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Salary payments to non-residents to be allowed as a deduction in the previous year in which withholding tax is paid

In brief

In the recent case of Tianjin Tianshi India Pvt Ltd¹ (the assessee), the Delhi Income-tax Appellate Tribunal (the Tribunal) held that salary payments to non-residents under section 40(a)(iii) of the Income tax Act, 1961 (the Act) would be allowed as a deduction in the previous year in which such tax was paid. It was also observed that a harmonious construction of sections 40(a)(ia) and 40(a)(iii) of the Act was necessary.

¹ Tianjin Tianshi India Pvt. Ltd v. ITO [TS-217-ITAT-2013(Del)]

Facts

The assessee made payments of salary of INR 3.3 million (approx.) to non-resident staff working in India for AY 2007-08. The tax amount of INR 0.08 million (approx.) was withheld but was deposited in the Government account in October, 2008 after the due date of filing of the tax return under section 139(1) of the Act. The AO disallowed the claim for expenditure.

Before the dispute resolution panel (the DRP), the assessee contended as follows:

Section 40(a)(iii) of the Act provides for disallowance of salary expenditure where taxes have not been paid or deducted. The section was silent on the time of payment of withholding tax.

Section 40(a)(ia) of the Act provides for payment of withholding tax by a specified date to escape disallowance i.e. before the due date of filing the tax return.

Since, the two sections are different from each other, no disallowance could be made if the withholding tax was deposited belatedly. In this regard, reference was made to *Dolphin Drilling Ltd*², wherein it has been held that where an assessee had withheld tax from salary paid to non-resident employees and had made a delayed payment of tax to the Government account, the payment could not be disallowed by invoking section 40(a)(iii) of the Act.

The DRP, however, affirmed the order of the AO. It observed that section 40(a)(iii) of the Act had to be read in harmony with section 40(a)(ia) of the Act and the tax deducted was required to be deposited within the time limit prescribed under section 40(a)(ia) of the Act, i.e. the due date of filing of return of income.

Issues before the Tribunal

- Whether salary expenditure covered under section 40(a)(iii) would be permanently disallowed where withholding tax was paid on or before the due date of filing of tax return under section 139(1) of the Act?
- Whether withholding tax was required to be paid before the due date of filing the tax return under section 139(1) of the Act even though section 40(a)(iii) of the Act was silent on the date of deposit of withholding tax?

Tribunal ruling

The Tribunal held that under section 40(a)(ia) of the Act, the tax was required to be withheld on or before the due date of filing the tax return and where the withholding tax was paid after the due date of filing the tax return, the amount of expenses would be allowed as a deduction in the previous year in which the tax was paid. The Tribunal held that the above position would equally apply to section 40(a)(iii) of the Act, as both the provisions—section 40(a)(ia) and section 40(a)(iii)—were required to be read in harmony with each other.

In view of the above, the Tribunal allowed the salary expenditure of the assessee if the amount of withholding tax was paid on or before the due date of filing of the tax return. However, where such sum was not paid, then it would be allowed as deduction in computing the income of the previous year in which such withholding tax was paid.

PwC's comments

The DRP in effect held that there could be no permanent disallowance of the salary expenditure even though withholding tax was deposited in the Government account after the due date of filing of the tax return under section 139(1) of the Act. The principle of the proviso to section 40(a)(ia) of the Act has been read into section 40(a)(iii) of the Act as well.

² DCIT v. Dolphin Drilling Ltd [2009] 28 SOT 141 (Delhi)

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