IN THE INCOME TAX APPELLATE TRIBUNAL "C" BENCH : KOLKATA

[Before Hon'ble Sri N.V.Vasudevan, JM & Dr.Arjun Lal Saini, AM]

I.T.A No. 149/Kol/2014

Assessment Year : 2007-08

D.C.I.T., Central Circle-VIII, Kolkata	-vs.-	M/s. Rupa & Co. Ltd. Kolkata [PAN : AABCR 2648 M]
(Appellant)		(Respondent)

For the Appellant : Shri G.Mallikarjuna, CIT(DR)
For the Respondent : Shri A.K.Tulsiyan, FCA

Date of Hearing : 09.08.2016.
Date of Pronouncement : 12.08.2016.

ORDER

Per N.V.Vasudevan, JM

This is an appeal by the Revenue against the order dated 18.11.2013 of CIT(A)-Central-I, Kolkata relating to AY 2007-08.

2. Grounds of appeal raised by the revenue reads as follows :-

"*1. That considering the facts and circumstance of the case the Ld. CIT(A)-C-1, Kolkata was not correct in deleting the disallowance of Royalty payment of Rs.1,44,15,452/- on which TDS was not deducted u/s 194J of the Income Tax Act, 1961.*

2. That department craves to add, modify or alter the grounds of appeal during the course of hearing of the case. "

3. The Assessee is a company engaged in the business of manufacturing and trading of knitwear. In the course of assessment proceedings u/s 143(3) of the Income Tax Act, 1961 (Act), the AO noticed that the assessee had debited a sum of Rs.1,44,15,452/- under the head "Royalty ' in the profit and loss account. Under the provisions of section 194J(1)(c) of the Act any person responsible for paying to a resident any sum by way of royalty shall, at the time of credit of such sum to the account of the payee or at the

time of payments thereof in cash or by issue of cheque or draft or by any other mode, **whichever is earlier,** deduct an amount equal to 10% of such sum as income tax on income comprised therein. It is pertinent to note that u/s 194J of the Act, obligation to deduct tax at source on payment of any sum as royalty was introduced by Taxation Laws (Amendment) Act 2006 w.e.f. 13.07.2006 only. Prior to that date for any payment of royalty to a resident there was no obligation to deduct tax at source u/s.194J of the Act. In the books of accounts of the assessee the credit of sum payable as royalty to M/s. Binod Hosiery was made on 30.06.2006. As on this date there was no obligation to deduct tax on the payment of royalty. As we have already stated it was only from 13.07.2006, there was an obligation to deduct tax at source on such payment. The plea of the assessee was that there was no obligation to deduct tax at source, as on the date when the credit of the sum was made in the account of M/S.Binod Hosiery on account of royalty and therefore there can be no consequent disallowance of royalty expenses u/s 40(a)(ia) of the Act. Besides the above stand the assessee also took the other stand which the AO has discussed in the order of assessment. These reasons are not discussed for the reason that the ultimate decision in the case would rest on subsequent amendment to the provision of section 40(a)(ia) of the Act. The AO invoking the provision of section 40(a)(ia) of the Act disallowed the sum of Rs.1,44,15,458/- which was royalty paid to M/.s. Binod Hosiery for failure to deduct tax at source by invoking the provision of section 40(a)(ia) of the Act, holding that the entry of payment of royalty made on 30.6.2006 was an afterthought.

4. On appeal by the assessee the CIT(A) deleted the addition made by the AO for the following reasons :-

> "In order to invoke section 40(a)(ia), it is necessary for the AO to prove that the assessee had legal obligation to deduct tax from an expenditure in conformity with Chapter XVIIB of the Act and that the assessee either failed to deduct or having deducted the tax failed to pay the same to the credit of the central government. However as discussed above, the assessee in its books credited the account of M/s. Binod Hosiery by the sum payable as royalty on 30-06-2006; and, as per the provisions of section 194J subsisting in the Act on the date of giving the credit, the assessee had no obligation to deduct tax u/s 194J. Such

obligation, if any, came into legal force only on 13-07-2006. Under the circumstances, I am satisfied that in respect of royalty of Rs.1,44,15,452/- which was credited to the payee's account on 30-06-2006; the assessee had no obligation to deduct tax under Chapter XVIIB. In that view of the matter, the assessee did not contravene the provisions of Chapter XVIIB and more specifically section 194J. In absence of any breach of the statutory provisions of Chapter XVIIB by the assessee, the AO was not justified in invoking provisions of section 40(a)(ia). In view of the above, the disallowance of Rs.1,44,15,452/- by applying section 40(a)(ia) is directed to be deleted. Since the assessee's appeal is allowed on the preliminary ground, the alternative submissions regarding retrospective application of the amended provisions of section 40(a)(ia) being effective from 01-04-2013 are not adjudicated. "

5. Aggrieved by the order of the CIT(A) the revenue has preferred the present appeal before the Tribunal.

6. We are of the view that the issues raised by the revenue in the appeal need not be adjudicated and it would be sufficient if we give a direction to the AO to verify if the payees have declared the receipt from the Assessee in their return of income and if it is found that the payees have so declared, then the addition u/s.40(a)(ia) of the Act should be deleted by the AO. The above conclusions of ours are made in the context of the following amendments to the provisions of Sec.40(a)(ia) of the Act. With a view to liberalize provisions of Section 40(a)(ia) of the Act Finance Act 2012 brought amendment w.e.f 01.04.2013 as under. The following second proviso was inserted in sub-clause (*ia)* of clause (*a*) of Section 40 by the Finance Act, 2012, w.e.f. 1-4-2013 :

"Provided further 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."

7. Since provisions of Section 40(a)(ia) as amended by Finance Act, 2012 is linked to Section 201 of the Act, in which a proviso was inserted, it is necessary to look into those provisions which read thus:

"Sec.201: (1) Where any person, including the principal officer of a company –

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of Section 192, being an employer, does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax:

Provided 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:

8. Memorandum explaining the provisions while introducing Finance Bill, 2012 provides the justification of the amendment to section 40(a)(ia) in the following words:-

> "In order to rationalise the provisions of disallowance on account of non-deduction of tax from the payments made to a resident payee, it is proposed to amend section 40(a)(ia) to provide that where an assessee makes payment of the nature specified in the said section to a resident payee without deduction of tax and is not deemed to be an assessee in default under section 201(1) on account of payment of taxes by the payee, then, for the purpose of allowing deduction of such sum, 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."

9. The provisions of Sec.40(a)(ia) of the Act are meant to ensure that the Assessee's perform their obligation to deduct tax at source in accordance with the provisions of the Act. Such compliance will ensure revenue collection without much hassle. When the object sought to be achieved by those provisions are found to be achieved, it would be unjust to disallowance legitimate business expenses of an Assessee. Despite due

collection of taxes due, if disallowance of genuine business expenses are made than that would be unjust enrichment on the part of the Government as the payee would have also paid the taxes on such income. In order to remove this anomaly, this amendment has been introduced. In case of payment to non-resident, the government does not have any other mechanism to recover the due taxes. Hence, no amendment was made in section 40(a)(i). The legislature has not given blanket deduction under section 40(a)(ia). The deduction as per amended section will be allowed only if the -

(i) payee has furnished his return of income under section 139;

(ii) payee has taken into account such sum for computing income in such return of income; and

(iii) payee has paid the tax due on the income declared by him in such return of income,

and the payer furnishes a certificate to this effect from an accountant in such form as may be prescribed.

10. The question is as to whether the amendment made as above is prospective or retrospective w.e.f. 1.4.2005 when the provisions of Sec.40(a)(ia) were introduced. Keeping in view the purpose behind the proviso inserted by the Finance Act, 2012 in section 40(a)(ia) of the Act, it can be said to be declaratory and curative in nature and therefore, 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. In *CIT Vs. Alom Extrusions Ltd. 319 ITR 306 (SC)*, the Hon'ble Supreme Court had to deal with the question, whether omission (deletion) of the second proviso to s. 43B of the IT Act, 1961, by the Finance Act, 2003, operated w.e.f. 1st April, 2004, or whether it operated retrospectively w.e.f. 1st April, 1988? Prior to Finance Act, 2003, the second proviso to s. 43B of the IT Act, 1961 (for short, "the Act") restricted the deduction in respect of any sum payable by an employer by way of contribution to provident

fund/superannuation fund or any other fund for the welfare of employees, unless it stood paid within the specified due date. According to the second proviso, the payment made by the employer towards contribution to provident fund or any other welfare fund was allowable as deduction, if paid before the date for filing the return of income and necessary evidence of such payment was enclosed with the return of income. In other words, if contribution stood paid after the date for filing of the return, it stood disallowed. This resulted in great hardship to the employers. They represented to the Government about their hardship and, consequently, pursuant to the report of the Kelkar Committee, the Government introduced Finance Act, 2003, by which the second proviso stood deleted w.e.f. 1st April, 2004, and certain changes were also made in the first proviso by which uniformity was brought about between payment of fees, taxes, cess, etc., on one hand and contribution made to Employees' Provident Fund, etc., on the other.

11. According to the Department, the omission of the second proviso giving relief to the assessee(s) [employer(s)] operated only w.e.f. 1st April, 2004, whereas, according to the assessee(s)-employer(s), the said Finance Act, 2003, to the extent indicated above, operated w.e.f. 1st April, 1988 (retrospectively). The Hon'ble Supreme Court held that the deletion of the second proviso was retrospective w.e.f.1.4.2004. The Court considered the scheme of the Act and the historical background and the object of introduction of the provisions of S. 43B. The Court also referred to the earlier amendments made in 1988 with introduction of the first and second provisos. The Court also noted further amendment made in 1989 in the second proviso dealing with the items covered in S. 43B(b) (*i.e.,* contribution to employees welfare funds). After considering the same, the Court was of the view that it was clear that prior to the amendment of 2003, the employer was entitled to deduction only if the contribution stands credited on or before the due date given in the Provident Fund Act on account of second proviso to S. 43B. The situation created further difficulties and as a result of

representations made by the industry, the amendment of 2003 was carried out which deleted the second proviso and also made first proviso applicable to contribution to employees welfare funds referred to in S. 43B(b).

> ***"15.*** *We find no merit in these civil appeals filed by the Department for the following reasons : firstly, as stated above, s. 43B (main section), which stood inserted by Finance Act, 1983, w.e.f. 1st April, 1984, expressly commences with a non obstante clause, the underlying object being to disallow deductions claimed merely by making a book entry based on mercantile system of accounting. At the same time, s. 43B (main section) made it mandatory for the Department to grant deduction in computing the income under s. 28 in the year in which tax, duty, cess, etc., is actually paid. However, Parliament took cognizance of the fact that accounting year of a company did not always tally with the due dates under the Provident Fund Act, Municipal Corporation Act (octroi) and other tax laws. Therefore, by way of first proviso, an incentive/relaxation was sought to be given in respect of tax, duty, cess or fee by explicitly stating that if such tax, duty, cess or fee is paid before the date of filing of the return under the IT Act (due date), the assessee(s) then would be entitled to deduction. However, this relaxation/incentive was restricted only to tax, duty, cess and fee. It did not apply to contributions to labour welfare funds. The reason appears to be that the employer(s) should not sit on the collected contributions and deprive the workmen of the rightful benefits under social welfare legislations by delaying payment of contributions to the welfare funds. However, as stated above, the second proviso resulted in implementation problems, which have been mentioned hereinabove, and which resulted in the enactment of Finance Act, 2003, deleting the second proviso and bringing about uniformity in the first proviso by equating tax, duty, cess and fee with contributions to welfare funds. Once this uniformity is brought about in the first proviso, then, in our view, the Finance Act, 2003, which is made applicable by the Parliament only w.e.f. 1st April, 2004, would become curative in nature, hence, it would apply retrospectively w.e.f. 1st April, 1988. Secondly, it may be noted that, in the case of Allied Motors (P) Ltd. Etc. vs. CIT (1997) 139 CTR (SC) 364 : (1997) 224 ITR 677 (SC), the scheme of s. 43B of the Act came to be examined. In that case, the question which arose for determination was, whether sales-tax collected by the assessee and paid after the end of the relevant previous year but within the time allowed under the relevant sales-tax law should be disallowed under s. 43B of the Act while computing the business income of the previous year ? That was a case which related to asst. yr. 1984-85. The relevant accounting period ended on 30th June, 1983. The ITO disallowed the deduction claimed by the assessee which was on account of sales-tax collected by the assessee for the last quarter of the relevant accounting year. The deduction was disallowed under s. 43B which, as stated above, was inserted w.e.f. 1st April, 1984. It is also relevant to note that the first proviso which came into force w.e.f. 1st April, 1988 was not on the statute book when the assessments were made in the case of Allied Motors (P) Ltd. Etc. (supra). However, the assessee contended that even though the first proviso came to be inserted w.e.f. 1st April, 1988, it was entitled to the benefit of that proviso because it operated retrospectively from 1st April, 1984, when s. 43B stood*

inserted. This is how the question of retrospectivity arose in Allied Motors (P) Ltd. Etc. (supra). This Court, in Allied Motors (P) Ltd. Etc. (supra) held that when a proviso is inserted to remedy unintended consequences and to make the section workable, a proviso which supplies an obvious omission in the section and which proviso is required to be read into the section to give the section a reasonable interpretation, it could be read retrospective in operation, particularly to give effect to the section as a whole. Accordingly, this Court, in Allied Motors (P) Ltd. Etc. (supra), held that the first proviso was curative in nature, hence, retrospective in operation w.e.f. 1st April, 1988. It is important to note once again that, by Finance Act, 2003, not only the second proviso is deleted but even the first proviso is sought to be amended by bringing about an uniformity in tax, duty, cess and fee on the one hand vis-a-vis contributions to welfare funds of employee(s) on the other. This is one more reason why we hold that the Finance Act, 2003, is retrospective in operation. Moreover, the judgment in Allied Motors (P) Ltd. Etc. (supra) is delivered by a Bench of three learned Judges, which is binding on us. Accordingly, we hold that Finance Act, 2003, will operate retrospectively w.e.f. 1st April, 1988 (when the first proviso stood inserted). Lastly, we may point out the hardship and the invidious discrimination which would be caused to the assessee(s) if the contention of the Department is to be accepted that Finance Act, 2003, to the above extent, operated prospectively. Take an example—in the present case, the respondents have deposited the contributions with the R.P.F.C. after 31st March (end of accounting year) but before filing of the Returns under the IT Act and the date of payment falls after the due date under the Employees' Provident Fund Act, they will be denied deduction for all times. In view of the second proviso, which stood on the statute book at the relevant time, each of such assessee(s) would not be entitled to deduction under s. 43B of the Act for all times. They would lose the benefit of deduction even in the year of account in which they pay the contributions to the welfare funds, whereas a defaulter, who fails to pay the contribution to the welfare fund right upto 1st April, 2004, and who pays the contribution after 1st April, 2004, would get the benefit of deduction under s. 43B of the Act. In our view, therefore, Finance Act, 2003, to the extent indicated above, should be read as retrospective. It would, therefore, operate from 1st April, 1988, when the first proviso was introduced. It is true that the Parliament has explicitly stated that Finance Act, 2003, will operate w.e.f. 1st April, 2004. However, the matter before us involves the principle of construction to be placed on the provisions of Finance Act, 2003.

16. *Before concluding, we extract hereinbelow the relevant observations of this Court in the case of CIT vs. J.H. Gotla (1985) 48 CTR (SC) 363 : (1985) 156 ITR 323 (SC), which reads as under :*

> *"We should find out the intention from the language used by the legislature and if strict literal construction leads to an absurd result, i.e., a result not intended to be subserved by the object of the legislation found in the manner indicated before, then if another construction is possible apart from strict literal construction, then that construction should be preferred to the strict literal construction. Though equity and taxation are often strangers, attempts should be made that these do not*

remain always so and if a construction results in equity rather than in injustice, then such construction should be preferred to the literal construction."

17. *For the aforestated reasons, we hold that Finance Act, 2003, to the extent indicated above, is curative in nature, hence, it is retrospective and it would operate w.e.f. 1st April, 1988 (when the first proviso came to be inserted). For the above reasons, we find no merit in this batch of civil appeals filed by the Department which are hereby dismissed with no order as to costs."*

12. We are of the view that the reasoning of the Hon'ble Supreme Court in the case of Alom Extrusions Ltd(supra) will equally to the amendment to Sec.40(a)(ia) of the Act whereby a second proviso was inserted in sub-clause (ia) of clause (a) of Section 40 by the Finance Act, 2012, w.e.f. 1-4-2013. The provisions are intended to remove hardship. It was argued on behalf of the revenue that the existing provisions allow deduction in the year of payment and to that extent there is no hardship. We are of the view that the hardship in such an event would be taxing an Assessee on a higher income in one year and taxing him on lower income in a subsequent year. To the extent the Assessee is made to pay tax on a higher income in one year, there would still be hardship.

13. The Hon'ble Delhi High Court in the case of CIT Vs. Ansal Land Mark Township (I) Pvt.Ltd., in ITA No.160/2015 judgment dated 26.8.2015 has taken the view that the insertion of the second proviso to Sec.40(a)(ia) of the Act is retrospective and will apply from 1.4.2005. The learned counsel for the Assessee has filed before us the copies of the returns of income of M/S.Binod Hosiery for AY 2007-08 and computation of total income and the profit and loss account to demonstrate the fact that the payees have included the amount received from the Assessee in their return of income and therefore there is no loss to the revenue. In fact, he also pointed out that the AO made enquiries in this regard with M/S.Binod Hosiery and was satisfied that the payees have included the sum received from the Assessee in their return of income and this satisfaction will emanate from in paragraph 8.1 of the assessment order. It was his submission that there

was no need to remand the issue to the AO also. We are of the view that it would be sufficient if the order of the CIT(A) is set aside and the issue remanded to the AO for verification as to whether payees have included the receipts from the Assessee in their returns of income in terms of the decisions referred to above. The other issues raised by the Revenue in their appeal are therefore left open without adjudication, for the present.

14. The appeal of the revenue is accordingly allowed for statistical purpose.

Order pronounced in the Court on 12.08.2016.

Sd/-	Sd/-
[Dr.Arjun Lal Saini]	[N.V.Vasudevan]
Accountant Member	Judicial Member

Dated : 12.08.2016.
[RG PS]

Copy of the order forwarded to:

1. M/s. Rupa & Co. Ltd., 1, Ho Chi Minh Sarani, Kolkata-700071.
2. D.C.I.T., Central Circle-VIII, Kolkata.
3. CIT(A)-Central-I, Kolkata. 4. CIT-Central-I, Kolkata.
5. CIT(DR), Kolkata Benches, Kolkata.

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By Order

Asstt.Registrar, ITAT, Kolkata Benches