

EY Tax Alert

Supreme Court resolves judicial conflict on the due date of payment of employees' contributions to Social Security Schemes for tax deduction

Executive summary

Tax 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.

This Tax Alert summarizes a recent ruling of Three-Judge Bench of the Supreme Court (SC) in a batch of appeals¹, with Checkmate Services P. Ltd. (Taxpayer) v. CIT as the lead matter. The issue before the SC was interpretation of due date for payment of employees' contribution to Social Security Schemes (SSS) like Provident Fund, Employees' State Insurance, etc. to qualify for tax deduction under Indian Tax Law (ITL).

There was judicial conflict of view between different High Courts (HC) on the issue. Majority of the HCs² (majority view) held in favor of taxpayers that the due date for deposit of employees' contribution is same as due date for deposit of employer's contribution i.e., the contributions are eligible for deduction in the relevant tax year itself if they are actually paid before the due date of filing return of income (ROI) for the relevant tax year; else, they are allowable in the year of actual payment. On the other hand, Gujarat and Kerala HCs took contrary view (minority view) favoring tax authority that the due date for deposit for employees' contribution is the statutory due date under the relevant statutes governing the SSS (statutory due date) and thus, if not paid within statutory due date, the taxpayer permanently forfeits the deduction.

Upholding the minority view, the SC, in the present case, ruled in favor of the tax authority and held that employees' contributions are deductible if paid before the statutory due date.

¹ [TS-791-SC-2022]

² Bombay, Himachal Pradesh, Calcutta, Guwahati and Delhi

The SC ruling effectively endorses the amendments made by Finance Act (FA) 2021 with effect from tax year 2020-21 in line with the minority view and makes it clarificatory in nature having retrospective effect to all past tax years.

Background

- ▶ Under the ITL, any sum received by taxpayer from its employees as contributions to any SSS is treated as income of the taxpayer. The taxpayer is eligible for deduction of such sums if it deposits them to the relevant SSS before the statutory due date. [Section (S.) 36(1)(va)]
- ▶ Under a separate provision of the ITL, the employer's contribution is allowed as deduction on actual payment made on or before the due date of filing ROI (ROI due date) for the relevant tax year; else, they are allowable in the year of actual payment [S.43B]. S.43B not only covers employer's contributions to SSS but many other statutory and non-statutory liabilities like tax, duty, cess, bonus, leave encashment, interest to specified financial institutions, etc. which are also allowable on payment by ROI due date.
- ▶ S. 43B as originally introduced by FA 1983 from tax year 1983-84, *inter alia*, covered only employer's contributions and allowed deduction on actual payment by ROI due date.
- ▶ Subsequently, FA 1987 introduced separate provisions dealing with employees' contributions in terms of which definition of "income" was amended to include contributions "received" from the employees but allowed as deduction under S.36(1)(va) on payment by statutory due date³. Simultaneously, FA 1987 also amended, S. 43B to change the due date for payment of employer's contributions from ROI due date to statutory due date. These amendments were effective from tax year 1987-88 onwards.
- ▶ However, FA 2003 again amended S.43B to restore the due date for employer's contributions from statutory due date to ROI due date with effect from tax year 2003-04. This amendment was pursuant to recommendations of Kelkar Committee which advocated uniform tax treatment of statutory liability relating to labor with other statutory liabilities. The Committee opined that complete disallowance of such payments for delay beyond statutory due date was too harsh a punishment for delayed payments.
- ▶ Although the amendment by FA 2003 to S.43B was stated to be effective from tax year 2003-04 onwards, the Two-Judge Bench of the SC in the case of CIT v. Alom Extrusions⁴ (Alom Extrusions ruling) held that the amendment was curative in nature, intended to remove difficulties faced by taxpayers and, hence, applied retrospectively from tax year 1987-88 itself. For this conclusion, it relied on the earlier Three-Judge Bench of SC ruling in the case of Allied Motors (P) Ltd v. CIT⁵ which had similarly held an earlier amendment to S.43B in tax year 1987-88 to be curative in nature, having retrospective effect from tax year 1983-84, having regard to object of removal of hardships faced by the taxpayers under the pre-amended law.
- ▶ Basis Alom Extrusions ruling, majority of HCs held that the FA 2003 curative amendment to S.43B also had the effect of changing the due date for employees contributions under S.36(1)(va) from statutory due date to ROI due date on a retrospective basis from tax year tax year 1987-88. This view favored the taxpayers.
- ▶ However, minority view of Gujarat HC⁶ and Kerala HC⁷ favored the tax authority. They held that amendment to S.43B dealing with employer's contributions had no impact on S.36(1)(va) dealing with employees' contributions for which due date continued to be statutory due date.
- ▶ While the issue was pending before the SC, FA 2021 further amended S.36(1)(va) and S.43B in line with the minority view with effect from tax year 2020-21 onwards. However, the language of the amendment states that it is "for removal of doubts" and "it is hereby clarified" raising an issue whether the amendment is clarificatory in nature. In this regard, some courts⁸, following the majority view, held the amendment to be prospective in nature.
- ▶ The tax years involved in appeal before the SC were prior to tax year 2020-21.

Taxpayer's contentions

- ▶ In terms of SSS, the employer is required to make composite payment comprising employer's and employee's contributions by statutory due date. Thus, S.43B covers both employer's and employees' contributions which the taxpayer is statutorily obliged to make as an employer.

³ For instance, statutory due date for Provident Fund contributions is 15 days from the end of relevant month and that for Employees State Insurance is 21 days from the end of relevant month.

⁴ (2009) 319 ITR 306

⁵ [(1997) 224 ITR 677]

⁶ Gujarat State Road Transport Corporation [(2014) 41 taxmann.com 100]

⁷ Popular Vehicles and Services Pvt Ltd [TS-378-HC-2018]

⁸ Sandeep Kumar Agarwal vs Assistant Director of Income-tax [2022] [139 taxmann.com 564 (Delhi - Trib.)], Gopalkrishna Aswini Kumar vs Assistant Director of Income-tax [2022] [134 taxmann.com 18 (Bangalore - Trib.)], Adyar Ananda Bhavan Sweets India (P) Ltd. [2022] [134 taxmann.com 56 (Chennai - Trib.)]

- ▶ S.43B starts with a “non-obstante clause”⁹. Hence, it overrides the statutory due date provided in S.36(1)(va) and provides for ROI due date for both employer’s and employees’ contributions. Furthermore, Alom Extrusions ruling held the amendment by FA 2003, to S.43B to restore due date from statutory due date to ROI due date, to be curative having retrospective effect. Hence, relevant due date for employees’ contributions is also ROI due date and not statutory due date.
- ▶ Alternatively, S.36(1)(va) merely covers contributions “received” from the employees and not those which are “deducted” from employees’ salary. Under Provident Fund law, the principal employer is required to ensure deposit of contributions in respect of employees of its contractor as well, if the contractor itself does not do so. In this case, the contributions may be said to be “received” by the employer without deduction from salary and, hence, covered by S.36(1)(va).

Tax authority’s contentions

- ▶ The legislative history of S.36(1)(va) and S.43B shows that the ITL has always differentiated between employees’ contributions and employer’s contributions. While S.36(1)(va) covers employees’ contributions, S.43B covers employer’s contributions and both provide for different due dates for claiming tax deduction.
- ▶ Employees’ contribution is deducted from employee’s salary and deposited by employer. It cannot be regarded as employer’s contribution. Employer’s contribution is not deducted from employee’s salary but required to be paid by the employer itself.
- ▶ S.43B was inserted in tax year 1883-84 to address the mischief of taxpayers claiming deduction of statutory liabilities (including SSS contributions) by simply making provision in books under mercantile method of accounting without actual payment.
- ▶ On the other hand, S.36(1)(va) was specifically inserted in tax year 1987-88 along with amendment to definition of “income” to provide the contributions collected from employees shall be treated as income of the taxpayer and allowed as deduction only upon payment by statutory due date. If they are not paid by statutory due date, the taxpayer forfeits the deduction.
- ▶ Thus, both the provisions have differing objectives and provide for different due dates for employees’ and employer’s contributions.

SC ruling

The SC upheld the minority view of the HCs in favor of the tax authority and held that the due date for claiming tax deduction for employees’ contribution as per S.36(1)(va) is statutory due date and not ROI due date. It adopted the following reasoning for its conclusion:

- ▶ There is distinction between provisions like S.43B on one hand and S.36(1)(va) on the other. S.43B and similar provisions are concerned with and enact different conditions, that the tax authority has to enforce, and the taxpayer has to comply with, to secure a valid deduction. On the other hand, provisions like S.36(1)(va) deal primarily with business, commercial or professional expenditure under various heads along with conditions to be met. It is, therefore, necessary to bear in mind that specific enumeration of deductions, dependent upon fulfilment of particular conditions, would qualify as allowable deductions whereas taxpayer’s failure to comply with those conditions, would render the claim vulnerable to rejection.
- ▶ In the light of the above scheme of the ITL, the provisions of S.36(1)(va) have remained unaltered since the inception from 1987 whereas provisions of S.43B have undergone changes from time to time. There is significant difference between nature of contributions covered by S.36(1)(va) and S.43B and conditions for deduction thereof.
- ▶ By inserting S.36(1)(va) and amending definition of “income”, the Parliament intended that amounts not earned by the taxpayer, but received by it – whether in the form of deductions or otherwise, as receipts, were to be treated as income. Since these receipts did not belong to taxpayer but were held by them as trustees, S.36(1)(va) was inserted to ensure that if these receipts are deposited in the relevant SSS on or before the “due date”, they could be treated as deductions. The “due date” is specifically defined as the date by which the amounts have to be credited by the employer, in the concerned SSS. Most importantly, this condition does not apply to employer’s contributions which is covered by separate provision. The essential character of employees’ contribution is that it is part of employees’ income, held in trust by the employer and has to be deposited by the statutory due date.
- ▶ On the other hand, the object of S.43B, as noted in a series of earlier SC rulings¹⁰, is to curb the practice of taxpayers who did not discharge their statutory liabilities (including employer’s contributions to SSS) for long periods but claimed deductions in that regard

⁹ “Notwithstanding anything to the contrary contained in any other provisions of this Act”

¹⁰Allied Motors (P.) Ltd. vs Commissioner of Income-tax [(1997) 224 ITR 677], Exide Industries [(2020) 425 ITR 1], M. M. Aqua Technologies [(2021) 436 ITR 582]

from their income on the ground that the liability to pay these amounts was incurred by them in the relevant tax year.

- ▶ The Parliament while introducing S.36(1)(va) was very conscious of the distinction between employer's contributions and employees' contributions. While introducing S.36(1)(va) in 1987, Parliament also amended S.43B to provide for uniform statutory due date for claiming deductions for both employers and employee's contributions. However, after 14 years, on the recommendations of Kelkar Committee, Parliament amended S.43B to restore the due date for employer's contributions to ROI due date. In Alom Extrusions ruling, the SC held this amendment to be curative and applicable since inception.
- ▶ However, in Alom Extrusions ruling, the SC did not consider the separate provisions of the ITL for employer's and employees' contributions or the amendment treating employees' contribution deposited beyond the statutory due date as employer's income.
- ▶ The following principles of interpretation of taxing statutes are relevant:
 - ▶ A taxing statute has to be construed strictly - one has to merely look at what is said in the relevant provision. There is no presumption as to tax. Nothing is to be read in, nothing is to be implied.¹¹
 - ▶ If a deduction or exemption is available on compliance with certain conditions, the conditions are to be strictly complied with. There is no room for equitable considerations.¹²
 - ▶ When the competent legislature mandates taxing certain persons/certain objects in certain circumstances, it cannot be expanded/interpreted to include those, which are not intended by the legislature¹³.
- ▶ The HCs, laying down the majority view, principally relied upon the amendment in 2003 to S.43B held by Alom Extrusions ruling to be curative in nature. No doubt, many of these rulings also dealt with S.36(1)(va), but they primarily adopted the approach set out in Alom Extrusions ruling which did not consider the provisions relating to employees' contributions.
- ▶ The legislative development since 1984 clearly shows that Parliament has treated employer's contributions and employees' contributions

separately. S.43B and S.36(1)(va) have differing objectives. Employer's contributions are to be paid out of employer's income and allowed as deduction if paid by ROI due date. Employees' contributions, deducted from employees' income and held in trust by the employer, are artificially treated as employer's income unless paid by statutory due date. The marked distinction between nature and character of two amounts has to be borne in mind while interpreting the two provisions. Hence, the HCs taking minority view were correct in holding that "non-obstante clause" in S.43B does not dilute or override employer's obligation to deposit employees' contribution by statutory due date.

¹¹ Ajmera Housing Corporation [2010 326 ITR 642], citing from classic landmark English ruling of Cape Brandy Syndicate vs IRC [(1921) 1 KB 64]

¹² Eagle Flask Industries Ltd. v. Commissioner of Central Excise [(2004) Supp (4) SCR 35], State of Jharkhand v Ambay Cements, [(2005) 1 SCC

368]. Commissioner of Income Tax v. Ace Multi Axes Systems Ltd., [2018 (2) SCC 158n]

¹³ Commissioner of Customs vs Dilip Kumar & Co [2018 (9) SCC 1]

Comments

The present SC ruling upholding minority view in favor of the tax authority effectively endorses FA 2021 amendment and makes it clarificatory in nature. Since the present SC ruling is of Three-Judge Bench while the earlier Alom Extrusions ruling was of Two-Judge Bench, the present ruling will supersede any contrary observations in the earlier ruling.

The present SC ruling highlights the distinction in the nature and tax treatment of employer's contributions and employees' contributions to SSS having regard to the legislative development. It upholds strict interpretation of taxing law.

The ruling may have an adverse impact on taxpayers falling within jurisdiction of majority view of HCs or other jurisdictions where the lower appellate authorities followed the majority view. Wherever the issues are pending in litigation, the taxpayers may need to pay up the shortfall in taxes, with consequential interest (unless waived by the tax authority in accordance with the administrative instructions provided by the Central Board of Direct Taxes)^[14]. Penalty levy for concealment of income or furnishing of inaccurate particulars of income or underreporting of income will be defensible on the grounds that the issue was highly debatable and subject matter of judicial conflict until resolved by the SC.

The tax authority can also validly initiate action for reassessment, revision or rectification of past years' assessment/appellate orders within the applicable time barring limits to give effect to the present SC ruling. Hence, taxpayers, who are presently not in litigation on the issue, may also need to consider the adverse impact of SC ruling and take appropriate remedial action for past years.

¹⁴ Waiver or reduction of interest [F.No. 400/129/2002-IT(B)], dated 26 June 2006.]

