



## **Minutes of discussion on challenges emerging from implementation of Section 194R with Kamlesh Varshney on 28 July 2022**

The US-India Strategic Partnership Forum (USIPF) in collaboration with KPMG in India organized an industry consultation with Mr. Kamlesh Varshney, Joint Secretary, Tax Policy and Legislation, Ministry of Finance on 28 July 2022. The session was focused on the challenges emerging from implementation of the new Tax Deduction at Source (TDS) provisions under Section 194R introduced by the Finance Act, 2022.

KPMG and the industry participants appreciated the issue of Circular No. 12 of 2022 (Circular) by the Central Board of Direct Taxes (CBDT) providing guidance on various issues. However, it was highlighted that various practical challenges still remain, and Mr. Varshney shared his insights and views on the highlighted issues.

Key takeaways from the discussion are summarized as under:

### **Scope of Section 194R**

#### **KPMG/ Industry view**

- The Memorandum to the Finance Bill 2022 mentions the reason for introduction of 194R as a means to curb underreporting of benefits and perquisites taxable under section 28(iv) by the recipients of such incomes.
- Circular mentions that, in order to apply TDS, the deductor is not required to check taxability of income under 28(iv) in the hands of the recipient. If a benefit exceeding the prescribed threshold is provided to an Indian resident during the course of business or profession, then the provider of benefit is required to apply TDS. Further, it is not



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necessary that the benefit shall be taxable under section 28(iv), as it could be taxable under other sections, including 41(1).

- Considering the language in the memorandum, 194R was intended to apply only to benefits or perquisites taxable u/s 28(iv) and that the circular, in effect, expanded the scope of 194R beyond what was envisaged by the statute. Further, applying TDS on income not taxable in the hands of recipient would create difficult business situations and possible frictions between business partners. Therefore, the scope of 194R TDS provisions should be restricted to benefits taxable u/s 28(iv) in the hands of the recipient.

***Mr. Varshney's comments***

- As per the Memorandum, underreporting of income taxable u/s 28(iv) is one of the reasons for the introduction of Section 194R and not the only reason. Therefore, the benefits made subject to TDS u/s 194R could be taxable under any provision as business income, including Section 41(1) and other clauses of Section 28, and are not restricted to Section 28(iv).
- While the provider of benefit claims expense deduction (e.g. marketing promotion expenses), the corresponding income is not offered to tax by the recipient resulting in income escaping taxation. 194R provisions have been introduced only to identify similar areas of tax evasion and boost the Government's revenue.
- CBDT is open to issuing more circulars to provide necessary clarifications to remove difficulties.



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- Restricting applicability of TDS u/s 194R to benefits taxable u/s 28(iv) can be done only through legislative amendments, which may be taken up as a part of budget recommendations with the Finance Ministry.

**Business Promotion Activities**

**KPMG/ Industry view**

- As a part of business promotion expenditure, various assets and promotional items are provided free of cost by manufacturers to their channel partners. Such assets and promotional items, branded as per sales strategy of the manufacturer, are provided solely for the benefit of the business of the manufacturer.
- In certain cases, the Company may give free of cost products to its customers purely as a means to demonstrate the use of product to the customer and to induce purchase by the customer.
- There may be cases where pharmaceutical companies give free samples directly to patients under Patient Assistance Programs, based on recommendations received.
- In the above cases, as no benefit accrues to the recipient, 194R TDS provisions shall not apply.
- There could be cases where employees of a contractor (service provider) providing services to a Company may be provided free meals/ transport services by the Company (service recipient). Would such provisions of free meals/ transport services qualify as benefit provided to the contractor?



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***Mr. Varshney's comments***

- “Ownership” is the key factor in determining applicability of TDS u/s 194R. If the manufacturer transfers the ownership of assets and promotional items to the channel partners, then they are free to use the assets based on their discretion. In such a case, the provision of asset free of cost would constitute a benefit chargeable to TDS u/s 19R.
- Alternatively, if the manufacturer retains ownership of the assets and the channel partner is obliged to return the assets after their use, then no benefit is provided to the channel partner and TDS liability u/s 194R shall not arise.
- With regard to provision of free of cost goods for demonstrating use to product, to induce purchase, this can be considered by the CBDT for exclusion from TDS requirement.
- With regard to free medical samples given directly to patients, the primary test of TDS of provision of benefit in the course of carrying out business or profession by the recipient would need to be satisfied. Therefore, it would be required to be seen if the patient is receiving benefit in the course of carrying out business or profession. Having said this, the rationale of the pharma company giving free medical samples without any consideration to patients would need to be analysed in order to determine deductibility of the expenditure in the hands of the pharmaceutical company.
- With regard to provision of free meals/ transport services to contractors, the Circular is very clear. In case of expense incurred by the service provider on behalf of the service recipient, if the invoice is in the name of the service recipient, then it should not qualify as a benefit, and shall not be subject to TDS.



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**Business conferences/ trips/ seminars**

**KPMG/ Industry view**

- Various business conferences are organized for channel partners, where the primary purpose of the trip is furtherance of the organizer's business and not to provide any leisure to the participants. Some leisure elements may be included in the trip, which is purely incidental and solely in line with customary business requirements (local sightseeing, gala dinner etc.).
- Therefore, business only trips, where leisure element is incidental, should be excluded from TDS applicability.
- As per the Circular, any expenditure on days prior to and after the conference shall be considered as benefit and shall be subject to TDS u/s 194R. However, there could be genuine business needs for travel dates before or after the actual conference dates. Therefore, suitable clarification may be issued such genuine cases from TDS applicability.

***Mr. Varshney's comments***

- Travel/ food and stay expenses incurred for organizing business conference/ seminars shall not constitute benefit and shall not be subjected to TDS.



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- There will not be any blanket exclusion from TDS for any planned outstation activity. In case there is a leisure element, the same shall constitute benefit and be subject to TDS u/s 194R.

**Post-sale cash/ quantity discounts**

**KPMG/ Industry view**

- Discounts are extended by manufacturer to channel partners in the form of credit notes and free of cost goods. As quantification of these discounts is done after the sale, the same are not given on-invoice. There is ambiguity regarding whether these post-sales discounts are covered under the exclusion provided in the Circular.
- There could be cases where a manufacturer deals in multiple products (say A and B) and the initial sale is of a particular product (say A), whereas the free of cost goods are of a different product (say B). Whether such a case would also constitute quantity discount and be covered under exclusion from TDS?
- In certain cases, manufacturers provide end-of life products to customers for free. Whether this shall constitute benefit and be subject to TDS?
- Sometimes sellers provide extend credit period to certain buyers (e.g. 60 days instead of 30 days to others). Whether this shall constitute benefit?

***Mr. Varshney's comments***



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- Any discount associated with volume/ quantity of purchase or early payment shall be eligible for exclusions under the Circular and shall not be subject to TDS. Mere fact that discount is post-sale, will not make a difference.
- In case free of cost goods of a different kind than goods under original sale are given as a discount, prima-facie they should be covered under exclusion under the Circular and exempt from TDS. The Board can consider this and issue necessary clarification in due course.
- For end-of life products, providing them free of cost shall constitute a benefit and shall be subject to TDS. This is primarily on account of the fact that the commercial value/ market value of an end-of life product of generally does not become nil. However, in case a company decides to sell it at a reduced price, then it is the commercial decision of the company and shall not be considered as a benefit.
- Providing extended credit period to certain buyers for commercial reasons shall not constitute benefit and shall not be subject to TDS u/s 194R.

**Loan waivers under One Time Settlement Schemes (OTSS)**

**KPMG/ Industry view**



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- Banks are required to undertake haircut on bad loans which includes accrued interest and transaction charges as well. This does not constitute benefit in light of Supreme Court ruling in Mahindra and Mahindra, where it has been held that cash benefits are not taxable u/s 28(iv). Further, applying TDS on such loan write off would add to the existing loss of banks. Therefore, loan write offs shall not constitute benefit and shall not be subject to TDS.
- Similar principles shall also apply to write off of bad debts in the books of accounts by a creditor.

***Mr. Varshney's comments***

- Firstly, Supreme Court ruling in Mahindra was rendered on specific facts and is applicable only in cases with similar facts.
- With regard to loan waivers under OTSS, the CBDT is actively considering the matter and shall issue a clarification in due course.
- Unilateral write off of bad debts in the books of accounts of the creditor, without any relinquishment of the right to recover the debt, is not comparable with loan waiver under OTSS. Taxpayers may evaluate whether such unilateral write off constitutes benefit and take positions accordingly.

**Covering Section 194R as eligible for lower TDS application u/s 197**

**KPMG/ Industry view**





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- Various sections have been mentioned u/s 197 which are eligible for lower TDS application. Presently, Section 194R is not included. Applying 10% TDS on gross basis would result in working capital blockage, as this may be higher than profit margins in typical manufacturing/ trading businesses.

***Mr. Varshney's comments***

- This would require legislative amendments and may be taken up as a part of budget recommendations with the Finance Ministry.

**Timing of TDS u/s 194R**

**KPMG/ Industry view**

- There is ambiguity on the timing of 194R TDS – at the time of debiting the expense in profit and loss account by the provider or release of benefit to the recipient or availment of benefit by the recipient.

***Mr. Varshney's comments***

- The point of applying TDS is before release of benefit by the provider to the recipient.

**Overlap of TDS provisions**

**KPMG/ Industry view**



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- Benefits/ perquisites may already be subjected to TDS under other sections. E.g., reimbursement of out-of-pocket expenses (OPEs) of consultant are already subject to TDS u/s 194J. This would result in applying TDS on the same amount twice in the name of the same person.
- There could also be cases where TDS could apply on the same amount in the name of different persons. E.g., on purchase of foreign trips exceeding Rs. 7 lacs – TCS u/s 206C(1G) would apply in the name of the tour package seller, whereas when these trips are given to channel partners - TDS u/s 194R would in the name of recipients.

***Mr. Varshney's comments***

- In case TDS on OPEs expenses has already been applied u/s 194J, such OPEs shall not be again subject to TDS u/s 194R.
- With regard to the second case of double TDS on tour packages, the Board can consider such cases for clarification in due course.



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**Depreciation on assets taxed as income u/s 28(iv)**

**KPMG/ Industry view**

- In case a taxpayer has paid tax on asset received as a benefit u/s 28(iv), there is no specific provision allowing such taxpayer to capitalize the asset under block of assets and claim tax depreciation on the same. As taxpayer has paid tax on the entire asset value, depreciation should be granted on such asset.

***Mr. Varshney's comments***

- This would require legislative amendments and may be taken up as a part of budget recommendations with the Finance Ministry.

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