

Amendment to Section 40(a)(ia) with respect to ‘no disallowance if TDS has been deposited before the due date of return filing’ is retrospective in nature – Supreme Court

Background

Recently, the Supreme Court in the case of Calcutta Export Company¹ (the taxpayer) held that the amendment made in the disallowance provision of Section 40(a)(ia) of the Income-tax Act, 1961 (the Act) should be interpreted liberally and equitable and therefore it is applicable retrospectively with effect from the date when Section 40(a)(ia) was introduced. The amendment was curative in nature, it should be given retrospective operation as if the amended provision existed even at the time of its insertion. Accordingly, no disallowance is to be made under Section 40(a)(ia) of the Act for a relevant year since the tax deducted at source was paid before the due date of filing of return.

Facts of the case

- The taxpayer is a partnership firm and is a manufacturer and exporter of casting materials having its principal place of business at Kolkata. During the AY 2005-06, the taxpayer paid export commission² to an agent after deducting tax at source. However, the tax was deposited on 1 August 2005, i.e. after the end of the financial year but before the due date for filing tax return.
- The Assessing Officer (AO) disallowed the export commission paid by the taxpayer in terms of the provisions of Section 40(a)(ia)³ of the Act as it stood then since the tax was not deposited before the end of the financial year⁴.

- The Commissioner of Income-tax (Appeals) [CIT(A)] and Income-tax Appellate Tribunal (the Tribunal) allowed the taxpayer's appeal holding that the commission amount is eligible for deduction for the said Assessment Year. Subsequently, the High Court also held the decision in favour of the taxpayer.
- Aggrieved, the tax department filed an appeal before the Supreme Court.

Issue before the Supreme Court

- Whether the amendment made by the Finance Act, 2010 in Section 40(a)(ia) of the Act is retrospective in nature?

Supreme Court decision

Amendment in the provisions in 2008 and 2010

- The provisions of Section 40(a)(ia) came into force in the year 2005. The purpose of bringing the said amendment to ensure tax compliance. The intention of the legislature was not to punish the taxpayer is further reflected from a bare reading of the provisions of Section 40(a)(ia) of the Act. It only results in shifting of the year in which the expenditure can be claimed as a deduction.
- In a case where the tax deducted at source was duly deposited with the government within the prescribed time, the said amount can be claimed as a deduction from the income in the previous year in which the Tax Deducted at Source (TDS) was deducted. However, when the amount deducted in the form of TDS was deposited with the government after the expiry of period allowed for such deposit, then the deductions can be claimed for such deposited TDS amount only in the previous year in which such payment was made to the government.

¹ CIT v. Calcutta Export Company (Civil Appeal Nos. 4339-4340 of 2018) – Taxsutra.com

² The export commission was paid on 7 July 2004, 7 September 2004 and 7 October 2004 respectively

³ As Section 40(a)(ia) of the Act was amended later to provide that no disallowance shall be made if the tax deducted at source is deposited with the government before the due date of return filing

⁴ i.e. 31 March 2005

- However, it has caused some genuine hardship to the taxpayers especially in respect of tax deducted at source in the last month of the previous year, the due date for payment of which as per the time specified in Section 200(1) of Act was only on 7 of April in the next year. The taxpayer in such case, thus, had a period of only seven days to pay the tax deducted at source from the expenditure incurred in the month of March so as to avoid disallowance of the said expenditure under Section 40(a)(ia) of Act.
- With a view to mitigate this hardship, Section 40(a)(ia) was amended by the Finance Act, 2008. The amendments made by the Finance Act, 2008 thus provided that no disallowance under Section 40(a)(ia) of the Act shall be made in respect of the expenditure incurred in the month of March if the tax deducted at source on such expenditure has been paid before the due date of filing of the return.
- Therefore, the taxpayers were, after the said amendment in 2008, classified in two categories, i.e. (i) those who have deducted that tax during the last month of the previous year⁵ (ii) those who have deducted the tax in the remaining eleven months of the previous year⁶. The net effect is that the taxpayer could not claim the deduction for the TDS amount in the previous year in which the tax was deducted, and the benefit of such deductions can be claimed in the next year only.
- The amendment though has addressed the concerns of the taxpayer falling in the first category but with regard to the case falling in the second category, it was still resulting into unintended consequences and causing grave and genuine hardships to the taxpayers who had substantially complied with the relevant TDS provisions by deducting the tax at source and by paying the same to the credit of the government before the due date of filing of their returns under Section 139(1) of the Act.
- The disability to claim deductions on account of such lately credited sum of TDS in the assessment of the previous year in which it was deducted, was detrimental to the small traders who may not be in a position to bear the burden of such disallowance in the present Assessment Year. In order to remedy this position and to remove

hardships which were being caused to the taxpayers belonging to such second category, amendments have been made in the provisions of Section 40(a)(ia) by the Finance Act, 2010⁷.

- Thus, the Finance Act, 2010 further relaxed the rigors of Section 40(a)(ia) of the Act to provide that all TDS made during the previous year can be deposited with the government by the due date of filing the return of income. Therefore, the controversy surrounding the above amendment was whether the amendment being curative in nature should be applied retrospectively i.e., from the date of insertion of the provisions of Section 40(a)(ia) or to be applicable from the date of enforcement.

Amendment of 2010 is retrospective in nature

- TDS results in a collection of tax and the deductor discharge dual responsibility of collection of tax and its deposition to the government. Strict compliance of Section 40(a)(ia) of the Act may be justified keeping in view the legislative object and purpose behind the provision but a provision of such nature, the purpose of which is to ensure tax compliance and not to punish the taxpayer, should not be allowed to be converted into an iron rod provision which metes out stern punishment and results in malevolent results, disproportionate to the offending act and aim of the legislation.
- A legislature can and do experiment and intervene from time to time when they feel and notice that the existing provision is causing and creating unintended and excessive hardships to citizens and subject or have resulted in great inconvenience and uncomfortable results. Obedience to law is mandatory and has to be enforced, but the magnitude of punishment must not be disproportionate by what is required and necessary. The consequences and the injury caused if disproportionate do and can result in amendments which have the effect of streamlining and correcting anomalies.

⁵ No disallowance under Section 40(a)(ia) of the Act shall be made if the tax deducted by them during the last month of the previous year has been paid on or before the last day of filing of return in accordance with the provisions of Section 139(1) of the Act for the said previous year

⁶ No disallowance under Section 40(a)(ia) of Act where the tax was deducted before the last month of the previous year and the same was credited to the government before the expiry of the previous year.

⁷ Section 40(a)(ia), as amended by Finance Act, 2010, with effect from 1 April 2010 - Any interest, commission or brokerage, rent, royalty, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident, for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not paid on or before the due date specified in Section 139(1) of the Act.

- The amendments made in 2008 and 2010 were steps in the said direction only. Legislative purpose and the object of the said amendments were to ensure payment and deposit of TDS with the government.
- A proviso which is inserted to remedy unintended consequences and to make the provision workable, a proviso which supplies an obvious omission in the section, is required to be read into the section to give the section a reasonable interpretation and requires to be treated as retrospective in operation so that a reasonable interpretation can be given to the section as a whole.
- The purpose of the amendment made by the Finance Act, 2010 is to solve the anomalies that the insertion of Section 40(a)(ia) was causing to the *bona fide* taxpayer. The amendment, even if not given operation retrospectively, may not materially be of consequence to the tax department when the tax rates are stable and uniform or in cases of big taxpayers having a substantial turnover and equally huge expenses and necessary cushion to absorb the effect.
- However, marginal and medium taxpayers, who work at low gross product rate and when expenditure which becomes subject matter of an order under Section 40(a)(ia) is substantial, can suffer severe adverse consequences if the amendment made in 2010 is not given retrospective operation, i.e., from the date of substitution of the provision. Shifting expenditure to a subsequent year, in such cases, will not wipe off the adverse effect and the financial stress. Such could not be the intention of the legislature. Hence, the amendment made by the Finance Act, 2010 being curative in nature required to be given retrospective operation, i.e., from the date of insertion of the said provision.
- The Supreme Court referring the decision of Allied Motors (P) Limited⁸ observed that the amended provision of Section 40(a)(ia) of the Act should be interpreted liberally and equitable and applies retrospectively from the date when Section 40(a)(ia) was inserted, i.e., with effect from the Assessment Year 2005-2006 so that the taxpayer should not suffer unintended and deleterious consequences beyond what the object and purpose of the provision mandates.
- As the developments with regard to the provisions of Section 40(a)(ia) of the Act indicates that the amendment was curative in nature, it should be given retrospective operation as if the amended provision existed even at the time of its insertion.

⁸ Allied Motors (P.) Ltd v. CIT [1997] 224 ITR 677(SC)

Our comments

The issue with respect to the retrospective applicability of amendment made by the Finance Act 2010 in Section 40(a)(ia) of the Act has been a matter of debate before the Courts. In determining whether an amendment is to be construed as prospective or retrospective, one needs to take into consideration various aspects. Various courts have provided guiding principles in the determination whether the amendment is construed as prospective or retrospective.

Some of the Courts⁹ have held that the amendment made in Section 40(a)(ia) by Finance Act, 2010 is retrospective since the aforesaid amendment was remedial/curative in nature. As per the amendment, if the tax had been deducted in the relevant previous year and same had been paid on or before the due date of filing of return of income for the said previous year, the corresponding amount from which such tax has been deducted shall be allowed as deduction.

The Special Bench of the Mumbai Tribunal in the case of Bharti Shipyard Ltd¹⁰ held that the amendment to Section 40(a)(ia) of the Act made by the Finance Act 2010 cannot be held to be retrospective in nature.

In the instant case, the Supreme Court had held that the amendment made in the disallowance provision of Section 40(a)(ia) of the Act should be interpreted liberally and equitable and is applicable retrospectively with effect from the date when Section 40(a)(ia) was introduced. The amendment was being curative in nature, it should be given retrospective operation as if the amended provision existed even at the time of its insertion. This is a welcome decision of the Supreme Court which resolves the controversy.

⁹ CIT v. Virgin Creations [ITA No. 302 of 2011 G.A. No. 3200 of 2011, dated 23 November 2011], CIT v. Naresh Kumar [2014] 362 ITR 256 (Del)

¹⁰ Bharathi Shipyard Ltd v. DCIT (ITA No. 2404/Mum/2009, AY 2005-06)

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