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TAX FLASH NEWS

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Payment for hiring vehicles to a truck operator is liable for TDS since it was a payment made to a sub-contractor. Further the disallowance under Section 40(a)(ia) not only covers the amount 'payable' but also when it is 'paid' and tax has not been deducted on the same – Supreme Court

Recently, the Supreme Court in the case of Shree Choudhary Transport Company[1] (the taxpayer) held that the taxpayer is under an obligation to deduct tax at source in relation to the payments for hiring vehicles for the purpose of its business of transportation of goods under Section 194C of the Income-tax Act, 1961. The contract of the company, for transportation of its goods, was awarded to the taxpayer and it was the taxpayer who further hired the services of the trucks. The payment made by the taxpayer to the truck operator/owner was clearly a payment made to a sub-contractor and therefore covered within the scope of Section 194C.

Further the disallowance under Section 40(a)(ia) covers not only those cases where the amount is 'payable' but also when it is 'paid' and tax has not been deducted on the same.

The Supreme Court also held that the disallowance under Section 40(a)(ia) as introduced by the Finance (No.2) Act, 2004 is applicable from AY 2005-2006 and thus applicable to the present case[2].

Further the benefit of restricted disallowance of 30 per cent as provided by the Finance (No.2) Act, 2014[3] is prospectively applicable from AY 2015-16 and thus not available to the taxpayer in the instant case.

Facts of the case

The taxpayer, a partnership firm, entered into a contract with an Indian cement company, for transporting cement to various places in India. In order to execute this contract, the taxpayer hired the transport vehicles, namely, the trucks from different operators/owners. During the Assessment Year (AY) 2005-2006, the taxpayer received freight charges from the consignor company, who indeed deducted tax at source while making such payment to the taxpayer. Thereafter, the taxpayer paid the charges to the persons whose vehicles were hired for transportation of goods. The taxpayer contended that the trucks hired were belonging to different operators/owners who were not the sub-contractors or contractors. The taxpayer did not have liability to deduct tax at source because it had not made payments exceeding INR 20,000 in a single transaction. The provisions of Section 40(a)(ia) were not applicable to the taxpayer.

The Assessing Officer (AO) observed that while making the payment to the truck operators/owners, the taxpayer did not deduct tax at source even if the net payment exceeded the threshold limit. The AO held that when the truck operators/owners were not to be considered as contractors, they were undoubtedly the sub-contractors of the taxpayer. The taxpayer's case was squarely covered within the provisions of Section 194C. Accordingly, the AO also disallowed the payments made to the truck operators/owners under Section 40(a)(ia). The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Supreme Court decision

Applicability of Section 194C

In the present case, the goods were transported through the trucks employed by the taxpayer. However, there was no privity of contract between the truck operators/owners and the said consignor company. Indisputably, it was the responsibility of the taxpayer to transport the goods (cement) of the company and how to accomplish this task of transportation was a matter

[1] Shree Choudhary Transport Company v. ITO (Civil Appeal No. 7865 of 2009) -Taxsutra.com
[2] The present case deals with AY 2005-06
[3] The amendment made in Section 40(a)(ia) by the Finance (No.2) Act, 2014, restricting and limiting the extent of disallowance to 30 per cent of the expenditure

exclusively within the domain of the taxpayer. Hence, hiring the services of truck operators/owners for this purpose could have only been under a contract between the taxpayer and the said truck operators/owners. Whether such a contract was reduced into writing or not carries hardly any relevance.

If a particular truck was not engaged, there existed no contract but, when any truck got engaged for the purpose of execution of the work undertaken by the taxpayer and freight charges were payable to its operator/owner upon execution of the work, i.e., transportation of the goods, all the essentials of making of a contract existed; and therefore, the said truck operator/owner became a sub-contractor for the purpose of the work in question.

The decision[4] relied on by the taxpayer were distinguishable on facts of the present case. In the present case, the taxpayer was not acting as a facilitator or intermediary between the consignor company and the truck operators/owners because those two parties had no privity of contract between them. The contract of the company, for transportation of its goods, had only been with the taxpayer and it was the taxpayer who hired the services of the trucks. The payment made to such a truck operator/owner was clearly a payment made to the sub-contractor. Whether the taxpayer had specific and identified trucks on its rolls or had been picking them up on freelance basis, the legal effect on the status of parties had been the same.

Applicability of disallowance under Section 40(a)(ia)

The aspects with respect to the amount 'payable' and 'already paid', do not require much dilation in view of the ratio of the decision of the Supreme Court in the case of Palam Gas Service. The Supreme Court in that decision observed that when the entire scheme of obligation to deduct the tax at source and paying it to the government is read holistically, it cannot be held that the word 'payable' occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. Accordingly, Section 40(a)(ia) covers not only those cases where the amount is 'payable' but also when it is 'paid' and tax has not been deducted on the same.

The term 'payable' has been used in Section 40(a)(ia) only to indicate the type or nature of the payments by the taxpayers to the payees referred therein. The decision in the case of Palam Gas Service on the core question of law is equally binding on the Supreme Court and could be doubted only if the view, as taken, is shown to be not in conformity with any binding decision of the Larger Bench or any statutory provisions or any other reason of the like nature.

Effective date of applicability of Section 40(a)(ia)

The Calcutta High Court in the case of PIU Ghosh[5] held that the Finance Act, 2004 got presidential assent on 10 September 2004. The taxpayer could not have foreseen prior to 10 September 2004 that any amount paid to a contractor without deducting tax at source was likely to become not deductible under Section 40. Section 11 of the Finance (No. 2) Act, 2004 by which sub-clause (ia) was added to Section 40(a) does not provide that the same was to become effective from the AY 2005-06. It merely says it shall become effective on 1 April 2005.

The Supreme Court distinguished the decision in the case of PIU Ghosh and observed that the provision in question, having come into effect from 1 April 2005, would apply from the AY 2005-2006 and would be applicable for the assessment in question. The legislature consciously made the said Section 40(a)(ia) of the Act effective from 1 April 2005, meaning thereby that the same was to be applicable from and for the AY 2005-2006.

It has been observed that by the amendment in question, clause (ia) was added to Section 40(a) with a proviso to the effect that where, in respect of the sum referable to TDS requirement, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid in any subsequent year after expiry of the time prescribed in Section 200(1), such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid. It is evident that the said proviso has totally escaped the attention of the Calcutta High Court in the case of PIU Ghosh. Therefore, the decision in the case of PIU Ghosh cannot be regarded as correct on law.

30 per cent disallowance

The taxpayer also argued that the Finance (No.2) Act, 2014 amended the provisions and restricted the disallowance under Section 40(a)(ia) to 30 per cent of the sum payable and the said amendment is retrospective in operation.

The Supreme Court observed that the Finance (No.2) Act of 2014 was specifically made applicable with effect from 1 April 2015 and clearly represents the will of the legislature as to what is to be deducted or what percentage of deduction is not to be allowed for a particular eventuality, from the AY 2015-2016.

Our comments

The issue with respect to disallowance of expenditure under Section 40(a)(ia) when amount is not 'payable' at the end of the year but 'paid' during the year has been a subject matter of debate before the Courts. The Supreme Court in the case of Palam Gas Service has

[4] CIT v. Hardarshan Singh [2013] 350 ITR 427 (Del)

[5] PIU Ghosh v. DCIT [2016] 386 ITR 322 (Cal)

dealt with this issue and held that when the entire scheme of obligation to deduct the tax at source and paying it over to the government is read holistically, it cannot be held that the word ‘payable’ occurring in Section 40(a)(ia) refers to only those cases where the amount is yet to be paid and does not cover the cases where the amount is actually paid. Accordingly, Section 40(a)(ia) covers not only those cases where the amount is ‘payable’ but also when it is ‘paid’ and tax has not been deducted on the same.

The Supreme Court in the present case relied on the decision of Palam Gas Service and held that the disallowance under Section 40(a)(ia) is not limited only to the amount outstanding but it equally applies to the amount of expenditure that had already been incurred and paid by the taxpayer.

Further the Supreme Court held that the contract of the company, for transportation of its goods, had only been with the taxpayer and it was the taxpayer who hired the services of the trucks. The payment made by the taxpayer to truck operator/owner was clearly a payment made to a sub-contractor. Therefore, the provision of deduction of tax at source under Section 194C are applicable to the taxpayer

The disallowance under Section 40(a)(ia) as introduced by the Finance (No.2) Act, 2004 with effect from 1 April 2005 is applicable to the taxpayer since the present case is relating to AY 2005-2006.

Further the benefit of restricted disallowance of 30 per cent as provided by amendment in 2014 is prospective in nature and not applicable to the instant case.

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