

IT : Employees of statutory corporation cannot be regarded as employees of State or Central Govt. and, hence, not entitled to exemption of entire sum of unutilized leave encashment under section 10(10AA)(i)

• Where assessee-KPTCL as an employer failed to deduct tax at source on salaries paid to its employees by including payment received by an employee in respect of any leave period not availed by employee, it was held that assessee being statutory corporation, its employees could not be regarded as employees of State or Central Govt. and, therefore, exemption under section 10(10AA)(i) was not available and assessee was liable to deduct tax. However, since assessee was under bona fide belief that its employees were to be regarded as employees of State Government and that its employees were entitled to exemption of entire sum of unutilized leave encashment under section 10(10AA)(i), KPTCL had discharged its obligation under section 192 and proceedings under sections 201(1) and 201(1A) were to be quashed.

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IN THE ITAT BANGALORE BENCH 'A'

KPTCL

v.

Income-tax Officer (OSD) (TDS), Bengaluru

N. V. VASUDEVAN, JUDICIAL MEMBER
AND JASON P. BOAZ, ACCOUNTANT MEMBER
IT APPEAL NOS. 2223 TO 2300 (BANG.) OF 2017
[ASSESSMENT YEARS 2013-14 TO 2014-15]
MAY 2, 2018

A. Shankar and **K.K. Chaitanya**, Advs. *for the Appellant.* **B.R. Ramesh** *for the Respondent.*

ORDER

Per Bench— In these group of appeals filed by M/s Karnataka Power Transmission Corporation Ltd.(hereinafter referred to as KPTCL or Assessee), against different orders of CIT(A), the only issue involved is as to whether KPTCL can be considered as "Assessee in Default" under the provisions of Section 201(1) of the Income Tax Act, 1961(Act) for not deducting tax at source and whether KPTCL is liable to pay interest on tax not deducted at source u/s.201(1A) of the Act?

2. The issue arises for consideration on the following facts and circumstances. KPTCL paid cash equivalent to its employees at the time of their retirement. Under Section 17(1)(va) "Salary" includes—(va) **any payment received by an employee in respect of any period of leave not availed of by him.** Under Section 192 of the Act, "Any person responsible for paying any income chargeable under the head "Salaries shall, at the time of payment, deduct income-tax on the amount payable at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made on the estimated income of the assessee under this head for that financial year. KPTCL as an employer was bound to deduct tax at source on the salaries paid to its employees by including the payment received by an employee in respect of any leave period not availed by the employee. **Section 201(1) & (1A) of the Act lays down consequences if tax is not deducted at source when there is a**

requirement to deduct tax at source laid down under any provisions of the Act and it reads thus:

"Section-201: Consequences for failure to deduct or pay.

(1) Where any person, including the principal officer of a company,—

- (a) who is required to deduct any sum in accordance with the provisions of this Act; or*
- (b) referred to in sub-section (1A) of section 192, being an employer,*

does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default in respect of such tax:

(1A) Without prejudice to the provisions of sub-section (1), if any such person, principal officer or company as is referred to in that sub-section does not deduct the whole or any part of the tax or after deducting fails to pay the tax as required by or under this Act, he or it shall be liable to pay simple interest —

- (i) at one per cent for every month or part of a month on the amount of such tax from the date on which such tax was deductible to the date on which such tax is deducted; and*
- (ii) at one and one-half per cent for every month or part of a month on the amount of such tax from the date on which such tax was deducted to the date on which such tax is actually paid,*

and such interest shall be paid before furnishing the statement in accordance with the provisions of sub-section (3) of section 200:]

3. Section 10(10AA) of the Act provides for certain exemption when payments are received by an employee in respect of leave period not availed by the employee. **Section 10(10AA) of the Act provides for the following exemption viz.,**

"Section 10: Incomes not included in total income.

In computing the total income of a previous year of any person, any income falling within any of the following clauses shall not be included—

(10AA) (i) any payment received by an employee of the Central Government or a State Government, as the cash equivalent of the leave salary in respect of the period of earned leave at his credit at the time of his retirement whether on superannuation or otherwise;

(ii) any payment of the nature referred to in sub-clause (i) received by an employee, other than an employee of the Central Government or a State Government, in respect of so much of the period of earned leave at his credit at the time of his retirement whether on superannuation or otherwise as does not exceed ten months, calculated on the basis of the average salary drawn by the employee during the period of ten months immediately preceding his retirement whether on superannuation or otherwise, subject to such limit as the Central Government may, by notification in the Official Gazette, specify in this behalf having regard to the limit applicable in this behalf to the employees of that Government:

4. It is not in dispute that the Specified Limit in the case of employee other than an employee of the

Central Government or a State Government i.e., employee falling within clause (ii) of Sec.10AA is Rs. 3,00,000 in salary to employees who retire, whether on superannuation or otherwise, after 1-4-1998 Vide Notification No. 123/2002 dated 31-5-2002.

5. As can be seen from the above provisions that if the employee to whom payment is made for unutilized leave period is an employee of Central or State Government then the entire payment so made is exempt and therefore an employee in such circumstances is not obliged to deduct tax at source on such payment. If on the other hand the person to whom such payment is made is not a Central or State Government employee then only Rs.3 lacs is exempt and the remaining sum is taxable and the employer has to deduct tax at source on payment in excess of Rs.3 lacs towards unutilized leave period.

6. Sec.10(10AA) does not define as to who is to be regarded as employee of Central or a State Government. The revenue's case is KPTCL is not State Government but a statutory corporation and therefore its employees cannot be regarded as employees of State Government.

7. KPTCL in the present group of cases did not deduct tax at source on payments made to its retirement employees towards unutilized leave period where such payment was made in excess of Rs.3 lacs. It is in this scenario that the Income Tax Authorities initiated proceedings against the Assessee u/s.201(1) & 201(1A) of the Act for treating KPTCL as an Assessee in default and also for levying interest on tax not paid to the credit of the Central Government for the period on which the tax deducted ought to have been remitted till such time they were actually remitted.

8. The plea of KPTCL was that its employees were employees of the State Government and therefore the entire payment to its employees towards unutilized leave period on retirement was exempt u/s.10(10AA)(i) of the Act. The revenue held that KPTCL was a statutory Corporation and therefore its employees were not employees of State Government and therefore KPTCL ought to have deducted tax at source on payment to employees towards unutilized leave period on retirement in excess of Rs.3 lacs which alone was exempt u/s.10(10AA)(ii) of the Act. In other words the stand of the revenue was that the clause applicable for determining liability to deduct tax at source was Sec.10(10AA)(ii) and not Section 10(10AA)(i) of the Act.

9. Both the AO and the CIT(A) rejected the plea of KPTCL and that is how KPTCL is in appeal before the Tribunal. The appellants in these appeals are the various divisions of KPTCL situate at various Districts in the State of Karnataka. One set of the divisions of KPTCL was represented by Mr.A.Shankar, Advocate and the other set of divisions of KPTCL was represented by Mr.K.K.Chaitanya, Advocate. The revenue was represented by Shri B.R Ramesh, Senior DR.

10. Five propositions were canvassed on behalf of KPTCL by the learned counsels for KPTCL challenging the orders of CIT(A) confirming the action of the AO in holding KPTCL to be an Assessee in default u/s.201(1) of the Act. They are:

- (i) *Assumption of jurisdiction by the respondent in all these appeals is bad in law and hence the orders passed u/s.201(1) & 201(1A) of the Act are invalid.*
- (ii) *The orders passed u/s.201(1) & 201(1A) of the Act are beyond the period of limitation and hence barred by time.*
- (iii) *The payments in question for which KPTCL was treated as "Assessee in default" for not deducting tax at source were not in the nature of income within the meaning of Sec.17(1)(va) of the Act and therefore there was no obligation on the part of the Assessee to deduct tax at source;*
- (iv) *The provisions of Sec.10(10AA)(i) of the Act are applicable in the case of the Assessee as the employees of KPTCL are to be regarded as employees of*

State Government;

- (v) *The provisions of Sec.201(1) & 201(1A) of the Act are not attracted in the present case because the non deduction of tax at source by KPTCL was under the bonafide belief that it was not obliged to deduct tax at source on payments in excess of Rs.3 lacs towards unutilized leave period as it believed that its employees were employees of State Government and therefore the applicable provisions will be only Sec.10(10AA)(i) of the Act.*

11. We have heard the parties on proposition (iv) and (v) alone as there are decisions of ITAT Bangalore Bench on identical facts and identical issues. As far as proposition No. (iv) is concerned, it was submitted by the learned DR that this Tribunal in the case of Central Food Technological Research Institute Vs. The ITO (TDS), Mysore, ITA No.1607 to 1611/Bang/2013 order dated 4.7.2014 this Tribunal has already taken a view on identical facts and circumstances of the case of the Assessee that employees of Statutory Corporations cannot be regarded as employees of the State or Central Government. In view of the aforesaid decision of the Tribunal, we hold that there is no merit in proposition No.(iv) canvassed by the parties before us.

12. As far as proposition No.(v) set out above, we have heard the rival submissions. Before the Tribunal submissions were made on behalf of KPTCL by the learned counsel for KPTCL pointing out the historical background under which KPTCL came into existence. Prior to enactment of Electricity Act, 2003 (Central Act) supply of Electricity was governed by the Electricity (Supply) Act, 1948 (again a Central Act). As per Section 5(1) of the Electricity (Supply) Act, 1948, every State had to constitute a State Electricity Board (SEB) by notification in Official Gazette. Sec.12 of the said Act stipulated that SEBs so constituted shall be a body corporate having perpetual succession and a common seal with power to acquire and hold property both movable and immovable and shall be capable of suing and be sued. That is how Mysore electricity Board came to be established on 1.10.1957 which was subsequently named as Karnataka State Electricity Board (KEB). Employees of State Government became employees of KEB.

13. In view of losses incurred by KEB, Government of Karnataka came out with general policy proposing fundamental and radical reforms in the power sector. Accordingly, Karnataka Electricity Reforms Act, 1999 (KERA) was enacted by the Karnataka State Legislature which advocated division of the functions of generation, transmission & Distribution of electricity and each function to be performed was entrusted to various statutory corporations. The function of generation of electricity was transferred to Visweshwaraiah Vidyuth Nigama Limited way back in 1970. By Section 14(3) of KERA, KPTCL was incorporated and the function of transmission and distribution of electricity was transferred to KPTCL. Subsequently the distribution function was given to four independent distribution companies in 2002 viz., BESCOM, MESCOM, HESCOM, GESCOM. Employees of KEB became employees of KPTCL.

14. It is the plea of KPTCL that after its inception till AY 2012-13 it has been deducting TDS by considering its employees as employees of State Government in view of the historical background under which KPTCL came into existence. The revenue has accepted in the past the manner in which tax was deducted at source by KPTCL by considering the employees of KPTCL as employees of State Government. It was pointed out that it is only in AY 2012-13, that the revenue took the stand that employees of KPTCL were not to be regarded as employees of State Government because employment under KPTCL cannot be equated with an office or post in connection with the affairs of such State. It was for the first time that the revenue took the stand that Statutory Corporations such as KPTCL, were not to be regarded as State Government. It has also been contended that the Assessee has been filing return of TDS for AY 2013-14 in the status of Statutory body (State Govt.) in form No.27A.

15. The learned counsel for KPTCL drew our attention to the Tripartite Agreement dated 31.7.1999 under the provisions of Sub-Section 2 of Section 15 of the Karnataka Electricity Reform Ordinance, 1999 between the Government of Karnataka and KEB and KEB Employees Union, wherein on corporatization of the transmission and distribution business by forming KPTCL employees of erstwhile KEB expressed apprehension that their services will be privatized. KEB under the tripartite agreement allayed their fears and assured them that all that the benefits employees will get as employees of KEB will continue to be available even after formation of KPTCL. Attention was drawn to some of the documents in the paper book filed regarding the extent of control and protection that the employees of the restructured corporate entities of the erstwhile KEB were subject to or given by the State Government.

16. The learned counsel for KPTCL also submitted that the issue of whether the Assessee was obliged to deduct tax at source on unutilized leave on retirement u/s.192 of the Act which casts obligation on an employer to deduct tax at source on salaries paid. It was argued that under clause (va) to Sec.17(1) of the Act it is only "**any payment received by an employee in respect of any period of leave not availed of by him**". It was submitted that on retirement the employer employee relationship between KPTCL and the retiring employee ceases and any payment made thereafter cannot be strictly termed as "Salary". Our attention was drawn to Finance Act, 2018 which inserted Sec.56(2)(xi) w.e.f. 1.4.2018 to avoid a possible plea that may be taken in such cases by holding that any payment post retirement will also be chargeable to tax under income from other sources, if it is not chargeable under the head income from salaries. To highlight the legal position that deeming provisions should receive strict construction in fiscal statute, the learned counsel referred to the decision of the Hon'ble Supreme Court in the case of *V.M.Salgaocar & Bros.(P) Ltd. v. CIT* 243 ITR 383(SC).

17. The learned counsel for the Assessee pointing out the above circumstances submitted that u/s.192(1) of the Act the obligation of the employer is only to deduct tax on the estimated income of the Assessee under the head Salaries for that financial year. If the estimate is made bonafide and tax deducted on such bonafide estimate then there can be no proceedings treating the person responsible for deducting tax at the time of payment, as "Assessee in default". The learned Counsel for KPTCL placed reliance on a decision of the ITAT Bangalore Bench in the case of Indian Institute of Science Vs. DCIT ITA No.1589/Bang/2014 for AY 2010-11 order dated 27.2.2015 on identical facts. In the aforesaid decision, the Tribunal took the view that the estimate of income under the head salary made by the Assessee on the belief that its employees were to be equated with State Government employees was a bonafide estimate and therefore the Assessee has discharged its obligation u/s.192 of the Act and hence proceedings u/s.201(1) & 201(1A) of the Act were to be quashed. Reliance was also placed on the decision of the Hon'ble Bombay High Court in the case of *CIT v. Kotak Securities Ltd.* 340 ITR 333 (Bombay) wherein the Hon'ble Bombay High Court took the view that when the question whether there was an obligation to deduct tax at source or not on a particular payment, is highly debatable then the Assessee cannot be held to be a defaulter for not deducting tax at source and consequently no disallowance u/s.40(a)(ia) of the Act for non deduction of tax at source should be made.

18. The learned DR submitted that no attempt whatsoever was made by KPTCL to show that the estimate of income under the head salaries made by it was bonafide. According to him there is always an option u/s.197 of the Act for the Assessee to approach the AO to clarify doubts regarding the correct rate of tax or the income on which tax has to be deducted. We observe that Sec.197 of the Act is only with regard to rate of tax or non deduction of tax at source and probably not applicable to resolve the question whether an item of income is taxable or not taxable. According to him KPTCL should have obtained estimate from the employees and only then their action can be said to be bonafide. The learned DR further placed reliance on the following decisions.

- (i) *SBI v. ACIT* ITA No.1395 to 1412, 1424 to 1426, 1456 to 1458/Bang/2018 order dated 6.4.2018.
- (ii) *Syndicate Bank v. ACIT* ITA No.1398 to 1403 and 1435 to 1477/Bang/2016 dated 6.4.2017.
- (iii) *CIFCO Finance Ltd. v. ITO* [2007] 13 SOT 376 (Mum)
- (iv) *Ernakulam District Co-operative Bank v. ACIT* [2005] 142 Taxman 98 (Kerala)
- (v) *CIT(TDS) v. Director, DPS* [2011] 14 Taxman.com 45 (P & H)
- (vi) *Drawing & Disbursing Officer v. ACIT* 115 ITD 411 (All)

19. It was submitted on identical facts such as the Assessee the ITAT Bangalore Bench confirmed orders u/s.201(1) of the Act in the case of *Central Food Technological Research Institute (supra)* and *CSIR National Aerospace Laboratories v. ACIT* ITA No.453 to 456/Bang.2014 order dated 27.8.2014.

20. We have very carefully considered the rival submissions. We are of the view that the facts and circumstances of the present case are identical to the case of *Indian Institute of Science (supra)* decided by the ITAT Bangalore Bench. In the said case the deduction of tax at source was u/s.192 of the Act. The question was valuation of perquisites in the form of rent free accommodation provided to employees of a statutory corporation such as the Assessee. The Assessee in that case took similar plea of bonafide belief as raised by KPTCL in the present proceedings. The Tribunal considered the submissions and firstly found that the law on the issue of bonafide belief in the matter of estimating of income under the head "salaries" for the purpose of Sec.192 of the Act, was explained in a decision of ITAT Bangalore in the case of *ACIT v. Infosys BPO Ltd.* 150 ITD 132 (Bang) in the following manner:

"26. It is no doubt true that TDS is to be made at the time of payment of salary and not on the basis of salary accrued. Sec.192(3) of the Act permits the employer to increase or reduce the amount of TDS for any excess or deficiency. We have already noticed that the fact that bills/evidence to substantiate incurring of expenditure on medical treatment up to Rs.15,000/- and the availing of the LTC by the employees and the fulfilment of the conditions contemplated by Sec.10(5) of the Act for availing exemption by the employees so availing LTC, have not been disputed by the AO. Even assuming the case of the AO, that at the time of payment the Assessee ought to have deducted tax at source, is sustainable; the Assessee on a review of the taxes deducted during the earlier months of the previous year is entitled to give effect to the deductions permissible under proviso (iv) to Sec.17(2) or exemption u/s.10(5) of the Act in the later months of the previous year. What has to be seen is the taxes to be deducted on income under the head 'salaries' as on the last date of the previous year. The case of the AO is that LTC and Medical reimbursement should be paid at the time the expenditure is incurred or after the expenditure is incurred by way of reimbursement and not at an earlier point of time. If it is so paid, then, even though the payment would not form part of taxable salary of an employee, the employer has to deduct tax at source treating it as part of salary, is contrary to the provisions of Sec.192(3) of the Act and cannot be sustained. The reliance placed by the AO on the expression "actually incurred" found in Sec.10(5) of the Act and proviso (iv) to Sec.17(2) of the Act, in our view cannot be sustained. In any event, the interpretation of the word "actually paid" is not relevant while ascertaining the quantum of tax that has to be deducted at source u/s.192 of the Act. As far as the Assessee is concerned, his obligation is only to make an "estimate" of the income under the head "salaries" and such estimate has to be a bonafide estimate.

27. The primary liability of the payee to pay tax remains. Section 191 confirms this. In a situation of honest difference of opinion, it is not the deductor that is to be proceeded against but the payees of the sums. To reiterate, the payment towards medical expenditure and leave travel is made keeping in view the employee welfare. The exclusion in respect of payment towards medical expenditure and

leave travel is considered after verifying the details and evidence furnished by the employees. No exemption is granted in the absence of details and/or evidence. The exemption in respect of medical expenditure is restricted to expenditure actually incurred by the employees, or Rs. 15,000/- whichever is lower. The exemption is granted even if the payment precedes the incurrence of expenditure. The requirements/conditions of section 10(5) and proviso to section 17(2) are meticulously followed before extending the deduction/exemption to an employee. No tax can be recovered from the employer on account of short deduction of tax at source under section 192 if a bona fide estimate of salary taxable in the hands of the employee is made by the employer, is the ratio of the following decisions.

CIT v. Nicholas Piramal India Ltd [2008] 299 ITR 0356 (BOMBAY);

CIT v. Semiconductor Complex Ltd [2007] 292 ITR 636 (P &H)

CIT v. HCL Info System Ltd. [2006] 282 ITR 263 (Del)

CIT v. Oil and Natural Gas Corporation Ltd [2002] 254 ITR 121 (Guj)

ITO v Gujarat Narmada Valley Fertilizers Co. Ltd [2001] 247 ITR 305 (Guj)

CIT v Nestle India Ltd [2000] 243 ITR 0435 (DEL)

Gwalior Rayon Silk Co. Ltd. v. CIT [1983] 140 ITR 832 (MP)

ITO v. G. D. Goenka Public School (No. 2) [2008] 306 ITR (AT) 78 (Del)

Usha Martin Industries Ltd. v. ACIT [2004] 086 TTJ 0574 (KOL)

Nestle India Ltd. v. ACIT [1997] 61 ITD 444 (Del)

Indian Airlines Ltd. v. ACIT [1996] 59 ITD 353 (Mum)"

21. The Tribunal thereafter proceeded to hold as follows:

"19. We have considered the rival submissions. In our view, the plea of the Assessee that it made a bona fide estimate of employee's salary by valuing the perquisites in the form of residential accommodation provided to the employees by valuing the same as if employees were employees of Central Govt. has to be accepted. In this regard, it is clear from the records that the position with regard to the assessee not being a Central govt. was brought to its notice by the department only in the proceedings initiated in 2013. Even thereafter, the Assessee has been taking a stand that its employees or employees of Central Govt. As held in several decision referred to by the ld.counsel for the Assessee, the obligation of the Assessee is only to make a bonafide estimate of the salary. In our view, in the facts and circumstance of the present case, assessee has made such an estimate. The Assessee's obligation u/s.192 is therefore properly discharged and hence proceedings u/s.201(1) & 201(1A) of the Act have to be quashed and are hereby quashed."

22. We are of the view that the circumstances explained by the learned counsel for KPTCL regarding the manner of formation of KPTCL and the action of the revenue in not questioning KPTCL's action in the past several years after its formation and the manner of exercise of control and affording protecting to employees of KPTCL by the State Government were definitely factors which weighed with KPTCL when it made estimate of its employees income under the head "Salaries". There is no reason for them to think that its estimate of employee's income under the head "Salaries" was incorrect as the belief it entertained was that its employees were to be regarded as employees of State Government and that its employees are entitled to exemption of the entire sum of unutilized leave encashment u/s.10(10AA)(i) of the Act.

23. With regard to the decisions cited by the learned DR in the case of *Central food Technological Research Institute(supra)* and *CSIR National Aerospace Laboratories (supra)* rendered by the ITAT Bangalore Benches, the said decisions are identical to the case of the Assessee but in those decisions the issue of bonfide estimate while deducting tax at source was never considered nor raised by the parties. Therefore that decision will help the plea of the revenue only to the extent to hold that the employees of KPTCL cannot be regarded as employees of State Government.

24. With regard to the other decisions cited by the learned DR, those are cases in which the person obliged to deduct tax at source were at no point of time instrumentality of State. They were either private parties or Banks. Those decisions are therefore neither relevant nor germane to the issue under consideration in these appeals.

25. For the reasons given above, we hold that KPTCL has discharged its obligation u/s.192 and hence proceedings u/s.201(1) & 201(1A) of the Act deserves to be quashed and are hereby quashed. All the appeals of KPTCL are allowed.

26. In the result, all the appeals of the assessee are allowed.

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