Norms for TDS on business perquisites/benefits- A mix of clarity, uncertainty

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This year's Union budget proposed a new TDS, or tax deducted at source, obligation through section 194R of the Income-tax (I-T) Act 1961, with effect from 1 July. This section requires deducting tax at 10% at the source by any person responsible for providing any benefit/perquisite to a resident arising from a business or profession carried out by such resident, subject to certain conditions. The Central Board of Direct Taxes (CBDT) recently issued guidelines aiming to clear doubts regarding the implementation of Section 194R but it has raised other questions.

Based on the explanatory memorandum accompanying the Finance Bill, 2022, and the similarity of the language with that of Section 28(iv), it was expected that section 194R would apply only to benefits/perquisites which are taxable in the hands of the recipient under section 28(iv) as business income. However, the CBDT's view in the guidelines is that the provider of the benefit/perquisite ('the provider' in this case) need not verify such taxability. While this would relieve uncertainty for the provider in determining the applicability of section 28(iv), the recipient of the benefit/perquisite ('the recipient') is likely to be selected for scrutiny upon the claim of non-taxability in the tax return. The tax authorities may also question the claim of TDS credit in absence of corresponding income being offered to tax.

In the case of Mahindra & Mahindra Ltd (404 ITR 1), the Supreme Court held that monetary benefits are not covered by section 28(iv). Unlike section 28(iv), the proviso to Section 194R contemplates a situation wherein the benefit/perquisite is partly/fully in kind. The CBDT's view is that the proviso indicates legislative intent to cover monetary benefits and that accordingly Section 194R applies even where the benefit/perquisite is partly or wholly in cash. This may lead to various difficulties.

For instance, upon waiver of a trade debt (due to insolvency, etc), the creditor may not only lose the sum he was to receive but the tax authorities may also contend that he is required to pay TDS after grossing up. Further, other TDS provisions could apply to monetary benefits and hence there could be situations of overlap. While the CBDT had clarified vide Circular No. 720, dated 30 August 1995, that withholding provisions are mutually exclusive, questions may arise as to which should prevail between section 194R and other provisions.

The guidelines mention that for section 194R, the value of benefits/perquisites should be based on fair market value (FMV), subject to exceptions. One exception is where the provider has 'purchased' the benefit/perquisite before providing it. While the guidelines mention that the 'purchase' price should be taken in such a case, this may be reasonably construed as extending to availing of facilities/services as well. The term fair market value has not been defined in the guidelines. As per section 2(22B) of the Act, it is defined generally to mean the price a capital asset would fetch in the open market or where not ascertainable, the price as per rules. No such rules have been prescribed till date.

For reimbursement of out-of-pocket expenses incurred by a service provider, the guidelines state that TDS will apply if the invoice for the expense is in the name of the service provider. This will result in implementation challenges for the service provider who would need to procure invoices in the name of the service recipient to ensure no TDS.

A mechanism has been laid out for cases where benefits/perquisites are provided in kind. The guidelines permit the provider to rely upon a declaration and proof received from the recipient that tax on such benefit/perquisite has been deposited as advance tax. Alternatively, the provider may deduct tax after considering the TDS too as a benefit. subject to section 194R. This would likely require a grossing up of the TDS borne by the provider. Alternatively, while the guidelines are silent on this aspect, the provider could explore collecting such tax from the recipient if the latter agrees to bear the tax.

The guidelines bring in a mix of welcome clarifications and new areas of debate. We hope that CBDT addresses the areas wherein the guidelines seem to be contrary to the intention of introducing Section 194R and that a recipient is provided the statutory ability to seek a nil/lower withholding certificate even in respect of this new provision. Accordingly, a deferral of the effective date for applicability of section 194R till at least 1 October would be helpful.

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