TAX DEDUCTION AT SOURCE : STRINGENT PROVISION OF INCOME-TAX

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The provisions relating to tax deduction at source "TDS" are of extremely great importance as it led to tax collection of 30 per cent. - 40 per cent. out of the total tax collection of Direct Taxes in a year. It also facilitates the Government with a continuous flow of funds and at the same time, eases the burden on the taxpayer. Tax deduction at source is a mechanism of collecting tax which combines twin concepts of "pay as you earn" and "collect as it is being earned". Thus, to widen the tax base and to bring in its purview a greater number of taxpayers and to minimise the tax evasions, every year the Government proposes several amendments in the provisions of tax deduction at source. In the Budget 2020, also "the Government proposed to deepen the tax net by bringing participants of e-commerce (sellers) within the tax net; the Government proposed to insert a new section 194-O in the Act to provide for a new levy of tax deduction at source at the rate of one per cent.

To ensure stringent compliance of tax-deduction-at-source laws, the Government has imposed rigorous consequences which include interest, penalties and prosecution for the defaulters. Under the Income-tax Act, 1961 (IT Act), payer of the income is required to deduct tax on certain payments to taxpayers. Thus, the payer of the income has been endowed with two responsibilities under tax-deduction-at-source provisions, i.e., firstly, the payer has to deduct the applicable tax at source and secondly, has to deposit the same with the Government within stipulated timeframe. Failure to comply with these provisions is an offence and attracts penal consequences – monetary (interest, penalty) as well as non-monetary consequences—prosecution (imprisonment ranging from 3 months to 7 years), e.g., if there is some default in payment of tax deduction at source in time by the assessee, then he is liable to pay interest at 1.5 per cent. per month plus penalty as decided by the Assessing Officer and also suffers the disallowance of 30 per cent. of corresponding expenditure in computation of his taxable income. In addition to the above, he is also exposed to prosecution under section 276B of the Income-tax Act. Prosecution for defaults in depositing the tax deducted at source under various provisions of the Act is dealt with by section 276B of the Income-tax Act. Section 276B has been

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inserted by the Finance Act, 1968 and amended several times to widen the scope of prosecution, whenever there is failure to pay to the credit of the Central Government and it reads as under "*If a person 'fails to pay' to the credit of the Central Government, the tax deducted at source by him as required by or under the provisions of Chapter XVII-B, he shall be punishable with rigorous imprisonment for a term which shall not be less than three months but which may extend to seven years and with fine.*"

The word "fails to pay" cannot be confined to total failure to pay the tax. Prosecution can be launched even for delayed payments of tax deducted to the credit of the Government, as decided in the case of *Rayala Corporation* v. *ITO* and also in many other cases. The legal provisions and the Central Board of Direct Taxes guidelines with respect to section 276B of the Income-tax Act, concerning the default in payment of tax deducted at source in time, involve very serious and harsh consequences. *The offence under section 276B is complete when tax deducted at source is not deposited in time. Even late deposit will not absolve the accused*. The same has been repeatedly held by courts in various cases. There are numerous instances, where even for a delay of 3-4 months in depositing the tax deducted at source to the credit of the Government, prosecution proceedings under section 276B are being launched. Recently in January 2020, in the case of *Footcandles Film Private Limited* by the Mumbai Court sentenced the director of the company to a one year of rigorous imprisonment for allegedly failing to deposit in time the tax of Rs. 25 lakhs deducted at source, to the Income-tax Department. The courtroom refuted the submission that the delay was due to monetary losses confronted by the corporate. "Tax deduction at source is the federal Government quantity, it cannot be used for private functions by the accused".

Mens rea is not compulsory to prove for prosecution under section 276B: The text contained in section 276B specifies that prosecution under section 276B is attracted in case of deficient deduction or no deduction which is a conscious act. Thus presence of mens rea, i.e., "guilty mind" is not necessary to initiate the prosecution under section 276B of the Act.

"*Reasonable cause" is required to avoid prosecution* : However, there is a relieving provision as contained in section 278AA of the Income-tax Act, 1961, "*which clearly provides that no person shall be punishable for any failure referred to in section 276B if he proves that there was a reasonable cause for such failure*". Thus, this section provides a window for the accused to escape from the penal consequence by proving that he had reasonable cause for the non-deposit of deducted TDS, within time limit.

The prosecution for default in paying the deducted tax to the credit of the Central Government does not automatically follow such default and the provision has, therefore, been made under section 279 of the Income-tax Act for sanction to be granted for such prosecution by the Chief Commissioner who is required to apply his mind considering all the relevant factors before deciding to initiate prosecution under each case. It also has been repeatedly held by several courts that *"the grant of sanction for launching prosecution is a very serious and extreme measure which entails proper exercise of discretion upon consideration of all relevant materials under each case"*, including mitigating circumstances in favour of the defaulting assessee.

The evasion of depositing deducted tax can lead to harsh and serious consequences in that the assessee is liable to pay penal interest at 1.5 per cent. per month and also suffers the disallowance of corresponding expenditure in computation of his taxable income plus penalties which may extend to 300 per cent. To add to that, he is also exposed to prosecution under section 276B of the Income-tax Act. So for *fair, impartial and effective implementation* of the prosecution provisions under section 276B of the Income-tax Act, the first step should be that the defaulters must be divided into separate categories based on the severity of default in terms of quantum of tax evaded and duration of non-payment.

Keeping in mind the above, the Central Board of Direct Taxes has eased criminal prosecution norms. The directive of Central Board of Direct Taxes is being seen as a major move to cut down tax litigation and save a number of assessees from prosecution proceedings.

With Circular No. 24 of 2019 dated September 9, 2019, the Central Board of Direct Taxes has laid down a new criteria to ensure only "deserving cases get prosecuted". The guidelines make it clear that no prosecution to be processed in normal circumstances in cases involving a tax amount of less than Rs. 25 lakhs or delay in deposit of less than 60 days from due date.

However, in case of habitual offenders, based on particular facts and circumstances of each case, prosecution may be initiated only with the administrative approval of the collegium of two Chief Commissioners of Income-tax (CCIT)/Directors General of Income-tax (DGIT) rank officers.

Combined reading of section 201, section 221 and section 276B

Section 201 states that "where an assessee fails to deduct or pay tax deducted at source then he is an assessee-in-default", the penalty on him, according to section 201, is prescribed under section 221. This penalty

cannot be imposed by the Assessing Officer if the assessee proves that there were *good and sufficient reasons* for the default to deduct and pay such tax. On a comparison of sections 201, 221 and 276B, it is clear that under sections 201 and 221, the assessee is required to prove *good and sufficient reasons* for the default whereas under section 276B he is required to show that failure was without *reasonable cause or excuse*.

It is very surprising that to avoid penalty assessee has to prove "good and sufficient reasons" whereas in a criminal case an assessee has to prove only "reasonable cause" to avoid prosecution. A cause, which is reasonable within the meaning under section 276B, may not necessarily be good and sufficient. On the other hand, if a reason is good and sufficient, it would necessarily also be a reasonable cause. Hence, the obligation which an accused has to discharge in criminal prosecution under section 276B that he had reasonable cause for not submitting the tax is much lighter than the obligation to be discharged by him in penalty proceedings under section 201.

Assessment proceedings and criminal proceedings are independent proceeding of each other : the two types of proceedings could run simultaneously ; one need not wait for the other. There is no bar on continuation of prosecution just because a proceeding which may ultimately affect the prosecution has been initiated or is pending. This cannot be a ground for stay or adjournment of prosecution proceeding. The same has been held in various cases by different courts from time to time, i.e., *Kingfisher Airlines Ltd.* v. *Asst. CIT* (2014), *P. Jayappan* v. *S. K. Perumal, First ITO* [1984] 149 ITR 696 (SC). However, in the case of *CIT* v. *Bhupen Champak Lal Dalal* [2001] 248 ITR 830 (SC), "the prosecution in criminal law and proceedings arising under the Act are undoubtedly independent of each other and, therefore, there is no legal impediment for the criminal proceeding to proceed in parallel to the proceedings under the Act. *However, a wholesome rule will have to be adopted in matters of this nature where courts have taken the view that when the conclusions arrived at by the appellate authorities have a relevance and bearing upon the conclusions to be reached in the case, one authority will necessarily have to await the outcome of the other authority*". This judgment has been followed by many High Courts including Delhi High Court in *ITO* v. *Giggles (P.) Ltd.* [2008] 301 ITR 32 (Delhi).

The following principles were laid down by the hon'ble Supreme Court in the case of *Radheshyam Kejriwal* v. *State of West Bengal* [2011] 333 ITR 58 (SC). The following principles were laid down by the Supreme Court :

• Adjudication proceeding and criminal prosecution can be *launched simultaneously*.

• Decision in adjudication proceeding is *not necessary* before initiating criminal prosecution.

• Adjudication proceeding and criminal proceeding are *independent* of each other.

• The *finding* against the person facing prosecution in the adjudication proceeding is *not binding on the proceeding against him for criminal prosecution*.

• The finding in the adjudication proceeding in favour of the person facing trial for identical violation will depend upon the nature of finding. If the acquittal in adjudication proceeding is *on technical ground* and not on merit, *prosecution may continue*. However, in case acquittal is on merits where allegation is found to be not sustainable at all and the person *is held to be innocent, criminal prosecution on the same set of facts and circumstances cannot be allowed* to continue underlying the principle that a higher standard of proof is required in criminal cases.

In case it is found on merit that there is no contravention of the provisions of the Act in the adjudication proceeding, the trial of the person concerned shall tantamount to abuse of the process of the court.

Offences by Companies, Firms and HUF under section 276B : In case the offence under section 276B is committed by a company then as per law the punishment for such offence is imprisonment and fine and in such a case, the company shall be punished with fine and every person involved shall be punished with imprisonment in accordance with law. The same has to be initiated in the name of Director or Principal Officer responsible for tax deduction at source compliances. For initiating prosecution proceedings against the director of the company, the Assessing Officer has to give notice under section 2(35) expressing his intention to treat such directors of a company as "principal officers".

In case the offence under section 276B has been committed by a HUF then the karta thereof shall be guilty of the offence and be proceeded against and punished accordingly. However, the prosecution against the karta can be defended if he proves that an offence has been committed without his knowledge in spite of his exercising all due diligence to prevent the offence.

Compounding of offence under section 276B : The offence under section 276B of the Income-tax Act can be compounded by the Chief Commissioner having jurisdiction in the case, either before or after the launching of

prosecution proceedings. In the recent past, several defaulters have submitted petitions for compounding such offences and compounding orders have also been passed in suitable cases. However, the compounding of offences cannot be claimed as a matter of right. But if the competent authority is satisfied that the assessee has fulfilled the eligibility conditions mentioned in the guidelines keeping in view the factors such as conduct of person, nature and magnitude of offence in the context of facts and circumstances of each case, he will proceed with the application.

Conclusion : Therefore, the discussion made above is a clear indication of the strict approach of the tax Department and the courts, regarding the stringent compliance with the provisions of Chapter XVII-B of the Act. Therefore, it becomes necessary for the taxpayers to check his compliance with the tax-deduction-at-source provisions in their organisations to escape any negative consequences. Further, in case of default, the taxpayer must consider the suitable remedies available under the Income-tax Act. The remedies available to him under section 276B are as follows :

1. Presence of "*reasonable cause*" for delay in submission of tax deducted at source to the credit of the Central Government.

2. Submit *application for compounding of offences* after submitting the prescribed compounding fees.

To elucidate the law of prosecution under the Income-tax Act under section 276B, some of the important judgments are :

(1) *Jagannath Prasad Jhalani* v. *Regional Provident Fund Commissioner* : Offence under section 276B is a *continuing offence and would terminate only when the deposit of the tax deducted* is made. Nonpayment of tax in accordance with law deducted from the salary of every employee each month would be a distinct offence.

(2) Where the penalty proceedings are dropped or penalty imposed is deleted, not on the merits but on technicalities, e.g., that the authority who had initiated the penalty proceedings had no jurisdiction to do so, the same will not affect the prosecution. (*Banwarilal Satyanarain* v. *State of Bihar* [1989] 179 ITR 387, 397, 398 (Patna)).

(3) The duty to deduct tax at source under any of the relevant provisions cannot be said to be discharged by depositing the tax to the credit of the Central Government sometime before the complaint is made for failure to do so. (*Rishikesh Balkishandas* v. *I. D. Manchanda, ITO* [1987] 167 ITR 49, 53 (Delhi)).

(4) The question whether the partners were liable to be prosecuted is a question of fact and *the High Court could not quash the complaint under its inherent powers*. (*S. M. Kabeer* v. *ITO* [1995] 216 ITR 359 (Mad)).

(5) Where both directors of company had signed the company's balance-sheet, their defence that they were not in charge of the affairs of company was untenable and they could not be acquitted merely on the ground that no separate notices were issued to them (*ITO* v. *Anil Batra* [2018] 409 ITR 428 (Delhi)).

(6) In *Sonali Autos Private Limited*, the assessee had properly deducted tax at source for relevant year but failed to deposit the same with the Central Government within the specified time limit – the said amount was deposited along with interest subsequently when the mistake was noticed by its statutory auditors – and prosecution proceedings was launched against the assessee after three years of the default. It was found that the impugned tax could not be deposited in time due to oversight on the part of the assessee's accountant. This would amount to a reasonable cause for non-deposit of tax within time and, thus, initiation of proceedings after three years would contravene the CBDT's Instruction dated May 28, 1980 and, therefore, deserved to be quashed.