TDS Credit in respect of tax deduced from the payments made to the assessee but not deposited.

I. INTRODUCTION

Many a times in case we find that the deductor of tax under the Income Tax Act ("Act") has kindly deducted tax from the payments made to the assessee but has, in an unkind gesture, failed to deposit the tax with the Government. Thus where the tax credit does not match with the claim of the assessee, the Assessing Officer, very kindly, issues a notice under Section 156 and asks the Assessee to pay the tax. Very often, this is done blindly, without going into the reasons of the mismatch.

The question that arises is that what the protection available to the assessee is. Can he be called upon to pay the tax and thus suffer a sort-of double taxation?

II. SCHEME OF TDS

The scheme of TDS is such that the assessee clearly does not have any say in the entire procedure. The Act imposes upon the person responsible for paying the sums defined under the Act to deduct the tax and deposit the tax with the Government treasury. Thus the entire transaction is between the deductor and the Government.

It is a sort of principal-agent relationship; where the Government is the Principal and the Deductor is the agent. Thus the rationale that follows is that if the agent makes a mistake, the Principal is equally liable and hence the third party cannot be asked to be accountable for the same.

III. SECTIONS IMPACTING TAX CREDIT

Section 199 is the section relating to tax credit available to the assessee. It reads as:

"Any deduction made in accordance with the foregoing provisions of this Chapter and paid to the Central Government shall be treated as a payment of tax on behalf of the person from whose income the deduction was made, or of the owner of the security, or of the depositor or of the owner of property or of the unit-holder, or of the shareholder, as the case may be."

Thus there are two conditions for giving credit to the deductee:

1. Tax must have been deducted from the income. (includes grossing up also as per Section 195(1A)
2. The tax must have been paid to the Central Government.

E.g. Mr. Gala, while paying professional fees to Mr.Lalan deducts the same and deposits it in the Government treasury via a challan. Thus Mr. Lalan would get the credit on receiving the Form 16A from Mr.A.

Suppose Mr. Gala does deduct the tax but does not pay the same. Then what happens? As per Section 199, Mr. Lalan will not get the credit. It will mean a double taxation, unfairly for Mr. Lalan because we know that the assessing officers promptly issue a notice under section 156 for mismatch of data.

In such cases, Section 205 comes to the rescue of Mr. Lalan. Section 205 reads as

"Bar against direct demand on assessee.
205. *Where tax is deductible at the source under [the foregoing provisions of this Chapter], the assessee shall not be called upon to pay the tax himself to the extent to which tax has been deducted from that income."*

Thus since the tax deductible has been deducted but not paid, still Mr. Lalan will not be called upon to pay the tax deducted.

This view was supported by the Ahmedabad Tribunal in **Ahluwallia and Associates** in **123TTJ 972** where it held that

"The assessee, in no case, shall be denied the benefit of TDS on the sole ground that the tax so deducted has not been paid to the credit of the Central Government. It is for the Department to recover such amount from the deductor and take such action against him as may be warranted in law but the deductee cannot be made to suffer for the illegalities committed by the deductor."

The Mumbai bench of the ITAT has also held similarly in the case of **J.G. Joseph vs. JCIT** in **303 ITR 395** that

"Under the peculiar circumstances of the case, we direct the Income Tax authorities not to recover any tax levied on assessee in respect of non-furnishing of TDS Certificate. There are various provisions in the Act which provide the powers to the Income Tax authorities to enforce the payment of tax by deductor and also enforce issue of Certificate in respect thereof to the payee. There is no material on record to show that whether such powers have been exercised by the Department to enforce the payment of tax deducted at source and also for the issue of Certificate thereof. In this view of the situation, the assessee cannot be held liable for the consequences which are beyond the control of the assessee, i.e. non-furnishing of TDS Certificate."

This is a very logical inference which also finds support from the Principal-Agency relationship mentioned earlier. The Revenue has all the powers to recover the tax from the deductor by holding it as "Assessee-in-default". Thus because of such powers, the tax can't be recovered from Mr. Lalan.

This view is supported by the **Honourable Karnataka high Court** in **Anusuya Alva vs DCIT and Ors.** in **278 ITR 206** wherein it held in para 10 that:

"Even on the general principles of law, the Law of Principal and Agent, as discussed above, for a default of the agent of the Revenue, the petitioner assessee ,who is a third party in relation to such relationship cannot be penalised. In the circumstances, I am of the view that the Revenue is to be definitely restrained in terms of

s. 205 of the Act from enforcing any demand on the assessee-petitioner insofar as the demand with reference to the amount of tax which had been deducted by the tenant of the assessee in the present case, and assuming that the tenant had not remitted the amount to the Central Government. The only course open to the Revenue is to recover the amount from the very person who has deducted and not from the petitioner."

IV. CONTRDICTION RESOLVED

But the biggest contradiction that remains is how does Mr. Lalan reconcile the fact that while he is not called upon to pay the tax again (Section 205) but he won't get the credit for the same unless the tax deduced has been paid by Mr. Gala in the treasury. This is an issue which has been resolved most harmoniously by the Honourable Bombay High Court in the case of **Yashpal Sahni** in **293 ITR 539**. The Bombay High Court has held that

"Though the credit of the tax deducted at source is not available to the petitioner (read Mr. Lalan) , since the said liability is not recoverable from the petitioner, the revenue is directed to earmark the said TDS liability as "not recoverable" from the petitioner."

V. THE DANGER AHEAD?

If we look at almost all the decisions the redeeming factor is the section 205 which puts a bar to further direct demand from the assessee. Just imagine what would happen to Mr. Lalan what would happen if Section 205 would not have been there in the Act!!!

This is exactly what has happened with the proposed Direct Tax Code. It does not contain a similar provision as that of section 205. Actually speaking, this may not be very surprising as the Draft of the Direct Tax Code, in the guise of simplicity, seeks to take away many beneficial provisions for the assessee.

At this juncture, I may add that I had personally raised this query with Mr. Arbind Modi, Joint Secretary, Ministry of Finance at the WIRC seminar on Direct Tax Code but Mr. Modi was evasive and said that the Revenue would have to collect taxes, ***from anyone party, at least.***

While one may wonder what would happen to our Mr. Lalan if the Direct Tax Code continues in its present form (i.e. without introduction of some provision safeguarding the deductee's interest), the Courts and ***Bhagwan*** remain the only hope.

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