IN THE INCOME TAX APPELLATE TRIBUNAL,
AGRA BENCH, AGRA
[Coram : Bhavnesh Saini, JM, and Pramod Kumar, AM]

I.T.A. No.:337/Agra/2013
Assessment year: 2006-07

Rajeev Kumar Agarwal ***……Appellant***
Madras House, Gal Balla
Holi Gate, Mathura
[PAN: AAWPA0065H]

Vs.

Additional Commissioner of Income Tax
Range 3, Mathura ***……Respondent***

Appearances by:
Dr Rakesh Gupta,*for the appellant*
Radha Sharma,*for the respondent*

Date of concluding the hearing : May 12,2013
Date of pronouncing the order : May 29,2013

O R D E R

Pramod Kumar:

1. This appeal, filed by the assessee, calls into question correctness of learned Commissioner (Appeals) order dated 2nd September, 2013, in the matter of assessment under section 143(3) of the Income Tax Act, 1961*(hereinafter to as 'the Act')*, for the assessment year 2006-07, upholding the disallowance of Rs 5,01,872 under section 40(a)(ia) of the Act.

2. The issue in appeal lies in a rather narrow compass of undisputed material facts. During the course of the scrutiny assessment proceedings, the Assessing Officer noticed that the assessee has made interest payments, aggregating to Rs 5,01,872, without discharging his tax withholding obligations under section 194A. It was in this backdrop that the Assessing Officer, having noted the undisputed position regarding applicability of section 194 A on the facts of this case, and having noted that the scope of section 40(a)(ia) restricting deduction in respect of sums in respect of which tax withholding liability is not discharged, disallowed Rs 5,01,872 under section 40(a)(ia) r.w.s. 194 A of the Act. Aggrieved, assessee carried the matter in appeal before the CIT(A). It was, *inter alia,* contended by the

assessee that in view of the insertion of second proviso to Section 40(a)(ia) by the Finance Act 2012, and in view of the fact that the recipients of the interest have already included the income embedded in these payments in their tax returns filed under section 139, disallowance under section 40(a)(ia) could not be invoked in this case. It was also contended that even though this proviso is stated to be effective 1st April 2013, since the amendment in "declaratory and curative in nature, and, therefore, it should be given retrospective effect from 1st April, 2005, being the date from which sub clause (ia) of section 40(a) was inserted by the Finance (No. 2) Act, 2004". None of these submissions, however, impressed the learned CIT(A). Relying upon a Special Bench decision in the case of **Bharati Shipyard Ltd Vs. DCIT (141 TTJ 129),** herejected this plea and concluded that insertion of second proviso to Section 40(a)(ia) cannot be held to have retrospective effect. The disallowance was thus confirmed by the learned CIT(A). The assessee is aggrieved and is in appeal before us.

3. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

4. Let us first take a look at the legislative amendment of section 40(a)(ia), vide Finance Act 2012, and try to appreciate the scheme of things as evident in the amended section. Second proviso to Section 40(a)(ia), introduced with effect from 1st April 2013, provides, that "**where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso".** In other words, as long as the assessee cannot be treated as an assessee in default, the disallowance under section 40(a)(ia) cannot come into play either. To understand the effect of this proviso, it is useful to refer to first proviso to section 201(1), which is also introduced by the Finance Act 2012and effective1st July 2012, and which provides that **"any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident-(i)**

has furnished his return of income under section 139; (ii) has taken into account such sum for computing income in such return of income; and(iii) has paid the tax due on the income declared by him in such return of income, and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed." The unambiguous underlying principle seems to be that in the situations in which the assessee's tax withholding lapse have not resulted in any loss to the exchequer, and this fact can be reasonably demonstrated, the assessee cannot be treated as an assessee in default. The net effect of these amendments is that the disallowance under section 40(a)(ia) shall not be attracted in the situations in which even if the assessee has not deducted tax at source from the related payments for expenditure but the recipient of the monies has taken into account these receipts in computation of his income, paid due taxes, if any, on the income so computed and has filed his income tax return under section 139(1). There is also a procedural requirement of issuance of a certificate, in the prescribed format, evidencing compliance of these conditions by the recipients of income, but that is essentially a procedural aspect of the matter. The legislative amendment so brought about by the Finance Act, 2012, so far as the scheme of disallowance under section 40(a)(ia) is concerned, substantially mitigates the rigour of, what otherwise seemed to be, a rather harsh disallowance provision.

5. As for the question as to whether this amendment can be treated as retrospective in nature, even in the case of **Bharti Shipyard** *(supra)*– a special bench decision vehemently relied upon in support of revenue's case,the special bench, on principles, summed up the settled legal position to the effect that "**any amendment of the substantive provision which is aimed at ……** *(inter alia)* **removing unintended consequences to make the provisions workable has to be treated as retrospective notwithstanding the fact that the amendment has been given effect prospectively**". It was held that if the consequences sought to be remedied by the subsequent amendments were to be treated as "intended consequences", the amendment could not be treated as retrospective in effect. The special bench then proceeded to draw a line of demarcation between intended consequences and unintended consequences, and finally the retrospectivity of first proviso was decided against the assessee on the ground that this special bench was of the considered view that "**the objective sought to be achieved by bringing out section 40(a)(ia) is the <u>augmentation of TDS provisions</u>**" and went on to add

that "**If, in attaining this main objective of augmentation of such provisions, the assessee suffers disallowance of any amount in the year of default, which is otherwise deductible, the legislature allowed it to continue**". It was further observed that "**this is the cost which parliament has awarded to those assessees who fail to comply with the relevant provisions by considering overall objective of boosting TDS compliance**"*(Emphasis by underlining supplied by us)*. In other words, the amendment was held to be prospective because, in the wisdom of the special bench, the 2010 amendment to Section 40(a)(ia) by inserting first proviso thereto, which is what the special bench was dealing with, was an "intended consequence" of the provision of Section 40(a)(ia).

6. However, the stand so taken by the special bench was disapproved by Hon'ble Delhi High Court in the case of **CIT Vs Rajinder Kumar (362 ITR 241).** While doing so, Their Lordships observed that, "The object of introduction of Section 40(a)(ia) is to ensure that TDS provisions are scrupulously implemented without default in order to **augment recoveries**.....Failure to deduct TDS or deposit TDS **results in loss of revenue and may deprive the Government of the tax due and payable**" *(Emphasis by underlining supplied by us)*". Having noted the underlying objectives, Their Lordships also put in a word of caution by observing that, "**the provision should be interpreted in a fair, just and equitable manner**". Their Lordships thus recognized the bigger picture of realization of legitimate tax dues, as object of Section 40(a)(ia), and the need of its fair, just and equitable interpretation. This approach is qualitatively different from perceiving the object of Section 40(a)(ia) as awarding of costs on the "assessees who fail to comply with the relevant provisions by considering overall objective of boosting TDS compliance". Not only the conclusions arrived at by the special bench were disapproved but the very fundamental assumption underlying its approach, i.e. on the issue of the object of Section 40(a)(ia), was rejected too. In any event, even going by Bharti Shipyard decision *(supra),* what we have to really examine is whether 2012 amendment, inserting second proviso to Section 40(a)(ia), deals with an "intended consequence" or with an "unintended consequence".

7. When we look at the overall scheme of the section as it exists now and the bigger picture as it emerges after insertion of second proviso to section 40(a)(ia), it is beyond doubt that the underlying objective of section 40(a)(ia) was to disallow

deduction in respect of expenditure in a situation in which the income embedded in related payments remains untaxed due to non deduction of tax at source by the assessee. In other words, deductibility of expenditure is made contingent upon the income, if any, embedded in such expenditure being brought to tax, if applicable. In effect, thus, a deduction for expenditure is not allowed to the assessees, in cases where assessees had tax withholding obligations from the related payments, without corresponding income inclusion by the recipient.That is the clearly discernable bigger picture, and, unmistakably, a very pragmatic and fair policy approach to the issue – howsoever belated the realization of unintended and undue hardships to the taxpayers may have been. It seems to proceed on the basis, and rightly so, that seeking tax deduction at source compliance is not an end in itself, so far as the scheme of this legal provision is concerned, but is only a mean of recovering due taxes on income embedded in the payments made by the assessee. That's how, as we have seen a short while ago, Hon'ble Delhi High Court has visualized the scheme of things – as evident from Their Lordships' reference to augmentation of recoveries in the context of "loss of revenue" and "depriving the Government of the tax due and payable".

8. With the benefit of this guidance from Hon'ble Delhi High Court, in view of legislative amendments made from time to time, which throw light on what was actually sought to be achieved by this legal provision, and in the light of the above analysis of the scheme of the law, we are of the considered view that section 40(a)(ia) cannot be seen as intended to be a penal provision to punish the lapses of non deduction of tax at source from payments for expenditure- particularly when the recipients have taken into account income embedded in these payments, paid due taxes thereon and filed income tax returns in accordance with the law. As a corollary to this proposition, in our considered view, declining deduction in respect of expenditure relating to the payments of this nature cannot be treated as an "intended consequence" of Section 40(a)(ia). If it is not an intended consequence i.e. if it is an unintended consequence, even going by Bharti Shipyard decision *(supra),* "removing unintended consequences to make the provisions workable has to be treated as retrospective notwithstanding the fact that the amendment has been given effect prospectively". Revenue, thus, does not derive any advantage from special bench decision in the case Bharti Shipyard *(supra).*

9. On a conceptual note, primary justification for such a disallowance is that such a denial of deduction is to compensate for the loss of revenue by corresponding income not being taken into account in computation of taxable income in the hands of the recipients of the payments. Such a policy motivated deduction restrictions should, therefore, not come into play when an assessee is able to establish that there is no actual loss of revenue. This disallowance does deincentivize not deducting tax at source, when such tax deductions are due, but, so far as the legal framework is concerned, this provision is not for the purpose of penalizing for the tax deduction at source lapses. There are separate penal provisions to that effect. Deincentivizing a lapse and punishing a lapse are two different things and have distinctly different, and sometimes mutually exclusive, connotations. When we appreciate the object of scheme of section 40(a)(ia), as on the statute, and to examine whether or not, on a "fair, just and equitable" interpretation of law- as is the guidance from Hon'ble Delhi High Court on interpretation of this legal provision, in our humble understanding, it could not be an "intended consequence" to disallow the expenditure, due to non deduction of tax at source, even in a situation in which corresponding income is brought to tax in the hands of the recipient. The scheme of Section 40(a)(ia), as we see it, is aimed at ensuring that an expenditure should not be allowed as deduction in the hands of an assessee in a situation in which income embedded in such expenditure has remained untaxed due to tax withholding lapses by the assessee. It is not, in our considered view, a penalty for tax withholding lapse but it is a sort of compensatory deduction restriction for an income going untaxed due to tax withholding lapse. The penalty for tax withholding lapse *per se* is separately provided for in Section 271 C, and, section 40(a)(ia) does not add to the same. The provisions of Section 40(a)(ia), as they existed prior to insertion of second proviso thereto, went much beyond the obvious intentions of the lawmakers and created undue hardships even in cases in which the assessee's tax withholding lapses did not result in any loss to the exchequer. Now that the legislature has been compassionate enough to cure these shortcomings of provision, and thus obviate the unintended hardships, such an amendment in law, in view of the well settled legal position to the effect that a curative amendment to avoid unintended consequences is to be treated as retrospective in nature even though it may not state so specifically, the insertion of second proviso must be given retrospective effect from the point of time when the related legal provision was introduced. In view of these discussions, as also for the detailed reasons set out earlier, we cannot subscribe to the view that it could have

been an "intended consequence" to punish the assessees for non deduction of tax at source by declining the deduction in respect of related payments, even when the corresponding income is duly brought to tax. That will be going much beyond the obvious intention of the section. Accordingly, we hold that the insertion of second proviso to Section 40(a)(ia) is declaratory and curative in nature and it has retrospective effect from 1st April, 2005, being the date from which sub clause (ia) of section 40(a) was inserted by the Finance (No. 2) Act, 2004.

10. In view of the above discussions, we deem it fit and proper to remit the matter to the file of the Assessing Officer for fresh adjudication in the light of our above observations and after carrying out necessary verifications regarding related payments having been taken into account by the recipients in computation of their income, regarding payment of taxes in respect of such income and regarding filing of the related income tax returns by the recipients. While giving effect to these directions, the Assessing Officer shall give due and fair opportunity of hearing to the assessee, decide the matter in accordance with the law and by way of a speaking order. We order so.

11. In the result, the appeal is allowed for statistical purposes in the terms indicated above. Pronounced in the open court today on 29th day of May, 2014.

Sd/xx ***Sd/xx***

Bhavnesh Saini **Pramod Kumar**
(Judicial Member) (Accountant Member)

Agra, the 29th day of May, 2014

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Copies to : *(1)* *The appellant*
(2) *The respondent*
(3) *CIT*
(4) *CIT(A)*
(5) *The Departmental Representative*
(6) *Guard File*

By order etc

Senior Private Secretary
Income Tax Appellate Tribunal
Agra bench, Agra