



## TDS provisions are applicable on the provision for expenditure created in books of accounts and reversed subsequently

### Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Toyota Kirloskar Motors Pvt. Ltd.<sup>1</sup> (the taxpayer) held that the taxpayer is liable to deduct tax on the provision for expenditure created in books of accounts which was reversed subsequently. The Tribunal observed that the reversal of provision is not in the beginning of the next accounting year and therefore, it is not acceptable that the income has not accrued to the payee. The taxpayer waited for 6 to 22 months for reversal of the entry. The Tribunal observed that the date of reversal is very much important to decide as to whether the income has accrued to the payee or not. If the reversal is after income has accrued to the payee, such reversal is not relevant to decide the liability of the taxpayer for deducting tax at source.

### Facts of the case

- During the Assessment Year (AY) 2012-13, the taxpayer made provision for expenditure in the books of accounts without deduction of tax at source. There was a pre-existing contract with known parties for identified services. Hence, the accounting for these transaction for services availed as per the transaction is a specific exercise.
- Subsequently, the taxpayer reversed the said provisions for expenditure on account of the fact that such provision was no longer required in the books of accounts. Such reversal was made after a gap of minimum 6 months to maximum 22 months.

- The Assessing Officer (AO) made disallowance with respect to reversal of such provision for expenditure on account of non-deduction of tax. The AO treated reversal of provision for expenditure is liable for deduction of tax at source. However, the taxpayer did not deduct tax at source. Accordingly, proceedings under Section 201(1) and 201(1A) of the Act were initiated against the taxpayer.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

### Tribunal's decision

- In the case of Karnataka Power Transmission Ltd<sup>2</sup>, the provision was made in respect of contingent liability for which no deduction was claimed for computation of income although it was debited to P&L Account in the first two years. However, in the present case, the provision is not for a contingent liability although disallowance was made by the taxpayer in respect of such amount of expenditure from which no tax was deducted in view of the provisions of Section 40(a)(ia) of the Act. Therefore, the decision of the Karnataka High Court is not applicable to the facts of the present case.
- In the decision of Bosch Limited<sup>3</sup> the Tribunal held that the provisions were made at the end of the year and the same were reversed in the beginning of the next accounting year. Whereas in the present case, as per the details of reversal of provision, the first reversal was made on 30 September 2012

<sup>1</sup> Toyota Kirloskar Motors Pvt Ltd v. ITO (ITA No. 1185/Bang/2014) – Taxsutra.com

<sup>2</sup> Karnataka Power Transmission Corporation Limited v. DCIT [2016] 383 ITR 59 (Kar)

<sup>3</sup> Bosch Limited v. ITO (ITA No. 1583/Bang/2014, dated 1 March 2016)

and last reversal was made on 31 January 2014. Hence, this is undisputed factual position that reversal in the present case is not in the beginning of the next accounting year. Part reversal is even after the end of the next accounting year.

- The date of reversal is very much important to decide as to whether the income has accrued to the payee or not since the Tribunal in the case of Bosch Limited observed that the liability for deduction of tax at source arises only when there is accrual of income in the hands of the payee. When the provision is made at the end of the accounting year and the reversal is made at the very beginning in the next accounting year, then there may be a case of income not accruing to the payee and the provisions is made in the books of accounts even before the income has accrued to the payee. However, in the present case, the reversal is not in the beginning of the next accounting year and therefore, it is not acceptable that the income has not accrued to be payee and still the taxpayer waited for this 6 months minimum to 22 months maximum for reversal of the entry. If the reversal is made after income has accrued to the payee, such reversal is not relevant to decide the liability of the taxpayer for deducting TDS.
- The decision in the case of TE Connectivity India Pvt. Ltd.<sup>4</sup> is also distinguishable to the facts of the present case. The Supreme Court decision in the case of Eli Lilly and Co. (India) P. Ltd.<sup>5</sup> is also distinguishable to the facts of the present case since in that case the issue was with respect to quashing of penalty proceedings under Section 271C of the Act. However, in the present case, there is no dispute regarding penalty proceedings under Section 271C and regarding the liability under Section 201 and 201(1A) of the Act, the decision of the Supreme Court does not help the taxpayer.
- The Bangalore Tribunal in the case of IBM India (P.) Ltd.<sup>6</sup> held that the taxpayer would be liable to deduct tax on provision for expenditure created in books of accounts. The Tribunal also held that when the taxpayer has admitted his default under Section 40(a)(i) and 40(a)(ia) of the Act, in the proceedings under Section 201 and 201(1A) of the Act, the taxpayer cannot argue that there was no liability under Chapter XVII-B. In the present case also, the taxpayer has made disallowance under Section 40(a)(ia) of the Act and it means that the taxpayer has admitted its default under Section 40(a)(ia) of the Act.
- Therefore, in the proceedings under Section 201 and 201(1A), the taxpayer cannot argue that there was no liability under chapter XVII-B. Since none of the decisions relied on by taxpayer is rendering any help to the taxpayer in the present case and the Tribunal's decision relied on by the tax department is applicable

to the facts of the present case, the appeal filed by the taxpayer is dismissed.

## Our comments

The issue with respect to applicability of TDS provisions on the provisions for expenditure and its subsequent reversal has been a matter of debate before the Courts/Tribunal. Some of the Courts/Tribunal<sup>7</sup> have held that mere passing of book entries, which have subsequently been reversed, would not give rise to an obligation to deduct tax at source. No income had accrued, arisen or deemed to have accrued or arisen, which is chargeable to tax in the hands of a payee. The Mumbai Tribunal in the case of Alliance Media & Entertainment Ltd.<sup>8</sup> held that the taxpayer had no liability to deduct tax in respect of provision made in the books of accounts since the payees are not identifiable at the time of making of the provision, no statutory obligation was cast upon the taxpayer to deduct tax at source. On the other hand, the Bangalore Tribunal in the case of IBM India (P.) Ltd. held that the taxpayer would be liable to deduct tax on provision for expenditure created in books of accounts.

The Bangalore Tribunal in the instant case observed that the date of reversal is very much important to decide as to whether the income has accrued to the payee or not since the liability for deduction of tax at source arises only when there is accrual of income in the hands of the payee. When the provision is made at the end of the accounting year and the reversal is made at the very beginning in the next accounting year, then there may be a case of income not accruing to the payee. However, in the present case, the reversal of provision is not in the beginning of the next accounting year and therefore, it is not acceptable that the income has not accrued to be payee. The taxpayer waited for 6 to 22 months for reversal of the entry.

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<sup>7</sup> DIT v. Ericsson Communications Ltd. [2015] 61 taxmann.com 117 (Del), Karnataka Power Transmission Corporation Limited v. DCIT (ITA Nos.750 and 758-759/2009)

<sup>8</sup> Alliance Media & Entertainment Ltd. v. ITO [2017] 79 taxmann.com 114 (Mum)

<sup>4</sup> TE Connectivity India Pvt. Ltd. v. ITO (ITA No. 3/Bang/2015 dated 25 May 2016)

<sup>5</sup> CIT v. Eli Lilly and Co. (India) P. Ltd. [2009] 312 ITR 225 (SC)

<sup>6</sup> IBM India (P.) Ltd. v. ITO [2015] 174 TTJ 622 (Bang)

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