

EY Tax Alert

Supreme Court upholds non-levy of penalty for delayed remittance of withholding tax since it is liable for prosecution

Executive summary

This Tax Alert summarizes a ruling of the Supreme Court (SC) dated 10 April 2023, in a batch of appeals, with the lead case being US Technologies International¹ (Taxpayer). The issue before the SC was whether the default of delayed remittance of withholding tax is liable to penalty under Section (S.) 271C of the Income Tax Act, 1961 (ITA), in addition to other consequences like interest and prosecution.

In the facts of the case, the Taxpayer deposited withholding tax from payment of salary and other contractual payments with a delay of five days to ten months for tax year 2002-03. The tax authority levied penalty under S.271C for such default, in addition to interest. The Taxpayer unsuccessfully challenged the levy of penalty in the Kerala High Court (HC).

On further appeal by the Taxpayer, the SC held that the instant case was of belated remittance of withholding tax, and not a case of failure to deduct withholding tax. The SC held that S.271C itself makes a distinction between “fails to deduct” withholding tax and “fails to pay” other tax. Since the default in the present case is not a failure to deduct withholding tax, no penalty can be levied on the Taxpayer. The penal provisions are required to be construed strictly and literally. Wherever the legislature intended to provide for consequences for delayed remittance, it has provided so by way of interest and prosecution. The circumstance of failure to pay withholding tax on time cannot be read into S.271C.

EY Alerts cover significant tax news, developments and changes in legislation that affect Indian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor.

¹ TS-171-SC-2023

Background

- ▶ Under the Indian Tax Laws (ITL), a taxpayer is statutorily required to deduct withholding tax from several specified payments and pay it to the government within the specified time limit.
- ▶ One of the consequences of withholding tax default is levy of interest. Up to 30 June 2010, there was a uniform rate of interest of 1% per month (or part of the month) specified for default of both non-deduction of withholding tax and failure to pay withholding tax on time after deduction. From 1 July 2010 onwards, a higher rate of interest of 1.5% per month (or part of the month) was provided for failure to pay withholding tax on time after deduction. However, the present case pertains to tax year 2002-03 when there was a uniform rate of interest for both defaults.
- ▶ Prior to amendment by the Direct Tax Laws (Amendment) Act, 1987 (DTLA), with effect from 1 April 1989, the prosecution provision for withholding tax default (S.276B) covered default of both failure to withhold tax and failure to pay withholding tax on time to the government. Post amendment by the DTLA and prior to subsequent amendments, it merely covered default of failure to pay withholding tax on time to the government.
- ▶ The DTLA inserted S.271C in the ITA, with effect from 1 April 1989, to provide for levy of penalty for failure to deduct whole or any part of withholding tax as required by or under the withholding tax provisions of the ITL.
- ▶ In 1997, both S.271C and S.276B were amended to expand the scope to the following defaults: (a.) Failure to pay dividend distribution tax (DDT). (b.) Failure to pay withholding tax on lottery winnings in kind.
- ▶ Recently, the Finance Act, 2023 further expanded the scope of both S.271C and S.276B, with effect from 1 April 2023², to cover failure to pay or ensure payment of withholding tax on payments in kind under several other withholding tax provisions, in addition to lottery winnings.

Facts

- ▶ The Taxpayer, a company engaged in software development, made certain salary and other contractual payments to its employees for tax year 2002-03. The Taxpayer withheld tax aggregating to INR11m on such payments, but deposited the tax with the government with a delay ranging from five days to ten months.

- ▶ The tax authority conducted a survey operation at the Taxpayer's premises which uncovered the delay, pursuant to which, the tax authority imposed a penalty under S.271C on the Taxpayer of an amount equivalent to the amount of withholding tax paid belatedly.
- ▶ The Taxpayer unsuccessfully challenged the levy of penalty up to the HC. Being aggrieved, the Taxpayer preferred further appeal before the SC.

Taxpayer's contentions

- ▶ The penalty under S.271C can be levied only in case of failure to deduct withholding tax and not in a case of belated or delayed remittance of withholding tax.
- ▶ The language of S.271C itself makes a distinction between two types of default: (a.) Failure to deduct whole or any part of withholding tax as required by or under the withholding tax provisions of the ITL. (b.) Failure to pay DDT or withholding tax on lottery winnings in kind. Thus, it does not cover default of failure to pay withholding tax on time.
- ▶ In terms of the principles of interpretation of statutes, penal provisions are to be interpreted strictly and literally. If penalty is levied for belated remittance of withholding tax, it would amount to extending the scope of the penal provision to what is not included therein.
- ▶ While the HC, in the Taxpayer's case, ruled against the Taxpayer, the full bench of the HC had, subsequently, overruled it in the case of Lakshadweep Development Corporation Ltd v. Addl CIT³.

Tax authority's contentions

- ▶ The object and purpose of S.271C is to levy penalty on failure to deduct withholding tax. Prior to amendment by the DTLA, such default attracted prosecution under S.276B. S.271C was inserted to provide for levy of penalty for failure to deduct withholding tax.
- ▶ Therefore, if a taxpayer deducts withholding tax but does not remit it to the government or remits it after a delay, such taxpayer is liable to pay penalty under S.271C. Any other view will frustrate the object and purpose of insertion of S.271C.
- ▶ Reliance was placed on a circular⁴ issued by the Central Board of Direct Taxes (CBDT), which explained the rationale for insertion of S.271C to contend that post amendment by the DTLA, in addition to prosecution, the person who had

² 1 July 2023 for online game winnings

³ [(2019) 411 ITR 213(Ker)(FB)]

⁴ Circular No. 551 dated 23 January 1998

deducted withholding tax but not remitted it to the government, shall also be liable to pay penalty under S.271C.

SC's ruling

The SC ruled in the Taxpayer's favour and held that no penalty can be levied for default of delayed remittance of withholding tax for the following reasons:

- ▶ The present case concerns default of belated remittance of withholding tax and not a case of failure to deduct withholding tax. It falls under the first part of S.271C which provides for levy of penalty for failure to deduct whole or any part of withholding tax, as required by or under the withholding tax provisions of the ITL. The first part of S.271C is very clear and covers case of "fails to deduct" alone. It does not speak about belated remittance of withholding tax.
- ▶ In terms of the settled position in law, the penal provisions are required to be construed strictly and literally. They are required to be read as they are. Nothing is to be added or taken out from the penal provisions.
- ▶ On a plain reading of S.271C, it is categoric and unambiguous that its first part does not apply to the default of belated remittance of withholding tax. It is only the second part of S.271C which applies to "fails to pay", but it is restricted to DDT and withholding tax on lottery winnings in kind. The court cannot read something more into the provision contrary to the intent and legislative wisdom.
- ▶ Where the legislature intended for separate consequences for non-payment or belated remittance of withholding tax, it has provided for levy of interest and prosecution.
- ▶ The tax authority's reliance on the CBDT circular (supra) is misplaced. On the contrary, the said circular supports the Taxpayer. The circular explains that prior to amendment by the DTLA, both types of default viz., failure to deduct withholding tax and failure to pay to the government after deducting, were liable to prosecution. Post amendment, the former (i.e., failure to deduct withholding tax) is made liable to penalty under S.271C, whereas the latter (i.e., failure to pay to the government after deducting), being a more serious offence, will continue to attract prosecution.
- ▶ Even otherwise, the words "fails to deduct" occurring in the first part of S.271C cannot be read into "failure to deposit/pay the tax deducted". Therefore, on true interpretation of S.271C, there shall not be any penalty leviable under S.271C on mere delay in remittance of withholding tax after deducting by the taxpayer. Such default will attract interest and prosecution.

Comments

The present SC ruling settles the controversy on whether penalty under S.271C covers case of failure to pay withholding tax after deduction, in addition to case of failure to deduct withholding tax, by holding that it does not cover circumstance of belated remittance of withholding tax which attracts interest and prosecution. This could be welcomed by taxpayers.

It may be noted that the tax year under consideration before the SC was tax year 2002-03. Both S.271C and S.276B have, subsequently, undergone amendments. The Finance Act, 2023 has expanded the scope of both S.271C and S.276B, with effect from 1 April 2023⁵, to cover both failure to deduct or failure to pay or ensure payment of withholding tax on payments in kind under several other withholding tax provisions, in addition to lottery winnings. However, the ratio of the SC ruling that penalty under S.271C cannot be levied for delayed remittance of withholding tax, will continue to apply for withholding tax on other payments.

It is likely that, as an outcome of the SC ruling, the tax authority will pursue prosecution more vigorously for default of delayed payment of withholding tax which, post 1 July 2010, also attracts higher interest at 1.5% per month.

It may also be noted that there is an independent general penalty provision (S.221) which empowers the tax authority to levy penalty where the taxpayer is in default or is deemed to be in default in making a payment of tax, which includes withholding tax. explanation to this provision provides that the taxpayer shall not cease to be liable to penalty under this provision merely because they had paid the tax before the levy of such penalty. The present case was rightfully required to be processed under this section. The SC, however, was not concerned with the levy of penalty under this provision since the tax authority had, instead, invoked S.271C.

⁵ 1 July 2023 for online game winnings

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