



Since the claim relating to provision of commission payment is not ascertainable, it is not an allowable expenditure

Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Hardik Jigishbhai Desai¹ (the taxpayer) dealt with an issue with respect to allowability of provision for commission expenditure. The taxpayer contended that since the payee parties were not known, the taxpayer is not able to deduct tax on such payments. However, the tax department contended that by stating this the taxpayer has accepted that the liability was not ascertainable and therefore the same is not allowable.

The Tribunal while upholding the tax department's contentions held that the claim relating to the provision of commission payment by the taxpayer is unascertainable, uncrystallised and fanciful. It does not assume the character of ascertained mercantile liability. Even in case of mercantile liability, Section 40(a)(ia) of the Income-tax Act, 1961 (the Act) clearly mandates that the expenditure cannot be allowed in the absence of corresponding payment of Tax Deducted at Source (TDS).

Facts of the case

- The taxpayer claimed to be following the mercantile system of Accounting. The Assessing Officer (AO) found that the taxpayer had debited an amount of INR2,699,355 under the head 'Commission Expenses' without deducting applicable TDS from the same.
- The taxpayer replied that the provision of commission of INR26 lakh was made on estimate basis and following the mercantile system of accounting; therefore the same was allowable. Since the names of payees were not known, TDS was not deducted as the taxpayer did not know in whose account TDS was to be credited.
- The AO observed that as per the provisions of Section 194H of the Act, TDS should be made from the commission amount 'likely to be credited' if the amount exceeded INR2,500 and as the amount of commission debited by the appellant was INR2,600,000 which was in excess of the amount stipulated in Section 194H of the Act, the taxpayer should have deducted tax at source on this commission amount.
- The AO also observed that the accounting practice of the taxpayer of debiting the amount of INR2,600,000 at the end of the year and crediting the same amount back on the first day of the next financial year (FY) by passing reverse entry shows that the taxpayer diverted his income which should have been taxed in the year under consideration.
- The AO invoked the provisions of Section 40(a)(ia) of the Act for disallowing the expenses of INR2,600,000 under the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO. The CIT(A) observed that the provision for commission payable for the year under consideration was created on 31 March 2009 and has been reversed on the first day of the next financial year. i.e. on 1 April 2009. This shows that the liability has not crystallised in the said year. Such contingent liability is inadmissible as a deduction whatever accounting method the taxpayer follows-mercantile or cash. This is so because even in mercantile system unless the liability to pay crystallises it cannot be claimed as a deduction. The CIT(A) also observed that

¹ Hardik Jigishbhai Desai v. DCIT [ITA No.1084/Ahd/2013] – Orange.taxsutra.com

according to the taxpayer, provision is made on the basis of 'about' 2 per cent of sales which is stated as customary commission which only shows that the provision amount is itself not justifiable or has not crystallised.

- The CIT(A) observed that the reason for verifying the genuineness of expenses is that in different submissions before the CIT(A) the taxpayer has stated different amounts of commission paid for the year none of which match with the provisions made. The CIT(A) also observed that the actual payments made on account of commission for sales/purchases in subsequent periods are different in different submissions. However, as far as the year under consideration is concerned, the provisions are contingent in nature, not quantifiable or accrued, and therefore inadmissible as a deduction.

Taxpayer's contentions

- Relying on the decision of the Mumbai Tribunal Industrial Development Bank of India and Mahindra & Mahindra² and the CBDT clarification³ it was contended that that the practice followed by the taxpayer has been accepted by the tax department in past year; therefore, making a provision on the estimate basis on the sales effected by the taxpayer, the commission become an ascertained liability and was allowable as business expenditure.
- The deduction of TDS became impossible as the exact names, amount of commission and TDS payable to each party was not known. Therefore, the taxpayer was not in a position to pay the TDS. This situation of impossible cannot be held against taxpayer to deny the claim of expenditure. Once the tax department has accepted this methodology, there is no justification in the disallowance of expenditure.

Tax department's contention

- The taxpayer himself admitted that the liability in question was unascertainable as the names, amount of commission and TDS payable thereon was not known to the taxpayer. Unless the taxpayer ascertains these details, it cannot be said that the liability had crystallised in effective terms and was an ascertained liability. Merely because the taxpayer's practice was

accepted in past does not apply as res judicata inasmuch as the provision of law will take precedence over an untenable practice adopted by the taxpayer.

Tribunal's ruling

- The CIT(A) has given clear findings that the provision was made on whims and fancies of the taxpayer without any proper basis and even the genuineness of the expenditure.
- The facts in the cases of IDBI and Mahindra and Mahindra are on different footings and the CBDT circular is also in a different context. In this case, the simple question is non-crystallisation and liability being unascertained entry in the books at the whims and fancies of the taxpayer, which cannot be an allowable expenditure and having made book entries claiming the expenditure it was legal obligation of the taxpayer to deduct the TDS and failure thereof will render the expenditure disallowable in clear terms of Section 40(a)(ia) of the Act.
- The findings of the CIT(A) are very elaborated and demonstrated that the provision of commission payment claim by the taxpayer is totally unascertainable, uncrystallised and fanciful. It does not assume the character of ascertained mercantile liability. Even in case of mercantile liability, Section 40(a)(ia) clearly mandates that the expenditure cannot be allowed in the absence of corresponding TDS payment in the government treasury.

Our comments

The issue with respect to allowability of certain year-end provisions made in the books of accounts has been a subject matter of debate before the courts/tribunal.

In the instant case, the Tribunal, did not agree with the taxpayer's reliance on the cases of IDBI and Mahindra and Mahindra and the CBDT clarification and observed that the provisions made by the taxpayer being totally unascertainable, uncrystallised and fanciful, does not assume the character of ascertained liability as they neither accrued nor were quantified. The Tribunal further observed that even in case of an ascertained liability, Section 40(a)(ia) of the Act clearly mandates that the expenditure cannot be allowed in the absence of corresponding payment of TDS.

² Industrial Development Bank of India v. ITO [2007] 293 ITR267 (Mum), Mahindra & Mahindra v. DCIT [TS-394-ITAT-2012(Mum)-O]

³ CBDT clarification dated 275/126/96-17(6) Dt. 05.07.1996

The Chennai Tribunal in the case of Dishnet Wireless Limited⁴, with regard to year-end provisions, observed that wherever the payee is identified and quantum is also ascertainable on the last day of the financial year, the taxpayer has to necessarily deduct tax at source.

The Delhi Tribunal in the case of Hero MotoCorp Ltd.⁵, held that in the case of provision for sales promotion expenditure payable to dealers and stockists, the taxpayer's contention that the identity of dealers was doubtful could not sustain. It was only the exact amount payable to each dealer that could not be ascertained before closure of accounts. Hence, the taxpayer was liable to deduct tax at source on such provisions.



⁴ Dishnet Wireless Limited v. DCIT [2015] 154 ITD 827 (Chennai)

⁵ Hero MotoCorp Ltd. v. ACIT [2013] (36 taxmann.com 103) (Del)

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