

IN THE HIGH COURT OF KARNATAKA AT BENGALURU



DATED THIS THE 2ND DAY OF FEBRUARY, 2016

PRESENT

THE HON'BLE MR. JUSTICE N.K. PATIL

AND

THE HON'BLE MRS. JUSTICE S. SUJATHA

ITA Nos.750 and 758-759/2009

BETWEEN

M/s Karnataka Power Transmission
Corporation Limited
Bangalore.

....Appellant

(By Sri.V.K. Gurunathan, Advocate
For Sri.S. Parthasarathi.)

AND

The Deputy Commissioner
Of Income-tax (TDS)
Circle 16(2), Bangalore.

...Respondent

(By Sri.K.V. Aravind, Advocate)

These Appeals are filed under Section 260-A of I.T.Act, 1961 to set aside the order passed by the ITAT Bangalore in ITA Nos.1449 to 1451/BNG/2008, dated 03.07.2009, in the interest of justice and equity

These Appeals having been heard and reserved for orders on 25th January 2016, coming on for pronouncement of Judgment this day, **S. Sujatha J.**, made the following.

JUDGMENT

These appeals are filed by the assessee challenging the common order dated 03.07.2009 passed by the Income Tax Appellate Tribunal, "B" Bench, Bangalore ('Tribunal' for short) under Section 260-A of the Income Tax Act, 1961 (the 'Act' for short) relating to the assessment years 2005-06 to 2007-08.

2. Facts in brief are:

The appellant is an undertaking of the Government of Karnataka engaged in power transmission. The appellant purchases electricity from various parties by entering into power purchase agreements. For such purchases, when payment of purchase price is delayed, the agreements provide for payment of interest to suppliers of electricity by the

appellant. During the assessment years i.e., 2005-06, 2006-07 and 2007-08 in question, the appellant had created provisions for a sum of Rs.17,65,75,903/-, Rs.12,40,70,972/- and Rs.5,74,39,557/- respectively for contingent payment of interest on belated payments to its suppliers. For the first two years, the appellants in their profit and loss account treated the said amount of provision as expenditure to arrive at the profit. However, in the returns of income filed for the assessment year 2005-06 and 2006-07, the appellant did not treat the said amount of provision towards contingent interest payable as expenditure instead, it arrived at the taxable income without excluding such amounts of provision towards such interest. However, as these amount of provision created by book entries towards contingent interest payable for assessment years 2005-06 and 2006-07, a corresponding reversal entries were made in the books of accounts during the financial year 2007, indicating that the subject amounts

of provision towards contingent interest would never be paid.

3. In respect of financial year ending on 31.03.2007, a similar provision towards contingent interest payable on belated payments were created but at the end of the year, the said amount though treated as expenditure in the profit and loss account was not excluded to arrive at the taxable income in the return of income filed for the year 2007-08. The TDS Officer invoked the provisions of Section 194(A)(1) read with explanation appended to the said Section, held that the appellant should have deducted tax at source on the amount of provision made towards likely interest payable in respect of related purchase payments and held the appellant as an assessee in default and further, invoked the provisions of Section 201(1) and 201(1A) of the Act Accordingly, orders under Section 201(1) and

Section 201(1A) of the Act for the assessment years in question were passed.

4. On appeal by the assessee before the Appellate Commissioner, the same was confirmed against which appeals were filed by the assessee before the Tribunal. All the three appeals filed by the assessee were considered together and disposed off by a common order, dismissing the appeals, confirming the orders passed by the Authorities. Being aggrieved by the said common order passed by the Tribunal for the assessment years in question, the assessee is before this Court. The matter was admitted on 20.11.2009 to consider the following substantial questions of law:

“1. Whether in law, the Appellate Tribunal was justified in ignoring the evidence and submissions of the appellant with regard to mutual agreement between the appellant and the suppliers of power not to enforce the interest clause in the Power Purchase Agreement and thereby the appellant had no obligation to pay interest and consequently, had no

obligation to deduct tax at source under Section 194A of the Act.

2. Whether in law, the Tribunal was justified in upholding the levy of tax u/S 201(1) and the interest u/S 201(1A) when the bonafides of the appellant had been proved for the non-deduction of tax at source if any u/s 194A of the Act?"

5. Heard Sri Gurunathan, learned counsel appearing for the appellant as well as Sri K V Aravind, learned counsel appearing for the revenue and perused the material on record.

6. Learned counsel appearing for the appellant would contend that the following three aspects are relevant to decide the questions raised

- (i) Character of the sum for which provision was made
- (ii) Liability for deduction of tax at source even when no income accrued to the payees (the suppliers)

(iii) Jurisdiction of the Officer to invoke Section 201(i) and 201(1A) of the Act.

7. The learned counsel elaborating the arguments on these three aspects would contend that primarily, the provision for contingent liability - payment of interest towards belated payments of purchase of electricity from power suppliers could not be considered as interest at all. In this background, the definition of interest as provided under Section 2(28) of the Act is relied on. It is submitted that the phrase "interest" mentioned in Section 194(A) of the Act would confine to interest payments made on deposits or loans with banks, post offices, co-operative societies etc. and not on the interest, a contingent liability for which a provision is made.

8. Next, it is argued by the learned counsel for the appellant though a provision for payment of interest towards delay in payment of purchase price was created

in the books of accounts, actually and ultimately, interest was not paid. There would be no liability to deduct tax as no income accrued to the payees (suppliers) as the interest was not paid. This is a case where the appellant and the suppliers by the understanding and conduct were *ad-idem* that no liability to pay interest arose on belated payment of purchase price.

9. Further, it is contended that there are two types of defaults that arise from non-compliance with the provisions of Section 194(A) of the Act. They are:

- (1) non-deduction of tax at source i.e., failure to deduct tax at source
- (2) failure to pay the tax so deducted at source to the revenue.

10. The consequences for the above two types of defaults are mentioned in the provisions of Section 201 read with Section 200 of the Act. To impose the consequences provided under Section 201, the provision

of Section 200 has to be read along with Section 201 of the Act. The provisions of Section 200 prior to the Finance Act, 2008 mandated that the amount of tax deducted should be paid to the credit of the Central Government within the prescribed time limit. It does not spell out about the person who has not deducted tax at source. It is concerned exclusively with those who had deducted tax at source. The provisions of Section 201(1) contemplates who are all the persons who would have to face the consequences of:

- (1) failure to deduct tax
- (2) failure to pay the tax deducted at source to Government account.

11. Much emphasis is placed on the words 'if any such person' appearing in Section 201(1) of the Act to contend that **any such person** referred to in Section 200 covers only the following categories:

- (i) Any person who has deducted any sum
- (ii) Employer referred to in sub-section (1a) of Section 192, and
- (iii) another category of persons referred to in Section 194 i.e., a company which makes a dividend is liable to deduct TDS on dividend payments

12. Subsequent to passing of Finance Act, 2008, though with retrospective effect from 01.06.2002, the term '**any such person**' that existed in the old provision was substituted by the terms '**any person**'. A new clause, clause a of sub-section(1) of Section 201, "who is required to deduct any sum in accordance with the provisions of this Act..." was introduced. The said Finance Bill, 2008 bringing in the above amendment with retrospective effect from 1.6.2002 received the assent of the President of India only on 10.05.2008 i.e., after the dates of orders of the TDS Officer being passed. It is the case of the appellant that there was no liability on the appellant as per the law that existed at the

relevant point of time to deduct tax at source and the provision of interest made and subsequently, the entries being reversed in the account books. The TDS Officer proceeded to pass the orders on a *non-est* provision during the relevant point of time. This crucial point has been lost sight of by the Appellate Commissioner as well as the Tribunal while upholding the order of the TDS Officer.

13. Learned counsel in support of his contention places reliance on the following Judgments:

1. [A] KEDARNATH JUTE MFG.CO.LTD. vs. COMMISSIONER OF INCOME TAX (1971) 82 ITR 0363

2. DIRECTOR OF INCOME-TAX vs ERICSSON COMMUNICATIONS LTD. ((2015) 378 ITR 395 (Delhi))

14. Per contra, learned counsel appearing for the revenue justifies the order and would contend that during the course of survey it was found that the assessee-company has made the provision for interest on belated payment for power purchased from different

power purchasers without deducting tax at source as evidenced in the Annexure – V of the 3CD report (auditor's report) for the relevant assessment years. Section 194A and the explanation thereof provides that the provision for interest is liable for deduction of tax at source. Non-compliance of the said provision provides for invoking Section 201 and Section 201A of the Act. No relief could be given for the provision if reversed later, would be out of the scope of the TDS provisions. The assessee not deducting tax can never take shelter under the provisions of Section 201 of the Act prior to the amendment to shed away with the statutory responsibility.

15. Learned counsel placing reliance on Circular No.1/2009 dated 27.03.2009 would contend that Sub-section (1) of Section 201 of the Act has been amended to clarify that where a person, including the principal officer of a company who is required to deduct any sum

in accordance with the provisions of the Act shall be an assessee in default under Section 201. This amendment is made applicable with retrospective effect from 01.06.2002. The said amendment is made to Section 200(1) to overcome the view that that the provisions of Sub-section (1) of Section 201 do not cover, failure to deduct tax at source, such an interpretation being contrary to the intent of the Legislature.

16. Learned counsel would further distinguish the judgment of **Erricson Communications** (*supra*) contending that the said judgment was rendered in the context of Section 195 of the Act wherein. Section 195 of the Act imposes a statutory obligation on any person responsible for paying the non resident any sum 'chargeable under the provisions of the Act' which expression do not find place in Section 194-A of the Act.

17. It is further contended that [a] the tax deductor had failed to satisfy the Officer-in-charge of TDS that taxes due have been paid by the deductee-assessee; [b] the assessee company is in default for non-compliance of TDS provision under Section 194A of the Act as held by the Tribunal. Any provision reversed in the account books belatedly in March 2007 for the assessment years in question would not come to the rescue of the Assessee to absolve him from deducting the tax at source under Section 194A of the Act. The Assessee-Company was under an obligation to deduct tax at source which it had failed to do so as evidenced from the Auditor's report and as such the Assessee is in default. In the circumstances, the Authorities have rightly invoked the provisions of Sections 201 and 201[1A] of the Act. The Tribunal after elaborately considering the grounds urged by the Assessee and analytically examining the material on record, had confirmed the order passed by the Authorities as

mandatory provision under Section 194A of the Act has not been complied by the Assessee.

18. It is further contended that even prior to the amendment to Section 201(1) of the Act by Finance Act, 2008, the law that existed at the relevant point of time provided for deduction of tax at source and Section 200 of the Act during the relevant period clearly attracted even in cases where the tax was not deducted. Accordingly, he submits that the order passed by the Tribunal is a well considered order, which cannot be found fault with.

19. We have considered the rival submissions made by the parties and perused the material on record.

20. It is not in dispute that the Assessee has made a provision towards contingent payment of interest to suppliers of electricity when payment of purchase price is delayed by the appellant. Though the

said provision is made towards contingent interest payable as expenditure, as per the return of income filed by the Assessee, the taxable income is arrived adding back such amount of provision towards contingent interest. The assessee having noticed, payment of such interest made in the provision would never be paid in view of the understanding between the appellant and its suppliers, corresponding reversal entries were made in the books of accounts during March 2007. It is noticed that though the amount made in the provision is treated as expenditure in the profit and loss account, was added back to arrive at the taxable income. In such circumstances, we have to examine the obligation of the Assessee in deducting the tax at source towards the provision of interest made reversed subsequently, which would not form 'any income' in the hands of payees (suppliers).

21. Section 194A[1] of the Act and explanation thereof reads thus:

“Interest other than “Interest on securities”

194A. (1) Any person, not being an individual or a Hindu undivided family, who is responsible for paying to a resident any income by way of interest other than income [by way of interest on securities], shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rates in force :

[Provided that an individual or a Hindu undivided family, whose total sales, gross receipts or turnover from the business or profession carried on by him exceed the monetary limits specified under clause (a) or clause (b) of section 44AB during the financial year immediately preceding the financial year in which such interest is credited or paid, shall be liable to deduct income-tax under this section.]

[Explanation.—For the purposes of this section, where any income by way of interest as aforesaid is credited to any account, whether called "Interest payable account" or "Suspense account" or by any other name, in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of

such income to the account of the payee and the provisions of this section shall apply accordingly.]”.

22. Section 201[1] of the Act reads thus:

“1) If any such person referred to in Section 200 and in the cases referred to in section 194, the principal officer and the company of which he is the principal officer does not deduct the whole or any part of the or after deduction fails to pay the tax as required by or under this Act, he or it shall, without prejudice to any other consequences which he or it may incur, be deemed to be an assessee in default in respect of the tax:

Provided that no penalty shall be charged under Section 221 from such person, principal officer or company unless the [Assessing] Officer is satisfied that such person or principal officer or company, as the case may be, has [without good and sufficient reasons] failed to deduct and pay the tax.”

23. The expression ‘any such person’ referred to in Section 200 of the Act and in the cases referred to in Section 194 of the Act restricts to the person mentioned in Section 200 of the Act. Section 200[1] of the Act contemplates that ‘any person deducting any sum in

accordance with the provisions of Chapter – XVII, shall pay within the prescribed time, the sum so deducted to the credit of the Central Government or as the Board directs. Section 200[2] of the Act contemplates that any person being an employer referred to in sub-section [1A] of Section 192 shall pay, within the prescribed time, the tax deducted to the credit of the Central Government or as the Board directs. As could be seen from these provisions, prior to passing of the Finance Act, 2008, the provisions of Section 200 mandated that the **amount of tax deducted** should be paid to the credit of the Central Government. It does not speak about the person who has not deducted tax at source. If the said Section 200 is applied to Section 201[1] of the Act, it is only the following three categories of persons are held liable for the consequence of failure to deduct tax at source [a] any person deducting any sum [b] Employer, who provides perquisites and [c] Company making

payment of dividends. Subsequently, the said provision is amended and the same is extracted below:

“Consequence of failure to deduct or pay:

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.

Provided further that no penalty shall be charged under section 221 from such person, unless the Assessing Officer is satisfied that such person, without good and sufficient reasons, has failed to deduct and pay such tax.”

24. By this amendment, the term ‘any such person’ is substituted with ‘any person’ including the Principal Officer of the Company. A new clause “who is required to deduct any sum in accordance with the provisions of the Act” is introduced. This amendment is given retrospective effect from 1.6.2002 and has received the assent of the President of India on 10.5.2008. The order of the TDS Officer has been passed as detailed below:

Assessment Year	Date of Order
2005-06	27.03.2008
2006-07	27.03.2008
2007-08	18.02.2008

Thus, it is clear the TDS Officer has passed the order based on non-existent law during the interregnum period between the period of Finance Bill becoming the Finance Act by the assent of the President.

25. We have also noticed the Circular No.1/2009 dated 27.03.2009 relied on by the Revenue to point out that the said amendment by Finance Act 2008 was introduced to clarify the term 'person' envisaged in Section 200 of the Act. In fact, it was the intention of the legislature to bring the person i.e., the Principal Officer of a Company who is required to deduct any sum in accordance with the provisions of the Act under the umbrella of Section 201[1] of the Act. The same is

clarified by the Finance Act, 2008 with retrospective effect from 1.6.2002. This amendment Act was not in force during the relevant assessment years in dispute at the time of passing of the orders by TDS Officer. In such circumstances, the Order of the Tribunal upholding the views of the TDS Officer and the Appellate Commissioner would go contrary to the provisions of Section 201[1] of the Act that existed during the relevant time.

26. We have examined the applicability of Section 194A of the Act to the present case. Section 194A of the Act mandates the tax deductor to deduct 'income tax' on 'any income by way of interest other than income by way of interest on securities'. The phrase 'any income' and 'income tax thereon' if read harmoniously, it would indicate that the interest which finally partakes the character of income, alone is liable for deduction of the income tax on that income by way

of interest. If the said interest is not finally considered to be an income of the deductee, as per reversal entries of the provision in the present case, Section 194A[1] of the Act would not be made applicable. In other words, if no income is attributable to the payee, there is no liability to deduct tax at source in the hands of the tax deductor. In view of the admitted fact that interest being not paid to the payees [suppliers] being reversed in the books of accounts, we are of the considered opinion that there would be no liability to deduct tax as no income accrued to the payees [suppliers]. It is true that in the case of ***Ericsson Communication Limited*** [supra], the Delhi High Court was dealing with the case of Section 195 of the Act wherein obligation of a person to deduct tax at source would be applicable to the 'income chargeable under the Act'. Absence of such words 'chargeable to tax' under the provisions of Section 194-A of the Act would not empower the authorities to

invoke the provisions of Sections 201 and 201(1A) of the Act ignoring the words 'any income by way of interest'.

27. Yet another reason assigned by the Tribunal to reject the appeal filed by the Assessee is to the CBDT Circular No.275/201/95-IT[B] dated 29.1.1997. The relevant portion of the said circular reads thus:

“no demand visualized u/s. 201[1] of the Act should be enforced after the tax deductor has satisfied the officer-in-charge of TDS, that taxes due have been paid by the deductee-assessee. However, this will not alter the liability to charge interest u/s. 201[1A] of the Act till the date of payment of taxes by the deductee-assessee or the liability for penalty u/s. 271C of the Act.”

Based on this circular, it is held that the assessee-company has failed to prove that neither the deductor-assessee had deducted and remitted the tax nor the deductee-assessee had paid the same through advance tax or self assessment tax. It is the case of the assessee

that the provision which was contingent was at no time materialized as income to be liable for payment of income tax on the said provision of interest. In such circumstances, the reasoning of the Tribunal that the deductor-assessee nor the deductee-assessee had paid the tax on the provision amount and thus the provisions of Sections 201 and 201[1] of the Act are attracted is not acceptable. There is no cavil with the CBDT Circular referred to above by the Tribunal. But, the said circular in no way assists the Revenue to reject the stance taken by the Assessee i.e., reversal of the provisions during March 2007.

28. The Apex Court in the case of **KEDARNATH JUTE MFG. CO. LTD.'s** [supra] has held thus:

“6. xxxx We are wholly unable to appreciate the suggestion that if an assessee under some misapprehension or mistake fails to make an entry in the books of account and although, under the law, a deduction must be allowed by the ITO, the assessee will lose the

right of claiming or will be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter.”

The said Judgment of the Apex Court would enunciate that the existence or absence of entries in the books of accounts is not decisive or conclusive factor in deciding the right of the Assessee claiming deduction. The said Judgment is squarely applicable to the facts of the present case. The provision of law existing on the relevant date of passing of the order by the TDS Officer would establish that Sections 201 and 201[1A] of the Act were not applicable to the appellant's case. In the circumstances, the Assessee falls outside the scope of Section 194A read with Section 200 of the Act during

the relevant assessment years. Thus, the consequential provisions of Section 201(1) and Section 201(1A) are not attracted.

29. For the foregoing reasons, we are of the considered view that the Judgment passed by the Tribunal is not sustainable.

30. Accordingly, we answer the substantial questions of law in favour of the Assessee and against the Revenue.

31. In the result, the appeals are allowed.
Ordered accordingly.

**Sd/-
JUDGE**

**Sd/-
JUDGE**

brn, AN/-