

## Supreme Court settles controversy on deductibility of employees' contribution to provident fund and other welfare funds

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## Summary

Deductibility of employees' contribution to provident fund (PF) and other welfare funds deposited before the due date of filing of the return of income (ROI), but after the due date prescribed under the relevant statute (respective Act) has been a subject matter of extensive litigation.

The Supreme Court (SC), in a batch of special leave petitions (SLP)<sup>1</sup>, has settled this controversy and has held that payment of employees' contribution to PF and other welfare funds cannot be claimed as a deduction if it is paid after the due date under the respective Act.

## Facts of the case

- Taxpayer deposited the employees' contribution to provident fund (PF) and other welfare fund (ESIC) after the due date under the respective Acts, but before the due date of filing its ROI.
- Taxpayer claimed the deduction of aforesaid amounts on the premise that these amounts were paid before the due date of filing the ROI.
- Revenue disallowed the claim, on the ground that these amounts are paid beyond the due date under the respective Acts. It was also held that such amounts would constitute as income<sup>2</sup> of the taxpayer.
- As per Revenue, the right to claim such amounts as allowable deduction was lost forever since these were paid beyond the due dates as prescribed under the respective Acts.
- In this case, the order passed by the Gujarat High Court (HC) was the subject matter of appeal before the SC.
- Considering that there are divergent rulings of various HCs<sup>3</sup> on this issue, the SC granted special leave to appeal in various taxpayer's cases and has dealt with the entire batch of appeals.

## Key observations of the SC

- The SC observed that Section 43B was introduced<sup>4</sup>, so that deductions, which were otherwise permissible and were being claimed on mercantile basis, would be allowed in certain cases on payment basis.
- Thereafter, Section 36(1)(va), 2(24)(x) and the second proviso to Section 43B were also introduced<sup>5</sup>.
- The SC observed that the Parliament intended to retain the separate character of employees' and employer's contribution to

1 Checkmate Services P. Ltd (Civil Appeal No. 2833/2016)

2 As per section 2(24)(x) of the Income-tax Act, 1961 (the Act)

3 High Courts of Bombay, Himachal Pradesh, Calcutta, Guwahati and Delhi favouring the interpretation beneficial to the assesses and the High Courts of Kerala and Gujarat preferring the interpretation in favour of the Revenue

4 Vide Finance Act, 1983

5 Vide Finance Act, 1989

the welfare funds based on use of different language in the statute<sup>6</sup>.

- Amount received from the employees (whether the amount is received from the employee or by way of deduction authorized by the statute) is deemed to be the income of the employer<sup>7</sup>. This amount is held in trust by the employer, underlined by the condition that it has to be deposited on or before the due date (under the respective Act).
- Deduction under Section 36(1)(va) of the Act can be claimed on payment of employees' share to the relevant fund within the prescribed time (as per the respective Act).
- The SC explained that the non-obstante clause in Section 43B has to be understood in the context of the entire provision and its rationale (i.e., to ensure timely payment of certain liabilities before the ROI is filed). For such liabilities (tax, interest payment and other statutory liabilities), some leeway is given by allowing taxpayers deduction even if the said liability is paid before filing its ROI.
- However, the non-obstante clause cannot apply in case of amounts held under trust (i.e., employees' contribution to welfare funds).

- The SC concurred with the Gujarat HC's finding in taxpayer's case that the non-obstante clause would not in any manner dilute or override the employer's obligation to deposit the employees' contribution to PF and ESIC, if it is not deposited on or before the due date (under the respective Act).
- With respect to taxpayer's reliance on earlier SC judgement<sup>8</sup> (which was also relied on by various HCs), the SC observed that the said judgement did not consider Section 2(24)(x) and 36(1)(va) of the Act and the fact that there are separate provisions in Section 36(1) for employer's contribution and employees' contribution.

#### Conclusion of the SC

- SC held that there is no infirmity in the approach of the Gujarat HC in disallowing the taxpayer's claim of deduction for employees' contribution to PF and ESIC which is paid beyond the due date under the respective Act.
- Further, it held that rulings of the other High Courts, holding to the contrary, do not lay down the correct law.

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<sup>6</sup> In Section 36(1)(va) and section 43B of the Act

<sup>7</sup> As per section 2(24)(x) of the Act

<sup>8</sup> CIT v. Alom Extrusions Ltd. (2010) (1 SCC 489)

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## Our comments

It is pertinent to note that the Finance Act, 2021 has amended Section 43B and Section 36(1)(va) of the Act with effect from 1 April 2021. As per the amendment in Section 43B of the Act, provisions of Section 43B of the Act do not apply and never deemed to have applied to any sum received by an employer from his employee. Further, as per changes in Section 36(1)(va) of the Act, it was clarified that the provisions of Section 43B of the Act do not apply and never deemed to have applied for the purpose of determining the 'due date' for employees' contribution.

Post these amendments, in certain cases, it has been held that these amendments are prospective in nature. The SC decision does not specifically deal with these amendments. However, based on the SC ruling in this case, the ambiguity in respect of claim of such deductions appears to have been settled even for years prior to assessment year 2021-22. Taxpayers may need to assess the impact on the facts of their case and evaluate the way forward.

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