place.

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Notifications and Circulars

Person not required to obtain Aadhaar Number for obtaining PAN

Section 139AA was inserted vide Finance Act, 2017 to mandate individuals to obtain and quote Aadhaar Number in application for PAN and in return of Income. This mandate was to be effective from 01st July 2017. Central Government was empowered vide sub-section (3) of section 139AA of the newly inserted provision to notify such persons to whom the provisions of section 139AA will not apply.

In exercise of powers conferred in section 139AA(3) of Income-tax Act, 1961 Central Government has notified that the provisions of section 139AA shall not apply to an individual who does not possess the Aadhaar number and is:-

(i) residing in the States of Assam, Jammu and Kashmir and Meghalaya;

(ii) a non-resident as per the Income-tax Act, 1961;

(iii) of the age of eighty years or more at any time during the previous year;

(iv) not a citizen of India.

This Notification No. 37/2017, dated 11th May 2017, shall come into force with effect from the 1st day of July, 2017.

Opting for corporate tax rate of 25% - Form notified

Section 115BA was inserted vide Finance Act, 2017 to provide that a company could opt for a corporate tax rate of 25% (instead of rate of 30%) with effect from A.Y. 2017-

18 if the company satisfies the following conditions:

(i) The company has been set-up and registered on or after 01st day of March 2016;

(ii) The company is engaged in the business of manufacturing any article or thing and research in relation thereto or distribution thereof; and

(iii) The total income of the company has been computed without claiming any specified deductions, additional depreciation and set-off of carry forward losses.

Sub-section (4) of section 115BA provided that the eligible company was required to intimate the factum of exercising option provided in section 115BA before due date of filing return of income in a manner as may be prescribed.

The manner of exercising option has been notified vide Rule 21AD. The newly notified Rule prescribes Form 10-IB as the relevant form for exercising the option. Notification No. 36/2017 dated 02nd May 2017 has been issued for the purpose.

Ratio decidendi

Waiver of interest received by amalgamating entity to be treated as income of amalgamated entity

The assessee had taken over a sick company by way of scheme of amalgamation and obtained benefit under Section 72A relating to carry forward and set off accumulated loss and unabsorbed depreciation. The sick company had received waiver of interest from some of the banks which had advanced loans to it. The interest (payable at the time) had been allowed as expenditure in the relevant years. The revenue authorities contended that the income which had accrued under Section 41(1) of the Act had to be set off against the accumulated losses. The Supreme Court held that when the assessee was entitled to take advantage of the accumulated losses while calculating these accumulated losses at the hands of amalgamated company, the income accrued under Section 41(1) of the Act at the hands of amalgamating company should be accounted for. Thus, the argument of the assessee that Section 41 refers to 'first mentioned person' which is the amalgmating entity and since it had ceased to exist, the income could not be taxed in the hands of the amalgamated entity was not accepted. [*Mc Dowell & Co.* v. *CIT*, Supreme Court, C.A No. 3893 of 2006, judgement dated 9-3-2017]

Onus on assesse to prove actual use of services – ALP can be determined at Nil

The assessee, had paid certain amount towards administrative fees, royalty etc', to its AE and claimed that they were at arm's length price, based on TNMM. However, the Revenue authorities held that the assesse have not shown what benefits had been derived by it and as such computed the ALP at Nil. The ITAT held that while as per the judgement of the High Corut of Delhi in *EKL Applicances(345*

ITR 241) the TPO cannot determine ALP to be nil the onus lay on the assesse to prove that the services for which the administrative services fees were paid were actually rendered and the of technical knowhow was used by it. The ITAT was of the view that the question of benchmarking would only arise if the assessee proved that there was actual transfer of technical knowhow and the same was actually used in the manufacturing activity. Further, ITAT noted that assessee had not filed any additional evidences for proving this aspect and consequently failed to discharge its onus. Referring provisions of Indian Evidence Act, it further held that a presumption can be drawn that assessee had no evidence to prove this aspect. [*Herbalife International India Pvt. Ltd.* v. *ACIT*, ITAT Bang, IT(TP)A No. 1406/2010, order dated 17-4-2017]

Adjustment of tax dues of AE against refund due to assessee can be international transaction

The AO had adjusted the tax due from the AE of the assessee against refund due to it. Subsequently the AE's case was taken up for scrutiny and it received a refund of the amount along with interest. The assessee then reclaimed the amount from its AE. The TPO held this to be an international transaction wherein the assessee had given a loan to its AE by liquidating its asset – refund. The assesse argued that the forced adjustment of tax due from its AE against the refund cannot be an international transaction in as much as this was not a loan transaction, there was no action in concert, no cooperation among the related parties and hence the adjustment proposed by the TPO was wrong. However, the ITAT held that since the assesse had not adduced any evidence of having objected to the 'forced' or 'unauthorised' adjustment and the transaction was akin to capital financing, it could be treated as international transaction. [*DDIT* v. *BG Exploration*, [2017] 80 taxmann.com 393 (Delhi- Trib.)]

Reimbursement of salary not FTS under India-UK DTAA

The assessee paid a sum towards salary expenditure to employees deputed for providing assistance in management, setting up of business and so on. The AO treated it as FTS as per the provision of India-UK DTAA and held that the company was liable for non-deduction of TDS. Bombay High Court upheld the order of ITAT that the reimbursement of salary for seconded employees was not FTS under India-UK DTAA and Section 195 for deducting tax at source not applicable. The Tribunal had noted that the service agreement drawn up for providing these services between the company was essentially a joint venture and that there was no rendering of service within the meaning of the DTAA. The officials/employees had been deputed for the promotion of the business of the assessee which is Indian arm of overseas AE. Since the said payment to the employees was already subjected to tax in India, there was no non-compliance as regards TDS. [*DIT* v. *Marks & Spencer Reliance India Pvt. Ltd.* Bombay High Court, Income Tax Appeal No. 893 of 2014, judgement dated 3-5-2017]

News Nuggets

Draft ICDS in respect of real-estate transaction

In exercise of powers conferred in section 145(2) of Income-tax Act, 1961, Central Government had notified Income Computation and Disclosure Standards ('ICDS') vide Notification No. 87/2016 dated 29th September 2016. The notified standards provided inter-alia, for recognition of revenue from construction contracts, sale of goods and provision of services. However, as stated in Circular No. 10/2017 dated 23rd March 2017, there was no specific standard providing for recognition of revenue in respect of real-estate transactions.

The Finance Minister had constituted a committee to suggest the areas in respect of which further ICDS may be notified. The Committee suggested notification of ICDS in respect of Real Estate Transactions and submitted the draft of the same. CBDT had placed the draft ICDS in respect of real estate transactions in public domain on 11th May 2017 for comments from stakeholders. The highlights of the draft standards are as under:

Scope of Standard: As per the draft, the proposed standards will apply to determine income from transactions involving sale of plots of land with or without development of common facilities, development and sale of residential and commercial units, acquisition, utilization and transfer development rights, redevelopment of existing buildings and joint development agreements.

Recognition of income from real-estate transactions: The draft provides that where the "economic substance of the project is similar to a construction project", project revenue and cost shall be recognized by reference to the stage of completion of the project. Further, in a case where the economic substance of the project is not akin to a construction project, the project income will be recognized in accordance with income from sale of goods as provided in ICDS-IV.

Economic substance similar to a construction project: The draft recognizes following indicators to provide that the economic substance of the project is similar to a construction contract:

(i) The duration of the project is beyond 12 months;

(ii) Project involves activities such as land development, structural engineering, architectural design or activities of similar nature;

(iii) The individual units of the project are interdependent upon completion of common activities;

(iv) The construction or development activities form a significant proportion of the project activity.

Application of percentage completion method: The draft provides that revenue in respect of project shall be recognized under the percentage of completion method when:-

(a) The expenditure incurred on construction and development costs exceeds 25% of total estimated construction and development cost of the project;
(b) 25% or more of the saleable project area is secured by contracts or agreements with buyers; and
(c) 10 % or more of the total revenue as per the agreements of sale are realised in respect of each of the contracts and it is reasonably certain that the parties to such contracts will comply with the payment terms as defined in the contracts.

Income from transferable development rights: The draft provides that revenue from development rights will be recognized when the title to the development rights is transferred to the buyer and it is reasonable to expect that revenue will be ultimately collected. The draft also provides that where the development rights are acquired by way of direct purchase or on construction of built-up area, cost of acquisition of development right will be the cost of purchase or amount spent on development of built-up area respectively. Further, where the development rights have been acquired by giving up rights over existing structures or open land, the development rights will be recorded at fair value of the development rights so acquired. It has also been provided that the cost of development rights will be added to the project cost.

Transactions with multiple elements: The draft recognizes that a person may contract with a buyer to deliver goods or services in addition to the construction or development of real estate. The draft provides that in such cases, the gross consideration will be split into separate identifiable components and the consideration will be allocated to each component on the basis of fair market value of each component. It is further provided that the revenue in respect of each of the components shall be in accordance with the notified ICDS for the respective component.

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