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Direct Tax Alert

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CBDT releases guidelines on withholding tax requirements on provision of benefit or perquisite

The Central Board of Direct Taxes ('CBDT') has released a Circular providing for some important guidelines and examples on the scope and coverage of the new provision (section 194R) which requires taxes to be deducted by any person on provision of benefit or perquisite to a resident. The key highlights of the Circular are summarised below.

Background

- The Finance Act, 2022 ('FA 2022') had inserted a new provision ('section 194R') (effective from 1 July 2022) providing for deduction of tax at source ('TDS') on provision of 'benefit' or 'perquisite' to a resident.
- Section 194R states that taxes shall be deducted at 10% by any person responsible for providing 'benefit' or 'perquisite' (whether convertible into money or not) to a resident provided such benefit or perquisite arises from business or exercise of profession of the recipient.
- The Explanatory Memorandum to Finance Bill, 2022 indicated that while the provision for taxing such 'benefit' or 'perquisite' as business income is already present in the statute[1], absence of any enabling TDS provision may lead to cases where the recipient may not offer such benefit in its return of income,

[1] Section 28(iv) of the Income-tax Act, 1961

perhaps in absence of any legal / documentary trail. Section 194R was thus inserted with an objective to widen and deepen the tax base.

- The amendment is expected to impact a wide range of industries (FMCG, retail, automobiles, pharma, etc.) and business models including, for example, a dealer/distributor model where typically several incentives are provided by the company to their dealers and distributors either voluntarily or as part of their commercial arrangement.

- Pursuant to this amendment, there were few concerns on what qualifies as a 'benefit' or a 'perquisite' in order to be covered within the ambit of section 194R. This is largely because the terms 'benefit' and 'perquisite' are not only subject matter of legal interpretation but whether an item is in nature of 'benefit' or 'perquisite' will also depend on specific facts and circumstances of each case.

- Considering the above, the CBDT has issued a Circular[2] which provides some guidelines and examples on the scope and coverage of section 194R in the form of 10 Questions and Answers. The Circular has been issued in exercise of the powers conferred by section 194(2). Section 194(2) provides that the CBDT may, with the previous approval of the Central Government, issue guidelines for the purpose of removing the difficulty which arises in giving effect of section 194R. Further, section 194R(3) provides that such guidelines shall be laid before each House of Parliament and shall be binding on the income-tax authorities and on the person providing any such 'benefit' or 'perquisite'.

- The key highlights of the Circular are summarised in the ensuing paragraphs.

Taxability in hands of recipient - whether relevant?

- The Circular provides that the obligation to deduct tax under section 194R is not contingent on whether the amount of benefit or perquisite would be taxable in the hands of recipient. Once it is established that a 'benefit' or 'perquisite' is being provided, there is an obligation to deduct TDS irrespective of the tax treatment of such receipt in the hands of the recipient.

- The Circular further provides that even if the benefit to the recipient is in the form of a capital asset (say car, land, etc.), the TDS obligation under section 194R would still be applicable.

Benefit or perquisite in monetary terms – Whether TDS applies?

- The Circular provides that section 194R will be applicable not only for payments which are wholly in kind but also for payments which are in cash or partly in cash and partly in kind.

[2] Circular no 12 of 2022 dated 16th June 2022

Valuation of benefit or perquisite

- As per the Circular, the valuation would be based on the fair market value of 'benefit' or 'perquisite' except in following cases:
  - If the benefit / perquisite has been purchased by the payer, the purchase price will be the value of benefit/perquisite for TDS purposes

  If the 'benefit' or 'perquisite' is in respect of items which are manufactured by the payer, then the price which the payer would otherwise charge to the customer will be the value of 'benefit' or 'perquisite' for TDS purposes. It is clarified that GST will not be included for the purpose of valuation.

Sales discounts, cash discounts, rebates – Whether benefit or perquisite?

- The Circular acknowledges that discounts / rebates represent nothing but a lesser realisation of the sale price and consequentially a reduction in purchase cost of the customer.

- The Circular thereafter states that though such discounts would be in the nature of benefit, however, to alleviate the difficulty of the seller, no TDS is required to be deducted under section 194R on sales discount, cash discount and rebates allowed to customers.

Sales promotion schemes (Buy One Get One type of schemes, etc.)

- The Circular provides that if free items (say 2 items) are provided on purchase of other items (say 10 items), then the seller is in substance selling 12 items at the price of 10 items. In such a case, the Circular provides that no TDS is required to be deducted on the 'benefit' (i.e. the free items) which the buyer would have received on its purchase.

- However, the Circular further provides that this relaxation will not apply if incentive is provided in cash or kind (thereby differentiating it from *Buy One Get One* type of schemes). As per the Circular, section 194R will trigger in the following illustrative cases:
  - Providing incentives (other than discount or rebates) in form of cash or kind such as car, TV, computer, gold coins, mobile phones, etc.
  - Sponsoring a trip on achieving certain milestones / targets
  - Providing free tickets to an event
  - Providing free samples to medical practitioners

Reimbursement of Out-of-Pocket expenses ('OPE') – whether benefit or perquisite?

- As per the Circular, if any expenditure (which is the liability of the person carrying on business) is met by or reimbursed by some other person, the same would be regarded as 'benefit' or 'perquisite' for the person who had the primary liability of incurrence.
- The Circular has explained this situation by way of an example of reimbursement of travel expenses of a consultant by its client. According to the Circular, the travel expenses would generally be an

allowable business expenditure of the consultant. However, if the same is reimbursed by the client of the consultant, the same would be regarded as benefit/perquisite liable for deduction of tax under section 194R.

- However, the Circular thereafter clarifies that if the travel bills are in the name of the client, paid by the consultant and thereafter reimbursed by the client then the same will not be considered as a 'benefit' / 'perquisite' and therefore there would not be any requirement to deduct taxes.

Dealer/business conferences

- The Circular provides that expenditure pertaining to dealer/business conferences will not be considered as a 'benefit' or a 'perquisite' if such conferences are held with the primary object to educate dealers/customers on the following:
  - Launch of new product
  - Obtaining orders from dealers/customers
  - Teaching new sales techniques to dealers
  - Addressing queries of dealers
  - Reconciliation of accounts of dealers
- The Circular, however, provides such conferences should not be in nature of incentive / benefits only for few select dealers/customers who have achieved their targets.
- The Circular thereafter provides that the following expenditure would be considered as benefit or perquisite for purposes of section 194R:
  - Expense attributable to leisure trip or leisure component even if it is incidental to the dealer conference
  - Expenditure incurred for family members accompanying the person attending the conference
  - Expenditure on participants for days which are either prior or beyond the conference dates.

Ensuring TDS compliances when benefit/perquisite is in kind or partly in cash and partly in kind

- Section 194R provides that in cases where benefit/perquisite is wholly in kind or partly in cash and partly in kind and if part of the cash is not sufficient to meet the TDS liability, the person responsible for providing such benefit/perquisite must ensure that taxes have been paid before releasing the benefit/perquisite.
- Towards this, the Circular provides that the tax deductor can rely on the declaration from the recipient that appropriate taxes have been discharged along with a copy of the advance tax payment challan. The advance tax challan number can then be linked to the TDS return to be filed by the deductor.
- Alternatively, the Circular provides an option to the tax deductor to himself deduct taxes under section 194R of the Act even in cases where the benefit/perquisite is provided in kind.

Computation of de minimis limit of INR 20,000

- Section 194R does not apply in case of a resident where the value or aggregate of value of the benefit or perquisite provided or likely to be provided to such resident during the financial year does not exceed INR 20,000. Given that this provision is effective from 1 July 2022, there were certain doubts on how the limit of INR 20,000 is to be computed for FY 2022-23.
- The Circular clarifies that if the total value of benefit/perquisite provided to a resident is likely to exceed INR 20,000 during FY 2022-23 (including the period upto 30 June 2022), section 194R will apply on any benefit/perquisite provided on or after 1 July 2022.

Dhruva Comments

The timely Circular issued by the CBDT provides for some welcome clarifications on many of the areas where apprehensions were expressed on the scope and coverage of section 194R. However, there are certain aspects of the Circular which appear to be at divergence as compared to the legal positions upheld by the Courts.

For instance, section 194R applies to a benefit/perquisite *whether convertible into money or not.* The Circular states that even if the 'benefit' or 'perquisite' is wholly or partly in money, then also it is covered by section 194R[3]. The expression *'whether convertible into money or not'* was analysed by the Supreme Court in the case of *Mahindra and Mahindra Ltd*[4] in the context of section 28(iv) of the Act wherein the Supreme Court held that to invoke Section 28(iv), the benefit which is received has to be in some other form rather than in the shape of money.

Further, the Circular provides that free distribution of samples, which are not for sale, to medical practitioners also constitutes benefit/ perquisite. In our view, it is arguable that there can be no personal benefit to the medical practitioner on receipt of the samples, which would be used by them to be given to patients who are likely to benefit from their use. In this regard, useful reference may be drawn from the judgement of the Supreme Court in case of *Eskayef v. CIT*[5] wherein the Court has held that expenditure on distribution of free samples constitutes an advertisement or a sales promotion expense for the company.

The Memorandum to Finance Bill 2022 highlights the scenario of non-reporting of transactions taxable under Section 28(iv) and then, introduces Section 194R to catch hold of such transactions. The Circular provides that the TDS provisions of Section 194R would apply, irrespective of taxability in the hands of the recipient or the section under which the benefit or perquisite would be taxable. The Circular therefore seems to enlarge the scope of provisions beyond the legislative intention as expressed in Memorandum and hence taxpayers may be

[3] If the benefit is paid in form of money, it may be covered under some other provisions of Chapter XVII-B of the Act

[4] [2018] 404 ITR 1 (SC)

[5] [2000] 245 ITR 116 (SC)

justified in taking positions contrary to what is expressed by the Circular.

Further, section 28(iv) levies tax on value of benefit or perquisite arising from business or exercise of a profession. In absence of any specific valuation mechanism available under section 28(iv), whether the Circular indirectly enforces valuation mechanism also for the recipient? A question may arise as to whether the recipient of benefit or perquisite can adopt a valuation different from the value of benefit or perquisite reported in TDS returns, for the purpose of computation of its income.

It is common for companies to launch sales promotion schemes for dealers and distributors. Such schemes may provide for distribution of certain items on achievement of varying sales targets. As per the Circular, distribution of items in kind like mobile phones, laptops, etc. on achievement of certain milestones are regarded as benefit / perquisite and therefore exigible to TDS under section 194R. One may want to explore whether a distinction can be made between such benefits for which the recipient is contractually entitled vis-à-vis a situation where such benefits are provided voluntarily / ex-gratia and over and above what the recipient is otherwise entitled to.

Further, in respect of dealer conferences, the Circular states that the benefit or perquisite would extend to expenditure attributable to 'leisure component' even if it is incidental to the dealer / business conference. Determining 'leisure component' of a dealer / business conference and then allocating it to individual dealers would present significant practical difficulties and subjectivities. This position to attribute some part of conference expenditure towards leisure trip or leisure component and thereby deducting TDS on the same also appears to be a bit far-fetched and contrary to the well accepted legal position. One would have expected that some leeway should have been provided in this regard.

Furthermore, the position adopted in the Circular treating reimbursement of OPE expenses as a benefit / perquisite for the recipient also appears to be arbitrary and will only add on the difficulties and compliance burden for the payer. This may cover a large array of services providers like consultants, advisors, lawyers, etc.

Given that the amendment is effective from 1 July 2022, it is imperative for taxpayers to analyse and identify transactions which would be liable for TDS under section 194R. Non-deduction of TDS would not only lead to disallowance of expenditure but could also lead to interest and penal implications.

It is a well-accepted principle of interpretation that a Circular binds the taxpayers only if it is favourable to taxpayers and not in cases where it is inconsistent with the correct legal position. However, it should be noted that this Circular has been issued in exercise of the powers conferred under section194(2). A combined reading of section 194(2) and section 194(3) may suggest that the Circular shall be binding on the income-tax

authorities and on the person providing any such benefit or perquisite, provided it has been issued for removal of difficulty and laid before each house of Parliament. Thus, if certain provisions of the Circular are not for the purpose of removing any difficulty but are perceived to enlarge the scope of section 194R, then a view could be taken that the Circular, to that limited extent, may not be binding on the taxpayer.

Therefore, taxpayers wishing to take positions contrary to the Circular would need to undertake a fact-specific analysis before concluding on the applicability or otherwise of section 194R in their case.

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