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Website: www.the lawway with lawyers.com

Email: thelawwaywithelawyers@gmail.com

AUTHORED BY:- Pranav Sri Krishna B

School of Law, SRM Institute of Science and Technology

SECTION 194N OF THE INCOME TAX ACT - CURBING OF CASH WITHDRAWALS

ABSTRACT:

India is a rapidly developing country with ambitious targets to achieve in the global arena. Eradication of poverty, proper transfer of benefits, and accountability in its economy are some significant aspects that will help India reach its goals. This paper aims to introduce the robust digital payment landscape of India and the country's aim to expand its territoriality. This research paper sheds light on a significant move made by the Government of India in order to achieve the above goals. This paper explores the Government's decision to tax huge cash withdrawals by the inclusion of Section 194N into the Income Tax Act, 1961 to discourage cash transactions. The paper explores various aspects of Section 194N such as its obligations, withdrawal limits, exceptions, etc. It also discusses the emphasis of placing a deterrent provision such as this as it makes way for more accountability, reduction in leakage of funds, and direct transfer of benefits.

The paper also examines various judicial decisions that have played a part in shaping Section 194N to its current form. It throws light on various technicalities within the Income Tax Act that have hampered the operation of this section. The paper concludes by highlighting the resilient nature of the provision which stands tall despite various legal challenges and showcases how important it is for shaping the financial behaviour in the country's economy.

Keywords: 1) Income Tax **2)** Section 194N **3)** Direct Transfer of Benefits (DBT) **3)** Cash Withdrawals **4)** Accountability **5)** Tax Deducted at Source.

INTRODUCTION:

The global economy is actively pushing for a cashless future where the aim is to curb cash/currency transactions. One of the best-known reasons to adopt this method is to bring accountability. It is also pertinent to note that countries spend a huge sum to print such currencies and coins. It is suffice to say India too is an active and prominent partner in this global initiative. In the year 2022, India had surpassed a whopping 89.5 Million digital Transactions[1]. The Indian Government has made significant efforts to discourage cash transactions, one such effort is the introduction of the Unified Payments Interface (UPI) and the setting up of the National Payments Corporation of India (NPCI). UPI turned out to be a remarkable project that aided the government's motives in curbing cash transactions. For instance, in January 2024 alone UPI saw a whopping 12.2 Million transactions amounting to Rs. 18.41 Crores[2]. It is safe to say that India is one of the biggest contributors toward a global cashless economy with it expanding its wings by implementing its digital transaction interface in foreign states such as Sri Lanka, Mauritius, Bhutan, Oman, Nepal, France, and UAE[3].

THE NEED FOR SECTION 194N OF THE IT ACT, 1962:

The Government in its journey towards a chase economy has successfully found ways to curb currency transactions. However, still, a large part of the population continues to use cash as their primary medium of transaction, especially small-scale businesses, local vendors, etc. Some transact specifically in cash to escape accountability and taxation. To discourage this, a solution was to be found. One should note that the primary source for people to receive currencies is from banks, especially through ATMs. In order to discourage this, banks imposed a daily threshold limit of Rs.50,000/-. The banks also started to levy charges for ATM withdrawals to make people regret withdrawing cash and to boost digitized transactions.

The other way to get cash out of banks was through cheques. People found this to be an easy method to pull currencies out of the bank coffers. Even many state governments in the country

[1]India dominating digital payment landscape with 89.5 million transactions in 2022, DD News (Jan. 10, 2023) (Acessed 16.07.2023).
[2] Monthly UPI Transaction Metrics (NPCI) https://www.npci.org.in/statistics/monthly-metrics (Acessed 16.07.2023).
[3]India Briefing, *Unified Payments Interface (UPI) from India: Expanding Global Use*, (Feb. 29, 2024), (Acessed 16.07.2023).

were found withdrawing huge amounts of cash in order to provide benefits to the public. The Central Government, in order to demoralize such withdrawals, had decided to charge Tax Deducted at Source (TDS) on them. Thus came Section 194N of the Income Tax Act, 1961 inserted by the Finance Act of 2019.

PROVISIONS OF SECTION 194N:

Payment of certain amounts in cash.[42]

194N. *Every person, being,—*

(i) a banking company to which the Banking Regulation Act, 1949 (10 of 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, being the amount or the aggregate of amounts, as the case may be, in cash exceeding 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 percent of such sum, as income-tax:

Provided *that in case of a recipient who has not filed the returns of income for all of the three assessment years relevant to the three previous years, for which the time limit of* file return of income under sub-section (1) of section 139 has expired, immediately preceding the previous year in which the payment of the sum is made to him, the provision of this section shall apply with the* *modification that—*

(i) the sum shall be the amount or the aggregate of amounts, as the case may be, in cash exceeding twenty lakh rupees during the previous year; and

(ii) the deduction shall be—

(a) an amount equal to two percent of the sum where the amount or aggregate of amounts, as the case may be, being paid in cash exceeds twenty lakh rupees during the previous year but does not exceed one crore rupees; or

(b) an amount equal to five percent of the sum where the amount or aggregate of amounts, as the case may be, being paid in cash exceeds one crore rupees during the previous year:

***Provided further** that the Central Government may specify in consultation with the Reserve Bank of India, by notification in the Official Gazette, the recipient in whose case the first proviso shall not apply or apply at a reduced rate, if such recipient satisfies the conditions specified in such notification:*

[43]***[Provided also** that where the recipient is a co-operative society, the provisions of this section shall have effect, as if for the words "one crore rupees", the words "three crore rupees" had been substituted:**]***

***Provided also** that nothing contained in this 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 (2 of 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 authorisation issued by the Reserve Bank of India under the Payment and Settlement

Systems Act, 2007 (51 of 2007):

Provided also *that the Central Government may specify in consultation with the Reserve Bank of India, by notification in the Official Gazette, the recipient in whose case the provision of this section shall not apply or apply at reduced rate, if such recipient satisfies the conditions specified in such notification*[4].

[4] Section 194N of the Income Tax Act, 1961.

BREAKING DOWN OF SECTION 194N:

Section 194N of the IT Act is a stringent section that levies TDS on cash withdrawals exceeding specified limits. It applies to entities such as banking companies, cooperative societies engaged in banking, and post offices. The section imposes obligations and conditions for deducting income tax when making cash payments from a person's accounts. The applicability of Section 194N extends to banking companies regulated by the Banking Regulation Act, of 1949, cooperative societies engaged in banking, and post offices. These entities, responsible for payments, must deduct an amount equal to two percent (2%) of the cash sum when the payment exceeds one crore rupees during the previous year.

In cases where the recipient has not filed income tax returns for the three preceding assessment years, the threshold is reduced to twenty lakh rupees. The deduction is two percent (2%) for cash payments exceeding twenty lakh rupees but not exceeding one crore rupees. If the cash payment exceeds one crore rupees, the deduction is done at five percent (5%). Government notifications, in consultation with the Reserve Bank of India, can specify recipients exempted from or subject to reduced rates under certain conditions. Additionally, for cooperative societies, the threshold is three crore rupees instead of one crore rupees[5].

Exceptions to the section include payments made to the government, banking companies, cooperative societies engaged in banking, post offices, business correspondents, and white-label automated teller machine operators, subject to specific conditions. Further flexibility is provided through government notifications, allowing the Central Government, in consultation with the Reserve Bank of India, to specify additional recipients exempted from or subject to reduced rates based on specified conditions.

EMPHASIS OF SECTION 194N:

The main intention behind the legislature to implement this provision into the Income Tax Act is to discourage large cash withdrawals. As discussed above, this provision proves to be effective in demoralizing people from trying to withdraw a huge sum of cash which in turn slows down

[5]Inserted by the Finance Act, 2023, to section 194N of the Income Tax Act, 1961 w.e.f. 1-4-2023.

currencies exiting the banks. The deterrent nature of this section will have a significant impact on any person who wishes to withdraw cash since a two percent deduction on anything above one crore rupee is a huge deal. In this way, the authorities are aiming to slowly but surely bring cash withdrawals to a definitive end and this section gives that dream an extra push.

This section also promotes Direct Benefits Transfer (DBT). Even now most State Governments withdraw lump sum cash from their coffers to provide scheme benefits to the people. These schemes or gifts are given to people as cash through various distribution mechanisms which constitute unaccountability and leakage of funds to non-beneficiaries. With this section in place, the governments might consider dropping cash distribution and directly transfer the scheme amounts to the beneficiaries' bank accounts. This enhances accountability and ensures the proper delivery of benefits to the right person[6].

JUDICIAL DECISIONS IMPACTING SECTION 194N:

Section 194N is a very new addition to the Income Tax Act, of 1961. However, various high courts were flooded with numerous petitions challenging the vires of the provision. The provision was argued to be unconstitutional and violative of Articles 14 & 19. One such petition was dismissed by the Madras High Court upholding the constitutional validity of the provision. It also stressed that section 194N makes way for the economy to be more transparent and accountable. Section 194N does not levy a charge rather, it merely provides a mechanism for collecting tax[7].

The main rebellions of the section 194N are the cooperative societies. The section provides that a cooperative society carrying out banking business shall be liable to deduct TDS under this section. However, the societies have approached the courts challenging the assessment orders and notification forcing them to implement the section. The societies take shelter under section 80P of the Income Tax Act which provides certain exceptions to the cooperative societies.

[6] Prabhat Barnwal, Curbing Leakage in Public Programs with Direct Benefit Transfers Evidence from India's Fuel Subsidies and Black Markets, 2016, (Accessed 17.07.2024)

[7] Income Tax Officer, TDS Ward-2 vs. Thanjavur District Central Cooperative Bank Ltd, [2024] 158 taxmann.com 490 (Madras).

However, the societies that still do banking activities are bound by the provisions of Section 194N and the defense of Section 80P is not applicable.

The confusion with regard to the above has seen various courts giving different kinds of judgments for this specific question of law and also inviting an amendment to the section. For starters, the Madras High Court exempted a transaction between the cooperative banks and their member societies from the liability of section 194N. It held the societies to be a mere business correspondent to the Government of Tamil Nadu and thus they are not liable for the deduction subsequently quashing the proceedings of the Income Tax Department[8].

In complete contrast to the above, the same Madras High Court in another batch of petitions filed by other cooperative societies gave a detailed ratio on the importance of the provisions of section 194N. It also favored the legislative intention behind the Section and stressed the fact that benefits given to the Government to people should directly be transferred to their bank accounts and not given as cash. This is to facilitate non-leakage of funds and proper identification transfer of benefits to the right beneficiaries. The court also stressed the dual nature of the cooperative societies which act both as the government's business correspondents and societies involved in banking functions [9].

It is pertinent to note that there was one particular judgment that invited the only amendment that has been made to this act. When the Madras High Court was hearing yet another batch of petitions filed by the cooperative societies, the court left it for the Central Board of Direct Taxes (CBDT) to decide on whether the Cooperative societies be exempted from the apprehension of Section 194N. The Court also directed that no coercive action shall be taken against these societies until a decision is arrived at by the CBDT[10]. Acting on these orders, the CBDT proposed an amendment of section 194N where the threshold limit for cash withdrawals is to be increased from Rupees One Crore to Three Crores for the cooperative societies. Consequently,

[8] Tirunelveli District Central Co-operative Bank Ltd. *V.* Joint Commissioner of Income Tax (TDS) Tirunelveli, [2020] 119 taxmann.com 21 (Madras).
[9] Chennimalai Siragiri Murugan Primary Handloom Weaver's Cooperative Society Ltd. Vs The Income Tax Officer [2023] 157 taxmann.com 636 (Madras)[18-12-2023].
[10] Erode Mavatta Valamana Thodakka Vs Managing Director, [2023] 153 taxmann.com 71 (Madras) [18-07-2023].

the amendment was inserted by the Finance Act, 2023, to section 194N of the Income Tax Act, 1961 w.e.f. 1-4-2023.

CONCLUSION:

To sum up, the implementation of Section 194N within the Income Tax Act of 1961 signifies a crucial move by the Indian government to foster a cashless economy and instill heightened financial accountability. Enacted in 2019, this provision mandates Tax Deducted at Source (TDS) on substantial cash withdrawals, acting as a deterrent and promoting the adoption of digital payment methods. Judicial decisions affirming its constitutional validity have highlighted the legislation's importance in promoting economic transparency.

Despite facing many legal challenges, particularly concerning cooperative societies, Section 194N has demonstrated its resilience in upholding the government's vision for a cashless financial environment. Legal considerations aside, Section 194N aligns with the government's objective of advancing Direct Benefits Transfer (DBT) and minimizing fund leakages. By taxing substantial cash withdrawals and encouraging digital transactions, the provision contributes to the streamlined delivery of scheme benefits directly to beneficiaries' bank accounts, ensuring proper settlement and reducing the risk of fund misallocation.

Section 194N is very important for changing financial behavior as it plays a significant role in taking India to a future without cash. Since the country is at a transitional level, laws like these are instrumental in increasing transparency and efficiency of the economy as well as creating a strong digital payment system.