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Short-withholding of tax would not attract expense disallowance

In brief

In a recent decision in the case of S K Tekriwal¹ (the assessee), the Calcutta High Court (HC) held that disallowance under section 40(a)(ia) of the Income-tax Act, 1961 (the Act) cannot be made in cases of short-withholding of tax due to *bona fide* wrong application of withholding tax (WHT) provisions. The HC also held that the assessee had discharged the duty as required under section 40(a)(ia) of the Act by withholding the tax and depositing it in the government treasury. Any shortfall in

WHT due to differing opinions of taxability can attract consequences under section 201 and not under section 40(a)(ia) of the Act.

Facts

- The assessee had withheld tax at source at 1% under section 194C(2) of the Act for the payments made to the sub-contractors which were wrongly debited to the profit and loss account under the head 'machinery hire charges'.
- The revenue contended that the payments are in the nature of machinery hire charges falling under the head 'rent' and that the provisions of section 194-I of the Act are applicable.

¹ CIT v. S.K.Tekriwal [TS-902-HC-2012 (Cal)]

- According to the revenue, the assessee has withheld tax at 1% under section 194C(2) of the Act as against the actual withholding of 10% under section 194-I of the Act.
- The revenue department initiated proceedings for short-withholding of tax accordingly, disallowed the payments proportionately by invoking the provisions of section 40(a)(ia) of the Act.

Issue

Whether the provisions of section 40(a)(ia) can be invoked in relation to short-withholding of tax?

Revenue's contentions

- Payments made by the assessee were in the nature of machinery hire charges falling under the head 'rent' and that the provisions of section 194-I of the Act should be applied.
- The assessee withheld tax at a lower rate, i.e., at 1% under section 194C instead of at 10% under section 194-I, thereby making a case of shortfall in withholding of tax.
- The revenue department disallowed the payments proportionately by invoking the provisions of section 40(a)(ia) of the Act.

Tribunal ruling²

- There is no word like 'failure' used in section 40(a)(ia) of the Act. It refers only to non-withholding of taxes and disallowance of such payments.

- The conditions laid down in section 40(a)(ia) of the Act for invoking disallowance is in a case where tax is required to be withheld and that such tax has not been withheld. In other words, the provisions of section 40(a)(ia) of the Act has two limbs, the assessee has to withhold tax and the second the tax withheld has to be paid into the government account.
- If tax is withheld by the assessee under a *bona fide* wrong impression, then the provisions of section 40(a)(ia) of the Act cannot be invoked.
- The assessee can be declared to be an assessee-in-default under section 201 of the Act. No disallowance can be made by invoking the provisions of section 40(a)(ia) of the Act in case of any shortfall due to any difference of opinion as to the taxability of any payments.

HC ruling

- The HC ruled in favour of the assessee and upheld the order of Tribunal.
- The appeal was dismissed on the basis that no substantial question of law was involved.

Conclusion

The decision in this case would provide a helpful defence against any such disallowance due to short-withholding of tax under a different tax provision. The taxpayers can take shelter pursuant to this judgement and that disallowance under section 40(a)(ia) would apply only in cases of non-withholding of tax and not in cases of short-withholding of tax.

² DCIT v. S K Tekriwal [2011] 48 SOT 515 (Kol)

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