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TDS Ambiguities - Law Needs a Median Fix

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Tax Deduction at Source (TDS) is a continuous compliance obligation under the Income Tax Act, 1961. The primary intent of the TDS mechanism is to ensure that income is taxed at the time of payment itself, facilitating early revenue collection and improving tax compliance. Every deduction made by the payer corresponds to income chargeable in the hands of the recipient (payee), who is expected to disclose such income in their return of income and claim credit for the tax deducted. He is required to show the income(s) earned irrespective of the fact whether tax is deducted or not. The current system, however, places the entire responsibility of deduction on the payer without providing any visibility into whether the payee has actually reported the income and claimed the credit. In such cases, any failure to deduct tax or any shortfall—even if unintentional—can result in disallowances, penalties, or prolonged litigation for the payer. This creates an imbalance where the payer is exposed to compliance risks, despite having no control over the payee's reporting behaviour.

Moreover, divergent interpretations between payers and payees on the applicability of TDS provisions are common. Importantly the transactions for this purpose may be recurring in nature so that the running compliance is warranted every now and then in succeeding months or years. Complex provisions are made to offer remedial measures through appeals, that are often time-consuming and resource-intensive.

This situation leads to unnecessary and repetitive litigation over routine compliance matters such as failure to deduct tax or shortfall in deduction of tax, consuming both taxpayer and departmental resources. To address this challenge in running compliance matters, there is a pressing need for the Income Tax framework to introduce **a simplified, efficient mechanism to resolve TDS-related disputes at the compliance stage itself**, rather than through long-drawn appeals. This could be in the form of allowing for real-time reconciliation or reporting confirmation from the payee or providing immunity to the payer in genuine cases where the income has been declared and tax has been paid by the payee, instead of disallowing such expenditure in the hands of the payer.

By adopting a more pragmatic and technology-enabled approach, the tax administration can significantly reduce avoidable litigation, ensure smoother compliance, and foster a more balanced and transparent tax ecosystem.

The Income Tax Department has often disallowed expenses under Section 40(a)(ia) where there is short deduction of TDS, i.e., tax is deducted under an incorrect section or at a lower rate. This leads to unnecessary litigations even where the tax was actually deducted and deposited

A recent decision in *CIT International Taxation* v. *Samsung Heavy Industries Co. Ltd.* [2025] 176 taxmann.com 482 decided by the Hon'ble High Court of Uttarakhand at Nainital on 10.07.2025 is a classic case where the matter related to the running compliance with a core issue of Whether Section 40(a)(ia) of the Income Tax Act, 1961 can be invoked in cases of short deduction of TDS—i.e., where tax is deducted at a lower rate under the wrong section (194C @ 2%) instead of the correct one (194J @ 10%).This matter is placed under limbo only because of a similar matter pending in Supreme Court for past 13 years.

The case pertained to Assessment Year 2012–2013. The assessee had deducted TDS at 2% under Section 194C (contract payments) on payments made for interior and electrification works. The Assessing Officer of the payer held that TDS should have been deducted at 10% under Section 194J (technical/professional services) and disallowed the expenses under Section 40(a)(ia) for short deduction of TDS. The Commissioner (Appeals) upheld the disallowance, but the Income Tax Appellate Tribunal (ITAT) reversed it, relying on favorable Calcutta and Delhi High Court rulings.

The High Court held that Short deduction of TDS (under a wrong section) does not attract disallowance under Section 40(a)(ia). It agreed with ITAT's reliance on Calcutta High Court's ruling in *CIT* v. *S.K. Tekriwal* [2024] 46 taxmann.com 444/361 ITR 432 and Delhi High Court's judgment in *Pr. CIT* v. *Future First Info Services (P.) Ltd.* [2022] 145 taxmann.com 35/[2023] 290 Taxman 490/[2022] 447 ITR 299 which held that Section 40(a)(ia) does not apply to short deduction of TDS.

The Court also invoked the Supreme Court's principle in *CIT* v. *Vegetable Products Ltd*. [1973] 88 ITR 192: When multiple non-jurisdictional High Courts give divergent views, the interpretation favorable to the assessee should be adopted.

The appeal was dismissed on the considered view that no substantial question of law arises for consideration. At the same time granting the liberty to the Revenue to approach the Court again if the pending Civil Appeal (for 13 long years) in the PVS Memorial Hospital Kerala High Court case decision (before Hon'ble Supreme Court) in similar matter is decided in their favor. This case involved the question whether payments made to fellow hospital are professional services or for contract work.

Key Takeaway:

To mitigate revenue against any possible case of short deduction or rate difference as well as to provide protection to the payer against any TDS ambiguities situation, it is desirable that we import the effect of the Supreme Court's principle in *Vegetable Products Ltd*. (*supra*) which favours adopting interpretation in favour of the taxpayer and provide in each TDS section a median rate of 0.5% for this purpose. And in that scenario no case for short deduction or disallowance be made out by the assessing officer if taxes are withheld at given median rate by the payer.

Further, until SC decides on PVS Memorial Hospital, this ruling provides strong support for assessees in non-jurisdictional states to argue against disallowance for short TDS deduction. Since the Kerala HC ruling is under challenge in SC, the matter is not conclusively settled at the national level.

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