**IN THE INCOME TAX APPELLATE TRIBUNAL**
**Hyderabad ' B ' Bench, Hyderabad**

**Before Shri Inturi Rama Rao, Accountant Member**
***AND***
**Shri K. Narsimha Charry, Judicial Member**

**ITA No.319/Hyd/2016**
(Assessment Year: 2010-11)

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| Asstt. Commissioner of Income Tax, Circle-1 Kurnool (Appellant) | Vs | Sri T. Satyanarayana Veldurthy, Kurnool PAN: ADKPT 8887D (Respondent) |

For Revenue : Smt. S. Praveena
For Assessee : None

Date of Hearing: 30.05.2017
Date of Pronouncement: 02.06.2017

**O R D E R**

**Per Inturi Rama Rao, Accountant Member.**

This is an appeal filed by the Revenue directed against the order of the learned CIT (A) Kurnool for the A.Y 2010-11. The Revenue has raised the following grounds of appeal:

*"1.Whether CIT(A) is right in deleting the addition of Rs.1,19,15,3501- holding that the amendment made by Finance Act, 2012, in respect of the Provisions of Sec.40(a)(ia) which is effective from 01.04.2013 is retrospective in nature?*

*2. CIT(A) failed to appreciate that the Supreme Court in the case of Gem Granite Vs. CIT reported in 271 ITR 322 held that no retrospectivity unless expressly stated or clearly implied.*

*3. CIT(A) erred in not appreciating that the beneficial provision does not necessarily imply that the amendment is to be given retrospective effect, unless*

*specifically made retrospective in operation as held by the Madras High Court in cases of CIT Vs. Pooshya Exports (P) Ltd., reported in 262 ITR 417, CWT Vs. Reliance Motor Co. Ltd., reported in 260 ITR 571 and CWT Vs. B.R. Theatres & Industrial Concerns (P) Ltd., reported in 272 ITR 177.*

*4. CIT(A) erred in deleting the addition made 1 proposed by the AO u/s 40(A)(2) without proving the reasonableness of the payment to relatives by the assessee as held by the Supreme Court in the case of Nund & Samonta Co.Pvt Ltd., Vs. CIT, reported in 78 ITR 268.*

*5. Any other ground that may be urged at the time of hearing".*

2. Brief facts of the case are that the respondent assessee is an individual and is in the business of Excavation & Sale of Iron Orefield. He filed return of income for the A.Y 2010-11 on 22.11.2010 admitting income of Rs.22,52,468. Against the said return of income, the assessment was completed by the learned Income Tax Officer Ward-1 Kurnool vide order dated 28.3.2013 passed u/s 143(3) of the Act at a total income of Rs.1,78,52,818. While doing so, the learned AO disallowed a sum of Rs.1,19,15,350 under the provisions of section 40(a)(ia) of the I.T. Act on the ground that no TDS was deducted in respect of the expenditure incurred on mining and processing charges. Being aggrieved by the above assessment order, an appeal was preferred by the assessee before the CIT (A) who vide the impugned order had deleted the addition following the decision of the Special Bench of the Income Tax Appellate Tribunal in the case of Merilyn Shipping & Transport (146 TTJ (1) and the Hon'ble Allahabad High Court in the case of CIT vs. Vector Shipping Services Ltd reported in 357 ITR 647 which has approved the above decision of

the Special Bench and submitted that the Hon'ble Supreme Court has dismissed the SLP(2013)262 CTR (All)545 reported in 357 ITR 642. Being aggrieved, the Revenue is in appeal.

3. The learned DR vehemently contested that the decision of the Special Bench of the Income Tax Appellate Tribunal Visakhapatnam Bench in the case of Merilyn Shipping & Transport (146 TTJ (1) and the Hon'ble Allahabad High Court decision CIT vs. Vector Shipping Services Ltd reported in 357 ITR 647 had been reversed by the Hon'ble Supreme Court in the case of M/s. Palam Gas Service vs. CIT in Civil Appeal No.5512 of 2017 dated 3rd May, 2017 and a copy of the judgment was filed before us. None appeared on behalf of the assessee despite due service of notice.

4. We have heard the rival submissions and perused the material on record. The issue in this appeal is covered in favour of the Revenue by the decision of the Hon'ble Supreme Court in the case of Palam Gas Service vs. CIT (cited Supra) wherein the decision of the Special Bench in the case of Merilyn Shipping & Transport (146 TTJ (1) and the Hon'ble Allahabad High Court decision CIT vs. Vector Shipping Services Ltd reported in 357 ITR 647 had been reversed. The relevant paragraphs of the judgment are reproduced below:

> "**14.** In the aforesaid backdrop, let us now deal with the issue, namely, the word *'payable'* in Section 40(a)(ia) would mean only when the amount is payable and not when it is actually paid. Grammatically, it may be accepted that the two words, i.e. *'payable'* and *'paid'*, denote different meanings. The Punjab & Haryana High Court, in **P.M.S. Diesels & Ors.**, referred to above, rightly remarked that the word *'payable'* is, in fact, an

antonym of the word *'paid'*. At the same time, it took the view that it was not significant to the interpretation of Section 40(a)(ia). Discussing this aspect further, the Punjab & Haryana High Court first dealt with the contention of the assessee that Section 40(a)(ia) relates only to those assessees who follow the mercantile system and does not cover the cases where the assessees follow the cash system. Those contention was rejected in the following manner:

*"19. There is nothing that persuades us to accept this submission. The purpose of the section is to ensure the recovery of tax. We see no indication in the section that this object was confined to the recovery of tax from a particular type of assessee or assessees following a particular accounting practice. As far as this provision is concerned, it appears to make no difference to the Government as to the accounting system followed by the assessees. The Government is interested in the recovery of taxes. If for some reason, the Government was interested in ensuring the recovery of taxes only from assessees following the mercantile system, we would have expected the provision to so stipulate clearly, if not expressly. It is not suggested that assessees following the cash system are not liable to deduct tax at source. It is not suggested that the provisions of Chapter XVII-B do not apply to assessees following the cash system. There is nothing in Chapter XVII-B either that suggests otherwise.*

*20. Our view is fortified by the Explanatory Note to Finance Bill (No. 2) of 2004. Sub-clause (ia) of clause (a) of Section 40 was introduced by the Finance Bill (No. 2) of 2004 with effect from 01.04.2005. The Explanatory Note to Finance Bill-2004 stated:*

*"….. ….. ….. ….. ..*

*With a view to augment compliance of TDS provisions, it is proposed to extend the provisions of section 40(a)(i) to payments of interest, commission or brokerage, fees for professional services or fees for technical services to residents, and payments to a resident contractor or sub-contractor for carrying out any work (including supply of labour for carrying out any work), on which tax has not been deducted or after deduction, has not been paid before the expiry of the time prescribed under sub-section (1) of section 200 and in accordance with the other provisions of Chapter XVII-B. ……"*

*21. The adherence to the provisions ensures not merely the collection of tax but also enables the authorities to bring within their fold all such persons who are liable to come within the network of tax payers. The intention was to ensure the collection of tax irrespective of the system of accounting followed by the assessees. We do not see how this dual purpose of augmenting the compliance of Chapter XVII and bringing within the Department's fold tax payers is served by confining the provisions of Section 40(a)(ia) to assessees who follow the mercantile*

*system. Nor do we find anything that indicates that for some reason the legislature intended achieving these objectives only by confining the operation of Section 40(a)(ia) to assessees who follow the mercantile system.*

*22. The same view was taken by a Division Bench of the Calcutta High Court in* ***Commissioner of Income Tax v. Crescent Export Syndicate*** *(supra). It was held:*

"12.3. It is noticeable that Section 40(a) is applicable irrespective of the method of accounting followed by an assessee. Therefore, by using the term 'payable' legislature included the entire accrued liability. If assessee was following mercantile system of accounting, then the moment amount was credited to the account of payee on accrual of liability, TDS was required to be made but if assessee was following cash system of accounting, then on making payment TDS was to be made as the liability was discharged by making payment. The TDS provisions are applicable both in the situation of actual payment as well of the credit of the amount. It becomes very clear from the fact that the phrase, 'on which tax is deductible at source under Chapter XVII-B', was not there in the Bill but incorporated in the Act. This was not without any purpose."

**15.** We approve the aforesaid view as well. As *a fortiorari*, it follows that Section 40(a)(ia) covers not only those cases where the amount is payable but also when it is paid. In this behalf, one has to keep in mind the purpose with which Section 40 was enacted and that has already been noted above. We have also to keep in mind the provisions of Sections 194C and 200. Once it is found that the aforesaid Sections mandate a person to deduct tax at source not only on the amounts payable but also when the sums are actually paid to the contractor, any person who does not adhere to this statutory obligation has to suffer the consequences which are stipulated in the Act itself. Certain consequences of failure to deduct tax at source from the payments made, where tax was to be deducted at source or failure to pay the same to the credit of the Central Government, are stipulated in Section 201 of the Act. This Section provides that in that contingency, such a person would be deemed to be an assessee in default in respect of such tax. While stipulating this consequence, Section 201 categorically states that the aforesaid Sections would be without prejudice to any other consequences which that defaulter may incur. Other consequences are provided under Section 40(a)(ia) of the Act, namely, payments made by such a person to a contractor shall not be treated as deductible expenditure. When read in this context, it is clear that Section 40(a)(ia) deals with the nature of default and the consequences thereof. Default is relatable to

Chapter XVIIB (in the instant case Sections 194C and 200, which provisions are in the aforesaid Chapter). When the entire scheme of obligation to deduct the tax at source and paying it over to the Central 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. If the provision is interpreted in the manner suggested by the appellant herein, then even when it is found that a person, like the appellant, has violated the provisions of Chapter XVIIB (or specifically Sections 194C and 200 in the instant case), he would still go scot free, without suffering the consequences of such monetary default in spite of specific provisions laying down these consequences. The Punjab & Haryana High Court has exhaustively interpreted Section 40(a(ia) keeping in mind different aspects. We would again quote the following paragraphs from the said judgment, with our complete approval thereto:

"26. Further, the mere incurring of a liability does not require an assessee to deduct the tax at source even if such payments, if made, would require an assessee to deduct the tax at source. The liability to deduct tax at source under Chapter XVII-B arises only upon payments being made or where so specified under the sections in Chapter XVII, the amount is credited to the account of the payee. In other words, the liability to deduct tax at source arises not on account of the assessee being liable to the payee but only upon the liability being discharged in the case of an assessee following the cash system and upon credit being given by an assessee following the mercantile system. This is clear from every section in Chapter XVII.

27. Take for instance, the case of an assessee, who follows the cash system of accounting and where the assessee who though liable to pay the contractor, fails to do so for any reason. The assessee is not then liable to deduct tax at source. Take also the case of an assessee, who follows the mercantile system. Such an assessee may have incurred the liability to pay amounts to a party. Such an assessee is also not bound to deduct tax at source unless he credits such sums to the account of the party/payee, such as, a contractor. This is clear from Section 194C set out earlier. The liability to deduct tax at source, in the case of an assessee following the cash system, arises only when the payment is made and in the case of an assessee following the mercantile system, when he credits such sum to the account of the party entitled to receive the payment.

28. The government has nothing to do with the dispute between the assessee and the payee such as a contractor. The provisions of the Act including Section 40 and the provisions of Chapter XVII do not entitle the tax authorities to adjudicate the liability of an assessee to make

payment to the payee/other contracting party. The appellant's submission, if accepted, would require an adjudication by the tax authorities as to the liability of the assessee to make payment. They would then be required to investigate all the records of an assessee to ascertain its liability to third parties. This could in many cases be an extremely complicated task especially in the absence of the third party. The third party may not press the claim. The parties may settle the dispute, if any. This is an exercise not even remotely required or even contemplated by the section."

**16.** As mentioned above, the Punjab & Haryana High Court found support from the judgments of the Madras and Calcutta High Courts taking identical view and by extensively quoting from the said judgments.

**17.** Insofar as judgment of the Allahabad High Court is concerned, reading thereof would reflect that the High Court, after noticing the fact that since the amounts had already been paid, it straightaway concluded, without any discussion, that Section 40(a)(ia) would apply only when the amount is *'payable'* and dismissed the appeal of the Department stating that the question of law framed did not arise for consideration. No doubt, the Special Leave Petition there against was dismissed by this Court in *limine*. However, that would not amount to confirming the view of the Allahabad High Court (See **V.M. Salgaocar & Bros. (P) Ltd. v. Commissioner of Income Tax** [2000 (243) ITR 383] and **Supreme Court Employees Welfare Association v. Union of India** [JT 1989 (3) SC 188].

**18.** In view of the aforesaid discussion, we hold that the view taken by the High Courts of Punjab & Haryana, Madras and Calcutta is the correct view and the judgment of the Allahabad High Court in **CIT v. Vector Shipping Services (P) Ltd.** [2013 (357) ITR 642] did not decide the question of law correctly. Thus, insofar as the judgment of the Allahabad High Court is concerned, we overrule the same. Consequences of the aforesaid discussion will be to answer the question against the appellant/assessee thereby approving the view taken by the High Court".

5. Even in the present case, the learned CIT (A) granted relief following the ratio laid down by the decision of the Special Bench in the case of Merilyn Shipping & Transport (146 TTJ (1) as there was no amount of outstanding as at the end of the

accounting year. Since the decision had been reversed by the Hon'ble Supreme Court, the order of the CIT (A) cannot be sustained in the eyes of law and the appeal filed by the Revenue is allowed.

6. In the result, appeal filed by the Revenue is allowed.

Order pronounced in the Open Court on 2nd June, 2017.

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| **Sd/-** | **Sd/-** |
| **(K. Narsimha Charry)**<br>**Judicial Member** | **(Inturi Rama Rao)**<br>**Accountant Member** |

Hyderabad, dated 2nd June, 2017.

***Vinodan/sps***

Copy to:

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3 CIT (A)-Kurnool
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5 The DR, ITAT Hyderabad
6 Guard File

*By Order*