



## Global Business Tax Alert Sharp Insights

Withholding of taxes under a wrong provision may attract disallowance u/s 40(a)(ia).

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# Synopsis

The Kerala High Court relying on the Apex Court decision in *Gurusahai Saigal vs Commissioner of Income Tax, Punjab* has observed that Section 40(a)(ia) of the Income Tax Act, 1961 ('Act') should be interpreted implying the ordinary rules of construction. The High Court has held that the expressions, "tax deductible at source under Chapter XVII -B" and "that such tax has not been deducted" employed in Section 40(a)(ia) is to be understood as tax deductible under the appropriate provision of Chapter XVII-B of the Act .

The High Court further held that tax deduction under a wrong provision will not save an assessee from adverse ramifications of Section 40(a)(ia) of the Act.

## Facts

- The assessee, a hospital, entered into an agreement with M/s Lakeshore Hospital and Research Centre Limited ('LHRC'). Underlying said agreement, LHRC to perform certain professional services in assessee's hospital.
- Assessee withheld taxes u/s 194C @ 2% on payments made by it to LHRC as consideration for their services, during the financial year (FY) 2004-05.
- Tax return for FY 2004-05 was picked up for scrutiny. Assessment was completed on the premise that taxes were supposed to be withheld on payments made to LHRC u/s 194J @ 5%. Entire payments made by assessee to LHRC was disallowed by the Assessing Officer u/s 40(a)(ia).
- Commissioner of Income Tax – (Appeals) and Income Tax Appellate Tribunal, Kerala upheld the action of Assessing Officer and rejected the appeal of assessee for FY 2004-05.
- Similar issue of disallowance u/s 40(a)(ia) was allowed in favor of assessee by the jurisdictional Kerala Tribunal in the immediately succeeding year i.e. FY 2005-06 following the Calcutta High Court judgment in the case of *CIT vs Tekriwal* (301 ITR 432).
- Assessee and tax department filed appeal(s) before the Kerala High Court challenging the order passed by Tribunal for FY 2004-05 and FY2005-06, respectively.

# Issues for consideration before Kerala High Court

- Whether the assessee was required to withhold taxes u/s 194J @ 5% or u/s 194C @ 2% on payments made by it for rendition of professional services to LHRC?
- Whether the assessee should be treated as 'assessee in default' under section 201(1) for withholding taxes under wrong section and the tax department shall proceed accordingly or else the entire payment to LHRC should be regarded as inadmissible in hands of assessee for its failure to withhold taxes under a correct provision?

## Ruling of Kerala High Court

- The High Court held the arrangement between LHRC and assessee as not of a work contract. Predominantly, arrangement between LHRC and assessee is merely for the rendition of professional services. Accordingly, taxes ought to be withheld u/s 194 J @ 5%.
- The High Court observed that Section 40(a)(ia) is not a charging section rather it is a machinery provision and accordingly, the same has to be construed by ordinary rules of construction i.e. in consonance with clear intention of the legislature to make the charge effective.
- The High Court has held that the expressions, "tax deductible at source under Chapter XVII -B" and "that such tax has not been deducted" employed in Section 40(a)(ia) is to be understood as tax deductible under the appropriate provision of Chapter XVII-B of the Act.
- The High Court disagreed with the judgment of Calcutta High Court in CIT vs S.K. Tekriwal [2014](361 ITR 432) regarding the interpretation of machinery provisions and has held that tax deduction by an assessee under the wrong provision will attract disallowance under Section 40(a)(ia).

# Comments

The Kerala High Court has simply dissented from the aforesaid judgment of Calcutta High Court and has not provided any explicit reasoning for it.

The High Court has also not considered few other judgments wherein it has been held that Section 40(a)(ia) could be invoked only when the twin conditions, namely, that tax is deductible at source and such tax has not been deducted is satisfied. Consequently, where tax is withheld by an assessee under a wrong provision and there is a shortfall, Section 40(a)(ia) disallowance could not be made.

Revenue may rely on this judgment going forward for making additions u/s 40(a)(ia) wherever appropriate taxes have not been withheld by an assessee.

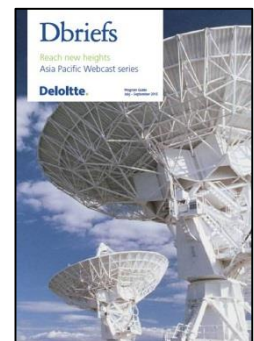
**Source :** Decision of Kerala High Court in case of Commissioner of Income Tax -1, Kochi Vs. P V S Memorial Hospital Ltd. [2015] 60 taxmann.com 69 (Kerala)

## Upcoming Dbriefs - Register

### India's New Export Incentive Schemes: A Real Boost for Exporters of Goods and Services

**Thursday, 27 August 2015, 11:30 AM – 12:30 PM IST**

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