

Disallowance on TDS Default - Practical Challenges

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Rajendra Agiwal

Advisor, Tax & Regulatory Services, S R B C & Associates LLP



Priyank S Shah

Senior Manager, Ernst & Young LLP



Ashwin S Agarwal

Senior Consultant, Ernst & Young LLP

INTRODUCTION

It is presumed that readers are fully aware of the purpose of introduction of disallowance u/s 40(a)(i) (pertaining to payments to non - residents) and disallowance u/s 40(a)(ia) (pertaining to payments to residents). Though the sections 40(a)(i) and (ia) are on statute for almost decades/a decade, the issues under these sections are not fully settled yet. These sections have passed through various amendments made whether it pertains to non-discrimination of non-resident taxpayers or timing for deduction and payment of tax deduction at source. Earlier, it was a 100 percent disallowance which was subsequently brought down to 30 percent disallowance for payments to the residents and even if there is failure to deduct tax at source, on obtaining certificate from payees' disallowance can be escaped and so on.

However, here in this write-up an attention is drawn to one procedural issue. To confer the benefit to taxpayers in real terms whether some remedial action in this procedural issue is yet warranted is thought put forward for consideration.

UNDERSTANDING SECTION 40(a)(i) / (ia)

As per Section 40(a)(i)/(ia), the deduction of expenses in the nature of any interest, royalty, fees for technical services or other sum chargeable to tax under the Act will not be available to the deductor, if the TDS has not been deducted or if deducted but not paid to the Government. A threshold for disallowance of 30% of sum payable has been prescribed for the payments to resident taxpayers and a threshold of disallowance of 100% of amounts has been prescribed for non-resident taxpayers.

For the benefit of this article, we have reproduced the bare text of section 40(a)(i)/ (ia) of the Act:

"40. Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—

(a) in the case of any assessee—

(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139:

Provided *that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid:*

Provided further *that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purposes of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the payee referred to in the said proviso.*

.....

(ia) thirty per cent of any sum payable to a resident, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139:

Provided *that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, thirty per cent of such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid:*

Provided further *that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the 67[***] payee referred to in the said proviso.*

....."

The above extracts reveals that the section has provided two kinds of relief to the deductors/ taxpayers by way of proviso under which the deduction of the entire expenditure will be available to the concerned Assessee. The reliefs provided are as follows:

□ **First** - If the TDS has been deducted by the deductor on or before last day of the financial year and the same been paid to the corpus of the Government before the due date of filing of tax return as per section 139(1) of the Act, the expenditure would be allowed.

□ **Second** - If no TDS has been deducted by the deductor on or before last day of the financial year the deductors are not deemed to be an Assessee in default under the first proviso to section 201(1) of the Act; subject to compliance of the prescribed conditions.

UNDERSTANDING “ASSESSEE IN DEFAULT” AND RELEVANT RULES THEREUNDER

Now let us understand who is “Assessee in default” as per section 201(1) of the Act. With effect from April 1, 2013, the provisions of section 201 of the Act provides that where taxpayer fails to deduct TDS or fails to deposit TDS so deducted on payments to resident and non-resident payee, such taxpayer shall not be considered to be an 'assessee in default', if such resident payee satisfies all the following cumulative conditions:

- Furnishes its income-tax return
- Accounts into such payments for computing income in its income-tax return
- Pays tax due on such income declared; and
- **Furnishes Chartered Accountant's ('CA') certificate in relation to above.**

For the benefit of this article, we have reproduced the bare text of section 201(1) of the Act:

“201. (1) Where any person, including the principal officer of a company,—

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of section 192, being an employer,

does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax:

Provided *that any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a payee or on the sum credited to the account of a payee shall not be deemed to be an assessee in default in respect of such tax if such [payee]—*

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income, and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed:”

The Act has also prescribed a Rule and a Form for furnishing certificate of accountant under the first proviso to section 201(1). An extract of the said Rule has been provided below:

“(1) The certificate from an accountant under the first proviso to sub-section (1) of section 201 shall be furnished in Form 26A to the Director General of Income-tax (Systems) or the person authorised by the Director General of Income-tax (Systems) in accordance with the procedures, formats and standards specified under sub-rule (2), and verified in accordance with the procedures, formats and standards specified under sub-rule (2).

(2) The Director General of Income-tax (Systems) shall specify the procedures, formats and standards for the purposes of furnishing and verification of the Form 26A and be responsible for the day-to-day administration in relation to furnishing and verification of the Form 26A in the manner so specified.”

The compliance to be done to avail the first benefit (supra) is quite easy, however, the same requires satisfaction of primary condition that the TDS has been deducted before the end of the financial year and paid before the due date for filing return of income u/s 139(1).

But to avail the second benefit, condition for deduction of TDS is not required before the end of the financial year. Despite of failure in making TDS if the prescribed conditions are satisfied the deductor can escape the disallowance. **However, this second benefit obliges taxpayers to furnish a certificate from a CA which should include a declaration that the payee has filed its income-tax return and has accounted such income received from deductor in computing income in its income-**

tax return on which due taxes has been paid on such income declared.

Authors after going through few of the ITAT decisions feel that despite the law has provided remedy to escape such disallowance, whether a deductor practically is able to enjoy this benefit or facing difficulties to avail this conferred benefit is the moot question. Why is it so, is attempted herein below to explain the procedural issue.

CHALLENGES IN OBTAINING CA CERTIFICATE

Fulfilling this condition has typical practical challenge which most of the taxpayers face leading to denial of the deduction of such expenditure and double payment of tax on the same amount. The typical challenge is to obtain information/ documents from the payee as envisaged in section 201(1) of the Act and to furnish a CA's certificate based on the said information/ documents.

When the deductor who suffered disallowance pleads before Appellate Authorities that payee is well known and having huge income / turnover say finance companies, etc. (part of big corporate houses), it is unlikely that they would not have disclosed the impugned income, say interest on which tax was deductible, and therefore, additional proviso gets attracted to confer the benefit. Also, the deductor would have submitted the required certificate or would submit the required certificate from payees to this effect and accordingly, the matter be remanded to the Assessing Officer for verification of certificate /reconsideration of the matter. This is a general trend of pleading on the issue and requests so made have been fortunately are generally accepted by the Appellate Authorities.

There have been some cases/ decisions in the past on accepting such prima-facie requests and ITAT has remanded back the matters to the tax officer giving direction that the taxpayer be directed to obtain and furnish a certificate from CA. Subsequent to the furnishing of CA certificate, the expenditure may be allowed as per law. Grounds of appeal are said to be allowed for statistical purpose.

WHETHER PAYEES ARE HONOURING REQUESTS OF DEDUCTOR TO FURNISH REQUIRED DETAILS/ CA'S CERTIFICATE:

The main reason behind this practical challenge in obtaining a certificate is due to the fact that the Act does not have machinery to impose a statutory obligation on the payee to give response to request of payer cum deductor. The payees then usually and unintentionally do not co-operate with the taxpayers in giving the information/ document and the ultimate benefit is not enjoyed by the taxpayers. Hence, the conditions of section 201(1) of the Act becomes devoid of practical benefit which sought to be conferred by the statute and virtually becomes redundant and of no use.

For example, in case of large corporate house where there are numerous transport contractors in the range of say 500's on which the TDS have to be deducted under section 194C of the Act and the Company sometimes misses deducting TDS from few of them due to such numerous transport contractors. Then in those cases, the Company faces difficulties in obtaining the details from that particular vendor and obtaining CA's certificate on the income declaration. This leads to disallowance of expenses for violation of section 194C.

Also, say in case of small payments where one-off professional services have been obtained on which TDS remained to be deducted under section 194J of the Act. In those cases, usually the vendors do not support as being a small one-off service. The Companies then face a real challenge in obtaining the certificate from a CA in order to claim a deduction of the entire expenditure.

Further, due to the mandatory disallowance, the taxpayers then end up paying double tax on the same amount. Here payment of double tax meant payees have paid taxes assuming income is offered in payees return and payer suffered disallowance for want of certificate to fulfil condition as prescribed in additional proviso. Sometimes though this is just a timing difference, but where the quantum of amounts is huge, this affects the tax liability, interest on such additional tax liability and working capital of the taxpayer.

JUDICIAL PRECEDENTS

The above issue of conditions given in the proviso to section 201(1) has also been discussed in the recent rulings of ITAT which has been discussed below:

The Hon'ble ITAT Chandigarh Bench ruling in the case of **SH. Rana vs Income-tax Office (ITA No. 171/Chd/2020)**^[4] remanded back the matter to the tax officer and held that the Assessee has to furnish a requisite certificate from the respective parties and where the certificates are so furnished by the Assessee containing the requisite information, the tax officer has to allow necessary relief to the Assessee. An extract of the said ruling has been provided below for the ready reference:

"12. The impugned assessment year is assessment year 2013-14 and there cannot be any dispute that the aforesaid amendment is applicable in the instant case. It has been contended that the payees are publicly known NBFCs and it is unlikely that they have not considered the payments so made by the assessee while computing their income and filing their respective tax returns and the assessee may be allowed an opportunity to furnish the requisite certificates in support of the same. We find that the legislative mandate so provided by the aforesaid amendment should be allowed to reach its logical conclusion and considering the same and in the interest of substantial justice, we hereby allow the assessee one more opportunity to furnish the requisite certificates from the respective parties and where the certificates are so furnished by the assessee containing the requisite information, allow the necessary relief to the assessee. The alternate contention is therefore not considered and left open. The matter is accordingly set-aside to the file of the Assessing officer for the limited purposes of examining and considering the certificates which shall be furnished by the assessee within reasonable period of time as so specified by the Assessing officer."

The above issue in obtaining certificate has also been addressed /deliberated by the Hon'ble ITAT Delhi Bench ruling in the case of **Nokia India Sales Private Limited vs Additional Commissioner of Income-tax (ITA No. 7244/Del/2017)**^[5] wherein it was held that where the assessee has defaulted in deducting the tax and at the same time, the recipient has offered the amounts received to tax, the Assessing Officer has to look into the provisions of section 201(1) **jointly and severally** as to whether there was a default in recovery, whether there was a delay in recovery, whether there was a infarction of the penal provisions or not and invoke the appropriate provisions of the Act to deal with different situations. An extract of the said ruling has been provided below for the ready reference:

*"11. The fact in this case is that, prima facie the assessee has defaulted in deducting the tax and at the same time, the recipient has offered the amounts received to tax which is not in dispute. Creating a demand for non-deduction of tax while the recipient has paid taxes on the same amount would result in recovery of taxes on the same amount twice. **We find that the Id. Assessing Officer has gone strictly by the letter and procedure of the Act leaving aside the spirit of the legislation.***

*12. The failure to adhere to the provisions of TDS result in delay of payments to the exchequer of the state, initiation of penalty provision u/s 271C and intervention in recovery provisions u/s 201(1). **The Assessing Officer has to look into these provisions jointly and severally** as to whether there was a default in recovery, whether there was a delay in recovery, whether there was a infarction of the penal provisions or not and invoke the appropriate provisions of the Act to deal with different situations.*

*13. Since, the issue raised before us pertain to the default of the recovery of taxes, **we find that the taxes have been duly received by the state from the recipient and any further action to recover the same from the assessee would amount to double taxation** . Hence the appeal of the assessee on this ground is hereby allowed."*

In author's view, reference to the sentence that **"The Assessing Officer has to look into these provisions jointly and severally"**, the Hon'ble bench is giving a justice prone loud message that this procedural aspect has to be seen with a view to confer the due benefit under the impugned proviso.

The intent behind bringing section 40(a)(i)/ (ia) of the Act was to curb the deductions of all the bogus expenditure and the deduction should be available for only those expenditure which are genuine in nature. With the conditions of section 201(1) of the Act, it becomes difficult for the genuine taxpayers to claim the actual/ genuine expenditures as they ultimately suffer by paying taxes twice on the same amount once by the payee and second by payer.

WAY FORWARD/ SOLUTIONS

To settle the challenges in obtaining certificate from the payee and furnishing the same to the tax officer, following could be the way forward:

A. Power to Call for information – An amendment should be made in the Act which puts certain statutory obligation on the payee to furnish the details as asked in section 201(1) of the Act to the deductor/ taxpayer. If the requests from the deductor is not honoured the payees be made subject to penal consequences.

□ As section 133(6) gives power to the tax officer to call for any information, likewise, a similar amendment should be made to section 201(1) of the Act to gives power to the tax officer of deductor to direct the payee by way of notice to furnish details as asked in the said section to the deductor and in time bound manner. Once the information/ documents are received from the payee, the deductor should then submit a certificate from a CA to the tax officer and accordingly, a relief should be granted to the deductor.

B. Technology and Automation – An online tab on the e-filing portal should be available which will give details of whether the tax return has been filed by the Vendor by giving PAN details of vendor and a facility for downloading only the acknowledgement should also be available. This will make more convenient for the deductor to submit proofs before the tax officer and obtain a CA certificate on the same with caveats. Due to technology and automation, the department is in circular motion to obtain quick details about the filings made by vendor.

Authors' feel that if some steps in this direction are initiated it will be good relief to taxpayers and intended benefit will be passed on.

The views and opinions expressed in this article are of authors.

[1] Inserted by Finance Act 2019 w.e.f. 1st April 2020

[2] Inserted by Finance Act 2012 w.e.f.1st April 2013

[3] Inserted by Finance Act 2012 w.e.f.1st April 2013

[4] (2021) 63 CCH 0319 (Chd. Trib)

[5] (2021) 63 CCH 0233 (Del Trib)