

Provisions pertaining to disallowance under section 40(a)(ia) are applicable to amounts that are “payable” as well as “paid”

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In brief

The Supreme Court (SC) in a recent decision¹ has held that, the provisions of section 40(a)(ia)² of the Income-tax Act, 1961 (Act) are applicable not only to the amount which was outstanding at the end of the relevant previous year, but to the entire expenditure which became liable for payment at any point during the year under consideration including the amount which was paid before the end of the relevant previous year.

In detail

Facts

- The taxpayer¹ was engaged in the business of purchase and sale of LPG cylinders. The main contract of the taxpayer was for carriage of LPG with the Indian Oil Corporation (IOC), Baddi. During the year, the taxpayer had received freight payments from the IOC, Baddi. The taxpayer in turn sub-contracted the transportation of the LPG to three persons who were paid during the year.
- The Tax Officer (TO) observed that the expenditure for the sub-contract for the

transportation of the LPG, by the taxpayer, was liable to withholding tax under section 194C of the Act. Further, on failure of the taxpayer to withhold tax on the aforesaid expenditure, the same was disallowed by the TO under the provisions of section 40(a)(ia)² of the Act.

The taxpayer preferred an appeal with successive appellate authorities *viz.*, the Commissioner of Income-tax (Appeals), the Income-tax Appellate Tribunal and the High Court (HC) of Himachal Pradesh, contesting both the assertions of the TO i.e. the expenditure being liable

to withholding tax under section 194C of the Act and the consequential disallowance under section 40(a)(ia) of the Act on default in withholding of tax. However, the actions of the TO were upheld by the appellate authorities. The taxpayer subsequently, filed an appeal before the SC, restricting the ground to the disallowance under provisions of section 40(a)(ia) of the Act.

Issue before the SC

Whether the provisions of section 40(a)(ia) of the Act shall be attracted when the amount is not “payable” to a contractor or sub-contractor but has been actually “paid”?

¹ Civil Appeal No. 5512 of 2017

² Section 40(a)(ia) of the Act enumerates certain items of expenditure which will not be allowed

to be deducted while computing income under the head “Profits and Gains from Business or Profession”, in the event of default in the deduction

and payment of the taxes required to be deducted at source thereon, as required under Chapter XVII-B of the Act.

Taxpayer's contentions³

- The taxpayer contended that there should not be any disallowance under section 40(a)(ia) of the Act as the freight charges had been paid during the year and were not payable at the end of the year.
- The taxpayer also contended that provisions of section 40(a)(ia) of the Act apply only in respect of amounts remaining payable at the end of the year. As such, the amount that has been paid during the year would not attract disallowance under the aforesaid provisions notwithstanding the default in withholding of taxes.

SC's decision

- The SC observed that the issue has come up for hearing before various HCs and divergent views have been expressed by the said HCs. The SC affirmed the view taken by Punjab and Haryana HC⁴ (P&H HC) which had ruled that the disallowance under the provisions of section 40(a)(ia) of the Act were attracted in respect of the entire expenditure that arose for payment and not restricted merely to the amount unpaid at the end of the year.
- The P&H HC, had noted that, grammatically, the words 'payable' and 'paid' have different connotations. The word 'paid' is, in fact, an antonym of the word 'payable'. This, however, is not significant to the interpretation of section

40(a)(ia) of the Act.

- The SC agreed with the observation of the P&H HC that the liability to withhold tax under the provisions of Chapter XVII-B was mandatory. A person responsible for paying any sum was also liable to deposit the amount in the Government account. The sections in Chapter XVII-B required a person to withhold tax at the rates specified therein. The requirement in each of the sections was preceded by the word 'shall'. The provisions were, therefore, mandatory. There was nothing in any of the sections that would warrant reading the word 'shall' as 'may'. The point of time at which the withholding was to be made also established that the provisions were mandatory.
- The SC also agreed with the view of the P&H HC that the method of accounting followed by the taxpayer i.e. cash or mercantile system of accounting was irrelevant in the context of applicability of provisions of section 40(a)(ia) of the Act.
- The SC, while making a reference to section 194C, 200 and 201 of the Act, observed that when the entire scheme of obligation to withhold tax and paying it over to the Central Government was read holistically, it could not be held that the word "payable" occurring in section 40(a)(ia) referred to only those cases where the amount was yet to

be paid and did not cover the cases where the amount was actually paid. The SC, further mentioned that, if the provisions were interpreted in the manner suggested by the taxpayer then, even when it was found that a person, like the taxpayer, had violated the provisions of Chapter XVII-B (or specifically sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such default in spite of specific provisions laying down consequences.

- The SC further stated that even though, the Special Leave Petition there against was dismissed by the SC itself, *in limine*, however, that would not amount to confirming the view of the Allahabad HC which had held that the disallowance on account of non withholding of tax would be applicable only in case of amount which were payable at the end of the year

The takeaways

This is a significant decision of the SC, as it discusses conflicting views by High Courts and settles the controversy in so far as the amount, whether "paid" or "payable at the end of the year" is to be considered for purposes of disallowance under section 40(a)(ia) of the Act.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

³ The judgment has not mentioned the taxpayer or the Tax Department's arguments

⁴ P.M.S. Diesels & Ors. v. Commissioner of Income Tax - 2, Jalandhar & Ors., (2015) 374 ITR 562

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