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Direct Tax

Tax Alert -

Allowance of Interest on
delayed payment of Tax
deducted at source

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ALLOWANCE OF INTEREST ON DELAYED PAYMENT OF TAX DEDUCTED AT SOURCE

In addition to one's own tax liability, a taxpayer is entrusted with the responsibility to collect and remit taxes such as service tax, TDS, TCS, to the coffers of the Government. While carrying out this responsibility, it may so happen that there is a delay at the end of the taxpayers in depositing the tax with the Government for which they become liable to pay interest under the applicable provisions of the Statute.

Any person deducting taxes at source in accordance with the provisions of Chapter XVIIIB of the Income Tax Act, 1961 ("the Act") is liable to pay the same to the credit of Central Government within prescribed time limit, failing which interest is leviable under Section 201(1A) of the Act. However the taxing authorities take a view that the interest so paid on account of delay in depositing the TDS amount is penal in nature and thus should not be allowed as deduction, often placing reliance on the judgment of the Hon'ble Supreme Court in the case of *Bharat Commerce & Industries Ltd. v.s Commissioner of Income-tax*[1998] 98 Taxman 151 (SC) wherein the disallowance was made in the Section 215 of the Act due to the delay in the payment of income tax by the assessee on the income disclosed under Voluntary Disclosure of income and Wealth Act, 1976. Consequently, the assessee having to face the dual hardship of bearing the interest as well as paying tax on the same, given that the TDS in question represents tax on income of another assessee and not a charge on his own income.

Section 37(1) of the Act provides for deduction of expenditure incurred wholly and exclusively for the purpose of business or profession, in computing the income therefrom. However, it does not allow deduction of expenditure if the same is incurred for any purpose which is an offence or is prohibited by law. The Statute only provides for an interest for such default committed by the assessee in discharging his statutory obligation under the Act, which is calculated with reference to the tax on income, however, the taxing authorities paint this interest paid on delay on deposit of collected taxes with the colour of "penalty" and resort to not allowing such interest as deduction from the income of the taxpayer at the time of assessment.

Fortunately, the Judiciary has at a few instances opined that where the assessee deducted TDS but paid the same late in Government exchequer, the interest paid for the period of such delay is compensatory and not penal in nature, as the interest is for the use of Government money for one's own purpose during the period of delay.

The issue of interest for delay in the payment of service tax is directly covered by the judgment of Hon'ble Supreme Court in the case of Lachmandas Mathura Vs. CIT reported in 254 ITR 799 in favour of assessee. The relevant extract of the judgment is reproduced below:

"The High Court has proceeded on the basis that the interest on arrears of sales tax is penal in nature and has rejected the contention of the assessee that it is compensatory in nature. In taking the said view the High Court has placed reliance on its Full Bench's decision in Saraya Sugar Mills (P.) Ltd. v. CIT [1979] 116 ITR 387 (All.) The learned counsel appearing for the appellant-assessee states that the said judgment of the Full Bench has been reversed by the larger Bench of the High Court in Triveni Engg. Works Ltd. v. CIT [1983] 144 ITR 732 (All.) (FB), wherein it has been held that interest on arrears of tax is compensatory in nature and not penal. This question has also been considered by this Court in Civil Appeal No. 830 of 1979 titled Saraya Sugar Mills (P.) Ltd. v. CIT decided on 29-2-1996. *In that view of the matter, the appeal is allowed and question Nos. 1 and 2 are answered in favour of the assessee and against the revenue.*"

The above principles can be applied to the interest expenses levied on account of delayed payment of TDS. In a judgment in the case of DCIT, Circle-3(1), Kolkata Vs. M/s Narayani Ispat Pvt. Ltd dated 30.08.2017 in ITA No.2127/Kol/2014, interest on late payment of both service tax and TDS was claimed by the assessee as deduction. However, Assessing Officer was of the view that the late payment of service tax and TDS is not allowable for the deduction from the income. Accordingly, AO after having reliance on the judgment of *Hon'ble Supreme Court in the case of Bharat Commerce Industries Ltd. Vs. CIT (supra)* has disallowed the claim of interest expenses and added the interest to the total income of assessee. Assessee preferred an appeal before Ld. CIT(A) and submitted that the interest expense was incurred on account of late deposit of service tax and TDS which is allowable expense u/s 37(1) of the Act. The assessee in this regard has relied on the judgment of Hon'ble Court's CIT vs. Mysore Electrical Industries Ltd. 196 ITR 884 (Kar) where Interest for failure to pay PF contribution was held deductible u/s. 37(1) and also in the case of Lachmandas Mathura vs. CIT 254 ITR 799 (SC) where interest paid on sales tax arrear was held deductible u/s. 37(1). The Ld. CIT(A) after considering the submission of assessee has deleted the addition made by the AO. On appeal by the revenue, the Hon'ble Tribunal at Kolkata distinguished the case of *Bharat Commerce Industries Ltd. Vs. CIT (supra)* on facts, observing that unlike in that case, the interest in question was on delayed payment of TDS, which does not represent the tax of the assessee but it is the tax of the party which has been paid by the assessee. Thus, any delay in the payment of TDS by the assessee cannot be linked to the income tax of the assessee

In CIT v. Mysore Electrical Industries Ltd. [1992] 196 ITR884 (KAR.), the assessee had failed to pay the contribution under the provisions of the Employees' Provident Fund Act to the concerned trust and consequently had to pay interest thereon. This interest was claimed as a deduction by the assessee under section 37. The ITO rejected the claim holding that the payment was penal in nature and therefore not deductible. The Tribunal however allowed the assessee's claim applying the principle stated by the *Supreme Court in Mahalakshmi Sugar Mills Co.'s case [1980] 123 ITR 429* where the assessee claimed deduction of certain amount paid as interest on arrears of cess due under the U.P. Sugarcane Cess Act, 1956 which was allowed by the Supreme Court because the interest paid for delay in cess cannot be described as a penalty paid for an infringement of the law. It was not disputed that the payment of interest represents expenditure laid out wholly or exclusively for the purpose of the business and that it is in the nature of revenue expenditure. Accordingly, the interest was allowed by the Hon'ble High Court.

In [ITO vs. M/s.Lakshdweep Development Corporation Limited \(ITA No.311/Coch/2018\)](#), the [Hon'ble Tribunal](#) has held that interest on delayed payment of VAT and TDS is only compensatory and is not penal in nature.

However, there also exists contrary view taken by the Hon'ble Ahmedabad and Bangalore Tribunal as well the Madras High Court in the matter of allowance of interest on delayed payment of TDS.