

SC upholds that the amendment relaxing the disallowance under section 40(a)(ia) was retrospective in nature

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In brief

In a recent decision,¹ the Supreme Court (SC) held that the provision of section 40(a)(ia) of the Income-tax Act, 1961 (the Act) amended *vide* the Finance Act, 2010 should have been interpreted liberally and equitably and have retrospective application from the date of insertion of section 40(a)(ia) of the Act i.e., with effect from assessment year (AY) 2005–06.

In detail

Facts

- The taxpayer was a partnership firm and a manufacturer and exporter of casting material.
- The taxpayer had paid export commission charges on which tax was withheld in financial year (FY) 2004–05 and was deposited with the Government in FY 2005–06.
- The tax officer (TO) disallowed export commission charges stating that tax withheld ought to have been deposited before the end of the previous year i.e., 31 March, 2005.
- On appeal the Commissioner of Income-tax (Appeals) [CIT(A)]

ruled in favour of the taxpayer.

- The Income-tax Appellate Tribunal (Tribunal) and the High Court of Calcutta upheld the CIT(A)'s order.

Issue before the Supreme Court

Whether the amendment made by the Finance Act, 2010 in section 40(a)(ia) of the Act should have been applied retrospectively i.e., from the date of insertion of the provisions of section 40(a)(ia) or from the date of enforcement of the amendment?

Revenue's contentions

- The plain reading of section 40(a)(ia) reveals its prohibitory nature and the taxpayer ought to have withheld and deposited the taxes with the Government

within the prescribed time limit.

- The amendment made under section 40(a)(ia) by the Finance Act, 2010 clearly states that the amendment is effective from AY 2010-11, and thus, it did not have retrospective application from AY 2005-06.
- The Revenue placed reliance on the special bench ruling in the case of Bharati Shipyard Limited² on a similar issue.

Taxpayer's contentions

- The purpose of inserting section 40(a)(ia) of the Act was to ensure compliance of withholding tax provisions and not punish *bona fide* taxpayers.
- Amendments of curative nature ought to have been applied retrospectively.

¹ Civil Appeal Nos. 4339-4340 of 2018

² Bharati Shipyard Limited v. DCIT [ITA No. 404/Mumbai/2009(Mumbai Tribunal)]

- The taxpayer relied on the decisions of the division bench of the Delhi High Court in the case of Ansal Land Mark Township Private Limited³ and the SC in the case of Allied Motors Private Limited⁴

Supreme Court's decision

- The SC observed that the purpose of inserting section 40(a)(ia) was to ensure tax compliance and not to punish the taxpayer.
- The said provision only resulted in shifting of the year in which the expenditure was claimed as a deduction.
- The said provision was first amended by the Finance Act, 2008 and then by the Finance Act, 2010 to mitigate the genuine and apparent hardships caused to marginal and medium taxpayers by extending the time period for depositing tax withheld into the Government's account.

- Any provision with a purpose of tax compliance should not have been converted into an iron rod provision, which metes out stern punishment and resulted in malevolent results disproportionate to the offending act and intention of the legislature.
- A proviso inserted to remedy unintended consequences and make provision workable should have been read into the section to give it a reasonable interpretation and required to be treated as retrospective in operation.
- The amendment made by the Finance Act, 2010 being curative in nature, was required to be given retrospective operation i.e., from the date of insertion of the above section.
- The SC, relying on its decision in the case of Allied Motors Private

Limited⁴ held that the amended provision of section 40(a)(ia) should have been interpreted liberally and equitably and applied retrospectively with effect from AY 2005-06.

The takeaways

- This ruling clarifies that the amendment made by the Finance Act, 2010 though not given operation retrospectively, being a curative amendment should be given retrospective operation.
- This ruling reaffirms that the taxpayer should not suffer unintended consequences beyond what the object and purpose of the provision mandates.

Let's talk

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

³ CIT v. Ansal Land Mark Township Private Limited [ITA Nos. 160 and 161/2015(Delhi HC)]

⁴ Allied Motors Private Limited v. CIT [1997] 224 ITR 677 (SC)

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