

# TAX FLASH NEWS

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## Since income is not accrued, TDS provisions are not applicable on the provision for expenses

### Executive summary

The Karnataka High Court in the case of Toyota Kirloskar Motor (P) Ltd.<sup>1</sup> (the taxpayer) dealt with the issue of applicability of provisions of Tax Deduction at Source (TDS) on the provision entry passed in the books of accounts. The High Court held that the taxpayer is not liable to deduct tax at source in absence of accrual of any income under the Income-tax Act, 1961 (the Act). The provisions were created during the course of the year and reversal of entry was made in the same accounting year. Consequently, the proceedings under Section 201 and 201(1A) could not be initiated.

### Facts of the case

The taxpayer is a joint venture company and it is a subsidiary of a Japanese company. The taxpayer is engaged in manufacturing and sale of passenger cars and multi-utility vehicles. The taxpayer follows mercantile system of accounting. During the Assessment Year 2012-13, the taxpayer made provision for marketing, overseas and general expenses on estimate basis in respect of works/contracts/service expenses. However, at the time of filing of the return of income, the provision which remain unutilised as per books of accounts was not claimed as deduction under Section 40(a)(i) and (ia) and the same was offered to tax.

Subsequent to filing of the tax return, the taxpayer received invoices from the vendors and the amount mentioned in the invoices was debited to the respective vendor account. The amount indicated in the invoices was utilised against the provision and the TDS along with interest was also discharged at the time of credit of the invoice amount to the vendor. Subsequently, the amount which remained unutilised in the provision account after completion of negotiation/finalisation of services was reversed in the books of accounts of the taxpayer.

The Assessing Officer (AO) initiated TDS proceedings and treated the taxpayer as an 'assessee in default' in respect of the amount made in provision which was reversed/unutilised. The Commissioner of Income-tax (Appeals) [CIT(A)] and the Tribunal upheld the order of the AO.

### High Court decision

On a perusal of TDS provisions, it indicate that TDS provisions are applicable when an income accrues under the Act. The Supreme Court in the case of Shoorji Vallabhdas & Co.<sup>2</sup> held that income tax is levy on income and the Act takes into account two points of time at which the liability to tax is attracted i.e., accrual of income or its receipt but substance of the matter is income. It has been held that if income does not result at all, there cannot be levy of tax even though the book-keeping entry is made about a hypothetical income which does not materialise. The Delhi High Court in the case of Ericsson Communications Ltd<sup>3</sup> has also taken a view that in the absence of any accrual of income, there was no obligation on the part of the taxpayer to deduct tax at source. Subsequently, various courts have taken a similar position.

In the present case also, the provisions were created during the course of the year and reversal of entry was made in the same accounting year. The tax authorities under the Act ought to have appreciated that in the absence of any income accruing to anyone under the Act, the liability to deduct tax at source on the taxpayer could not have been fastened and consequently, the proceedings under Section 201 and 201(1A) could not have been initiated.

<sup>2</sup> CIT v. Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC)

<sup>3</sup> DIT v. Ericsson Communications Ltd [2015] 378 ITR 395 (Del)

<sup>1</sup> Toyota Kirloskar Motor (p) Ltd. v. ITO (ITA No. 245/2018) – Taxsutra.com

## Our comments

The accrual of amount payable to the payee is an important factor in determining the liability of the payer to deduct tax at source under the provisions of the Act. A mere passing of book-keeping entry by a taxpayer cannot be his income unless such income is actually accrued and it has become chargeable to tax<sup>4</sup>. The liability to pay an income by the payer and right to receive such income by the payee should go hand-in-hand. In the context of Section 201, the Karnataka High Court in the case of Motor Industries Co.<sup>5</sup>, held that where the amount itself was not due because the foreign collaboration agreement had not been formalised, there was no liability to deduct tax at source.

It is important to note that mere entries in the books of account does not establish the accrual of income in the hands of the payee<sup>6</sup>. Further 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<sup>7</sup>.

However, the Karnataka High Court in case of United Breweries Ltd.<sup>8</sup> held that there was a liability arising as a result of the entries made in the books of account of the taxpayer and the same was acknowledged by way of claiming deduction for the relevant years. Since, there was a definite liability on the taxpayer, the taxpayer was liable to deduct tax on the guarantee commission under Section 195 in the year of credit in the books of account.

Thus, whether the taxpayer has claimed deduction of expenditure in the computation of business income could also play an important part in such cases. In the instant case, the taxpayer had not claimed any expenditure and suo-motu disallowed the expenditure.

On one hand, the Courts in some of the cases<sup>9</sup> have held that TDS provisions are applicable on the year-end provisions and once an amount is credited, the taxpayer is liable to deduct tax at source. However, on the other hand the Courts<sup>10</sup> have held that where identity of a payee is not known and exact amounts are not ascertainable, a view can be taken that tax is not deductible on the year-end provisions so made. Thus identification of the payer is also important to determine

whether TDS provisions are applicable on such provisions made in the books of accounts.

In this regard, it is pertinent to refer to the decision of Chennai Tribunal in the case of Dishnet Wireless Limited<sup>11</sup> where it was held that wherever the payee is identified, and quantum is also ascertainable on the last day of the financial year, the taxpayer has to deduct tax at source. Similarly, the Bangalore Tribunal in the case of IBM India (P.) Ltd.<sup>12</sup> had held that the taxpayer would be liable to deduct tax on the provision for expenditure created in the books of accounts. The accrual of liability for any expenditure was not dependent on receipt of an invoice from any person to whom payment for expenditure has to be made. The claim of the taxpayer that it created provision on an estimated basis, on historical basis using some arithmetic/geometric progression method was not acceptable due to lack of concrete evidence. However, the Mumbai Tribunal<sup>12</sup> observed that the taxpayer had no liability to deduct tax in respect of provision made in the books of accounts since the payees were not identifiable at the time of making of the provision, thus no statutory obligation was cast upon the taxpayer to deduct tax at source.

Recently, the Gujarat High Court in the case of Sanghi Infrastructure Ltd.<sup>13</sup> observed that the tax was not deducted by the taxpayer on the provision for expenses since the same were contingent in nature and for which bills were not received/issued. Subsequently, when the bills were received/issued, the tax was deducted by the taxpayer. Accordingly, the disallowance under Section 40(a)(ia) was deleted.

Similarly, the Karnataka High Court in the present case has held that the taxpayer is not liable to deduct tax in absence of any income accruing to anyone under the Act. In the absence of any income, the liability to deduct tax at source on the taxpayer could not have been fastened. The provisions were created during the course of the year and reversal of entry was made in the same accounting year. Consequently, the proceedings under Section 201 and 201(1A) could not have been initiated.

In view of above, the important factors to determine applicability of provisions of TDS on the provision entry passed in the books of accounts are-

- Whether the income is accrued,
- Whether there is proper estimation of liability,
- Whether payee is identifiable,
- Whether the taxpayer has claimed the expenditure, etc.

It is pertinent to note that if TDS provisions are not applicable on the provision of expenses for the reason that it has not accrued as income of the payee, then there could be a challenge in claiming such sum as deduction under Section 37 in the hands of payer due to the absence of liability to pay such income.

<sup>4</sup> CIT v. Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC)

<sup>5</sup> ACIT v. Motor Industries Co. [2001] 249 ITR 141 (Kar)

<sup>6</sup> CIT v. India Discount Co. Ltd. [1970] 75 ITR 191 (SC), Godhra Electricity Co. Ltd. v. CIT [1997] 225 ITR 746 (SC)

<sup>7</sup> Toyota Kirloskar Motors Pvt Ltd. v. ITO (ITA No.1185/Bang/2014) (Bang)

<sup>8</sup> United Breweries Ltd. v. ACIT [1995] 211 ITR 256 (Kar)

<sup>9</sup> DCIT v. Jaslok Hospital & Research Centre (2013) ITA no. 2894-2896 and 3100-3103/Mum/2009 (Mum), Hero MotoCorp Ltd. v. ACIT [2013] 36 taxmann.com 103 (Del)

<sup>10</sup> Industrial Development Bank of India v. ITO [2007] 107 ITD 45 (Mum), DCIT v. Telco Construction Equipment Co. Ltd [2014] (ITA 478/Bang/2012) (Bang), Pr. CIT v. Sanghi Infrastructure Ltd. (2018) 96 taxmann.com 370 (Guj)

<sup>11</sup> Dishnet Wireless Ltd. v. DCIT [2016] 45 ITR(T) 430 (Chennai)

<sup>12</sup> IBM India Private Ltd. v. ITO (ITA Nos.749 to 752/Bang/2012) (Bang)

<sup>13</sup> DCIT v. Sanghi Infrastructure Ltd. (ITA No. 2576/Ahd/2012)

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