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A Quandary In Tax Collection At Source

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Finance Act, 2020 brought about changes in Income Tax Act, 1961 and in order to widen and deepen the tax net, Section 206C was amended to levy TCS on Sale of goods above certain limit. The scope of Tax Collection at Source (TCS) has been greatly enhanced with relatively low thresholds which will invariably bring in a large number of transactions under the scope of Section 206C(1H) of the Income Tax Act, 1961.

Sanyasi Rao Case

A Constitutional bench of the Supreme Court in the case of ***UOI & Anr Vs. A Sanyasi Rao*** [1] *held that the object in enacting Sections 44AC and 206C of the Income Tax Act, 1961, was to enable the Revenue to collect the legitimate dues of the State from the persons carrying on particular trades in view of the peculiar difficulties experienced in the past. Trade or business produces or results in income which can be brought to tax. In order to prevent evasion of tax legitimately due on such "income", Sections 44AC and 206C were enacted, so as to facilitate collection of tax on that income which is bound to arise or accrue, at the very inception itself or at an anterior stage. These provisions are akin to advance tax.*

Widening and deepening of tax net?

The Explanation to the Finance Bill, 2020 states that the Amendment to Section 206C to levy TCS on sale of goods above specified limit is towards widening and deepening the tax net. It is indeed worrisome if the Government needs a special vehicle like TCS in order to identify and bring into the tax net businesses which purchase goods of a value in excess of Rs. 50 Lakhs. When a seller has a turnover in excess of Rs. 10 crores, he is likely to be in the organized sector and when his buyer purchases goods from him in excess of Rs.50 lakhs, the seller would naturally carry out adequate due diligence. A person purchasing goods in excess of Rs.50 lakhs, in an era of digital trail, Aadhaar and PAN driven operations, will have to carry out magic to be out of the tax system. The introduction of GST has ensured that a supplier who has a turnover of more than Rs.20 lakhs would require registration and GST registration is not possible without PAN.

The ostensible objective of widening and deepening the tax net does not pass muster when the scope of the levy is across all goods and not merely evasion prone goods.

Accounting Nightmare

India has made giant strides in digital payments and post Covid-19, the emphasis on online payments is on the rise. Business operates on mercantile system of accounting and cash or receipt system of accounting is quite antiquated. In this scenario, Section 206C (1H) provides for TCS liability to be discharged *at the time of receipt of consideration*. It is quite normal for businesses to have running accounts; payments in installments; negotiated part payments; advances; adjustments; netting off; sales returns; post supply discounts; prompt payment discounts etc. *If one were to implement Section 206C (1H) in letter and spirit, it is quite clear that the cost of compliance could very well be more than the amount of tax by way of TCS.* When there are staggered payments and adjustments and running account payments which are not necessarily identified with any particular invoice, discharging TCS based on receipt of consideration would be an accounting nightmare. It is very well possible for businesses to weigh the time and cost involved and choose to discharge TCS on invoice basis as against receipt basis. The Government would get the revenue even earlier. However, businesses which discharge TCS based on receipt would be wasting significant productive time and energy. Further, they will have to invest in IT packages or modules to implement systems for calculating TCS based on receipts. The reconciliation would be a horror story in itself.

Is the levy constitutionally valid?

It is true that the Supreme Court upheld the levy in the case of **Sanyasi Rao**, but a deeper analysis of the judgement would demonstrate that the reasons given for upholding the validity are as under:

(i) The power to legislate under Entry 82 of the Union List would take in all incidental and ancillary matters

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including the authorization to make provisions to prevent evasion of tax.

(ii) The object of enacting Section 44AC and 206C was to enable the Revenue to collect legitimate dues of the State, from the persons carrying on particular trades in view of the peculiar difficulties experienced in the past.

(iii) Considered in the light of the **practical difficulties** envisaged by the Revenue to locate the persons and to collect the tax due in **certain trades**, if the legislature in its wisdom thought that it will facilitate the collection of tax due from **specified traders** on a presumptive basis, there is nothing to offend Article 14.

The justification for the levy at the relevant point of time was the practical difficulties experienced in making assessments of persons who take contracts for sale of liquor, scrap, forest produce etc. The explanatory memorandum to Finance Bill, 1988 at the time of introduction of Section 206C stated that *it has been the Department's experience that for taking such contracts, firms or AOPs are specifically constituted and very often no trace is left regarding them or their members after the contract has been executed. Since tax is payable in the assessment years, in respect of the incomes of the previous years, the time by which the incomes of the 'previous years' become assessable, such persons are not traceable. With a view to facilitate collection of taxes from such assessees, it is proposed to introduce a new Section 206C.*

It is pertinent to note that the Revenue while defending the challenge had contended that there were sufficient materials before the Parliament to hold that due to very many causes, income from certain trades could not be brought to tax and there was *large scale evasion*. In certain trades where evasion was predominant, legislation was called for to secure the payment of tax through appropriate machinery. The Supreme Court in pg. 349 has observed that '*we have seen that the object in enacting Section 44AC and Section 206C was to enable the Revenue to collect legitimate dues from the persons carrying on particular trades in view of the peculiar difficulties experienced in the past and the measure was so enacted to check evasion of substantial revenue due to the State. Having regard to the past difficulties in making normal assessments and collection in the case of certain categories of assessees, for convenience sake the legislature has chosen to make appropriate provisions for collection of tax at an anterior stage by adopting the purchase price as a measure of tax*'.

As can be seen from the above, the original 206C survived the challenge only on the ground that it was a tool introduced to address evasion in certain trades.

It would be interesting to note the position of the Government of India, when it seeks to justify Section 206C (1H) **when it applies to all goods**. Would it then be correct to assume that purchasers of all goods are evaders and are difficult to locate, warranting a mechanism to identify and collect tax at an anterior date? If such an assumption is the basis for levy, then it is a clear case of trust deficit.

Obviously, considering the huge growth in direct tax revenues and the high threshold of Rs. 50 lakhs, it would not be possible for the government to say that persons purchasing goods above Rs. 50 lakhs are not traceable and collection of tax is difficult. It would be even more of a challenge for the Government to then concede that purchasers of goods of a value less than Rs.50 lakhs are easy to locate and the Government has no difficulty in collecting income tax from them.

The reasons that were given for defending Section 206C in **Sanyasi Rao** case can no longer be brought into play given the wide scope and generality of Section 206(1H).

<u>101st Constitutional Amendment</u>

In the **Sanyasi Rao** case, the petitioners had contended that the levy under Section 206C is highly arbitrary and discriminatory. Section 44AC levies a tax on 'purchase' The Court had held that the legislature had chosen to make appropriate provisions for the collection of tax at an anterior stage by adopting the purchase price as a measure of tax. It was held that this was permissible that and the levy on the purchase price will not make it a tax on purchase of goods.

The language of Section 206C (1) which was upheld by the Supreme Court is not the same as the language adopted in Section206C (1H). In the original provision, it was a specified percentage on purchase price. Section 206C (1H) provides for a specified percentage of the sale consideration. Further, it refers to receipt of any amount as consideration, for the sale of any goods.

When the levy itself is on the consideration for sale of goods then there can be an interesting legal proposition to the effect that the provision may have travelled beyond its character of being a machinery provision and has taken an avatar of a charging provision. If so construed, then the provisions may have to be tested in the light of Article 246A introduced by the 101st Constitutional Amendment Act.

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GST is a tax on any supply of goods or services or both, except supply of alcoholic liquor for human consumption. The levy of GST by the Centre and State is on 'supply for consideration'. Therefore, if supply for consideration is already subject to GST under Article 246A, even though Section 206C (1H) is ostensibly a tax on income the levy is on consideration for a sale transaction. It would not be possible for the Government to justify the levy by contending that every buyer of goods is an evader and Section 206C (1H) is the only method through which the buyer can be traced. Article 246A confers power to make laws with respect to GST imposed by the Union or such State. Whether the new Section 206C (1H) can survive the test of constitutionality or not remains to be seen.

While there are legal issues with reference to the levy, implementation of the provisions as such pose a greater challenge. Some of the key issues that are debated in the industry and the professional community are given below:

(i) Whether GST should be factored while computing TCS?

The CBDT vide Circular No. 1/2014 dated 13.01.2014 had clarified that if in terms of the agreement/contract between the payer and the payee, the service tax component comprised in the amount payable to a resident is indicated separately, tax shall be deducted at source under Chapter XVII-B of the Act on the amount paid/payable without including such service tax component. The CBDT reiterated this principle in the context of GST vide Circular No. 23/2017 dated 19.07.2017.

Para No.4.6 of the CBDT Circular No. 17/2020 dated 29.09.2020 simply states that no adjustment on account of sale return or discount or indirect taxes including GST is required to be made for TCS since collection is made with reference to receipt of amount of consideration. It is quite baffling that GST can take a different meaning for TCS when in the context of TDS it was clearly understood that the GST element need not be taken into account at the time of Tax Deduction at Source.

GST itself is a levy on 'supply for consideration'. It is a tax on a transaction and levied on the consideration. GST does not take the character of consideration. The amount of GST collected does not belong to the seller and the seller is required to remit the same to the account of the Government. Further the GST charged by a seller would qualify as Input Tax Credit (ITC) to the buyer and would not form part of the cost of the goods purchased. Further, in terms of Section 16(2) of CGST Act, 2017 the buyer is required to pay the supplier the amounts towards value of supply along with the tax payable thereon within 180 days from the date of invoice to retain the ITC availed. This itself demonstrates that under GST law that value of supply and the GST thereon are understood to be different.

(ii) Whether software is 'goods'?

The Constitution Bench of the Supreme Court in the case of ***TCS Vs. State of Andhra Pradesh*** [2] has held that since software is capable of abstraction, consumption, use, transmission, transfer, delivery, storage, possession it would be goods for the purpose of levy of sales tax. However, the Explanation 4 to Section 9(1)(vi) of the Income Tax Act provides that 'transfer of all or any rights in respect of any right, property or information, includes and has always included transfer of all or any right for use or right to use computer software (including granting of license) irrespective of the medium through which such right is transferred. This Explanation is in the context of 'royalty'. Section 194J deals with TDS on royalty and royalty has the same meaning as in Explanation 2 to Section 9(1)(vi).

The proviso to Section 206C (1H) provides that TCS shall not apply if the buyer is liable to deduct tax at source under any other provision of the Act. In the context of Section 194J the CBDT vide Notification No. 21/2012 dated 13.06.2012 issued under Section 197A (1F) had set of the scenarios where no deduction of tax shall be made. If it is accepted that the liability to deduct tax at source exists as per the provisions and stands eclipsed as per the Notification under certain circumstances, then TCS should not apply. However, this can be a debate by itself.

(iii) Applicability of TCS to high sea sales

The definition of 'buyer' does not include a person importing goods into India. When 'A' from India places an order on a foreign supplier and transfers the documents of title to the goods before the goods cross the customs frontiers of India, in favour of 'B' in India, the transaction is commercially identified as a high sea sale. 'B' is considered as the importer of goods under law and is required to file a 'Bill of Entry' and clear the goods on payment of applicable customs duty. 'B' is the person importing goods and hence TCS would not apply.

Conclusion

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It is a fact that the rate of TCS is not very significant and the thresholds are liberal. However, the provisions of Section 206C(1H); its scope and applicability; challenges in implementation and the confusion around the provisions further compounded by circulars and press releases only affects ease of doing business. If the objective is to widen the tax net then Section 206C(1H) seems to paint a picture as if all buyers of goods of more than Rs. 50 Lakhs are not in the tax net and need to be located and brought into the tax net through Section 206C(1H). If that is a true objective, then it is a sorry state of affairs. However, if that is not the objective, then the rationale for the levy of TCS collapses and TCS would only be an additional compliance burden.

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[1] (1996) [TS-5022-SC-1996-O]

[2] (2004) (SC)