



India: TDS On Cash Withdrawal – Tax Deducted But Not On "Income"- A Legal Conundrum

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With an aim to discourage cash transactions and move towards a cashless economy, the first budget of Modi Government 2.0 has proposed to levy TDS @ 2% on **cash payments** in excess of Rs. 1 CR in aggregate made during the year, by a banking company or corporate bank or post office, to any person from one or more accounts maintained by the recipient.

The provision which has been introduced, at first glance appears to address the need of the hour to combat the menace of black money and to aid a truly cashless economy. However, the devil lies in the details.

Section 194N is reproduced below –

"194N. Every person, being, —

- i. a banking company to which the Banking Regulation Act, 1949 applies (including any bank or banking institution referred to in section 51 of that Act);
- ii. a co-operative society engaged in carrying on the business of banking; or
- iii. a post office, who is responsible **for paying any sum, or, as the case may be, aggregate of sums, in cash, in excess of one crore rupees during the previous year, to any person** (herein referred to as the recipient) **from one or more accounts maintained by the recipient with it shall, at the time of payment of such sum, deduct an amount equal to two per cent. of sum exceeding one crore rupees, as income-tax:**

Provided that nothing contained in this sub-section shall apply to any payment made to, —

- i. the Government;
- ii. any banking company or co-operative society engaged in carrying on the business of banking or a post office;
- iii. any business correspondent of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the guidelines issued in this regard by the Reserve Bank of India under the Reserve Bank of India Act, 1934;
- iv. any white label automated teller machine operator of a banking company or co-operative society engaged in carrying on the business of banking, in accordance with the authorization issued by the Reserve Bank of India under the Payment and Settlement Systems Act, 2007;
- v. such other person or class of persons, which the Central Government may, by notification in the Official Gazette, specify in consultation with the Reserve Bank of India."

[Emphasis Added]

The provisions keep a seemingly large cap, that is for a cash withdrawals of more than Rs 10 million. However the same will commercially hurt the liquidity of various manufacturing industries with huge labor requirements where cash payment is essential. In fact, the tea industry which is largely not in well connected places, will be the worst hit.

This article focuses on the details to identify whether the said section can at all be legally valid.

A. TDS can be imposed only on income of the assessee

The concept of TDS was introduced with an aim to **collect tax from the very source of income**. As per this concept, a person (deductor) who is liable to make payment of a specified nature to any other person (deductee) shall deduct tax at source and remit the same into the account of the Central Government. The **deductee from whose income** tax has been deducted at source would be entitled to get credit of the amount so deducted on the basis of Form 26AS or TDS certificate issued by the deductor. Therefore, withholding tax is an income tax to be paid to the Government by the payer of the income on the behalf of the payee.

In fact, section 190 of the Act clearly states as under:

"Section 190 – Deduction at source and advance payment under Chapter XVII of the Act – Collection and Recovery of Tax

190. (1) Notwithstanding that the regular assessment in respect of any income is to be made in a later assessment year, **the tax on such income shall be payable by deduction or collection at source** or by advance payment or by payment under sub-section (1A) of section 192, as the case may be, in accordance with the provisions of this Chapter.

(2) Nothing in this section shall prejudice the charge of tax on such income under the provisions of sub-section (1) of section 4."

[Emphasis Added]

From the perusal of the above provisions of the Act, it is clear that tax can be deducted or collected at source only on the income of the assessee. Cash withdrawal from one or more accounts maintained with a bank, cooperative society engaged in the business of banking or a post office, does not partake the character of income of the recipient and hence cannot be said to be a payment. They are merely returning the money, which belongs to the recipient, on demand of the recipient. Hence, cash withdrawal from banks cannot under any stretch of imagination be treated as the income generated by the recipient as one cannot make income from himself.

Further, Section 198 of the Act clearly states that the tax deducted at source is income received. The provisions of Section 198 are reproduced below –

Tax deducted is income received.

"198. **All sums deducted** in accordance with the foregoing provisions of this Chapter shall, for the purpose of computing the income of an assessee, **be deemed to be income received**:"

Provided that the sum being the tax paid, under sub-section (1A) of section 192 for the purpose of computing the income of an assessee, shall not be deemed to be income received."

[Emphasis Added]

The above section was amended by the Notice of Amendments to Finance Bill, 2019 as introduced in the Lok Sabha on 18 July 2019 by adding a proviso to Section 198 and now is a part of the Finance Act, 2019, which is reproduced as under –

"Provided further that the sum deducted in accordance with the provisions of Section 194N for the purpose of computing the income of an assessee, shall not be deemed to be income received."

The above amendment itself intends to mean that the tax deducted on withdrawal of cash shall not be the income of an assessee and hence clearly shows that the TDS on withdrawal of cash is not on income and therefore is in violation of Section 190 of the Act.

B. The new provision does violation to the existing provisions of the Act

Section 199 of the Act read with Rule 37BA of the Income Tax Rules, 1962 (the Rules), states that taxes deducted by the payer shall deemed to be tax paid on behalf of the payee on the its income. The same is reproduced for the sake of convenience –

Credit for tax deducted.

"199. (1) **Any deduction made** in accordance with the foregoing provisions of this Chapter and paid to the Central Government **shall be treated as a payment of tax on behalf of the person from whose income the deduction was made**, or of the owner of the security, or of the depositor or of the owner of property or of the unit-holder, or of the shareholder, as the case may be.

..."

[Emphasis Added]

Credit for tax deducted at source for the purposes of section 199

"37BA

(1)...

..

(3) (i) **Credit for tax deducted at source** and paid to the Central Government, **shall be given for the assessment year for which such income is assessable.**

(ii) *Where tax has been deducted at source and paid to the Central Government and the income is assessable over a number of years, credit for tax deducted at source shall be allowed across those years in the same proportion in which the income is assessable to tax."*

[Emphasis Added]

From the perusal of the above, it is clear that the credit of tax deducted shall be given in the assessment year in which such income is assessed. However, tax deducted under section 194N is not against any income and the recipient is never going to treat the cash withdrawn as its own income. Further the amendments made in Section 198 of the Act also clearly states that the tax deducted on cash withdrawal under section 194N of the Act shall not be treated as income of the assessee. No corresponding amendment has been made in Section 199 of the Act so as to state that how the credit of the tax deducted under section 194N will be given to the assessee since the amendment in Section 198 itself states not to treat the tax deducted under section 194N as income of the assessee.

Therefore, the question remains unanswered as to how the credit of the tax deducted under section 194N would be given to the assessee as there is no corresponding income. Hence, the provisions of Section 194N are in violation to the existing provisions of the Act as TDS is only allowable against income assessable under section 199 of the Act read with Rule 37BA(3) of the Rules.

C. The proposition leads to an Expenditure Tax which is prima facie unconstitutional

The provisions of Section 194N is leading to tax the expenditure of the recipient of money from the bank. The sum of money withdrawn from the bank is not the income generated by the recipient. Such sum of money withdrawn shall be expended by the recipient either for personal use or for meeting his business expenditure. Thus, TDS on cash withdrawal is leading to a tax on the expenditure of the recipient.

Article 265 of the Constitution of India states that "**no tax shall be levied or collected except by authority of law.**" Further, Seventh Schedule of the Constitution of India defines and specifies the allocation of powers and functions between the Union and the States. None of the lists (Union List or Concurrent List) of the Seventh Schedule empowers the levy of tax on expenditure. Hence, the expenditure tax is unconstitutional.

D. Parallel provisions of Banking Cash Transaction Tax ("BCTT") (2005-2009) and rejection of recommendations of the Tax Administration Reforms Commission ("TARC") for re-introduction of BCTT

BCTT was introduced vide Finance Act, 2005 by the then Finance Minister P. Chidambaram. The intention of the levy of BCTT was explained in the Budget Speech which has been reproduced below –

"I am concerned about large cash transactions, especially withdrawals of cash, when there is no ostensible purpose to withdraw such large amounts of cash. These cash withdrawals leave no trail, and presumably become part of the black economy. Therefore, I propose to introduce two anti-tax-evasion measures: Firstly, I propose to levy a tax on withdrawal of cash on a single day of over Rs.10,000 or more from banks at the rate of 0.1 per cent. Thus, a person withdrawing Rs.10,000 in cash would have to pay a small sum of Rs.10. Secondly, I propose to require banks to report to the Government all deposits which are exempt from TDS on interest. I intend to observe the results of these steps before I propose any further measures."

The BCTT was levied in respect of cash withdrawals in a day exceeding Rs. 50,000 in the case of an individual or HUF and Rs. 1,00,000 in the case of other persons from their bank accounts other than savings accounts to track unaccounted money and trace its source and destination.

It remained in the statute for about four years and was withdrawn with effect from 1 April 2009. While withdrawing the levy, the Finance Minister in his budget speech had stated:

"The Banking Cash Transaction Tax (BCTT) has served a very useful purpose in enlarging the information system of the Income Tax Department. Since the information is also being gathered through other instruments introduced in the last few years, I propose to withdraw this tax with effect from April 1, 2009."

The Government of India in its Budget, 2013-14, had, *inter alia*, announced the setting-up of TARC for reviewing the application of Tax Policies and Tax Laws in the context of global best practices and to recommend measures for reforms required in Tax Administration to enhance its effectiveness and efficiency. Accordingly, the Ministry of Finance, Government of India set-up TARC *vide* its Notification No. F.No.A.50050/47/2013-Ad.I., dated 21 August 2013, with thirteen terms of reference.

The following recommendations were made to the CBDT by the TARC headed by Dr Parthasarathi Shome in its third report released on 30 November 2014 –

"There is no instrument at present that captures details of cash withdrawals from bank accounts, other than savings accounts. The availability of such information would help the I-T department widen its information base on the use of black money since excessive cash withdrawal can help it understand the extent of the cash economy. Hence, Rule 114E of the IT Act should be suitably revised to include in its ambit cash withdrawals exceeding specified amounts in a day from bank accounts other than savings accounts. Alternatively, BCTT should be reinstated as an effective administrative measure."

However, such recommendation was not accepted by the CBDT.

In view of the above, with the introduction of the TDS provisions on cash withdrawal, various industries whose operations are majorly cash oriented and labor intensive, like sugar, jute, tea, construction of infrastructure, etc. will be affected adversely since the liquidity of these industries would be affected with the introduction of the TDS provisions. The provisions being prima facie unconstitutional will affect industries which in turn may affect the 5 trillion-dollar roadmap for the Indian economy.

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