

Interest for default in payment of advance tax not applicable prior to FY 2012-13 if tax was deductible at source: Supreme Court

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Summary

The Supreme Court (SC), in a recent case¹, has held that for years prior to financial year 2012-13, the taxpayer is entitled to reduce the amount of income tax which would be deductible or collectible at source (TDS or TCS) while computing the advance tax liability, notwithstanding the fact that the taxpayer has received the full amount without any deduction.

The SC, thus, held that in such cases interest liability for shortfall in payment of advance tax (due to failure to deduct tax on the part of the tax deductor) would not arise.

Facts of the case

- The taxpayer is a non-resident company incorporated in Japan, with operations in India.
- It is engaged in carrying out trading activities in carbon crude oil, LPG, ferrous products, industrial machinery, mineral, non-ferrous metal and products, textiles, automobiles, etc., through its liaison offices in India.
- During Assessment Year (AY) 1998-99 to 2004-05, the tax officer, rejecting taxpayer's contentions, determined the income attributable to Indian operations² of the taxpayer and accordingly, charged interest³ for shortfall in payment of advance tax.
- With respect to levy of interest on shortfall in payment of advance tax, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)].
- The CIT(A) concluded that the taxpayer is liable to pay advance tax even if no TDS has been deducted by the payer. Consequently, it held that interest⁴ shall be applicable in the present case.
- Thereafter, the Income Tax Appellate Tribunal (ITAT), relying on the Special Bench decision in the case of Motorola Inc⁵ and

¹ Mitsubishi Corporation [TS-869-SC-2021]

² under India-Japan tax treaty Articles 4, 5 and 6 of the tax treaty read with the provisions of the Income-tax Act, 1961 (the Act)

³ under Section 234B of the Act

⁴ under Section 234B of the Act

⁵ Motorola Incorporation v. Deputy CIT (2005) 95 ITD 269 (Delhi) (SB)

other High Court (HC) decisions⁶, held in favour of the taxpayer.

- The tax department challenged the matter before the HC. The question of law framed by the HC was whether the levy of interest⁷ for shortfall in TDS is mandatory and is leviable automatically.
- The HC referred to various HC rulings⁸, to hold that TDS should be excluded while estimating advance tax liability. Further, the HC observed that interest cannot be imposed on a taxpayer for failure on the part of the tax deductor.

The tax department has challenged the matter before the Supreme Court (SC).

Department's arguments before the SC

- **Independent obligation:** The obligation to pay advance tax is independent of the obligation of the deductor to deduct TDS.
- **Compensatory in nature:** Levy of interest compensates the government for the delay in recovery of taxes.
- **Mode of recovery cannot be restricted:** When there are two modes of recovery of tax, i.e., one from the taxpayer and other

from the tax deductor, the choice of the tax department cannot be restricted.

- **Standalone provisions:** It was argued that provisions dealing with interest computation (under the Act) is a standalone provision. Hence, the wording used in provisions relating to computation of advance tax⁹ cannot be imported into provisions dealing with interest computation¹⁰.

Taxpayer's arguments before the SC

- **Interest provisions cannot be read in isolation:** The taxpayer argued that provisions prescribing manner of computing interest cannot be read in isolation with provisions dealing with computing advance tax liability under the Act.
- **Taxpayer cannot be penalised for tax deductor's default:** Apart from the decisions relied by the HC, the taxpayer relied on the SC ruling in the case of Ian Peter Morris¹¹. It was argued that TDS and direct payment of tax are two different modes of tax-recovery under the Act. Accordingly, the taxpayer cannot be

⁶ CIT vs Tide Water Marine International Inc (2009) 309 ITR 85 (Uttaranchal), DIT vs NGC Network Asia LLC (2009) 313 ITR 187 (Bombay)

⁷ under Section 234B of the Act

⁸ Uttarakhand HC in the case of CIT v. Sedco Forex International Drilling Co. Ltd. (2003) 264 ITR 320 (Uttaranchal), Bombay HC in the NGC Network Asia LLC case and decision of the Madras HC in CIT vs v. Madras Fertilizers Ltd. (1984) 149 ITR 703 (Madras)

⁹ section 209(1)(d): This section prescribes the manner of computing advance tax, it allows taxpayer to reduce tax "deductible or collectible at source" at the time of computing advance tax.

¹⁰ Section 234B: This section uses the term tax "deducted or collected at source" while defining the term "assessed tax".

¹¹ Ian Peter Morris vs ACIT (2020) 15 SCC 123

penalised for default on the part of the tax deductor.

- **Imminent liability necessary to attract interest:** It was argued that an imminent liability to pay advance tax and a subsequent default of such payment should be established to attract interest liability. In the present case, these pre-conditions have not been satisfied¹².

Observations and decision of the SC

- The SC noted that the issue in the instant case revolves around interpretation of the term 'deducible or collectible at source'¹³.
- The SC noted the amendment¹⁴ made vide the Finance Act, 2012. As per the amendment, a taxpayer who has received any income without TDS or TCS, is made liable to pay advance tax in respect of such income, as well. The amendment came into force from 1 April 2012 and was made applicable to cases of advance tax payable in the financial year 2012-13 and thereafter.
- In the instant case, all the years are prior to the aforesaid amendment. Thus, the SC, placing reliance on earlier ruling¹⁵, noted that in dealing with matters of construction, subsequent legislation may be looked for proper interpretation, where the earlier Act

is obscure or ambiguous or readily capable of more than one interpretation.

- The SC accordingly held that if the interpretation of the tax department is accepted in the instant case, the amendment made vide the Finance Act 2012 would become meaningless.
- The SC, thus, held that in order to give intended effect to the amendment, it has to be understood that, for all years prior to the financial year 2012-13, the taxpayer is entitled to reduce the amount of TDS or TCS while computing the advance tax liability, notwithstanding the fact that the taxpayer has received the full amount without any deduction.
- The SC also rejected tax department's arguments that provisions dealing with interest computation needs to be read in isolation and held that while the definition of 'assessed tax'¹⁶ pertains to tax deducted or collected at source, the pre-conditions for attracting interest¹⁷ have to necessarily be satisfied.
- The SC concluded that the taxpayer cannot be held to have defaulted in payment of advance tax by stating that prior to the financial year 2012-13, the amount of

¹² as advance tax liability did not arise due to application of section 209 of the Act.

¹³ under section 209(1)(d) of the Act

¹⁴ in section 209(1)(d) of the Act

¹⁵ State of Bihar vs S.K. Roy (1966) Supp. SCR 259

¹⁶ under Section 234B of the Act

¹⁷ viz. liability to pay advance tax and non-payment or short payment of such tax

income-tax which is deductible or collectible at source can be reduced by the taxpayer while calculating the advance tax liability.

Our comments

This ruling provides much-needed clarity on computation of interest liability on shortfall of advance tax payments, where the entire amount of income was liable for TDS. This case may not be helpful for FY 2012-13 onwards, considering the amendments made by Finance Act, 2012, though it will go a long way in settling existing litigation relating to years prior to FY 2012-13.

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