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AN ANALYSIS***

Prasenjeet Kumar

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INTEREST ON LATE PAYMENT OF TDS CONSTITUTES EXPENDITURE OR NOT: AN ANALYSIS

*Prasenjeet Kumar**

[Abstract: *Income Tax Act, 1961 intends to levy and collect direct tax from assessee. This paper aims to analyse the problem related to the allowance of expenditure, upon the interest amount while collection of tax deduction at source amount, to claim it as a deduction. The problem arises because the assessee or the TDS deductor does not submit TDS at the prescribed time and due to this an interest is imposed upon that person over that TDS amount due to late payment. In this paper the problem is analysed by taking the help of various judgments pronounced by various tribunals and courts which due to which the content become authenticated. The purpose of this paper endeavors to provide a thought, pragmatic analysis of the concerned proposition and proper interpretation of the problem so that it will be helpful for the readers. It will show why an expenditure sometimes become a deduction and sometimes not. The idea behind this paper is taken from the facts of a case whose analysis is also present. It is hoped that the analysis under this study will inform the legal aspirants, practitioners and assessee about the amount on which the taxable amount is decided. There is clarity in the assessee's mind regarding the calculation of taxable income; this paper will help them to solve this issue.*

Keywords: *Tax, Source, Levy, Collection, Assessee, Expenditure, Deductor, Income, Deduction.]*

* Prasenjeet Kumar is a law student of Central University of South Bihar. Email: prasenjeetk15@gmail.com.

I

INTRODUCTION

The Income tax Act provides various provisions for the collection of taxes from the assessee. The Act not only talks about the collection of taxes but also provides the scope of various exemptions and deductions while calculating the total taxable income. The exemption and deduction is based upon the expenditure of the assessee. The word expenditure here means costs associated with an accounting period's operations, with income generated during that period, or with benefits limited to that period. With regard to expenditure, there are two kinds of provisions present under this Act. First that shows which kind of expenditure is allowable and the other one shows which kind of expenditure is not allowable that is they override the provisions.

Even in case of defaults, the person is responsible for paying interest under sections 234A¹ for failing to file an income tax return, 234B² for failing to pay advance tax, 234C³ for failing to pay an individual advance tax instalment, 271H⁴ for failing to deduct TDS, and section 201(1A)⁵ deals with interest for failure to deduct tax at source/delay in payment of tax deducted at source. Section 206C(7)⁶ deals with and interest levied for failure to collect tax at source/delay in payment of tax collected at source. These sections clearly show that if a person makes any kind of default then he has to give the interest on that amount. The question of this assignment is whether the interest amount comes under the scope of any deduction or exemption. To collect tax from the very source of income, the TDS concept was introduced. As per this concept, a deductor, who makes a payment of specified nature to any other person is known as deductee, shall deduct tax at source and remit the same into the treasury of the Central Government. And if this duty is not performed by the deductor then he shall be liable under section 201(1A) of the Income Tax Act, 1961.

The issue to be analysed in this paper is whether or not the interest paid on a late Tax Deducted at Source payment after deduction can be claimed as an expense for the calculation of the taxable income. For this I will examine section

¹ The Income Tax Act, 1961, S. 234A.

² The Income Tax Act, 1961, S. 234B.

³ The Income Tax Act, 1961, S. 234C.

⁴ The Income Tax Act, 1961, S. 271H.

⁵ The Income Tax Act, 1961, S. 201(1A).

⁶ The Income Tax Act, 1961, S. 206C(7).

40(a)(ii)⁷, section 201(1A) section 36(1)(iii)⁸, specially, *Universal Energies Ltd. v. DCIT*⁹ in which the answer for the same question is given by the Income tax appellate tribunal.

II

REQUIREMENT FOR EXPENDITURE

Before analysing the issue, it is required to understand whether a particular expenditure is deductible or not and for this, the first and foremost requirement is to enquire whether the deduction is expressly prohibited under any other provision of this Act. If the deduction is not prohibited, then only the expenditure is allowed to deduct under section 37(1). According to Section 37(1), a deduction can only be taken into account if the expense was made with the intention of using the money for a business or profession.

If it is prohibited then section 40 and 40A comes into play and there is section 43B which provides certain deduction which can only be allowed if actual payment is done. According to Section 40, there are several expenses that cannot be taken into account when calculating income under the heading "Profits and gains of business or profession".

Relation of expenditure and interest paid on late remittance of TDS

This Act primarily establishes two requirements for claiming expenses.

1. Expenses that are allowed under Sections 30 to 37 of the Act, and
2. Expenses that are not allowed under Sections 40 and 43B.

For claiming interest for a late TDS remittance, the same guidelines apply.

Definition of Interest

Interest as defined in section 2(28A) of the Act means:

*'Interest that is due in any way on borrowed funds or debts of any kind (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge related to the amount borrowed, the debt incurred, or the use of any credit facility which has not been utilized.'*¹⁰

It clearly means that for the purpose of this Act, the interest must be paid on

⁷ The Income Tax Act, 1961, S. 40(a)(ii)

⁸ The Income Tax Act, 1961, S. 36(1)(iii).

⁹ *Universal Energies Ltd. v. DCIT*, ITA No. 2761/Del/2018.

¹⁰ The Income Tax Act, 1961, S. 2(28A).

the borrowed money and debt incurred or any credit facility which is not utilized. It shall be read with Section 36(1)(iii) of the Act which allows the interest paid on borrowed capital shall be deducted but only while computing the income from the business or profession of the assessee.

It was decided in *K.M.S. Lakshmanier And Sons v. CIT*¹¹ that the word "borrowed money" relates to actual lending or borrowing. It must be understood in light of its plain and usual meaning, which indicates actual borrowing and lending. A true borrowing is necessary because it requires the presence of both a borrower and a lender. Contrary to section 2(28A), the phrase "debt incurred" is not present in section 36(1)(iii). Hence, Section 36(1)(iii) has used it in a restrictive manner whereas section 2(28A) defines 'interest' in a wider sense. Therefore, it can be claimed that in order to be eligible for an allowance under Section 36(1)(iii) of the Act, a loan on which interest is paid is necessary. In the case of a loan transaction, both the lender and the borrower must exist.

For understanding payment on which the deduction which is allowed when the amount has been actually paid during the previous year section 43B can be referred.

Section 43B Deduction allowed on actual payment:

'Notwithstanding anything contained in any other provisions of the income-tax Act, in respect of certain expenditure/payments, the deduction is allowed (irrespective of the previous year to which the liability to pay such sum was incurred by the assessee) only if the amount has been actually paid during the previous year. However, in case an assessee follows mercantile system of accounting, the payments mentioned below can be claimed on 'due' basis, provided the payment for the same is made within stipulated period mentioned against each expenditure:

Nature of Expense

- 1) Any sum payable by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force.*
- 2) Any sum payable by the assessee as an employer for the welfare of employees by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund.*
- 3) Any sum payable to an employee as bonus or commission for service rendered.*
- 4) Any sum payable as interest by the assessee on any loan or borrowing from any public financial institution or State Financial Corporation or*

¹¹ *K.M.S. Lakshmanier And Sons v. CIT* 1953 SCR 1057 (SC).

State Industrial Investment Corporation like IDBI, IFCI, UPSIDC, Delhi Financial Corporation, etc., in accordance with the terms and conditions of the agreement governing such loan or borrowing.

5) Any sum payable by the assessee as interest or any loan or advance from scheduled bank in accordance with the terms and conditions of the agreement governing such loan.

6) Any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee.

*7) Any sum payable by the assessee to the Indian Railways for the use of railway assets.'*¹²

III

Answer of the question that arises because the assessee or the TDS deductor does not submit TDS at the prescribed time and due to this an interest is imposed upon that person over that TDS amount due to late payment is analysed in the case of **Universal Energies Ltd. V. DCIT**¹³.

Facts of the Universal Energies Ltd. V. DCIT

A copy of the ledger account for the interest on TDS was provided by the assessee. The assessee acknowledged that Rs. 9,70,248 worth of interest on TDS had not been included back into the computation of income. It was claimed by the assessee that the amount of interest shall be treated as expenditure and hence eligible for deduction under the head income from business or profession. As Interest on TDS is not allowable expense as per provision of Income Tax Act, 1961. As a result, the assessing officer rejected expenses totalling Rs. 9,70,248.

Issue before the Tribunal

Whether or not the interest on a late TDS payment can be claimed as an expense for the calculation of the taxable income.

Observation of Tribunal

As per the order of the Assessing Officer and according to the Income Tax Act of 1961, an account of interest on TDS is not a legitimate expense. The provisions of Section 40(a)(ii) of the Act clearly state that income tax inputs, interest, and penalties are not permitted. Although the allowability of interest amount as deduction needs to be examined for a better understanding of wider

¹² The Income Tax Act, 1961, S. 43B.

¹³ *Universal Energies Ltd. v. DCIT*, ITA No. 2761/Del/2018.

scope of law. As per Section 201(1A) of the Income-tax Act which mandates interest will be levied from Assessee at the rate of 1.5% per month, or a portion of a month, if TDS is deducted and the payment of TDS to the central government's treasury is delayed. There are two conditions which talks about the allowance of expenditure as it can be deducted or not. Section 30 to 37 of the Act provides an allowance of expenditure and non-allowable expenditure as per section 40 and section 43B.

As per Section 36(1)(iii) of the Act allows subtraction of the interest paid on borrowed money only when it is borrowed for the purpose of the business or profession, and here interest amount is not for the borrowed capital that is the non-payment of taxes does not mean that the capital is borrowed from the government that's why this amount which is accrued due to non-payment of taxes i.e. interest is not covered under section 36(1)(iii) of the Income Tax Act,1961. There is also a residuary section that is section 37 which allows business expenditure while computing taxable income. Under section 30 to 36 there are provisions which talks about the expenses which are allowed as deduction under income from profits and gains of business or profession. The interest amount which is to be paid on the late payment of TDS is nowhere covered under sections 30 to 36 that's why it qualifies for examination under section 37. Section 37(1) provides that

*'Any expense incurred wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head, "Profits and Gains of Business or Profession," with the exception of any expense described in sections 30 to 36, capital expenditure, or personal expenses of the assessee.'*¹⁴

This interest amount does not come under the scope of capital expenditure and personal expenditure of the Assessee. This interest amount is the responsibility of assessee i.e tax payment, including deduction and submission of TDS, is a necessary aspect of running a business. That means the assessee is not authorised to use these funds on the government's behalf. The nature of the levy with which the interest is paid lends colour to the interest payment. The tax is required to be paid but not paid in time due to which the assessee becomes liable of the payment of the interest and that's why it takes the nature of direct tax and needs to be paid as tax under Income Tax Act, 1961. These statements clearly conclude that the tax is deducted or remitted in the course of business but it does not take the character of business expenditure which makes it out of the scope of section 201(1A) of the Income Tax Act,1961. Therefore, it cannot be viewed as a compensation payment.

¹⁴ The Income Tax Act, 1961, S. 37(1).

In *M/s. New Modern Bazaar Departmental Store Pvt. Ltd. v. ITO*¹⁵ it was held by the Tribunal that the interest on a TDS payment that was made late does not count as a business expense. The assessee claimed that the interest was compensatory in character and related to its business activities. The Revenue argued that because payment of interest on overdue TDS deposits is a payment in the form of tax rather than an expense that is completely and exclusively incurred for business purposes. This payment is not an expense that is permissible. The ITAT dismissed the appeal of the assessee.

In the case of *Lachmandas Mathura v. CIT*¹⁶

*'The High Court rejected the assessee's argument that the interest on sales tax arrears is compensatory in form and instead proceeded on the theory that it is penal in nature. In taking the said view the High Court relied on its full bench's ruling in Saraya Sugar Mills (P.) Ltd. v. CIT*¹⁷ *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*¹⁸ *(FB), where it has been decided that the interest on tax arrears is compensatory and not punitive in character.'*

In the case of *CIT v. Chennai Properties & Investment Ltd.*¹⁹ the Madras High Court declared that the assessee's payment of interest under Section 201(1A) does not qualify as a business expense and cannot be seen as a compensatory payment. This decision of Hon'ble Madras High Court has also been followed by various benches of ITAT, specifically in *Velankani Information Systems Limited v. DCIT*²⁰ as under: -

*"Regarding the delay in remitting TDS under Section 201(1A) of the Act, we discover that the Honorable Madras High Court has come to the conclusion that interest under Section 201(1A) is also of the nature of tax and, despite the fact that it is not the assessee's tax liability, the same cannot be allowed as deduction."*²¹

Decision of the Tribunal

It was held by the Tribunal that paying interest on late TDS payments is not a tax-deductible business expense and is not expected to be compensating. The

¹⁵ *M/s. New Modern Bazaar Departmental Store Pvt. Ltd. v. ITO*, ITA. No. 590/Del/2018.

¹⁶ *Lachmandas Mathura v. CIT*, 254 ITR 799.

¹⁷ *Saraya Sugar Mills (P.) Ltd. v. CIT*, [1979] 116 ITR 387 (All.)

¹⁸ *Triveni Engg. Works Ltd. v. CIT*, [1983] 144 ITR 732 (All.)

¹⁹ *CIT v. Chennai Properties & Investment Ltd.*, (1999) 239 ITR 435 (Mad.)

²⁰ *Velankani Information Systems Limited v. DCIT*, [2018] taxmann 599 (Bangalore- Trib.)

²¹ *ibid*

payment of interest on late deposits of TDS assessed under Section 201(1A) is not an expense solely and exclusively expended for business purposes; hence it is not deductible under Section 37(1) of the Act. The reason behind this is that the tax is required to be paid but not paid in time due to which the assessee becomes liable of the payment of the interest and that's why it takes the nature of direct tax and needs to be paid as tax under Income Tax Act, 1961. Consequently, the AO's disallowance is hereby confirmed. The appeal's ground is rejected.

IV

COMPARISON OF THE INTEREST ON LATE PAYMENT OF TDS AND THE INTEREST ON THE LOAN FROM THE BANK

The amount borrowed from the bank is used for the purpose of business or profession. Its character is that of the business expenditure. Expenditure must be interpreted according to its literal, natural and common meaning, which denotes that there is actual lending and borrowing. It necessitates the presence of a borrower and a lender, and as a result, a genuine borrowing is required. That is for claiming allowance under section 36(1)(iii) of the Act there is the presence of borrower and lender and an agreement of borrowing of loan amount stating the purpose of borrowing the money.

The interest on late payment of TDS has occurred because the TDS has not been either deducted or remitted at the prescribed time. It cannot be said that as the interest is on the amount which is to be paid to government, that's why it is a kind of borrowing. For coming under the scope of the definition of borrowing, there shall be a presence of lender and borrower and an agreement needs to be there for lending the money but in this case, the government had never given the money for any business. It is only a kind of default made by the payer and hence liable under section 201(1A) of the Income Tax Act, 1961 and not covered under section 36(1)(iii) or section 37 of the Income Tax Act, 1961.

According to Section 201, if the person who is required to deduct tax at source has failed to do so or failed to deposit the full amount of tax due in the government's treasury after doing so the he must have to pay simple interest in the manner outlined below:

- Interest shall be collected at 1% on the amount of such tax for every month or part of a month. Further, this is calculated from the day the tax was deductible until the day it was deducted, this is calculated.
- Interest shall be levied at 1.5% on the amount of such tax, for each month or part thereof. Further, this is calculated from the day on which the tax was deducted to the day on which the tax was really deposited

to the government's treasury.

It can be said that interest will be assessed at 1.5% for each month or fraction of a month where the remittance after the deduction is delayed and at 1% for each month or fraction of a month when the deduction is delayed.

Every deductor, for tax deducted by him, has to furnish a quarterly statement known as TDS return. In accordance with section 201(1A), interest for late TDS payments must be paid before submitting the TDS return.

Interest is charged when TCS is delayed or not collected at source.

As per section 206C(7)²², the first is that if the person in charge of collecting tax fails to do so. The second requirement is that, after collecting the tax, he neglects to credit it to the government by the deadline established in this respect. If both or any of the above two conditions got fulfilled then he will be responsible for paying simple interest at a rate of 1% per month, or a portion of that month on the amount of the tax. From the time the tax was due for collection to the time it was actually paid, interest will be charged.

Interest will be charged if tax is not paid by the deadline mentioned in the demand notice

If tax is not paid within the time frame provided in the demand notice, interest must be paid under Section 220(2). According to section 220(2), the taxpayer is responsible for paying simple interest at a rate of 1% for each month or portion of a month if the amount mentioned in any notice of demand issued under section 156(1)²³ is not paid within the time frame permitted. Interest will be charged for the time frame starting on the day after the notice's specified time period ends and ending on the day the money is paid.

A notification that details the amount that is payable or refundable is produced after the processing of TDS/TCS statements. This notification shall be considered notice of demand under Section 156. Failure to pay the applicable tax outlined in the notification will result in interest under Section 220(2)²⁴. According to section 220(2), no interest may be levied on the amount for the same time period as interest is assessed under section 201(1A) on the amount of tax mentioned in the intimation made under section 200A(1)²⁵.

The interest amount paid or payable by the taxpayer under section 220(2) may be reduced or waived by the Principal Chief Commissioner, Chief Commissioner, Principal Commissioner, or Commissioner if he is convinced

²² The Income Tax Act, 1961, S. 206C(7).

²³ The Income Tax Act, 1961, S. 156(1).

²⁴ The Income Tax Act, 1961, S. 220(2).

²⁵ The Income Tax Act, 1961, S. 200A(1).

that:

- i. Payment of such interest has caused the taxpayer to face genuine hardship;
- ii. Circumstances beyond the taxpayer's control led to the failure to pay the amount on which interest has been charged;
- iii. The taxpayer has experienced genuine hardship as a result of the payment of such interest.

Interest if default is made in payment of advance tax [Section 234B]

Section 234B²⁶ provides for levy of interest for default in payment of advance tax. Interest under section 234B is charged when a taxpayer fails to pay advance tax even though he is required to do so, or when the taxpayer paid advance tax which is less than 90% of the assessed tax. According to Section 208 of the Act, advance tax must be paid by the taxpayer throughout the financial year if the assessee's estimated tax due for that year is 10,000 rupees or more.

V

CRITICAL ANALYSIS OF THE JUDGMENT OF *UNIVERSAL ENERGIES LTD. V. DCIT*

Section 36(1)(iii) of the Act which allows the interest paid on borrowed capital shall be deducted but only while computing the income from business or profession of the assessee. While "interest" is defined broadly in section 2(28A), it is only used in limited circumstances in section 36(1)(iii). Therefore, it can be claimed that in order to be eligible for an allowance under Section 36(1)(iii)²⁷ of the Act, a loan on which interest is paid is necessary. Both the lender and the borrower must be real parties in the loan transaction. The assessee is responsible for this interest amount even if the deduction and remittance of TDS to the government, is an integral element of business operations. This implies that the assessee lacks the authority to use the funds on the government's behalf. The type of tax used to pay the interest gives the interest payment character. The tax is required to be paid, but if it is not paid on time, the assessee is responsible for the payment of interest; as a result, the tax assumes the form of direct tax and must be paid as tax in accordance with the Income Tax Act of 1961.

According to Section 37(1), a deduction can only be taken into account if the expense was made with the intention of using the money for a business or

²⁶ The Income Tax Act, 1961, S. 234B.

²⁷ The Income Tax Act, 1961, S. 36(1)(iii).

profession. Sections 40 and 40A come into effect if section 37(1) is prohibited, and section 43B allows for some deductions that are only valid if actual payment is made. According to Section 40, a number of expenses are not allowed to be taken into account when calculating income under the heading "Profits and gains of business or profession." TDS interest is charged for late payments because the TDS is not timely deducted or remitted. It cannot be claimed that because the interest is calculated on the sum that must be paid to the government, this qualifies as borrowing. There must be a lender and borrower present, as well as an agreement, for something to fall under the definition of borrowing, but in this case, the government had never provided funding for a firm. It is just a specific type of payer default, making it subject to section 201(1A) of the Income Tax Act of 1961 and excluded from section 36(1)(iii) or section 37 of the Income Tax Act.

Since the payment of interest on late TDS deposits imposed under Section 201(1A) is not an interest entirely and exclusively incurred for business purposes, it is not deductible under Section 37(1) of the Act. This is owing to the fact that the tax is required to be paid, but if it is not paid on time, the assessee is then responsible for the payment of interest, the result of which is that the tax assumes the form of direct tax and that's why it must be paid in accordance with the Income Tax Act, 1961.

VI

CONCLUDING REMARKS AND SUGGESTIONS

The payment of interest on late deposits of TDS assessed under Section 201(1A) is not an expense solely and exclusively expended for business purposes; hence it is not deductible under Section 37(1) of the Act. Even if the deduction and remittance of TDS to the government are essential components of business operations, the assessee is nonetheless liable for this interest amount. This suggests that the assessee does not have the right to spend the money on the government's behalf. The character of the interest payment is determined by the sort of tax utilised to pay it.

This conclusion is reached by analysing the case of *New Modern Bazaar Departmental Store Pvt. and Velankani Information Systems Limited v. DCIT, K.M.S. Lakshmanier And Sons v. CIT* and *Universal Energies Ltd. v. DCIT* and relevant provisions of Income Tax Act, 1961 the deduction for TDS cannot be claimed as an expense for calculating taxable income, hence it might be inferred that the assessee is accountable for paying interest on late payments. TDS interest is charged for late payments because the TDS is not timely deducted or remitted. It cannot be claimed that because the interest is calculated on the sum that must be paid to the government, this qualifies as borrowing. Every

deductor, for tax deducted by him, has to furnish quarterly statement known as TDS return.