dhruva

Direct Tax Alert

September 15, 2022

CBDT releases additional guidelines for tax withholding on benefit and perquisite

The Central Board of Direct Taxes ('CBDT') has released another Circular providing for additional guidelines and clarifications on the scope and coverage of 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

- Considering the various difficulties arising in interpretation of section 194R, the CBDT had issued a Circular[1] (hereinafter referred as "Former Circular") in the month of June 2022[2] to provide some guidelines and examples on the scope and coverage of section 194R in the form of 10 Questions and Answers. However, subsequently, some more clarifications were requested by the stakeholders on various issues. Considering the representations made by the stakeholders, the CBDT has issued another Circular[3] (hereinafter referred as "Present Circular") to provide additional clarifications and thereby remove difficulties in implementation of section 194R.

[1] Circular no 12 of 2022 dated 16th June 2022
[2] Click here to read our Tax Alert on Former Circular
[3] Circular no 18 of 2022 dated 13th September 2022

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

Section 194R not applicable to waiver or settlement of loan by certain institutions

- The Present Circular states that waiver or settlement of loan may be an income in hands of borrower. However, it acknowledges that subjecting such a transaction to section 194R would put extra cost on the lender as this would require payment of tax by the lender (deductor) in addition to the haircut borne by it.

- Hence it has been clarified that one-time loan settlement or waiver of loan would not be subjected to tax deduction under 194R in respect of the following lenders:
  - Public financial institutions
  - Scheduled banks
  - Co-operative banks
  - Primary co-operative Agricultural and Rural Development Bank
  - State Financial Corporation
  - State Industrial Investment Corporation
  - Deposit taking Non-Banking Financial Company (NBFC)
  - Systemically Important Non-deposit taking NBFC
  - Public company engaged in providing long term finance for construction or purchase of houses in India for residential purpose and which is registered in accordance with guidelines/directions issued by National Housing Bank
  - Asset Reconstruction Companies

- The Present Circular further clarifies that the tax treatment of settlement/waiver in the hands of borrower would not be impacted by the Circular.

Dhruva comments:

- The Present Circular has provided relaxation from withholding under section 194R only to public banks, certain public sector institutions, NBFCs, etc. which meet the qualifying conditions. One will therefore need to check the relevant definitions to ensure that the entity is covered by the definition and hence entitled to benefit of the Present Circular. However, it seems to suggest that waiver of loans does give rise to 'benefit' within the meaning of section 194R. Other taxpayers such as private banks (which are not scheduled banks), private parties (other than qualifying NBFCs), etc. may be required to comply with the provisions of section 194R, notwithstanding the fact that they would also face similar hardships and additional tax costs.
- Taxpayers may also like to explore their case on merits if it is perceived that the inference from the Present Circular does not represent a correct legal position and/or enlarges the scope of section 194R.

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

- As per the Former 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 Former Circular had explained this situation by way of an example of reimbursement of travel expenses of a consultant by its client. If the travel bills are in the name of the consultant, paid by the consultant and thereafter reimbursed by the client then the same will be considered as a 'benefit' / 'perquisite' and therefore there will be an obligation to deduct tax under section 194R.
- The Present Circular has confirmed the correctness of the above clarification provided by the Former Circular. The Present Circular has linked the liability of expenditure with the input GST credit. It states that if the invoice is in the name of service provider (consultant), then the underlying expense is the liability of service provider as it would be availing the input credit of GST. If it was the liability of service recipient (client), then GST input credit would have been allowed to it and not to service provider.
- Further, the Present Circular clarifies that if the service provider qualifies as a "pure agent" as per the GST laws, then the reimbursement received by the service provider would not be subjected to tax deduction under section 194R.
- As per the GST laws, a service provider would be considered as a 'pure agent' provided the following conditions are fulfilled:
  - It enters into a contract with the recipient of supply (say, its client) to incur expenditure/costs in the course of supply of goods or services or both
  - It neither intends to hold nor holds any title to the goods or services or both, so procured or provided as pure agent of the client
  - It does not use for its own interest such goods or services so procured
  - It receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply it provides on its own account
  - It acts as a pure agent of the client, when it makes payment to the third party on authorization by client
  - The payment made by it on behalf of the client has been separately indicated in the invoice issued by it to the client
  - The supplies procured by it from the third party are in addition to the services it supplies on its own account

Dhruva comments:

- The Present Circular has reiterated that the TDS obligation in case of reimbursement is also dependent on the person in whose name invoice has been issued, irrespective of terms of

agreement. However, one may argue that merely because the invoice is in the name of service provider, it should not alter the character of expenses as a mere reimbursement with no benefit attached as long as the service recipient is contractually obliged to incur the same and reimburse the service provider. A view can be explored that there is no 'benefit' provided to the service provider. The service recipient is contractually obliged and liable to reimburse the expenses incurred by the service provider on its behalf. Merely because the invoice is in the name of service provider or the service provider has arranged some facility to enable the furtherance of its duties, should arguably not be the sole factor for treating it as a benefit. There should be an actual benefit for the purpose of Section 194R and not a notional benefit.

- Further, if the invoice is in the name of service provider, it needs to be examined whether it still satisfies the conditions of a "pure agent" as per the GST laws and thereby absolves the client from the obligation to deduct tax basis the relaxation provided in the Present Circular.
- For example, consider a case of a service provider who arranges services of a third party for the sole benefit of the client. The invoice though raised by the third party in the name of service provider, the same is reimbursed by the client. In such case, it may be possible to explore treating the service provider as a 'pure agent' and thereby relieving the client from the TDS obligation on the reimbursement paid to the service provider. This is because the services of third party have benefited the only the client and have not been utilized by the service provider while providing its own services.
- However, in cases where the services (say, travelling / accommodation) are utilized by the service provider itself while providing its services to the client, then the implications may be different and the client may need to withhold tax even if it is in the nature of reimbursement. This is because the service provider in such a case may not fulfil the conditions of being regarded as a 'pure agent'.
- Needless to mention that determining whether a person qualifies as a 'pure agent' or not is a fact specific exercise and involves subjectivity.

Whether tax deduction under section 194R is required if tax has been deducted on the OPE under 194C/194J?

- The Present Circular provides that if reimbursement of OPE is already part of the gross consideration and tax has been deducted on the gross consideration under the relevant provisions of the Act, then there will not be further liability to deduct tax under section 194R.

Dhruva comments:

- This is a welcome clarification and in line with the industry expectations and the current legal position.

Withholding on expenses incurred in Dealer's conference

- The Former Circular clarified that expenditure pertaining to arrangement of dealer's conference would be regarded as benefit or perquisite and hence liable for withholding under section 194R, unless such conference is arranged with primary object to educate dealers / customers on 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 Former Circular granted relaxation provided the conference is not only for select dealers who have achieved certain targets.
- Further, expenses attributable to leisure element, expenditure incurred for family members accompanying the dealers or expenditure pertaining to overstay or prior stay shall attract withholding obligation.
- The Present Circular further clarifies that it is not necessary that all dealers should be invited to the conference for expenses not to be considered as benefit or perquisite for the purpose of section 194R.
- Further, expenditure pertaining to participants' stay a day immediately prior to actual start date of conference and a day immediately following the actual end date of conference would not be considered as overstay and shall not automatically attract withholding obligation.
- The Present Circular further states that if the benefit/perquisite is provided in a group activity and it is difficult to allocate such benefit/perquisite to each participant using a reasonable allocation key, the benefit/perquisite provider may at its option not claim the expense, in computation of its total income. In such a case, the benefit / perquisite provider shall not be held 'assessee-in-default' for the purpose of section 201 and interest and penal consequences shall be avoided.

Dhruva Comments

- The above clarifications pertaining to prior stay and over-stay and participation of select dealers are welcome.
- The Present Circular provides conditional relaxation from tax withholding and consequential interest and penalty exposure, if the taxpayer voluntarily disallows the expenditure which cannot be reasonably allocated to a particular person (especially in cases of group activity, etc). This view seems quite harsh and may be regarded as

against the well-established legal principles.

- Issues on interplay of other withholding tax provisions (say, section 194C or section 194J) with section 194R may also need to be considered. For example, a taxpayer may choose to exercise his option to not deduct taxes under section 194R and thereby foregoing the deduction in computing his taxable income. However, this does not absolve him of his liability to deduct tax under section 194C or section 194J as may be applicable. In such cases, the quantum of disallowance under section 40(a)(ia) could also be a subject matter of dispute. Furthermore, the benefit, if any, may still be taxable in the hands of the recipient even if the taxpayer chooses to not claim the deduction for expenses incurred by it.

Depreciation on capital assets received as benefit / perquisite

- The Former Circular clarified that capital assets given as benefit or perquisite shall be taxable in the hands of recipient and the benefit / perquisite provider shall be liable to withhold taxes at source under section 194R.
- In furtherance thereto, the Present Circular clarifies that value of such benefit / perquisite offered as 'income' shall deemed to be 'actual cost' in the hands of recipient and shall be eligible for depreciation under section 32 of the Act.

Dhruva Comments

- Neither section 32 nor section 43(1) deals with computation of 'Actual cost' for the purpose of depreciation on capital assets received as benefit / perquisites. While the Former Circular clarified withholding obligation on capital assets, the Present Circular favourably resolves the issue regarding depreciation allowance in favour of service providers. The clarification is in line with the Supreme Court ruling in case of *CIT v. Groz-Beckert Saboo Ltd.*[4]
- Further, it may also be possible to place reliance on the Present Circular to claim deduction in respect of goods / facilities received as benefit / perquisites and subsequently consumed in business or profession on revenue account.

Applicability of section 194R on Embassy / High Commissions

- The Present Circular exempts certain foreign institutions from applicability of section 194R. Accordingly, section 194R shall not apply on benefit/perquisite provided by, an organization in scope of The United Nations (Privileges and Immunity Act) 1947, an international organization whose income is exempt under specific Act of Parliament (such as the Asian Development Bank Act 1966), an embassy, a High Commission,

[4] [1979] 116 ITR 125 (SC)

legation, commission, consulate and the trade representation of a foreign state.

Dhruva Comments

- The CBDT clarification eases out practical difficulty for few strategically important foreign institutions in implementation of section 194R. However, such relaxations are applicable only for benefit / perquisite provided by specified organisations.

Withholding on issue of bonus / right shares

- The Present Circular states that section 194R shall not apply on right / bonus shares by a company in which public are substantially interested[5], if such bonus / right shares are offered to all the shareholders by such company.

Dhruva Comments

- This clarification is likely to cause difficulties for closely held companies[6] in respect of withholding obligation on issue of bonus / right shares to shareholders. Whether the corporate actions by way of issue of bonus/ right shares result into benefit/ perquisite for the recipient shareholders? Whether such corporate action can be held to be 'benefit / perquisite' 'arising in the course of business / profession'? Whether withholding obligation under section 194R on corporate action is within the scope of legislative intent? While the courts are busy dealing with tax implications of bonus / right shares under section 56(2)(vii)/ (x), applicability of the withholding provisions shall not allow the Courts to take a breather. However, without prejudice to merits, another view could be that the underlying principles basis which relaxation has been given to widely held companies should equally apply to closely held companies in absence of any specific embargo / limitation in the Present Circular. There is no reason why the rationale provided in the Present Circular cannot be made applicable to closely held companies. However, this may get finally settled only after litigation and will therefore add to the bucket of difficulties created by this new provision and the clarificatory circulars issued by the CBDT.

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For any queries in relation to this tax alert, please feel free to reach out.

[5] Section 2(18) of the Act defines a company in which public are substantially interested

[6] The companies in which public are not substantially interested as per section 2(18) of the Act

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