# M/S Palam Gas Service vs Commissioner Of Income Tax on 3 May, 2017

## Equivalent citations: AIR 2017 SUPREME COURT 2502, (2017) 3 KCCR 333, (2017) 124 CUT LT 463, (2017) 4 MAD LJ 585, (2017) 177 ALLINDCAS 2 (SC), AIR 2017 SC (CIVIL) 1827, (2017) 2 ORISSA LR 64, (2017) 5 SCALE 759, (2017) 2 KER LT 99, 2017 (7) SCC 613

## Author: A.K. Sikri

## Bench: Ashok Bhushan, A.K. Sikri

REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 5512 OF 2017

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| M/S. PALAM GAS SERVICE | .....APPELLANT(S) | |
| VERSUS | | |
| COMMISSIONER OF INCOME TAX | .....RESPONDENT(S) | |

J U D G M E N T

A.K. SIKRI, J.

The neat question which arises for consideration in this appeal relates to the interpretation of Section 40(a)(ia) of the Income Tax Act, 1961 (hereinafter referred to as the 'Act'). Section 197C of the Act has also some bearing on the issue involved.

Section 40 of the Act enumerates certain situations wherein expenditure incurred by the assessee, in the course of his business, will not be allowed to be deducted in computing the income chargeable under the head 'Profits and Gains from Business or Profession'. One such contingency is provided in clause (ia) of sub-section (a) of Section 40. This provision reads as under:

> "S. 40 - Amounts not deductible:
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> Notwithstanding anything to the contrary in Sections 30 to [38], the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",— xxx xxx xxx (ia) any interest,

> commission or brokerage, fees for professional services or fees for technical services payable to a resident, or amounts payable to a contractor or sub-contractor, being resident for carrying out any work (including supply of labour for carrying out any work), on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid during the previous year, or in the subsequent year before the expiry of the time prescribed under sub-section (1) of Section 200;

Provided that where in respect of any such sum, tax has been deducted in any subsequent year or has been deducted in the previous year but paid in any subsequent year after the expiry of the time prescribed under sub- section (1) of section 200, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

xxx xxx xxx" As per clause (ia), certain payments made, which includes amounts payable to a contractor or sub-contractor, would not be allowed as expenditure in case the tax is deductible at source on the said payment under Chapter XVIIB of the Act and such tax has not been deducted or, after deduction, has not been paid during the previous year or in the subsequent year before the expiry of the time prescribed under sub-section (1) of Section 200 of the Act. In the instant case, certain payments were made by the appellant assessee, in the Assessment Year 2006-2007 but the tax at source was not deducted and deposited. We may point out here itself that as per Section 194C of the Act, payments to contractors and sub-contractors are subject to tax deduction at source. The Income Tax Department/Revenue has, therefore, not allowed the amounts paid to the sub-contractors as deduction while computing the income chargeable to tax at the hands of the assessee in the said Assessment Year.

It can be seen that Section 40(a)(ia) uses the expression 'payable' and on that basis the question which is raised for consideration is:

> "Whether the provisions of Section 40(a)(ia) shall be attracted when the amount is not 'payable' to a contractor or sub-contractor but has been actually paid?"
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> Some facts which will have bearing on the aforesaid issue need to be mentioned at this stage:
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> The appellant-assessee is engaged in the business of purchase and sale of LPG cylinders under the name and style of M/s. Palam Gas Service at Palampur. During the course of assessment proceedings, it was noticed by the Assessing Officer that the main contract of the assessee for carriage of LPG was with the Indian Oil Corporation, Baddi. The assessee had received the total freight payments from the IOC Baddi to the tune of Rs.32,04,140/-. The assessee had, in turn, got the transportation of LPG done through three persons, namely, Bimla Devi, Sanjay Kumar and Ajay to whom he made the freight payment amounting to Rs. 20,97,689/-. The Assessing Officer observed that the assessee had made a sub-contract with the said three persons within the meaning of Section 194C of the

Act and, therefore, he was liable to deduct tax at source from the payment of Rs. 20,97,689/-. On account of his failure to do so the said freight expenses were disallowed by the Assessing Officer as per the provisions of Section 40(a)(ia) of the Act. Against the order of the Assessing Officer, the assessee preferred an appeal before the Commissioner of Income Tax (Appeals), Shimla who vide its order dated August 17, 2012 upheld the order dated November 30, 2011. The matter thereafter came up in appeal before the Income Tax Appellate Tribunal (for short 'ITAT') which too met with the same fate.

In further appeal to the High Court under Section 260A of the Act, the outcome remained unchanged as the High Court of Himachal Pradesh also dismissed the appeal affirming the order of the ITAT.

It may be pertinent to observe that the question raised now and formulated above was specifically raised before the authorities below, including the High Court.

The question is, as noted above, when the word used in Section 40(a)(ia) is 'payable', whether this Section would cover only those contingencies where the amount is due and still payable or it would also cover the situations where the amount is already paid but no advance tax was deducted thereupon. This issue has come up for hearing before various High Courts and there are divergent views of the High Courts there upon. In fact, most of the High Courts have taken the view that the aforesaid provision would cover even those cases where the amount stands paid. This is the view of the Madras, Calcutta and Gujarat High Courts. Contrary view is taken by the Allahabad High Court. In a recent judgment, the Punjab & Haryana High Court took note of the judgments of the aforesaid High Courts and concurred with the view taken by the Madras, Calcutta and Gujarat High Courts and showed its reluctance to follow the view taken by the Allahabad High Court.

In this scenario, we would like to first discuss the reasons given by the High Courts in two sets of judgments, arriving at a contrary conclusion. Before that, we would also like to reproduce relevant portions of Section 194C and 200 of the Act as well as Rule 30(2) of the Income Tax Rules, since they are also relevant to decide the controversy. These provisions make the following reading:

"194-C. Payments to contractors.—(1) Any person responsible for paying any sum to any resident (hereafter in this section referred to as the contractor) for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and a specified person shall, at the time of credit of such sum to the account of the contractor 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 an amount equal to— ..... ..... ..... .....

200. Duty of person deducting tax.—(1) Any person deducting any sum in accordance with the foregoing provisions of this chapter] shall pay within the prescribed time, the sum so deducted to the credit of the Central Government or as the Board directs.

(2) Any person being an employer, referred to in subsection (1-A) of Section 192 shall pay, within the prescribed time, the tax to the credit of the Central Government or as the Board directs.

(3) Any person deducting any sum on or after the 1st day of April, 2005 in accordance with the foregoing provisions of this chapter or, as the case may be, any person being an employer referred to in sub-section (1-A) of Section 192 shall, after paying the tax deducted to the credit of the Central Government within the prescribed time, prepare such statements for such period as may be prescribed] and deliver or cause to be delivered to the prescribed income tax authority or the person authorised by such authority such statement in such form and verified in such manner and setting forth such particulars and within such time as may be prescribed." Rule 30(2) of the Income Tax Rules which stipulates the time prescribed for payment of the tax deducted to the credit of the Central Government as required by Section 200(1) and relevant portion thereof reads as under:

"Time and mode of payment to Government account of tax deducted at source or tax paid under sub-section (1A) of section 192.

30(1) All sums deducted in accordance with the provisions of Chapter XVII-B by an office of the Government shall be paid to the credit of the Central Government-

..... ..... ..... .....

(2) All sums deducted in accordance with the provisions of Chapter XVII-B by deductors other than an office of the Government shall be paid to the credit of the Central Government-

on or before 30th day of April where the income or amount is credited or paid in the month of March; and in any other case, on or before seven days from the end of the month in which-

the deduction is made; or income-tax is due under sub-section(1A) of section 192." As per Section 194C, it is the statutory obligation of a person, who is making payment to the sub-contractor, to deduct tax at source at the rates specified therein. Plain language of the Section suggests that such a tax at source is to be deducted at the time of credit of such sum to the account of the contract or at the time of payment thereof, whichever is earlier. Thus, tax has to be deducted in both the contingencies, namely , when the amount is credited to the account of the contractor or when the payment is actually made. Section 200 of the Act imposes further obligation on the person deducting tax at source, to deposit the same with the Central Government or as the Board directs, within the prescribed time.

A conjoint reading of these two Sections would suggest that not only a person, who is paying to the contractor, is supposed to deduct tax at source on the said payment whether credited in the account or actual payment made, but also deposit that amount to the credit of the Central Government within the stipulated time. The time within which the payment is to be deposited with the Central Government is mentioned in Rule 30(2) of the Rules.

The Punjab & Haryana High Court in P.M.S. Diesels & Ors. v. Commissioner of Income Tax – 2, Jalandhar & Ors., (2015) 374 ITR 562, has held these provisions to be mandatory in nature with the following observations:

> "13. The liability to deduct tax at source under the provisions of Chapter XVII is mandatory. A person responsible for paying any sum is also liable to deposit the amount in the Government account. All the sections in Chapter XVII-B require a person to deduct the tax at source at the rates specified therein. The requirement in each of the sections is preceded by the word "shall". The provisions are, therefore, mandatory. There is nothing in any of the sections that would warrant our reading the word "shall" as "may". The point of time at which the deduction is to be made also establishes that the provisions are mandatory. For instance, under Section 194C, a person responsible for paying the sum is required to deduct the tax "at the time of credit of such sum to the account of the contractor or at the time of the payment thereof. ....." While holding the aforesaid view, the Punjab & Haryana High Court discussed the judgments of the Calcutta and Madras High Courts, which had taken the same view, and concurred with the same, which is clear from the following discussion contained in the judgment of the Punjab & Haryana High Court:
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> "14. A Division Bench of the Calcutta High Court in Commissioner of Income Tax v. Crescent Export Syndicate, (2013) 216 Taxman 258 (Calcutta) held:-
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> "13..... ..... ..... The term 'shall' used in all these sections make it clear that these are mandatory provisions and applicable to the entire sum contemplated under the respective sections. These sections do not give any leverage to the assessee to make the payment without making TDS. On the contrary, the intention of the legislature is evident from the fact that timing of deduction of tax is earliest possible opportunity to recover tax, either at the time of credit in the account of payee or at the time of payment to payee, whichever is earlier."
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> 15. Ms. Dhugga invited our attention to a judgment of the Division Bench of Madras High Court in Tube Investments of India Ltd. v. Assistant Commissioner of Income-Tax (TDS), [2010] 325 ITR 610 (Mad). The Division Bench referred to the statistics placed before it by the Department which disclosed that TDS collection had augmented the revenue. The gross collection of advance tax, surcharge, etc. was Rs. 2,75,857.70 crores in the financial year 2008-09 of which the TDS component alone constituted Rs.

1,30,470.80 crores. The Division Bench observed that introduction of Section 40(a)(ia) had achieved the objective of augmenting the TDS to a substantial extent. The Division Bench also observed that when the provisions and procedures relating to TDS are scrupulously applied, it also ensured the identification of the payees thereby confirming the network of assessees and that once the assessees are identified it would enable the tax collection machinery to bring within its fold all such persons who are liable to come within the network of tax payers. These objects also indicate the legislative intent that the requirement of deducting tax at source is mandatory.

16. The liability to deduct tax at source is, therefore, mandatory." The aforesaid interpretation of Sections 194C conjointly with Section 200 and Rule 30(2) is unblemished and without any iota of doubt. We, thus, give our imprimatur to the view taken. As would be noticed and discussed in little detail hereinafter, the Allahabad High Court, while interpreting Section 40(a)(ia), did not deal with this aspect at all, even when it has a clear bearing while considering the amplitude of the said provision.

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.
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> 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." 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.
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> 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.
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> 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." 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.

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 thereagainst 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, (1989) 4 SCC 187.

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.

The appeal is, accordingly, dismissed with costs.

.....J. (A.K. SIKRI) .....J. (ASHOK BHUSHAN)
NEW DELHI;

MAY 03, 2017.