ISSUES UNDER SECTION 194R OF INCOME TAX ACT, 1961

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The Finance Act, 2022 has introduced a new section 194R 'Deduction of tax on benefit or perquisite in respect of business or profession'. The section as it stands in the statue is as follows…

(1) Any person responsible for providing to a resident, any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, by such resident, shall, before providing such benefit or perquisite, as the case may be, to such resident, ensure that tax has been deducted in respect of such benefit or perquisite at the rate of ten per cent of the value or aggregate of value of such benefit or perquisite:

Provided that in a case where the benefit or perquisite, as the case may be, is wholly in kind or partly in cash and partly in kind but such part in cash is not sufficient to meet the liability of deduction of tax in respect of whole of such benefit or perquisite, the person responsible for providing such benefit or perquisite shall, before releasing the benefit or perquisite, ensure that tax required to be deducted has been paid in respect of the benefit or perquisite:

Provided further that the provisions of this section shall 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 twenty thousand rupees:

Provided also that the provisions of this section shall not apply to a person being an individual or a Hindu undivided family, whose total sales, gross receipts or turnover does not exceed one crore rupees in case of business or fifty lakh rupees in case of profession, during the financial year immediately preceding the financial year in which such benefit or perquisite, as the case may be, is provided by such person.

(2) If any difficulty arises in giving effect to the provisions of this section, the Board may, with the previous approval of the Central Government, issue guidelines for the purpose of removing the difficulty.

(3) Every guideline issued by the Board under sub-section (2) shall, as soon as may be after it is issued, 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.

Explanation[1]. – For the purposes of this section, the expression "person responsible for providing" means the person providing such benefit or perquisite, or in case of a company, the company itself including the principal officer thereof.]

Explanation [2]. – For the removal of doubts, it is clarified that the provisions of sub-section (1) shall apply to any benefit or perquisite, whether in cash or in kind or partly in cash and partly in kind.

* Explanation 1 & 2 were inserted with effect from 01-04-2023 (Finance Act, 2023).

BACKGROUND:

As per the Memorandum explaining the Finance Bill, 2022 the intent behind insertion of Section 194R is to bring into the tax net, the benefits or perquisites which are taxable under Section 28(iv) and which in many cases may not get reported in the return of income by the recipients. The Hon'ble Apex Court in the case of Commissioner v. Mahindra and Mahindra Ltd. [2018] 404 ITR 1 has held that in order to invoke the

provisions of Section 28(iv) of the Act, the benefit which is received has to be in some other form rather than in the shape of money. Therefore, in case where benefit or perquisite is in cash, the provisions of Section 28(iv) would not get triggered.

However, after the insertion of Explanations to the Section, with effect from 01-04-2023, the cash benefit or perquisites are now covered under the radius of Section 194R.

It may be noted that, erstwhile, the circulars were issued by CBDT under the powers given by Section 119 of the Act, which was to give instructions and directions to other income tax authorities for proper administration of the act. These circulars are binding only on the tax departments.

However, under recent trends Section 194R(2) has empowered the Board to issue guidelines for the purpose of removing difficulties. As per sub-section (3), these circulars and guidelines issued by CBDT under Section 194R(2), are binding on the income-tax authorities and the person providing the benefit or perquisite.

Under the powers conferred under Section 194R(2), the CBDT has issued Circular No.12 dated 16th June, 2022 providing "*Guidelines for removal of difficulties under sub-section (2) of section 194R of the Income Tax Act, 1961*" and Circular No.18 dated 13th September, 2022 providing "*Additional Guidelines for removal of difficulties under sub-section (2) of section 194R of the Income-tax Act, 1961*". These circulars have tried to clarify certain doubts, but have left many ambiguities.

This article highlights certain ambiguities or practical issues, which may require more clarification from the authorities concerned, till then the taxpayers will have to face many difficulties and may invite litigations.

CASH BENEFIT OR PERQUISITE AND SECTION 194R:

- Looking at the intent, from the Memorandum to Finance Bill, 2022 and wordings of Section 194R, it is very clear that scope of section was to bring benefit or perquisite in kind, which is taxable under Section 28(iv) of the Act, under the ambit of TDS provision. Thereafter, FAQ 2 of Circular 12 (2022) has widened the scope of Section 194R.

  The Section 194R as enacted in the statue, circulars issued by CBDT and the judicial pronouncement by Supreme Court in the case of Commissioner v. Mahindra and Mahindra Ltd. [2018] 404 ITR 1, can it be challenged that the cash benefit or perquisite received during FY 2022-23, is out of the scope of Section 194R?

  In my humble view, one can take such a position and argue that the enlargement of scope of Section 194R is by issuances of clarifications under the circulars and is not sufficiently backed by the statue. The amendment to Section 194R, inserting explanations to section, widening the scope, came into effect from 01-04-2023.

WAIVER OR ONE TIME SETTLEMENT OF LOAN WITH BORROWERS BY SPECIFIED PERSONS:

The waiver or one time settlement of loan was referred in FAQ 3 of Circular 12 (2022). Further, the guidelines given under FAQ 1 of Circular 18 (2022), on waiver or one time settlement of loan with borrowers safeguards the following:

- ✓ One-time loan settlement with borrowers;
- ✓ Waiver of loan granted on reaching settlement with the borrowers;
- ✓ Lender should be the one specified in the circular.

The above safeguards in the circular are providing exclusions to specified persons from making TDS under Section 194R. However, it does not cover the other persons and different situations which still, I feel, would be requiring clarifications; which are dealt here below:

- Whether the circular applies only on arrival of settlement between the two parties, i.e, the lender and the borrower of the loan?

  The Circular provides for 'one time loan settlement' between the lender and the borrower. For the assessee to claim the benefit of Circular, the loan must be settled and there exist a Settlement Agreement, vouching for the same.

- Whether it applies to writes-off of 100% of the amount in absence of any settlement?

  The Circular clarifies on loan settlement or waiver by the bank but does not clarify any 'write-off of loan or any accounting write-off' in books. In case when there is write-off of any amount, on plain reading of Section 194R, the same would amount to benefit or perquisite to the other party, on his part of satisfying his obligation. One view could be that such write-off, having the colour of benefit or perquisite, would attract the provisions of Section 194R.

  On the contrary, technically, the lender retains his right to recover intact and accordingly, there is no benefit or perquisite provided. The benefit or perquisite should be a 'real benefit or perquisite' and not mere 'accounting benefit or perquisite' and hence, provisions of Section 194R does not apply. In order to avoid litigation, this requires clarification from CBDT.

- Whether restructuring of a loan, viz….

  1) Moratorium period granted for repayment of loan, or
  2) Reducing rate of interest, or
  3) Assignment or discounting of loan at discount to third party, or
  4) Conversion of loan to equity, or
  5) Settlement of loan for some other asset, etc.

  are subject to provisions of Section 194R?

  The provisions of Section 194R are attracted if there exists 'any benefit or perquisite'. Restructuring or modifications or conversion of loan, per se does not lead to any benefit or perquisite, and therefore the provisions of Section 194R does not get triggered. However, the wordings of circular provide for exclusions to one time loan settlement, thereby giving different interpretations. Thus, in order to avail the benefit of exclusion, assessee may face challenges in future.

- Whether settlement by operational creditors and / or financial creditors under Insolvency & Bankruptcy Code attract deduction of tax under Section 194R?

  Circular 18 (2022) is restricted only to a waiver of loan and that too by specified persons. In case of settlement under the Insolvency & Bankruptcy Code, financial creditors may avail the benefit of this Circular if they fall within the category of specified persons. However, there is no such benefit provided to operational creditors or financial creditors (who are other than the specified persons under the circular). Thus, there is unjust discrimination which can create differences of opinion.

- Whether waiver of interest on loan by specified persons be subject to tax under Section 194R?

  Circular 18 (2022) makes reference to waiver of 'Loan' and does not provide any clarification as to waiver of 'interest on loan'. In these circumstances, it can be contended that unpaid interest on loan is also a debt accrued and can thus be deemed to be loan and hence should fall within the exclusions of Circular.

- Whether write-off of loans or trade receivables written-off as bad debts are subject to deduction of tax under Section 194R?

  The Circular 18 (2022) does not provide clarity on write-off of loans or write-off of trade receivables as bad debts. However, the purpose of Section 194R is to tax benefit or perquisite arising in a transaction. Since, write-off does not intend to any benefit or perquisite to the other party, the exclusions provided under the circular ought to be extended in such cases. Further, writing of bad debts is preferred by the lender, then to settlement of dues as it retains the right to recover the debt in future.

- Whether waiver of interest charged on late payments from debtors, subsequently written-off, attracts provisions of Section 194R?

  The circulars do not clarify for waiver of interest charged on outstanding receivables pursuant to settlement or understanding with customer. One can argue that the said waiver of interest charged, which is subsequently written off, is not a benefit or perquisite and no tax should be deducted under Section 194R. However, this requires detailed clarification.

Some of the other issues are:

- Whether loan credit given to the credit card holders & interest receivable thereon is covered under section 194R, if such credit and interest thereon is settled with the recipient?

- The circular provides exclusions to specified persons only, however there is no clarity as to loan given by companies or other persons?

- There could be a situation of waiver or settlement of loan by holding company for loans given to their subsidiary. How should the same be dealt with?

- Whether inter-corporate deposits or loans waived or written-off are also covered under these exclusions?

  Where the circulars are not covering the situation, on standalone or on one-to-one basis, the questions will have to be answered on the merits of provisions of Section 194R of the Act.

  The circulars should have dealt with 'in principle' rather than carving out the exclusions which would have better addressed more questions or issues.

TDS ON REIMBURSEMENT:

Reimbursement, as we all know, means a case where the payer reimburses the recipient for expenditure incurred on behalf of the payer. Section 194R applies only when the benefit or perquisites is provided by the recipient under business or profession. In case of reimbursement, when exact amount of expenditure is paid back to recipient, there is no question of any benefit or perquisite provided by one person to another.

TDS should not be deducted on reimbursement as upheld in following decisions:

- ✓ Zephyr Biomedicals v JCIT [2020] 122 taxmann.com 124 (Bombay)
- ✓ PCIT y National Health & Education Society [2019] 103 taxmann.com 286 (Bombay)

FAQ 7 of Circular 12 (2022) and FAQ 2 of Circular 18 (2022), provides for test to be carried out as to whether the expenditure reimbursed is the liability of the person carrying on business or profession (i.e. service recipient) which is met by the other person (i.e. service provider).

For example: Customs duty, other import charges, etc. paid by C&F agent on behalf of his client who is an importer of goods. In this case, the expense is of service recipient and is paid by service provider in the course of disseminating his services and therefore, it does not amount to any benefit or perquisite.

Contrary to the above, one will have to keep in mind that, if the expense incurred, in any case, was expense of service provider (& not of service recipient) and the said expense is not a separate expense incurred during the course of service provided, then, in substance (irrespective of the terms agreed upon) such expense is liability of service provider and not of the service recipient and therefore the exclusion can be denied.

Now, the concept of 'pure agent' is introduced for the first time in TDS and thereby under the Income Tax Act and this may open up a different set of questions under different provisions of Income Tax, wherever the concept of 'Principal-Agent' is followed.

"*Pure agent*" *means a person who.*….(Similar to GST Law)

a) enters into a contractual agreement with the recipient of supply to act as his pure agent to incur expenditure or costs in the course of supply of goods or services or both;

b) neither intends to hold nor holds any title to the goods or services or both, so procured or provided as pure agent of the recipient of supply;

c) does not use for his own interest such goods or services so procured; and

d) receives only the actual amount incurred to procure such goods or services in addition to the amount received for supply he provides on his own account.

As per circular, to establish the status of pure agent, the supplier will have to satisfy the following additional conditions:

i) the supplier acts as a pure agent of the recipient of the supply, when he makes payment to the third party on authorization by such recipient; (Authorisation condition)

Here, Authorisation should be prior to expenditure incurred by the service provider.

In case of Leave and License agreement, where electricity, water, etc. is consumed by tenant but such expense of lessee (tenant) is paid by lessor, prior to authorisation obtained, then benefit of pure agent is not available. [Indiana Engineering Works (Bombay) (P.) Ltd.: AAR - Maharashtra]

ii) the payment made by the pure agent on behalf of the recipient of supply has been separately indicated in the invoice issued by the pure agent to the recipient of service; (Invoicing condition)

In case composite invoice is raised, 'reimbursement' should be separately specified and indicated in the same invoice.

iii) the supplies procured by the pure agent from the third party as a pure agent of the recipient of supply are in addition to the services he supplies on his own account. (Additional Supply condition)

It means that there has to be additional supply of goods or services by service provider for which he is to incur expense and later on to get it reimbursed. In case, if the service provider is liable to pay charges, which he was supposed to pay for providing his services, then that expense is of service provider & not of service recipient and therefore, such reimbursement of expense may face challenges and pure agent concept won't rescue from application of provisions of Section 194R.

If all the above conditions of pure agent are fulfilled, then the expense incurred by such an agent will be on behalf of principal and will not attract the provisions of Section 194R. However, in case of non-fulfilment of any one of the conditions stated herein above may attract the provisions of Section 194R and the provisions Section 201 (1) and Section 201 (1A) of the Act.

For example: A CA enters into an agreement with the client where it is agreed that out-of-pocket expense is to be borne by the client, over and above the amount payable as professional fees. Then such out-of-pocket expenses shall not be the basis to determine the status of pure agent, when no two separate sets of services are involved and such ancillary services are required by the CA to render his professional services. (The expense related to such ancillary services is supposed to be incurred by the professional in execution of his professional services). Therefore, by virtue of law, one cannot grant the other person the status of pure agent. So, one should not principally state the ancillary services for pure agent, just because reimbursement is stated.

- Whether non-compliance of procedural aspects or some conditions (say absence of contractual agreement) attract TDS under Section 194R?

  The Circular clarifies that it is must for an assessee to satisfy all the conditions to qualify as 'pure agent' and then only claim the benefit of circular. However, I believe that mere non-compliance of certain procedural aspects should not be harsh on the part of the assessee and deny him the benefit as provided in circular. This requires some clarification to avoid challenges in future.

  Following are the illustrations of person to be held as 'pure agent':

  - ✓ Customs broker paying port fees, port charges, custom duty, dock dues, transport charges etc. on behalf of owner of the goods.
  - ✓ C&F agent paying expenses such as freight, godown charges, etc. and later on reimbursed by principal.

  Following are the illustrations of person not to be held as 'pure agent':

  - ✓ Applicant is engaged in service of supply of labour and engages manpower & assumes responsibilities under various Acts. Applicant invoices for manpower supply cost on actual basis.
  - ✓ Applicant provides housekeeping services to hospitals. The hospitals pay service fees and reimburses supervisors salaries and wages on actual basis.

INTERPLAY BETWEEN SECTION 194R AND SECTION 194J/SECTION 194C:

As per question 30 of Circular No. 715 dated 8th August, 1995; it is clarified therein, that, whenever service provider raises a bill for their service fees along with reimbursement of out-of-pocket expenses, then TDS under Section 194J or under Section 194C (for services rendered by technical professionals) should be done on gross amount i-e. including reimbursement of expenses. This is for the reason that the applicability of TDS under these sections is based on the wordings used… 'any sum' payable to payee is subject to TDS.

Introduction of Section 194R requires TDS to be done on any benefit or perquisites `provided' to any resident during course of business or profession. However, FAQ 2 of Circular 18 (2022) clarifies that, in case of such reimbursement of expenses paid to 'pure agent' (as explained here in above), there is no need to deduct TDS on such reimbursement of expense payable to pure agent.

Circular 18 (2022) merely states that if tax is deducted on gross amount (i-e. even on reimbursement) under Section 194J or Section 194C, then no tax is required to be deducted under Section 194R. However, it does not give order of priority to apply Section 194J, Section 194C over Section 194R.

Therefore, issue arises that….

- Is it possible for payer to deduct TDS under Section 194R only on service fees and exclude out-of-pocket expenses claiming exclusions on the basis of pure agent rather than deducting TDS under Section 194J or Section 194C on gross amount?

  In my view, in the absence of clarification of order of priority to apply Section 194J / Section 194C over Section 194R, one can claim this benefit.

  Also, illustration given under Rule 33 of GST Valuation Rules, 2017 states as under….

  Corporate services firm A is engaged to handle the legal work pertaining to the incorporation of Company B. Other than its service fees, A also recovers from B, the registration fee and approval fee for the name of the company paid to the Registrar of Companies. The fees charged by the Registrar of Companies for the registration and approval of the name are compulsorily levied on B. A is merely acting as a pure agent in the payment of those fees. Therefore, A's recovery of such expenses is a disbursement and not part of the value of supply made by A to B.

  The example is in support of this argument and being part of the other legislation and therefore such a proposition cannot be denied.

  Another proposition could be that, when there are two components of service provided, viz:

  - Service fees charged for professional services rendered and
  - Reimbursement of expenses

  one can argue, that in case of reimbursement of expense there is no benefit or perquisite, under the bonafide belief that service provider is acting as pure agent, and therefore no TDS is applicable on such reimbursement under Section 194R, taking support of the clarifications provided under the circulars.

  At the same, TDS can be done on service fees for professional services rendered under Section 194J or Section 194C (for technical professionals), as the case may be. However, this requires clarification to avoid litigations in future.

DEALERS OR BUSINESS CONFERENCE:

As per FAQ 8 of Circular 12 (2022), the expenditure pertaining to dealer or business conference would not be considered as benefit or perquisite for the purposes of Section 194R, in a case where such conference is held with the prime object to educate such dealers or customers about the aspects specified therein.

FAQ 4 of Circular 18 (2022) further clarifies that, the expense on conference would not be considered as benefit or perquisites in following cases:

1) It is not necessary that all dealers are required to be invited in a dealer or business conference.
2) If the dealers arrive only one day before and leave immediately or one day after the end of dealer or business conference.
3) Dealers or business conference expense need to be classified among each participant using reasonable allocation key.

However, in case of group activities, there are multiple dealers & identifying such benefit or perquisite to actual recipient is practically difficult and reasonable allocation is not possible. In such a case, the circular clarifies that the benefit/perquisite provider may at his option not claim the expense to avoid disallowance.

However, taxpayer will always consider claiming the expense which would attract disallowance under Section 40(a)(ia) at 30% of expense unlike 100% disallowance under alternative provided in the circular. But, this may invoke provisions of Section 201(1) and Section 201(1A). However, Person claiming benefit of Section 10AA will still opt for the alternative provided by the circular, which is beneficial to him.

In-spite of the clarifications provided by the circular, following issues may still arise:

- Where it is difficult to match such benefit or perquisite to each participant using a reasonable allocation key driver, is wisdom of assessee in determination of difficulty, is subject to scrutiny?
- Does the circular mandate the assessee to document the difficulties it faced, in determination of reasonable allocation key, so as to justify option selected?
- Can assessee opt 'pick and choose option' for each of the conference out of the various conferences held during the period under consideration?

The issues require more clarifications, so as to avoid inquiries and challenges in future.

GIFT OF ASSET AND SECTION 194R:

FAQ 5 of Circular 18 (2022) clarifies that benefit or perquisites received, in the form of asset, shall be offered as an income, in the Return of Income of the recipient, then it would be treated as "actual cost" of the asset for the purposes of Section 32. Also, the assessee, on fulfilment of other conditions as applicable, can claim depreciation.

However, following practical difficulties still arise…..

- The recipient of gift would not have any documentary evidence to prove the actual cost of the asset except the income offered in his Return of Income.
- The valuation of asset will be a real challenge to the recipient and may attract litigation.
- In case when the asset is gifted and TDS is paid additionally by the donor of asset, then for the purpose of Section 194R, the value of benefit or perquisite needs to be grossed up. In this scenario, what would be the actual cost of the asset in the hands of the recipient?

EMBASSY/HIGH COMMISSIONS AND SECTION 194R:

FAQ 6 of Circular 18 (2022) clarifies that provisions of Section 194R would not apply on benefit or perquisites provided by Embassy or High Commissions, etc.

BONUS SHARES AND RIGHTS SHARES

FAQ 7 of Circular 18 (2022) clarifies that the tax under Section 194R is not required to be deducted on issuance of bonus or right shares by a company in which the public are substantially interested, as defined under Section 2(18) of the Act.

- Here, the primary question arises that whether issuance of bonus shares or rights shares are in the course of business or profession?

Some of the other issues are:

- Whether the benefit of exclusion from Section 194R is limited to company in which the public are substantially interested or applies to all the companies?
- Whether Section 194R applies to issue of shares on a preferential basis?
- Whether buy-back of shares at less than FMV attract provisions of Section 194R?

DIFFICULTIES IN CLAIMING TDS CREDIT AGAINST INCOME NOT CHARGEABLE TO TAX:

FAQ 1 of Circular 12 (2022) and Para 7 of Circular 18 (2022), has clarified that the deductor of tax is not required to analyse the taxability of the benefit or perquisite in the hands of the recipient while deducting tax under Section 194R. Accordingly, there may be a situation where taxes are deducted under Section 194R but the corresponding amount is not taxable in the hands of the recipient.

Section 199 read with Rule 37BA states that credit for taxes deducted at source shall be available to the assessee in respect of the assessment year for which such income is assessable. There has been no amendment in Rule 37BA, after the introduction of Section 194R as was done in case of Section 194N. This might lead to future litigations where the tax authorities might deny the TDS credit, where the corresponding income is not offered to tax. Proper guidelines should be provided to avoid any kind of hardships to the deductee in claiming credit of taxes deducted.

VALUATION OF BENEFIT OR PERQUISITE:

FAQ 5 of Circular 12 (2022) clarifies that the valuation of benefit or perquisite should be on Fair Market Value (FMV), except where the purchase price and price charged to its customers, if the benefit provider manufactures such item, is available.

However, further clarification is required on the following issues…

- Basis of the calculation of FMV under various scenarios.
- When manufacturer supplies goods to distributors as well as retailers at different prices, which price should be considered for Section 194R?
- In the case of services, one may face challenges to arrive at the FMV of services provided.

In the absence of any clarification, different approaches adopted by the taxpayer may lead to anomalies and litigations in future.

The above list of issues is not exhaustive or conclusive, there could be many more issues under Section 194R which requires early redressal by the legislature.

CONCLUSION:

The introduction of Section 194R has surely increased the compliance burden for the taxpayer. Further, even after issuance of circulars and guidelines by CBDT, there are various areas which are not yet settled, and more clarification is required on the same. Hence, the taxpayer will have to ensure due care in taking positions and complying with the provisions of Section 194R of the Act.

Disclaimer: The views presented herein are for better understanding the subject, person using the same is advised to confirm with their professional consultant and look into circulars, guidelines and judicial pronouncements before acting upon the same. The author does not carry any responsibility for the same.