

# TAX FLASH NEWS

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## Karnataka High Court's decision on the applicability of TDS provisions on the year-end provision

Recently, the Karnataka High Court in the case Volvo India Private Limited<sup>1</sup> (the taxpayer) dealt with the issue of applicability of TDS provisions on the year-end provision. The High Court observed that the payees were not identifiable when the year-end provisions were made. If the payer has not claimed any deduction on the year-end provision in the return of income and the same is claimed in the subsequent year after the receipt of the bills/invoices, the matter has to be analysed having regard to, whether income has accrued to the payees to deduct tax at source. It was further observed that the Tribunal had not appreciated the taxpayer's contentions with respect to non-identification of the payees and the disallowance of expenditure under Section 40(a)(ia) of the Income-tax Act, 1961 (the Act). Accordingly, the High Court remanded the matter back for fresh consideration.

### Facts of the case

The taxpayer is engaged in the business of manufacturing and dealing in tractors, trailers, bus chassis, road machinery and trading in construction equipment and also provides software, product design and other support services.

During the assessment years (AY) 2012-13 and 2013-14, the taxpayer created provision for expenses, head wise, on adhoc basis in respect of various services received to facilitate closing of the books without reference to any particular party. Such excess amounts of provisions created got reversed subsequently. The taxpayer had not deducted any tax in respect of such provisions.

The Assessing Officer (AO) initiated TDS proceedings under Section 201(1)/201(1A) considering the taxpayer as 'assessee in default' in respect of the amount of tax which was not deducted at source on such provisions. The Commissioner of Income-tax (Appeals) and Income-tax Appellate Tribunal (the Tribunal) upheld the order of the AO. Aggrieved, the taxpayer filed an appeal before the High Court.

### High Court's decision

The provision made by the taxpayer was not identifiable with the parties. The High Court in the case of Karnataka Power Transmission Corporation Ltd.<sup>2</sup> while dealing with a similar issue held that if no income was attributable to the payee, there was no liability to deduct tax at source in the hands of the deductor.

Reference was made to the decision of TE Connectivity India Pvt. Ltd.<sup>3</sup> where it was observed that the provisions, made at the end of the accounting year were reversed in the beginning of the next year and payees were not identifiable. The exact amount of liability also cannot be quantified. The provisions were made merely in the Management Information System. In such circumstances, the Tribunal following the decision in the case of Karnataka Power Transmission Corporation Ltd. held that the taxpayer was not liable to deduct tax at source since no income has accrued in the hands of the payee.

The appeal filed by the taxpayer was dismissed by the Tribunal observing that the facts of the case of TE Connectivity India Pvt. Ltd. were distinguishable. The Tribunal in the present case observed that the payees were identifiable. However, the High Court did not

<sup>1</sup> Volvo India Private Limited v. ITO (ITA.No.369/2018) – Taxsutra.com

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

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

agree with the said observation since in the provisions made, the payees were not identified. Further, the genuineness of the provision cannot be determined on the basis of the figures. The cryptic reasoning of the Tribunal was not sufficient to support the findings arrived at. It is trite that proper reason was the essential ingredient of a valid order.

It was apparent that the contentions of the taxpayer in as much as non-identification of the payees in the provisions and the disallowance of expenditure under Section 40(a)(ia) have not been rightly appreciated by the Tribunal. In this scenario, the decision of the Supreme Court in the case of Shree Choudhary Transport Company<sup>4</sup> would not be of any assistance to the tax department unless the material aspects are considered with respect to Section 40(a)(ia) read with Sections 194C, 194H, 194-I, 194J under which TDS was required to be deducted by the taxpayer. These factors necessarily require to be addressed by the Tribunal keeping in mind the provisions of the Act as well as the legal principles enunciated by the Courts.

If the payer has not claimed any deduction on the year-end provision in the return of income and the same is claimed in the subsequent year after the receipt of the bills/invoices, the matter has to be analysed having regard to, whether income has accrued to the payees to deduct tax at source. Accordingly, the Tribunal's order was set aside and the matter was reminded back to the Tribunal for fresh consideration.

## 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. The Supreme Court in the case of Shoorji Vallabhdas & Co.<sup>5</sup> held that 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. 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>6</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.

The Bangalore Tribunal in the case of Toyota Kirloskar Motors Pvt Ltd<sup>7</sup> held that 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, 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.

It is important to note that while in some of the cases, the Courts<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. On the other hand, some of the Courts<sup>10</sup> have held that where identity of a payee is not known and exact amounts are not ascertainable, tax is not deductible on the year-end provisions so made.

In the instant case, the Karnataka High Court observed that the payees were not identifiable when the year-end provisions were made. Further the Tribunal had not appreciated the taxpayer's contentions with respect to identification of the payees and the disallowance of expenditure for non-deduction of tax. Accordingly, the High Court remanded the matter back for fresh consideration.

<sup>4</sup> Shree Choudhary Transport Company v. ITO [2020] 118 taxmann.com 47 (SC)

<sup>5</sup> CIT v. Shoorji Vallabhdas & Co. [1962] 46 ITR 144 (SC)

<sup>6</sup> ACIT v. Motor Industries Co. [2001] 249 ITR 141 (Kar)

<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)

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