

1. The issue of **employee's contribution u/s 36(1)(va)** even after insertion of Explanation 2 refuses to die in the form of whether the amendment has **retrospectivity** or not.

**Let us examine this in detail.**

**2. The amended provision;**

***Other deductions.***

**36. (1)** *The deductions provided for in the following clauses shall be allowed in respect of the matters dealt with therein, in computing the income referred to in section 28—*

*[(va) any sum received by the assessee from any of his employees to which the provisions of sub-clause (x) of clause (24) of section 2 apply, if such sum is credited by the assessee to the employee's account in the relevant fund or funds on or before the due date.*

*<sup>71a</sup> [Explanation 1].—For the purposes of this clause, "due date" means the date by which the assessee is required as an employer to credit an employee's contribution to the employee's account in the relevant fund under any Act, rule, order or notification issued thereunder or under any standing order, award, contract of service or otherwise.]*

*<sup>71b</sup> [Explanation 2.—For the removal of doubts, it is hereby clarified that the provisions of section 43B shall not apply and shall be deemed never to have been applied for the purposes of determining the "due date" under this clause;]*

*71a. Explanation renumbered as Explanation 1 by the Finance Act, 2021.*

**71b. Inserted by the Finance Act, 2021.**

3. This means that where an employee's contribution to any provident fund or superannuation fund or any fund set up under the provisions of ESI Act or any other fund for the welfare of such employees is not credited to the employee's

3. This means that where an employee's contribution to any provident fund or superannuation fund or any fund set up under the provisions of ESI Act or any other fund for the welfare of such employees is not credited to the employee's account in the relevant fund(s) on or before the due date specified under relevant Act, rules, etc. of the relevant fund then the corresponding deduction shall not be allowed. Also employer shall be liable to deposit the said sum in the said fund.
4. The controversy subsisting even now is whether the insertion of Explanation 2 is retrospective or prospective.
5. Before considering some rulings and other aspects it would be appropriate to note a **corresponding amendment brought out in s 43B by way of insertion of Explanation 5.**

**[Certain deductions to be only on actual payment.**

**43B.** Notwithstanding anything contained in any other provision of this Act, a deduction otherwise allowable under this Act in respect of—

- [(a) any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or]
- (b) any sum payable by the assessee as an employer by way of contribution to any provident fund or superannuation fund or gratuity fund or any other fund for the welfare of employees,

<sup>98a</sup> **[Explanation 5.—For the removal of doubts, it is hereby clarified that the provisions of this section shall not apply and shall be deemed never to have been applied to a sum received by the assessee from any of his employees to which the provisions of sub-clause (x) of clause (24) of section 2 applies.]**

**98a.** Inserted by the Finance Act, 2021.

**6. Section 2 aspect too may be noted.**

2(24) "income" includes—

<sup>62</sup>[(x) any sum received by the assessee from his employees

any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948 (34 of 1948), or any other fund for the welfare of such employees ;]

**62. Inserted by the Finance Act, 1987, w.e.f. 1-4-1988.**

7. The decision on retrospectivity has been made by **Salzgitter Hydraulics (P.) Ltd. v. ITO** [2021] 128 taxmann.com 192 (Hyderabad – Trib. BENCH 'SMC'). [ASSESSMENT YEAR 2019-20] **delivered on** JUNE 15, 2021 holding as follows:

"2. Coming to the sole substantive issue of ESI/PF disallowance of Rs. 1,09,343/- and Rs. 3,52,622/-, the assessee's and revenue's stand is that the same has been paid before the due date of filing sec. 139(1) return and after the due date prescribed in the corresponding statutes; respectively. I notice in this factual backdrop that the legislature has not only incorporated necessary amendments in sections 36(va) as well as 43B vide Finance Act, 2021 to this effect but also the **CBDT has issued Memorandum of Explanation that the same applies w.e.f. 1-4-2021 only**. It is further not an issue that the foregoing legislative amendments have proposed employers contributions; disallowances u/s 43B as against employee u/s 36 (va) of the Act; respectively. **However, keeping in mind the fact that the same has been clarified to be applicable only with prospective effect from 1-4-2021, I hold that the impugned disallowance is not sustainable** in view of all these latest developments even if the Revenue's case is supported by the following case law.

- (i) *CIT v. Merchem Ltd.* [2015] 61 taxmann.com 119/235 Taxman 291/378 ITR 443 (Ker.)
- (ii) *CIT v. Gujarat State Road Transport Corpn.* [2014] 366 ITR 170 (Guj.)
- (iii) *CIT v. South India Corpn. Ltd.* [2000] 108 Taxman 322/242 ITR 114 (Ker.)
- (iv) *CIT v. GTN Textiles Ltd.* [2004] 269 ITR 282 (Ker.)
- (v) *CIT v. Jairam & Sons* [2004] 134 Taxman 503/269 ITR 285 (Ker.)"

8. The relevant part of the **MEMORANDUM TO FINANCE BILL** relied upon is as follows:

Accordingly, in order to provide certainty, it is proposed to (i) amend clause (va) of sub-section (1) of section 36 of the Act by inserting another explanation to the said clause **to clarify that the provision of section 43B does not apply and deemed to never have been applied** for the purposes of determining the—due date|| under this clause; and (ii) amend section 43B of the Act by inserting Explanation 5 to the said section to clarify that the provisions of the said section **do not apply and deemed to never have been applied** to a sum received by the assessee from any of his employees to which provisions of sub-clause (x) of clause (24) of section 2 applies. These amendments will take effect from 1<sup>st</sup> April, 2021 and will accordingly apply to the assessment year 2021-22 and subsequent assessment years. **!Clauses 8 and 9!** .

**Note:** this drafting by CBDT and other executive is daft and unfortunate in so far as the last line is concerned because it is in direct conflict with the immediately preceding line. This incompetent drafting has led to an entirely unnecessary controversy and the **Salzgitter decision (supra)** as well as others.

9. Respectfully, **the reliance is misplaced for the following reasons:**

- i. The letter of law only is to be read, and that too is to be read, as per established rules of interpretation, primary being the Literal rule .
- ii. Even if it is part of material tabled before the Legislature and deemed part of the understanding of the Explanation, even then, **in the same memorandum**, the following phrase is used as well WHICH ALSO BECOMES EXPLICIT PART of the ACT: **“and deemed to never have been applied”**. If the interpretation of the order (supra) is taken, this phrase becomes

OTIOSE. This is plainly not the legislative intent.

iii. Contrary decisions, apart from those referred in the decision referred have come. To wit, in **Vidras India Ceramics (P.) Ltd v. DCIT** [2021] 129 taxmann.com 320 (Ahmedabad - Trib. 9<sup>th</sup> July 2021 AY 14-15) it has been held that "8.1 There is no ambiguity to the fact that the assessee failed to deposit Employees Contribution to PF/ESI within the due date specified under the relevant Act i.e. PF/Employees State Insurance. Thus the assessee is not entitled for the deduction for such amount of contribution to PF/ESI as discussed above in view of the judgment of Hon'ble Gujarat High Court\*. In view of the above we do not find any merit in the ground of appeal raised by the assessee. Hence the ground of appeal of the assessee is hereby dismissed."

\*[**CIT v. Gujarat-State Road Transport Corpn.** [2014] 366 ITR 170.]

**Morakhia Copper and Alloys (P.) Ltd.** [2020] 119 taxmann.com 214 (Ahd - Trib.) holds likewise even prior to insertion of explanation.

iv. There was a view prevalent that provision of section 43B overrides other provisions of the Act including section 36(1)(va); therefore, payment of employee's contribution to the specified fund is allowable as deduction if it is paid beyond the due date specified under relevant applicable provision but before the due date of filing of return. E.g. **CIT v. Ghatge Patil Transports Ltd.** [2014] 368 ITR 749 (Bom.); **CIT v. Hindustan Organics Chemicals Ltd.** [2014] 366 ITR 1 (Bom.) etc.

Some took a contrary view: **CIT v. Merchem Ltd.** [2015] 378 ITR 443 (Ker.); **Unifac Management Services (India) Pvt. Ltd. v. Dy. CIT** [2018] 409 ITR 225 (Mad.) etc.

v. The part of the Explanatory Memorandum [pages 39-40] which the hon'ble bench did **not** consider in **Salzgitter Hydraulics** ruling in this regard reads as under:

"Though section 43B of the Act covers only employer's contribution and does not cover employee contribution, some courts have applied the provision of section 43B on employee contribution as well. There is a distinction between employer contribution and employee's contribution towards welfare fund. It may be noted that employee's contribution towards welfare funds is **a mechanism to ensure the compliance by the employers of the labour welfare laws.** Hence, it needs to be stressed that the employer's contribution towards welfare funds such as ESI and PF needs to be clearly distinguished from the employee's contribution towards welfare funds. **Employee's contribution is employee own money and the employer deposits this contribution on behalf of the employee in fiduciary capacity. By late deposit of employee contribution, the employers get unjustly enriched by keeping the money belonging to the employees.** Clause (va) of sub-section (1) of Section 36 of the Act was inserted to the Act *vide* Finance Act, 1987 as a measures of **penalizing employers who mis-utilize employee's contributions.**"

vi. This needs to be read with Finance Act, 1987 - Circular No. 495, Dated 22-9-1987 :

**Measures of penalising employers who misutilise contributions to the provident fund or any fund set up under the provisions of the Employees' State Insurance Act, 1948, or any other fund for welfare of employees**

**12.1** The existing provisions provide for a deduction in respect of any payment by way of contribution to a provident fund or superannuation fund or any other fund for welfare of employees in the year in which the liability is actually discharged [section 43B].

The effect of the amendment brought about by the Finance Act, is that no deduction will be allowed in the assessment of the employer(s) unless such contribution is paid to the fund on or before the "due date". Due date means the date by which an employer is required to credit the "contribution" to the employee's account **in the relevant fund** under the provisions of any law or term of contract of service or otherwise.

[Explanation to section 36(1)(va) of the Finance Act]

**12.2** In addition, contribution of the employees to the various funds which are deducted by the employer from the salaries or wages of the employees will be taxed as income [insertion of new sub-clause (x) in clause (24) of section 2] of the employer, if such contribution is not credited by employer in the account of the employee in the relevant fund by the "due date". Where such income is not chargeable to tax under the head "Profits and gains of business or profession", it will be assessed under the head "Income from other sources".

**12.3** Payment by way of tax on duty, liability for which has accrued in the previous year, will be allowed as a deduction if it is made by the due date of furnishing the return under section 139(1) in respect of the assessment year to which the aforementioned previous year relates.

**12.4** These amendments will take effect from 1-4-1988 and will, accordingly, apply from the assessment year 1988-89 and subsequent years.

[Sections 3(b), 9, 10, 26 and 27 of the Finance Act]

vii. Legislative intent is thus clear. It always has been, in fact. However

due to some contrary decisions, the mischief had to be corrected. The subsequent rulings in favour of employers did exactly what was sought to be prevented by the 1987 circular: **penalising employers who misutilise contributions** and what the present memorandum had to re-clarify viz., **unjust enrichment by misuse of fiduciary capacity in which funds stand entrusted to the employer.**

10. That said, there is a deeper issue involved. That of **retrospectivity of the Explanation as a principle.** Nature of Explanation in a statute stands clarified by Hon'ble Supreme Court in the case of **Sundaram Pillai v. Pattabiram reported in (1985) 1 SCC 591**, whereby Fazal Ali, J. culled out from earlier cases the following as objects of an explanation to a statutory provision:-

- (a) To explain the **meaning and intendment** of the Act itself,
- (b) Where there is any obscurity or vagueness in the main enactment to clarify the same so as to make it consistent with the dominant object which it seems to subserve,
- (c) To provide an **additional support** to dominant object of the Act in order to make it meaningful and purposeful,
- (d) an Explanation cannot in any way interfere with or change the enactment or any part thereof but where some gap is left which is relevant for the purpose of the Explanation, **in order to suppress the mischief and advance the object of the Act if it can help or assist the Court in interpreting the true purport and intendment** of the enactment, and
- (e) It cannot, however, take away a statutory right with which any person under a statute has been clothed or set at naught the working of an Act by becoming an hindrance in the interpretation of the same.

11. Clarifying the existing position or removing unintended consequences to make the provision workable shall inevitably lead to the presumption of retrospectivity notwithstanding the fact that the amendment has been given effect prospectively. In *Gold Coin Health Food (P.) Ltd.* ([2008] 304 ITR 308/172 Taxman 386 (SC)) the Hon'ble Supreme Court held that the amendment to Explanation 4 to section 271(1)(c)(iii) **simply clarified** the position which was existing since inception of the provision that the penalty is leviable on concealment irrespective of the fact whether ultimately assessed income is positive or negative. Similarly in the case of *Kanji Shivji & Co.* ([2000] 242 ITR 124/108 Taxman 531 (SC)), the Hon'ble Apex Court held that the purpose of Explanation 2 to section 40(b) was simply to clarify that the Income-tax Act recognizes individual status of a person as different from his representative capacity. **This Explanation did not bring in a new provision but clarified that the position was so since the introduction of the provision itself;** the object of such insertions is always to clarify the intention of the legislature as it was there at the time of insertion of the original provision. **That is why the clarificatory amendments are always retrospective irrespective of the date from which effect has been given to them by the legislature.** In our case we also need to apply **the Mischief Rule** to see how the insertion of Explanation is to be read. That we have seen (supra).

12. In the commentary of Justice G.P. Singh-Principles of Statutory Interpretation [13th edition, pages 567-568], in the context of retrospective applicability of law, it is stated that:

*"The usual reason for passing a **declaratory Act** is to set aside what Parliament deems to have been a **judicial error**, whether in the statement of the common law or in the interpretation of the statutes. Usually, if not invariably, such an Act contains a preamble, and also the word 'declared' as well as the word 'enacted'. But the use of the words 'it is declared' is not conclusive that the Act is declaratory for these words may, at times, be used to introduce new rules of law and the Act in the latter case will only be amending the law and will not necessarily be retrospective. **In determining, therefore, the nature of the Act, regard must be had to the substance rather than to the form.** If a new Act is 'to explain' an earlier Act, it would be without object unless construed retrospective. **An explanatory Act is generally passed to supply an obvious omission or to clear up doubts** as to the meaning of the previous Act. It is well settled that **if a statute is curative or merely declaratory of the previous law retrospective operation is generally intended. The language 'shall be deemed always to have meant' or 'shall be deemed never to have included' is declaratory and is in plain terms retrospective.**"*

**12.1** This clinches the issue decisively. The phrase used in the explanation in our case is **"deemed to never have been applied"**. It is thus clear that in our context the Explanation is retrospective and any decision to the contrary, with respect, is per incuriam, and not good in law.