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Rajput Jain & Associates

Chartered Accountant

Analysis of section 194R

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Analysis of Obligations to Deduct Tax at Source on Benefits or Perquisites under Section 194R & CBDT Circular No. 12/2022 dated 16.06.2022

Section 28 clause (iv) of Income Tax Act, 1961 provides for including value of any benefit or perquisite whether convertible into money or not, arising from the business or exercise of profession as income from business or profession. This clause was inserted to bring to tax any incidental benefit like gifts, pleasure trip, etc. in the course of business or profession. Considering the fact many of these are given in kind and remains unreported, the Finance Act, 2022 has inserted section 194R to put an obligation on every person responsible for providing to a resident any benefit or perquisite whether convertible into money or not, arising from business or the exercise of profession to deduct tax at source at the rate of 10% of the value of such benefit or perquisite. This amendment is effective from 1St July, 2022.

Now, in order to address some of the issues arising from this amendment, CBDT recently issued Guidelines on 16th June, 2022. Before analyzing these guidelines, it may first be relevant to briefly discuss the provision of this newly inserted section 194R.

Brief overview of provision of section 194R

Under this section 194R, any person responsible for providing any benefit or perquisite arising from business or exercise of profession to a resident is required to deduct tax at source at 10% before providing such benefit or perquisite. The obligation to deduct tax at source under this Section 194R is in case any 'benefit' or 'perquisite' arising from business or exercise of profession is provided to a resident. The term 'benefit' or 'perquisite' has a very wide connotation. Any concession given by any vendor or even by a customer may be termed as a benefit arising in the course of business. However, it may be relevant to highlight that carrying on business/profession by the resident recipient is a prerequisite in order to invoke section 194R. Thus, in case any benefit or perquisite is not arising in the course business or profession, there should be no obligation to deduct tax under the

newly inserted section 194R. Further, in case recipient is not carrying on business or profession, there should be no obligation to deduct tax under this section.

It may be noted that the obligation to deduct tax is not limited to benefits or perquisites in kind. The proviso to section 194R(1) expands the scope of section 194R and requires deduction of tax at source under section 194R even in respect of benefits or perquisites which are wholly in cash or partly in cash and partly in kind. The only condition is that such 'benefit' or 'perquisite' should arise from the business or exercise of profession by the recipient. Though the objective behind insertion of section 194R was, apparently, to subject only those payments to TDS which are taxable under section 28(iv) in the hands of resident recipient (which as per the dictum laid down by **Hon'ble Apex Court** in the case of ***Mahindra and Mahindra Ltd in Civil Appeal Nos. 6949-6950 of 2004*** covers only benefits in kind and not cash benefits), however, the way this section has been worded, it is applicable on all kinds of benefits, whether provided in cash or kind.

It may be noted that this newly inserted section 194R is applicable only in respect of benefit/perquisite provided to a resident. Thus, this section is not applicable in respect of any benefit or perquisite provided to a non-resident. This doesn't mean that there is no TDS obligation in respect of benefit or perquisites provided to a Non-Resident. The obligation to deduct tax in respect of non-resident is already covered under the provisions of section 195, wherein TDS is deductible if the income is chargeable to tax in the hands of non-resident in India. Further, under section 195, TDS is to be deducted at the rates in force which are mentioned in the Finance Act or the rates provided in DTAAs, whichever is more beneficial to the assessee. However, in case benefits/perquisites are paid to a resident, the newly inserted section 194R shall be applicable which provides that TDS shall be deducted @ 10%.

As regards the category of 'payers' who are required to deduct TDS under section 194R of the Act, it is to be noted that any 'person' responsible for providing any benefit or perquisite as aforesaid is required to deduct TDS under section 194R of the Act. Thus, the provision is applicable on all kind or payers such as individuals, Firm, HUF, Company,

Firm, LLP, etc. However, in view of the exception carved out under the third proviso to section 194R, an individual or HUF whose total sales, gross receipts or turnover does not exceed Rs. 1 crore in case of business and Rs 50 lakhs in case of profession in the preceding financial year shall not be required to deduct TDS under section 194R of the Act. Thus, in case the person providing benefits/perquisites is an individual/HUF, then they will not be covered under the provisions of section 194R if:

- They did not carry any business/profession in the preceding financial year, or
- They carried business/profession in the preceding financial year, but the turnover from such business or gross receipts from profession was less than Rs. 1 crores/50 lakhs respectively.

However, in case the person providing the benefit/perquisite is any other entity such as a partnership firm, LLP, Company, Society, AOP, etc, then these will be covered under the provisions of section 194R, irrespective of whether these entities carried on any business/profession in the preceding financial year or not. The only requirement is that these entities should provide any benefit/perquisite to a resident, and such benefit/perquisite should arise in the hands of a recipient in the course of business/profession of such recipient and such recipient is a resident.

Further, it may be noted that a blanket threshold exemption limit of Rs. 20,000/- per financial year has been provided under section 194R i.e. in case the aggregate value of benefit or perquisite provided during the financial year does not exceed Rs. 20,000, then there shall be no requirement to deduct TDS under section 194R of the Act.

CBDT Circular No. 12/2022 - Guidelines for removal of difficulties

CBDT vide Circular No. 12/2022 dated 16.06.2022 has issued guidelines to remove difficulties arising in giving effect to provision of section 194R. While the guidelines have been issues for removal of difficulties, however, it appears that the Circular in some cases is, apparently, expanding the scope of the provision itself. The clarifications issued by the Board are as under:

- **Cash Benefits also to be subject to TDS under section 194R**

  It has been clarified that benefit must not be in kind only in order for provision of section 194R to be applicable. TDS under section 194R shall be applicable even where the benefit is in cash or partly in cash and partly in kind.

- **Declaration and advance tax challan to be obtained to ensure that recipient has paid tax in respect of benefit**

  In case benefit/perquisite is in kind or partly in cash and partly in kind and cash component is not sufficient to cover the TDS obligation, it has been clarified that the deductor must take sufficient steps to ensure that tax has been deducted and paid by the recipient before releasing the benefits/perquisites to resident recipient. In such cases, it has been clarified that the deductor may rely on a declaration along with advance tax payment challan provided by the recipient confirming that tax required to be deducted on such benefits/perquisites has been deposited. It has been clarified that the challan number shall also be required to be reported in Form 26Q (TDS Return).

- **Grossing up principle to apply where TDS borne by deductor**

  In case benefit/perquisite is in kind or partly in cash and partly in kind and cash component is not sufficient to cover the TDS obligation, for removal of difficulty, it has been clarified that the deductor, in alternate to the above option (where he obtains declaration and advance tax challan from the recipient), may himself deposit tax under section 194R of the Act. If tax is so borne and deposited by the deductor, then the deductor shall not only deposit tax in respect of such perquisite or benefit but shall also be required to deposit tax in respect of the TDS by considering the same as a benefit or perquisite i.e. the principle of grossing up enshrined under section 195A shall be followed.

- **No requirement to check whether benefit chargeable to tax in the hands of the recipient**

It has been clarified that the deductor is not required to check whether benefits/perquisites are taxable in the hands of resident recipient and/or under which provisions of the Act the same is taxable. This is because unlike section 195, section 194R of the Act does not require that TDS shall only be deductible when benefits/perquisites are chargeable to tax under the Act.

- **No requirement to check whether benefit is a capital receipt or revenue receipt**

  It has been further clarified that the deductor is also not required to verify whether benefits/ perquisites constitute capital receipt or revenue receipt in the hands of recipient. Thus, regardless of the nature of receipt in the hands of the recipient, TDS shall be required to be deducted in respect of benefit or perquisite under section 194R.

- **Cash discount/sales discount/rebates**

  For removal of difficulties, it has been clarified that where cash discount/sales discount, rebate, etc. is given by a seller to a purchaser, then there shall be no requirement to deduct TDS under section 194R on such cash discount/sales discounts/rebate. Thus, in case the seller sells 100 pieces of toys of Rs. 50 each at discounted value of Rs. 45 per piece, Rs. 5 per piece shall not be considered as a benefit/perquisite and no TDS shall be required to be deducted under section 194R.

- **Quantity discount vs Free sample**

  By way of an illustration, it has been clarified that quantity discount will also be outside the scope of section 194R. For 'quantity discount', let's suppose that a seller is selling 100 items and giving 5 items free along with them to the customer. So, the buyer is actually purchasing 105 items at a price of 100. In this situation, it has been clarified that if the invoice mentions the 100 items as well as the 5 items as a part of scheme, then no TDS is required to be deducted.

  However, the Circular clarifies that situation will be different when 'free samples' are given and that TDS shall be required to be deducted under section 194R in case of

free samples. Thus, in case the 5 items are given as 'free samples' in the above example, then as per the above Circular, TDS shall be required to be deducted. Accordingly, moving forward, it will be advisable that free samples are not given independently and are rather made a part of the invoicing itself.

Separately, it has been clarified that all other sorts of benefits/ perquisites like free ticket, sponsorships, free medical samples to medical practitioners, incentives in the form of cash/kind like car, TV, computers, gold coin, mobile phones, etc. will be subject to TDS.

- **Use of benefit by owner/director/employee of recipient entity**

  It has been clarified that in case benefit or perquisite is used by the owner/director/employee of the recipient entity or their relatives, tax shall be required to be deducted under section 194R even if such owner/director/employee/relative in their individual capacity may not be carrying on business or exercising a profession. In such cases, it has been clarified that the TDS shall be deducted in the name of recipient entity since the usage by owner/director/employee/relative is by virtue of their relationship with the recipient entity.

  By way of an illustration, it has been clarified that in case benefit is provided to an employee of the recipient entity, say a doctor who is an employee in the hospital, then TDS shall first be deducted under section 194R in the name of the recipient entity i.e. the hospital and this benefit shall be treated as income of the hospital. The hospital may subsequently treat this benefit as perquisite given to an employee under section 17 and deduct TDS under section 192 in the name of the employee. In such a case, the benefit will first be chargeable to tax in the hands of the hospital and subsequently be allowed as deduction as salary expenditure to the hospital. This way, the benefit would ultimately get taxed in the hands of the employee and not in the hands of the hospital.

It has been clarified that above said treatment may also be followed in case benefit is provided to a doctor who is working as a consultant in the hospital (as against an employee) wherein TDS under section 194R may first be deducted by the person giving gift in the name of the hospital and subsequently, hospital may again deduct TDS under section 194R in the name of the consultant for providing the same benefit to the consultant doctor. In order to remove difficulty in such cases (consultant relationship), it has been clarified that original benefit or perquisite provider may directly deduct tax under section 194R in the case of consultant as a recipient.

- **TDS under section 194R not applicable where recipient is Government**

  It has been clarified that the provisions of section 194R shall not apply to benefits/perquisites provided to Government entity not carrying on business/profession (for ex: Government Hospital).

- **Valuation of benefit and perquisite at Fair Market Value**

  It has been clarified that the benefits/perquisites will have to be valued at 'fair market value'. However, 2 exceptions to the said Rule has been specified in the Circular as under:

  - In case the provider purchases them before giving it to the recipient, the benefits/perquisites shall be valued at 'purchase price'.
  - In case the provider self manufactures them, the benefits/perquisites shall be valued at the price charged from other customers for such items.

- **GST not to be included in valuation of benefit**

  It has been clarified that GST, if any, shall not be included for the purposes of valuation of benefits/perquisites.

- **Products used by social media influencers**

  It has been clarified that products used by social media influencers to make their audios/videos will be subject to the provisions of section 194R, only if such products are retained by the person after its use for providing the service. However, in case

the product is returned to the provider manufacturing company after using the same for the purpose of rendering service, then it will not be treated as a benefit/perquisite and tax shall not be required to be deducted under section 194R.

- **Reimbursements to be treated as benefit**

  Reimbursement of out of pocket expenses incurred by the service provider in the course of rendering services is a common transaction. For instance, a lawyer based out of Delhi in order to provide services to its client may have to travel to Bangalore. The expenses incurred on travel and hotel stay are ordinarily reimbursed by the client as out of pocket expenses. In this context, CBDT has clarified that reimbursement of expenses in such cases shall also be considered as a benefit/perquisite for the purpose of section 194R. However, it has been clarified that reimbursement in such cases shall not be considered as a benefit/ perquisite if the invoice for such expenses to be reimbursed is in the name of the person reimbursing such expense (i.e. the client in the given case).

  Thus, in case the invoice is not in the name of the person reimbursing such expenses (i.e. client) but in the name of the service provider (lawyer in the present case), then such reimbursements shall be treated as benefit/perquisite and TDS shall be required to be deducted under section 194R of the Act. In such cases, the benefit shall be considered as income of the service provider (lawyer) and the service provider shall be entitled to deduction of expenses paid for which reimbursement was sought (travel and hotel stay in the given example).

  The above clarification apparently seeks to expand the scope of section 194R. When a service recipient is reimbursing the service provider for expenses incurred in the course of providing the services, it is not clear as to how such reimbursement can be considered as a 'benefit' or 'perquisite' for the service provider. Be that as it may, it may be relevant to point out that way back in 1995, CBDT had issued Circular No. 715 dated 08.08.1995 to provide clarification on TDS provisions. Vide FAQ No. 30, CBDT considered the issue as to whether the deduction of tax at source under section

194C and 194J has to be made out of gross amount of the bill including the reimbursement or excluding reimbursement for actual expenses. In this regard, CBDT clarified that TDS has to be deducted on gross amount of bill including the reimbursement. Relevant extract is as under:

> ***Question 30*** *: Whether the deduction of tax at source under section 194C and 194J has to be made out of the gross amount of the bill including reimbursements or excluding reimbursement for actual expenses ?*
>
> ***Answer :*** *Sections 194C and 194J refer to any sum paid. Obviously, reimbursements cannot be deducted out of the bill amount for the purpose of tax deduction at source.*

Going forward, in case the main invoice issued by the hotel, airlines, etc is not in the name of the client but in the name of the service provider, while reimbursing such expenses, an issue may arise as to whether one should follow the earlier Circular No. 715/1995 and accordingly deduct TDS with reference to the provision under which main service is subjected to tax (say 194C, 194J, other provision where term used is 'any sum') or to follow present Circular No. 12/2022 and deduct TDS under section 194R. Since the rate of TDS prescribed under section 194R is higher (10%), it may be advisable to deduct TDS under section 194R to safeguard oneself from litigation.

- **TDS obligation in respect of dealer conferences**

Dealer/business conferences is a common trend in the industry. For instance, a car manufacturer may host conferences for its dealers from time to time. In such a case, an issue may arise as to whether such conferences shall be considered as benefit/perquisite for the purpose of section 194R.

CBDT has been clarified that expenditure pertaining to dealer/business conference would not be considered as benefit/perquisite in a case where dealer/business conference is held with the prime object to educate dealers/customers about any of the following or similar aspects:

(i) new product being launched

(ii) discussion as to how the product is better than others

(iii) obtaining orders from dealers/customers

(iv) teaching sales techniques to dealers/customers

(v) addressing queries of the dealers/customers

(vi) reconciliation of accounts with dealers/customers

It may be noted that the above list is not an exhaustive list and ordinary dealer conferences to educate dealers regarding topics similar to the ones stated above shall not be considered as benefit/perquisite.

Incentives for specific dealers – to be treated as benefit

It has been clarified that in case dealer conference is the nature of incentives/benefits to select dealers/customers who have achieved particular targets, then the same shall be treated as a benefit/perquisite. Thus, in case the objective of dealer conference is not to educate dealers in general but to only give benefit to only few specified dealers (say as a reward) who have achieved particular targets, then the same shall be considered as a benefit and TDS shall be required to be deducted under section 194R of the Act.

Instances relating to Dealer conferences which shall be considered as 'benefit'

Additionally, it has been clarified in the Circular that the following specific cases will be considered as benefit/perquisite for the purpose of section 194R of the Act:

(i) **Leisure component -** Expense attributable to leisure trip or leisure component, even if it is incidental to the dealer/business conference.

(ii) **Accompanying Family member:** Expenditure incurred for family members accompanying the person attending dealer/business conference.

(iii) **Stay prior or after dealer conference -** Expenditure on participants of dealer/business conference for days which are on account of prior stay or overstay beyond the dates of such conference

The stand of the Department that stay of family members and the say period prior to/after the dealer conference should be considered as benefit may be understandable. However the circular envisages that the expense attributable to leisure trip or leisure component, even if it is incidental to the dealer/business conference, shall still be considered as benefit or perquisite. This clarification may lead to litigation.

Say a Corporate organizes a dealer conference in Goa for 3 days wherein the hotel stay and all meals are paid for. The dealer conference normally takes place during the day time from 10 AM to 5 PM. In such a case, Revenue may argue that expense attributable to the hotel stay and night meals shall be considered as leisure component and should be considered as a benefit. Taxpayer on the contrary may argue that the same should not be seen as a benefit as it is a normal practice that hotel stay and meals are covered during 3 day period during which dealer conference takes place. This clarification thus may lead to litigation between the taxpayer and the Department. Taxpayers will now be required to be identify as to whether there is any 'leisure component' in the dealer conference and expenses attributable to the same shall be required to be considered as perquisite.

- **20,000 threshold to be computed with reference to benefit provided during entire FY 22-23**

It has been clarified that section 194R is applicable from 01.07.2022 and tax shall be required to be deducted only in respect of benefits provided on or after 01.07.2022. No Tax shall be required to be deducted for benefits provided prior to 01.07.2022. However, it has been clarified that for the purpose of checking limit of Rs.20,000/- in FY 2022-23, it has been clarified that the entire financial year beginning from 01.04.2022 shall be considered.

Thus, in case benefit of say Rs. 50,000 has already been provided to a particular person during April-June 2022, subsequently, in case a benefit of Rs. 10,000 is provided to such person in July/August, 2022, TDS shall be required to be deducted under section 194R in respect of Rs. 10,000 notwithstanding that the quantum is less than Rs. 20,000.

Contact Us

P – 6/90 , Connaught Place,
New Delhi –110001 , India

Phone No. - 9555555480
E-mail – singh@carajput.com
Website – www.carajput.com