IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 01.03.2016

+ ITA 32/2004

ANZ GRINDLAYS BANK
(now Standard Chartered Grindlays Bank Ltd.) .....Appellant

versus

DEPUTY COMMISSIONER OF INCOME TAX
AND ORS. ..... Respondents

Advocates who appeared in this case:

For the Appellant : Ms Shashi N. Kapila with Mr Pravesh Sharma and Mr Sanjay Kumar.

For the Respondents : Mr P. Roy Chaudhari, Senior Standing Counsel with Ms Lakshmi Gurung, Ms Easha Kadian, Mr Ishant Goswami and Mr Rajesh Kumar.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J

1. The present appeal has been filed by Standard Chartered Grindlays Bank Ltd., formerly known as 'ANZ Grindlays Bank Ltd.' (hereafter the 'Assessee') under Section 260A of the Income Tax Act, 1961 (hereafter the 'Act') impugning an order dated 29th August, 2003 passed by the Income Tax Appellate Tribunal (hereafter 'the Tribunal') in ITA No. 1442/Del of 1997. The said appeal, ITA 1442/Del of 1997, was preferred by the Assessee against an order dated 14th January, 1997 passed by the

Commissioner of Income Tax (Appeals) [hereafter 'CIT(A)'] in Appeal No.164/96-97 which in turn was preferred by the Assessee against the assessment order dated 25th March, 1994 passed in respect of Assessment Year (AY) 1991-92 .

2. The controversy involved in the present appeal relates to the denial of deduction of expenses - by virtue of provision of Section 40(a)(iii) of the Act -for failure on the part of the Assessee to deduct and deposit Tax Deducted at Source (TDS) within the prescribed time. This appeal was admitted on 28th April, 2005 and two questions of law were framed. At the hearing on 22nd December 2015, the Assessee did not press for one of the questions as it was stated that it had since obtained relief in respect thereof. Consequently only the following question of law arises for consideration:

> "Whether the Income Tax Appellate Tribunal was right in law in holding that salaries paid to ex-patriate employees overseas on which tax was paid in accordance with CBDT Circular dated 685 dated 17/20 June 94 and Circular 686 dated 12.8.94, is not permissible as a deduction in computation of taxable business income in view of the provisions of Section 40 (a)(iii) of the Income Tax Act, 1961 read with Article 7 of the Indo-UK Double Taxation Avoidance Treaty?"

3. The aforesaid question has to be considered in the following context:

3.1 During the relevant period - financial years 1984-85 to 1993-94 - the Assessee was a non-resident banking company and its principal place of business was situated outside India. The Assessee also carried on banking business in India through its branches situated within the country. During the relevant period, the Assessee seconded some of its employees from overseas to its branches in India. These expatriate employees were employed for the business carried on in India. They received a part of their remuneration by way of salaries and perquisites in India which were duly reflected in the Profit and Loss Account drawn up by the Assessee in respect of its Indian operations. The Assessee also deducted tax at source on so much of the remuneration that was payable to the aforementioned expatriate employees in India. Undisputedly, such TDS was deposited with the Government.

3.2 In addition to the remuneration paid to the aforementioned expatriate employees in India, the Assessee's head office situated overseas also made certain payments to and/or for the benefit of such expatriate employees. However, the Assessee did not account for such payments, which were in the nature of salaries, allowances and

perquisites, in its Profit and Loss Account drawn up in respect of its business in India. The Assessee neither claimed such payments as a deduction for the purposes of computing its income chargeable to tax in India nor deducted any tax under Chapter XVII B of the Act.

3.3 During the relevant period, some of the other non-resident assessees, who had employed expatriate employees in India, had also not deducted TDS on payments made to and/or for the benefit of such employees abroad on an erroneous understanding that payments made abroad were not subject to withholding tax in India. In order to clarify the position, the Central Board of Direct Taxes (CBDT) issued a Circular i.e. Circular No. 685 dated 17/20th June, 1994. By the aforesaid Circular, the CBDT clarified that all payments made and perquisites provided to employees overseas for services rendered in India are taxable in India irrespective of the place where such payments or perquisites have been made or provided. Accordingly, if the employees have rendered services in India, the employers are liable to deduct tax at source even in respect of payment of salary, allowances and perquisites paid and/or provided to such employees overseas. The said circular also indicated that in order to encourage immediate voluntary compliance, CBDT had decided that penalty proceedings under Section 221 and 271C of the Act and

prosecution under Section 276B of the Act would not be initiated in cases where the employers came forward and paid the entire amount of tax due under Section 192 of the Act along with interest before 31st July, 1994.

3.4 Pursuant to the aforesaid Circular (CBDT Circular No.685 dated 17/20th June, 1994), the Assessee deposited a sum of Rs.9,69,43,214/-, being the amount of TDS pertaining to the payments made abroad to and/or for the benefit of the employees serving in India during the financial years 1984-85 to 1993-94 and the interest due thereon, with the Income Tax Authorities.

3.5 The tax and interest deposited by the Assessee was duly verified and accepted by the income tax authorities and the concerned Commissioner of Income Tax issued a communication on 11th November, 1994 duly informing the Assessee that in view of the payments made, no penalty or prosecution action would be initiated in respect of the payments made overseas to and/or for the benefit of the expatriate employees.

3.6 The assessments for the six assessment years from AY 1985-86 to 1990-91 stood concluded as on 28th July, 1994 and, thus, the Assessee could not claim any deduction on account of the payments made in

respect of the said years. However, the Assessee's appeal in respect of AY 1991-92 was pending before CIT(A) and the Assessee sought to claim a deduction of an amount of Rs.1,32,46,994/- in respect of payments made pertaining to the financial year 1990-91. The CIT(A) rejected the Assessee's claim by holding that such claim could not be made in appellate proceedings. He also observed that no deduction could be claimed in view of Section 40(a)(iii) of the Act. He doubted whether the entire tax due had been paid by the Assessee since the amount of tax paid would also be includable as income of the employees and, therefore, have the effect of increasing their income and consequently, the tax payable thereon. He further observed that it was possible that the salaries paid to the employees overseas were a part of the head "office expenses".

3.7 On appeal, the Tribunal permitted the Assessee to urge the additional ground but rejected the same principally as falling foul of Section 40(a)(iii) of the Act. The Tribunal observed that Section 40 of the Act is a 'prohibitive' or 'disincentive' provision and, thus, had to be considered strictly. It held that since no tax had been deducted at source under Chapter XVII B of the Act within the prescribed time, no deduction under Section 40(a)(iii) was permissible. The Tribunal was of the view that a deduction would be permissible only if the provisions of Chapter

XVII B are strictly complied with and TDS is deducted and paid within the prescribed time. It observed that the CBDT Circular only gave immunity to the Assessee from penalty and prosecution but did not remove the disincentive under Section 40 of the Act.

3.8 The Tribunal also referred to Section 40(a)(i) of the Act which expressly provided that no deduction would be allowed in respect of any interest, royalty, fees for technical services or other sum chargeable under the Act which is payable outside India and in respect of which no tax has been deducted and paid under Chapter XVII B of the Act. The Tribunal noted that proviso to Section 40(a)(i) of the Act expressly provided that where tax in relation to any sum mentioned in sub clause (i) of clause (a) of Section 40 of the Act is paid or deducted in any subsequent year, the deduction would be allowed in the previous year in which such tax was paid or deducted. The Tribunal reasoned that since no such similar provision existed in respect of sub clause (iii) of clause (a) of Section 40 of the Act, no deduction would be permissible for payments which are chargeable under the head "Salaries" if tax had not been paid or deducted under Chapter XVII B.

4. The question whether an assessee is liable to deduct tax at source on the aforementioned payments made to and/or for benefit of its

employees seconded from its head office situated outside India, is no longer *res integra* in view of the decision of the Supreme Court in ***Commissioner of Income Tax v. Eli Lilly & Co. (India) P. Ltd.*: (2009) 312 ITR 225 (SC)**. The same is also not a subject matter of dispute in the present appeal.

5. It cannot be disputed that the Assessee has paid the tax which it was required to withhold under the provisions of Section 192 of the Act. Although before the CIT(A), the Revenue had sought to contend that the amount paid to the employees has not been verified as it did not form a part of the Profit and Loss Account submitted by the Assessee, however, the same is without merit as the communication dated 11th November, 1994 issued by the Commissioner of Income Tax (hereafter also referred to as "CIT") duly indicates that the Assessee had made a disclosure of the payments made outside India for financial years 1984-85 to 1993-94 in respect of its expatriate employees and further had provided "full details". The Commissioner of Income Tax had also obtained a report from the lower authorities and the TDS payments made were duly verified. The AO had also examined the exchange rates applied by the Assessee while determining the amount of tax to be deposited. It is only after duly verifying the relevant facts that the CIT had issued the communication

accepting that no action for penalty or prosecution would be initiated in respect of the payments made to expatriate employees.

6. Undisputedly, the entire tax payable on the salaries along with interest due thereon has been received by the Revenue. Even before us, Mr P. Roy Chaudhari, learned Senior Standing Counsel for the Revenue did not dispute that the Assessee had paid the requisite amount of tax.

7. Concededly, the powers of a CIT (A) are wide and in an Appeal against an Assessment order, it may confirm, reduce, enhance or annul the assessment. Thus, in cases where there is dispute as to the material facts for entertaining a claim, the CIT (A) would be well within his powers to do so. In the present case, the reliance placed by the CIT (A) on the decision of ***Additional Commissioner of Income Tax v. Gurjargravures P. Ltd:*** **[1978] 111 ITR 1 (SC)** is mis-placed as in that case neither any claim was made before the AO nor was there any material on record to support the claim. The Supreme Court specifically noted the same and held that on the facts of that case, the question referred to the High Court should have been answered in the negative. In the present case, there is no dispute as to the material facts required for allowing the deduction as claimed by the Assessee. The TDS paid on the expenses claimed have been duly verified and the tax on the payments

made which are chargeable under the head 'Salaries' have been recovered by the Government. The only reason for denying the claim is non-deposit of TDS within the prescribed time. The TDS having been deposited, there is no impediment for Assessee to claim the related expense.

8. In the aforesaid circumstances, the principal issue to be addressed is whether the provisions of Section 40(a)(iii) disentitles an assessee to claim a deduction on account of Salaries paid to its employees if the tax is not paid within the specified time but is paid subsequently. Mr Chaudhari, learned Senior Standing Counsel for the Revenue has contended that there are twin requirements to be fulfilled; the first being that tax should have been deducted under Chapter XVII B of the Act; and second being that tax should have been paid. He argued that even if the tax is paid in subsequent years, deduction on account of expenses could not be allowed because the second condition which is deduction of tax at the time of payment of the amount as required under Section 192 of the Act would not be fulfilled. According to him, if the tax is not deducted and paid within the time prescribed for such deduction or payment under the relevant provisions, an assessee would not be entitled to claim that it had deducted or paid the tax under Chapter XVII B of the Act. He also referred to the decision of the Supreme Court in ***Eli Lilly & Co. (India)***

P. Ltd. *(supra)* in support of his contention that Section 40(a)(iii) was an integrated code and Section 40(a)(iii) would have to be read in conjunction with Section 192 of the Act which required an employer (assessee) to deduct and deposit the tax payable in respect of payments chargeable under the head "Salaries".

9. Mr Chaudhari further supported the Tribunal's view that absence of proviso similar to that as under Section 40(a)(i) also indicated that no deduction under Section 40(a)(iii) was allowable in case where tax was not deducted or paid within the prescribed time under Chapter XVII B of the Act.

10. In order to address the controversy, it is necessary to refer to the provisions of sub-clauses (i) and (iii) of clause (a) of Section 40 of the Act as in force during the relevant period and the same are reproduced hereunder:

> "40 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",—
>
> (a) in the case of any assessee—
>
> (i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable

> under this Act, which is payable outside India, on which tax has not been paid or deducted under Chapter XVII-B;
>
> Provided that where in respect of any such sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.
>
> *****
>
> (iii) Any payment which is chargeable under the head "Salaries" if it is payable outside India and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII B."

11. Section 40 of the Act begins with the *non obstante* clause and, thus, expressly disentitles an assessee to claim deductions which may otherwise be allowable under Sections 30 to 38 of the Act. Thus, even though an amount is deductable in computing the income chargeable under the head “profits and gains of business or profession”, the same would not be deductable if it falls foul of any of the clauses of Section 40 of the Act. A plain reading of Section 40(a)(iii) of the Act as was in force during the relevant year indicates that no deduction would be allowable in respect of any payments chargeable under the head “Salaries” if (a) the same are payable outside India and (b) if tax has not been paid or deducted thereon under Chapter XVII B of the Act. The said clause (iii) was substituted by virtue of the Finance Act, 2003 with effect from 1st

April 2004. By virtue of the aforesaid amendment, the rigor of sub clause (iii) of clause (a) of Section 40 of the Act now also extends to any amount payable as salaries in India. Plainly, the principal object of the aforesaid sub clause (iii) is to provide a further disincentive for non-compliance of provisions of Section 192 of the Act.

12. The provisions of Section 192 fall within Chapter XVII B of the Act which relates to collection and recovery of tax. Provisions for deduction of tax at source are a part of the machinery provided for collection of taxes payable by a payee (recipient of income) by directly imposing upon the payer an obligation to withhold the tax due and deposit the same with the Government. Such tax is deposited to the credit of the payee and not the payer. In case of salaries, any person responsible for paying the income chargeable under the head "Salaries" - who would inevitably be the employer - is obliged to deduct the tax chargeable on the income of the employee (payee) under the head "Salaries". Thus, in the present case, the tax deposited by the Assessee is clearly in discharge of its obligation under Chapter XVII B of the Act. In this view, the contention advanced by Mr Chaudhari that the condition that the Assessee has not deducted and deposited the tax under Chapter XVII B of the Act, cannot be accepted. Indisputably, the Assessee has deposited the

requisite amount which it was required to deposit in respect of amounts chargeable under the head "Salaries" that was payable to and or for the benefit of employees outside India. The said tax is deposited to the credit of such employees. Thus, for all intents and purposes the same is considered as a part of their Salaries which has not been paid to them but has been deposited directly with the Government.

13. It is also relevant to mention that Circular No. 685 dated 17/20th June, 1994, in compliance of which the Assessee had deposited the amount of tax, was issued under Chapter XVII B of the Act; the said Circular granted amnesty from penalties and prosecution to the assessees who complied with their obligation to deposit TDS in terms of Section 192 of the Act for the preceding years for which they had not done so, on or before 31st July, 1994. The said circular clarified the position regarding the applicability of provisions to withhold and deposit tax in respect of payments made abroad and required the employers to immediately comply with the provisions of Section 192 of the Act. Such compliance was also incentivised by granting the amnesty as aforesaid. In the circumstances, it can hardly be disputed that the tax deposited by the Assessee was in discharge its obligations, albeit belatedly, as imposed under Chapter XVII B of the Act. That being so, the Assessee had also

overcome the rigor of sub-clause (iii) of clause (a) of Section 40 of the Act as the necessary condition for applicability of the said provision, that is, non-deduction and payment of TDS under Chapter XVII B of the Act, no longer held good. Having complied with the said obligation, the Assessee could not be denied the deduction which was otherwise allowable under Section 37 of the Act.

14. In our view, an absence of a provision similar to the proviso to sub-clause (i) of clause (a) of Section 40 of the Act cannot be read as to disentitle an Assessee to claim a deduction even though it has complied with the condition under sub-clause (iii) of clause (a) of Section 40 of the Act. A plain reading of proviso to sub-clause (i) of clause (a) of Section 40 of the Act indicates that where an Assessee has not deducted or paid the tax at source in terms of Chapter XVII B in respect of any sum as specified under sub-clause (i) of clause (a) of Section 40 of the Act, the Assessee can, nonetheless, claim a deduction in the year in which the assessee deposits the tax. This benefit is not available to an assessee in respect of payments chargeable under the head "Salaries" which fall within sub-clause (iii) of clause (a) of Section 40 and not sub-clause (i) of clause (a) of Section 40 of the Act. Thus, an assessee would not be entitled to claim deduction on account of salaries if it fails to deduct or

pay the amount under Chapter XVII B of the Act. In cases where such assessee deposits the amount in a subsequent year, the Assessee would still not be able to claim the deduction in the year in which such tax is deposited; his claim for deduction can be considered only in respect of the year to which such expense relates. Therefore, in cases where the assessments stand concluded, the Assessee would lose the benefit of deduction for the expenses incurred on account of its failure to have deposited the tax at source. Thus, concededly, in the present case the Assessee has lost its right to claim a deduction for a period of six years - AY 1985-86 to AY 1990-91- even though the Assessee has paid the TDS on the expenses pertaining to said period.

15. If a provision similar to the proviso to Section 40(a) (i) was applicable to Section 40(a) (iii) then the Assessee would have been entitled to claim the entire expenses on account of salaries paid overseas pertaining to financial years 1984-85 to 1993-94 in the financial year 1994-95 relevant to AY 1995-96 as the payment for the tax for the aforesaid years was paid on 20th July, 1994. However, absence of a provision similar to that under sub-clause (i) of clause (a) of Section 40 does not mean that the Assessee would also be disentitled to claim deduction on account of salaries in the year to which such expenses

pertained even though the Assessee has subsequently discharged its obligation to deposit the tax and has thus overcome the rigor of sub-clause (iii) of clause (a) of Section 40 of the Act.

16. The Tribunal has proceeded on the basis that if the tax due on salaries paid overseas is not deposited strictly within the time prescribed under Chapter XVII B of the Act, Section 40(a) (iii) would be applicable. In our view, this added condition that the tax must be deducted and paid within time, cannot be read in Section 40(a) (iii) of the Act. The plain language of the Section 40(a) (iii) does not permit such interpretation. If the parliament so desired, it would have specifically enacted so. This becomes apparent when one reads the legislative amendments made to Section 40 of the Act.

17. Sub-clause (i) and sub-clause (iii) of clause (a) of Section 40 were substituted by Finance Act, 2003 w.e.f. 1st April, 2004. The said sub-clauses as substituted read as under:-

> "(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act which is payable,--
>
> (A) Outside India: or
>
> (B) In India to a non-resident, not being a company or to a foreign company, 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 other provisions of Chapter XVII-B:

Provided that where in respect of any such sum, tax has been deducted under Chapter XVII-B or paid in any subsequent year, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.

Explanation.---For the purposes of this sub-clause,---

(A) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;

(B) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;"

xxxx xxxx xxxx

"(iii) any payment which is chargeable under the head "Salaries", if it is payable—

(A) Outside India; or

(B) To a non-resident,

and if the tax has not been paid thereon nor deducted therefrom under Chapter XVII-B;"

(underlining for emphasis)

18. It is at once seen that where the legislature wanted to make payment of tax within a specified time a necessary pre-condition, it had expressly indicated so. The Parliament has expressly enacted that deduction in respect of payments made under sub-clause (i) of clause (a) of Section 40 of the Act would not be available where such payments

were made in India to a non-resident in respect of which tax had not been paid "before the expiry of time prescribed under sub Section (i) of Section 200". However, no such condition for depositing the tax paid within a prescribed time was introduced in sub clause (iii) of clause (a) of Section 40 of the Act.

19. It is also relevant to note that sub-clause (i) of clause (a) of Section 40 was further substituted by sub-clauses (i), (ia) and (ib) by virtue of Finance Act (No.2) w.e.f. 1st April, 2005. However, the pre-condition for depositing the tax within the time prescribed under Section (i) of Section 200 was retained in sub-clause (i) and (ia). Thereafter, by virtue of Finance Act (No.2), 2014, sub clause (i) was further amended and the principal condition of depositing tax in respect of payments made in India was amended and instead of the pre-condition of depositing the tax within the time prescribed under Section 200 (i) of the Act, it was now stipulated that the tax be deposited "on or before the due date specified in sub section (i) of Section 139".

20. With effect from 1st April, 2015, sub-clause (i) of clause (a) of Section 40 reads as under:

> "**40**. 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",---
>
> (a) in the case of assessee--
>
> [(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,---
>
> (A) outside India; or
>
> (B) in India to a non-resident, not being a company or to a foreign company, 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 [*on or before the due date specified in sub-section (1) of section 139*]:
>
> [**Provided** *that where in respect of any such sum, tax has been deducted in any subsequent year, or has been deducted during the previous year but paid after the due date specified in sub-section (1) of section 139, such sum shall be allowed as a deduction in computing the income of the previous year in which such tax has been paid.*]
>
> Explanation.--For the purposes of this sub-clause,--
>
> (A)"royalty" shall have the same meaning as in *Explanation 2* to clause (vi) of sub-section (1) of section 9;
>
> (B)"fees for technical services "shall have the same meaning as in *Explanation* 2 to clause (vii) of sub-section (1) of section 9;"

It is apparent from the above that the condition to deposit TDS within the prescribed time cannot be read into sub-clause (iii) of clause (a) of

Section 40 of the Act as-unlike the language of item (B) of sub-clause (i) of clause (a) of Section 40-the same has not been specifically enacted.

21. We are also unable to agree with Mr. Chaudhari's contention that no deduction can be claimed by the Assessee as the salaries were not reflected in the profit and loss account. The controversy whether an Assessee can claim deduction on an expense which is not reflected in its profit and loss account for the relevant period has been authoritatively settled by the Supreme Court in its decision in ***The Kedarnath Jute Mfg. Co. Ltd. v. The Commissioner of Income Tax, (Central), Calcutta*****: [1971] 82 ITR 363 (SC)** wherein the Court held as under:-

> "We are wholly unable to appreciate the suggestion that if an assessee under some misapprehension or mistake fails to make an entry in the books of account and although under the law, a deduction must be allowed by the Income Tax Officer, the assessee will lose the right of claiming or will be debarred from being allowed that deduction. Whether the assessee is entitled to a particular deduction or not will depend on the provision of law relating thereto and not on the view which the assessee might take of his rights nor can the existence or absence of entries in the books of account be decisive or conclusive in the matter."

22. In view of the above, the question of law is answered in the negative, that is, in favour of the Assessee and against the Revenue.

23. The appeal is allowed. In the circumstances, the parties are left to bear their own costs.

VIBHU BAKHRU, J

S.MURALIDHAR, J

MARCH 1, 2016
RK/pkv