

TDS from Contract Payments

M. George Korah FCA, DISA

Ramesh Menon is a worried man. His partnership firm, M/s Menon Traders has received a notice from the Income Tax Department, enquiring whether the firm has deducted tax at source from contract payments & whether these taxes have been remitted on time.

Ramesh has a discussion with his Accountant, who tells him very casually, “Sir, no problem, we have not made any payments to contractors”. However Ramesh is not convinced .He starts scrutinizing the payments made by the Firm over the last 12 months and finds the following payments:

- Monthly payment of Rs. 6000 to the Security Agency for providing Guards
- Two half yearly payments of Rs. 25,000 each to a Computer Service Centre towards Annual Maintenance Contract for the Firm’s computers.
- Payment of Rs. 72,500 to an Advertisement Agency for newspaper advertisement.
- Payment of Rs. 47,000 to electrical contractor for re-wiring of office.
- Purchase of one Computer & Printer costing Rs. 32,000

All the above, except the last payment towards purchase of Computer & Printer, are payments in the nature of “Contract payments” and are covered under the provisions of Section 194C of the Income Tax Act,1961. This section relates to TDS from Contract Payments.

Before we look at the major provisions of this Section 194C, let us understand why the payment relating to purchase of the Computer & Printer is outside the

scope of this section. The reason is very simple. This payment is for purchase of goods and does not come under the purview of Section 194C.

Like Ramesh Menon, there are many of us who do not know the applicability of TDS on Contract payments. To get a better understanding, let us first look at some important provisions of Section 194C.

Who is responsible for tax deduction?

In case of contracts all entities other than individuals and HUFs.

In case of subcontracts, even individuals & HUFs also need to deduct tax if they come under the ambit of Sec 44 AB in the previous financial year, in other words, if they have a turnover of Rs. 40 lakhs (for businesses) or Rs. 10 Lakhs (for Professionals) in the previous financial year, then they have to deduct TDS.

When has tax to be deducted at source:

Tax is to be deducted either at the time of credit of such sum to the account of the payee, or at the time of payment thereof in cash or by issue of cheque or by any other mode, whichever is earlier.

For this purpose, any sum credited to any account, whether called “Suspense account” or by any other name in the books of account of the payer, is treated as credit of such income to the account of the payee.

Accordingly, tax has to be deducted even if amount payable to resident contractor or sub-contractor is transferred to a “Suspense account” by the payer in his books of account.

Exemption limit

The provisions upto 30th September 2004 were as follows:

If any individual contract does not exceed Rs. 20,000 then no tax has to be deducted at source.

However the Finance Act 2004 has made an important amendment in this area and states that after 1st October 2004 the exemption will be available only if

- a) Each individual contract is below Rs. 20000 and
- b) The total amount paid or credited to a contractor or subcontractor in a financial year does not exceed Rs. 50000.

Hence if there are two contracts with the same person in a financial year, the first being for an amount of Rs. 18,000 & the second for Rs. 40,000, then TDS will apply on the total Rs. 58,000.

Before 1st Oct, 2004, you needed to apply TDS only on the contract of Rs.40,000. Hence the provisions have become tighter.

Meaning of Work Contract

Provisions of section 194C relating to tax deduction from payment to contractors/subcontractors are applicable only where contract is either a “Work Contract” or a “Contract for supply of labour for works contract”.

These provisions are, therefore, not applicable for payments made under contract for sale of goods. We have seen that the payment for purchase of Computer & Printer by Ramesh Menon's firm does not fall within the ambit of Section 194C.

Definition of "Work"

The expression "work", shall include (a) advertising, (b) broadcasting and telecasting including production of programmes for such broadcasting or telecasting, (c) carriage of goods and passengers by any mode of transport other than by railway, and (d) catering.

Please note that this is an 'inclusive' definition, which means that other types of contracts may also come under this definition.

Rate of Tax deduction

The TDS rates prescribed under Section 194C are fairly reasonable and are as follows:

From Contractors	2%
From Subcontractors	1%
From Advertising Agencies	1%

On these TDS rates, there will be a surcharge of 10% applicable, for payments made to firms and companies. In case payments to individuals exceed Rs. 1 million, then these payments are also hit by the surcharge provision.

Educational cess of 2% of the TDS amount as well as the Higher Educational cess of 1% will be also applicable.

Hence for payments to Contractors it will be 2.266% and for Sub-contractors & Advertising agencies 1.133%

Now that we have seen some of the salient provisions of Section 194C, let us see what is the course of action that Ramesh Menon will have to take.

He will first have to calculate the TDS amount on the payments that were listed above (other than for purchase of Computer & Printer). This calculation is given below:

Service Providers	Total Annual Payment with TDS
Security Agency	Rs. 6000 x 12 months= Rs. 72,000 TDS @ 2.266 % = Rs. 1632
AMC for computers	Rs. 25,000 x 2 = Rs. 50,000 TDS @ 2.266 % = Rs. 1133
Advertisement Agency	Rs. 72,500 TDS @ 1.133 % =Rs. 821
Electrical Contractor	Rs. 47,000 TDS @ 2.266 % = Rs. 1065

Hence a total TDS of Rs. 4651 has to be deducted & remitted at the earliest. While remitting the TDS amount, Ramesh will have to calculate & additionally pay interest @ 12%per annum, on the delayed period.

The Income Tax Officer has the powers under Section 271C to levy a penalty for non-deduction of TDS. The quantum of this penalty will be equal to the amount of TDS which Ramesh has failed to deduct or pay.

Hence in addition to the interest burden, there could be an additional amount to be paid as penalty. Further Ramesh will have to e-file quarterly returns as well as issue TDS Certificates to the persons from whom he is deducting taxes.

Ramesh Menon, now knows how costly it was to remain ignorant of the TDS provisions.

He is also looking for a good Accountant as a replacement for his present one!!

Korah and Korah CAS