

CBDT Circular II on section 194R

- A perspective

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Background

- Section 194R was introduced by Finance Act 2022 which was perceived as corollary to section 28(iv)
- Guidelines in the form of Circular No 12 of 2022 (Circular I) was issued to remove difficulty
- Industry perceived Circular I as regressive and subject to judicial challenge of being read down by Court
- Pursuant to representations, additional guidelines in the form of Circular 18 of 2022 (Circular II) were issued
- Guidelines issued under section 194R(2) are binding on tax authorities and person providing benefit or perquisite [section 194R(3)]

Loan waiver [Qs 1]

First Principles

- Section 194R reads – ‘any person responsible for **providing** to a resident, any benefit of perquisite’. It may be possible to contend that waiver or settlement is a forced act and cannot be said that the deductor voluntarily provided benefit
- As per SC in case of CIT v Mahindra & Mahindra Ltd. [2018] 404 ITR 1 (SC)], there is no benefit or perquisite which arises from business or profession in hands of recipient
- Assuming section 194R is applicable, since amount is not taxable in hands of recipient, it may be possible to content that section 201 and section 201(1A) should not apply

Example of loan waiver in FAQ 3 of Circular I created doubt as to whether section 194R applies to loan waiver

Qs 1 of Circular II

Question 1: If loan settlement/waiver by a bank is to be treated as benefit/perquisite, it would lead to hardship as the bank would need to incur the additional cost of tax deduction in addition to the haircut that he has taken. Will section 194R of the Act apply in such a situation ?

- It is true that waiver or settlement of loan by the bank may be an income to the person who had taken the loan. **It is also true that subjecting such a transaction to tax deduction under section 194R of the Act would put extra cost on such bank, as this would require payment of tax by the deductor in addition to him taking a haircut already.** Hence, to remove difficulty, it is clarified that one-time loan settlement with borrowers or waiver of loan granted on reaching settlement with the borrowers by the following would not be subjected to tax deduction at source under section 194R of the Act

Analysis of Qs 1

- Circular safeguards following
 - One-time loan settlement with borrowers;
 - Waiver of loan granted on reaching settlement with the borrowers;
 - Lender should be the one listed in the circular
- Importantly, Circular recognizes subjecting such a transaction to tax deduction under section 194R would put an extra cost on the such bank as this would require payment of tax by the deductor in addition to him taking haircut already
- However, Circular does not state that, in such instance, no benefit or perquisite is provided to recipient leaving question open for other situations not covered in the Circular

Ambiguities in FAQ 1

- Waiver or settlement of interest : Circular makes reference to loan and does not refer interest. It can be contended that unpaid interest is also a debt accrued and thus loan and hence should fall within the Circular
- Question states ‘loan settlement / waiver by the bank’ without qualification. Answer states “one-time settlement with borrower or waiver of loan granted on reaching a settlement”. This raises the issue as to whether the circular applies if the specified institutions writes off 100% of the amount in absence of any settlement
- Whether an accounting write off [which does not involve settlement] falls within section 194R. Technically, lender keeps his right to recover intact and accordingly there is no benefit or perquisite provided

Ambiguities in FAQ 1

- Whether restructuring of a loan by way of say extension of the repayment period, conversion of loan into equity at concessional rate, modification of terms of payment (say repayment schedule, moratorium, interest rate reduction etc) will attract section 194R?
- Assignment of the loan at less than FMV or realizable value – Example deals with waiver or settlement by Borrower. This situation does not fall within Circular. However, it can be argued that transaction at less than FMV does not attract section 194R. Benefit or perquisite is realised by recipient only at the time of realisation of loan which seller may not be aware
- Buyback of debenture at discount– It is held that gain is not taxable in hands of recipient [DCIT v Pidilite Industries Ltd [2019] 107 taxmann.com 91 (Mumbai - Trib.)]

Ambiguities in FAQ 1

- Waiver of Guarantees given by promoter or group companies pursuant to loan waiver or one time settlement of loan by financial institutions specified in Circular – if section 194R applies, how to value perquisite or benefit?
- Bad debt write off in entirety or partially or waiver of interest on outstanding receivable pursuant to settlement or understanding with customer
- Waiver or reduction in processing fees, interest on the credit card or other charges levied by Banks/Financial institutions pursuant to settlement or otherwise on account of commercial expediency
- Loan waiver/one-time settlement on account by parties other than specified in Circular II [e.g. loan between parent and subsidiary, Waiver or settlement of Intercompany Company Deposit [ICD] between group companies, NBFC not listed in specified institutions]

Ambiguities in FAQ 1

- Haircut by operational creditors in IBC settlement – FAQ 1 is restricted only to a waiver of loan and that too by specified financial institutions.
 - Financial Creditor can avail the benefit of Circular II – whether unjust discrimination?

TDS on reimbursement [Qs 2]

First Principles

- Section 194R applies only when benefit or perquisite is provided to the recipient in the exercise of business or profession
- Reimbursement involves a case where the payer reimburses the recipient of expenses incurred on behalf of payer
- Reimbursement should not trigger section 194R as there is no benefit or perquisite provided by one person to another
- TDS should not be deducted on reimbursement is upheld in following decisions
 - Zephyr Biomedicals v JCIT [2020] 122 taxmann.com 124 (Bombay)
 - PCIT v National Health & Education Society [2019] 103 taxmann.com 286 (Bombay)

Question 2 of Circular II

Question 2: If under the terms of the agreement, the expense incurred by the service provider is the cost of service recipient and such cost is reimbursed by the service recipient to service provider, how is it benefit/perquisite if the bill is not in the name of service recipient??

- In answer to question No 7 of the Circular No 12 of 2022, it has been clarified that any expenditure **which is the liability of a person carrying out business or profession, if met by the other person** is in effect benefit/perquisite provided by the second person to the first person in the course of business/profession.
- Now, if service provider incurs some expense **in the course of rendering service to service recipient** and the bill is in the name of service provider, then in substance (irrespective of the terms of the agreement) this expense is the liability of the service provider and not of service recipient.

Question 2 of Circular II

Pure Agent under GST Valuation Rule 2017

- 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.

Question 2 of Circular II

Additional conditions to be satisfied by pure agent

- a) 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;
- b) 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; and
- c) 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

TDS on reimbursement

- Obligation to deduct TDS is linked with concept of pure agent under GST
- This places high burden then reimbursement as accepted by judiciary [See earlier slide for case laws]
- Levy of GST and credit of ITC has no bearing on compliance under Income Tax Act 1961. However, Qs 3 makes section 194R deduction dependent on treatment under GST law
- Whether subsequent ruling under GST law where pure agent relationship is not accepted by GST authorities make payer liable for deduction under section 194R?
- Can concept of pure agent be imported by assessee or tax authorities to other TDS provisions like section 194C, 194J, section 194Q etc?

TDS on reimbursement

- All conditions of pure agent needs to be satisfied to claim exemption. The benefit of Circular II cannot be granted if any conditions are violated
- Circular II states 'amount incurred by such 'pure agent' for which he is reimbursed by the recipient would not be treated as benefit/perquisite for the purpose of section 194R
 - Can non-satisfaction of some conditions (e.g. absence of contractual agreement) make payment as benefit or perquisite? How can benefit or perquisite be dependent on procedural compliance?

Before we proceed

The concept of a pure agent is highly factual and legal. The ensuing slide covers judicial precedent in GST context which should equally apply to section 194R. The purpose is to bring out various facets of a pure agent so that adequate care and precautions are taken at the time of availing exemption.

Case laws are fact sensitive and no direct conclusion should be reached. In practice, each case should be evaluated independently in light of judicial exposition

Facets of pure agent definition

- Pure agent should be agent of service recipient
- For a person to act as a pure agent he must be a supplier of goods or services or both and then he must procure certain goods or services for the said supply, for which, he incurs expenditure
[Department of Printing, Stationery and Publications, Inre [2020] 116 taxmann.com 209 (AAR - Kar)]
- Ancillary charges for which pure agent status is claimed should be provided by third party to service recipient [deductor in context of section 194R] and not incurred by pure agent for the purpose of rendering its service **[E-Square Leisure (P.) Ltd Inre [2019] 104 taxmann.com 121 (AAR - Mah.)]**
- Mere payment on actual cost would not be enough to show the existence of pure agency
- Pure agent does not take input credit on GST paid by third party service provider. Service recipient [deductor for section 194R) should claim credit [CBIC Circular No. 115/34/2019-GST, dated 11-10-2019]

Pure agent – authorisation condition

Authorisation

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

Analysis

- Authorisation at the time of payment is a mandatory condition. Subsequent authorisation is not valid
- Exemption as pure agent is not available while making payment of electricity and water charges collected from tenants as neither instructions nor authorization was obtained from tenants to act as pure agent and to make payment to third parties [Indiana Engineering Works (Bombay) (P.) Ltd., In re [2022] 137 taxmann.com 389 (AAR - MAHARASHTRA)]

Pure agent – authorisation condition

Analysis

- Pure agent benefit cannot be claimed when electricity procured from electricity supply authority for residents is also used for providing maintenance services and the agreements entered with residents do not provide any clause/reference on acting as pure agent; electricity charges recovered from residents on actual basis are subject to levy of GST [**Antara Purukul Senior Living Ltd., In re**] [2022] 141 taxmann.com 281 (AAR - UTTARAKHAND)
- Benefit of the pure agent cannot be availed in absence of a contractual agreement. Stipend paid by training institution subsequently reimbursed by industry partners was held chargeable to GST [**Teamlease Education Foundation, In re**] [2022] 138 taxmann.com 283 (AAR - KARNATAKA)

Pure agent – authorisation condition

Analysis

- Applicant could not establish that the Supplier of the Applicant was duly authorized at the time of making payment of stamp duty for giving bank-guarantee in favour of the Applicant. In this case the Applicant was importer and the payment of stamp duty was made by his Supplier outside India **[M/s ENPAY TRANSFORMER COMPONENTS INDIA PRIVATE LIMITED 2021-VIL-210-AAR]**

Pure agent – invoicing condition

Invoicing

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

Analysis

- Reimbursement is separately indicated in the same invoice itself if composite invoice is issued
- A separate invoice for reimbursement with appropriate backup to show no markup

Pure agent – additional supply

Additional Supply

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

Analysis

- Invoice and agreement should specify services in addition to the ones for which he is 'purportedly' acting as a pure agent
- The test is whether service provider is liable to pay charges no matter what service recipient does [**Udayan Cinema (P.) Ltd., In re [2019] 103 taxmann.com 219 (AAR - WEST BENGAL)**]
- The relationship between the Pure Agent and the recipient of service in respect of the main service is on a Principal to Principal basis and in respect of other ancillary services is that of a Pure Agent

Illustration of person not held to be pure agent

- Applicant is engaged in service of supply of labour. It engages manpower and assumes responsibilities under various Acts. Invoice for manpower cost was on actual. Applicant cannot be categorized as a "pure agent" [**Prodip Nandi, In re [2022] 134 taxmann.com 119 (AAR - WEST BENGAL)**] ; **Bhadresh Dave, In Re [2021] 123 taxmann.com 190 (AAR - GUJARAT)**)
- Applicant provides housekeeping services to hospitals. Hospitals pays service fees and reimburses supervisors salaries/wages at actual. Applicant cannot be said to be a pure agent [Smt. Bhagyalakshmi Devamma Vangimallu, In re **[2022] 134 taxmann.com 65 (AAR - TELANGANA)**]
- Applicant hotelier, provides arrangements like flower decoration, DJ, Dance Floor etc., in addition to foods, beverages and renting of premises and collects nominal/facilitation charges from the recipient, the applicant does not satisfy the condition of being a 'pure agent' **Global Vectra Helicorp Ltd., In re [2021] 124 taxmann.com 38 (AAR - HARYANA)**

Illustration of person not held to be pure agent

- Line Producer procuring production services from foreign suppliers in addition to services he supplies on his own account [**Udayan Cinema (P.) Ltd., In re [2019] 103 taxmann.com 219 (AAR - WEST BENGAL)**]

Illustration in Rule 33 of GST Valuation Rule 2017

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.

Illustrations appended to a section form part of it and are of relevance and value in construing the section [Jumma Masjid v. Kodimaniandra Deviah, AIR 1962 SC 847]

Illustrations of pure agent

- Applicant provides coaching, learning and training services and collects certain amount as examination fee from students and remits same to respective college or university without any profit element, activity of collecting examination fee is a service as a pure agent [Arivu Educational Consultants (P.) Ltd., In re [2019] 110 taxmann.com 426 (AAR - KARNATAKA)]; Cigma Medical Coding (P.) Ltd., In re [2021] 128 taxmann.com 191 (AAR - KERALA)]
- Applicant is providing clinical trial management services. Agreements provide that applicant gets clinical trials conducted through principal investigators/institutions and applicant transfers payment to investigators when it receives same from sponsors. Applicant qualifies as pure agent **[Asiatic Clinical Research (P.) Ltd., In re [2020] 113 taxmann.com 297 (AAR - KARNATAKA)]**
- Lessor in receipt of electricity charges from lessor if there is separate sub-meter and lessor collect charges at actual [Gujarat Narmada Valley Fertilizers & Chemicals Ltd [2021] 123 taxmann.com 380 (AAR - GUJARAT)]

Illustrations of pure agent

- Assessee, a commission agent, acting on behalf of its principal, paid over amounts under Primary claim/Retail Scheme to various retailers selling products of its principal and later got reimbursement thereof, said amount was not includible in value of services [UOI v Raj Wines [2015] 53 taxmann.com 445 (Chhattisgarh)]
- Port fees, Port charges, Custom duty, dock dues, transport charges etc. paid by Customs Broker on behalf of owner of goods*
- Expenses incurred by C&F agent and reimbursed by principal such as freight, godown charges*

* https://www.cbic.gov.in/resources//htdocs-cbec/gst/Pure_Concept_in_GST_new.pdf

The interplay of section 194J and
section 194R [Qs 3]

Qs 3 of Circular II

Question 3: Question No 30 of CBDT Circular No 715 dated 8th August 1995 clarifies that tax deduction under section 194C and 194J is required to be made from the gross amount of bill including the reimbursement. A person has provided service to a Company and out of pocket expenses are charged by him to the Company along with service fee in the same bill. Company deducts tax under section 194J of the Act on both service fee component as well as on out of pocket expense in accordance with this circular. Is there a non-compliance with the provision of section 194R of the Act?

If out of pocket expenses (reimbursement) are already part of the consideration in the bill on which tax is deducted under the relevant provisions of the Act, other than section 194R, in accordance with the Circular No 715 dated 8th August 1995, it is clarified that there will not be further liability for tax deduction under section 194R of the Act.

Interplay of section 194J and section 194R

- Circular merely states if tax is deducted on gross amount (i.e. even on reimbursement) no tax is required to be deducted under section 194R
- It does not seem to give primacy to section 194J over section 194R
- It may still be possible for payer to deduct tax under section 194R and exclude out-of-pocket expenses on the basis of pure agent exemption
- Any other view would turn pure agent exemption in Question No 2 redundant

Dealers conference

Clarifications in Circular II

Issue	Clarification
Is there any requirement that all dealers must be invited in the conference	It is not necessary that all dealers are required to be invited in a dealer/business conference
What if dealers arrive one day before and one day after	<ul style="list-style-type: none"><li data-bbox="758 539 1949 868">• Expenditure on participants of dealer/business conference for days which are on account of over stay prior to the dates of conference or beyond the dates of such conference would be considered as benefit/perquisite for the purposes of section 194R of the Act.<li data-bbox="758 882 1935 1096">• However, 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 over stay

Clarifications in Circular II

Issue

- How to identify benefit against individual dealers in a group activity

Clarification

- There may be practical difficulties in identifying such benefit/perquisite to actual recipient due to the fact that it is a group activity and reasonable allocation is not possible
- Noncompliance of the provision of section 194R of the Act, in such a case, would not only result in disallowance under clause (ia) of section 40 of the Act but may also result in treating the benefit/perquisite provider as assessee in default under section 201 of the Act with all other consequences

Clarifications in Circular II

Clarification

- In order to remove these practical difficulties, it is clarified prerequisite benefit/perquisite is **provided in a group activity** in a manner that it is **difficult to match such benefit/perquisite to each participant using a reasonable allocation key**, the benefit/perquisite provider may at his option not claim the expense, representing such benefit/perquisite, as deductible expenditure for calculating his total income
- If **he decides to opt so**, he will not be required to deduct tax under section 194R on such benefit/perquisite and therefore he will not be treated as assessee in default under section 201 of the Act. Thus, in such a case he must add back the expenditure, representing such benefit/perquisite, to calculate his total income if such expenditure is debited in the account

Analysis

- Preference of TDS under section 194R v/s disallowance under the head profit and gains of business or profession
- Disallowance under section 40(a)(ia) is 30% of expenditure v/s 100% disallowance under alternative provided in Circular
- Can tax authorities invoke section 40(a)(ia) disallowance on the ground that reasonable allocation is possible and invoke section 201 proceedings
- Timing of opting disallowance :
 - At the time of filing of return of income;
 - In course of assessment proceeding where compliance to section 194R is held unacceptable;
 - In course of section 201 proceeding;
 - Reassessment proceeding

Analysis

- Is option restricted to dealer's conference:
 - Question 8 of Circular I deals with business and dealers conference
 - Question 3 of Circular II modifies Question 8
 - Accordingly, the option should be applicable to all business conference
- Benefit or perquisite provided in a group activity
 - Group activity – whether restricted to an activity in a conference or the entire conference itself can be said to be a group activity
 - Can group activity outside conference avail benefit of Circular II e.g. distribution of valuable brand reminders, insurance of distributors and staff, distribution of sample to distributors with obligation to distribute to end users as manufacturer may not be able to match ultimate user

Analysis

- Difficult to match such benefit/perquisite to each participant using a reasonable allocation key drivers
 - Is wisdom of assessee in determination of difficulty subject to scrutiny?
 - Does the circular mandate the assessee to document and maintain difficulties it faced in determination of reasonable allocation key so as to justify option selected?
- Can assessee opt pick and choose option for each conference?
- Is only direct cost of conference covered or even indirect costs e.g. employees involved in planning and execution of conference are covered as well?
- As regards direct cost where TDS is deducted, whether option can be exercised in respect of balance group cost?

Analysis

- Even in a case where direct matching is not possible, can assessee adopt partial approach
 - Not deducting TDS under section 194R upto annual limit of Rs 20,000 per dealer
 - Balance cost disallowed by exercise of option
- Assuming assessee allocates cost based on reasonable cost drivers and deducts TDS under section 194R for group activity – can AO mandate assessee to opt for disallowance as drivers are argued to be incorrect
- Consequence of TDS default under provisions after opting for disallowance option e.g. Assessee fails to deduct TDS on catering charges or fees paid to event organiser or fees paid to artist/performer
 - Can section 40(a)(ia) disallowance be invoked again for expenditure which is already disallowed?
 - Can assessee be treated as AID under section 201 for TDS default?

Peculiar case of Pharma Companies

- Expenditure incurred on Health Care Professionals (HCP) are disallowed under section 37(1) read with MCI guidelines
- Disallowance is irrespective of whether benefit can be matched to HCP or is a group activity
- Can Pharma Company avail benefit of Circular and not withhold tax under section 194R?

Analysis

- Impact on ongoing controversy: Can assessee be deemed to be in default under section 201 if expenditure is disallowed under section 40(a)(ia)

Favourable decisions

- Pfizer Limited [2012] 28 taxmann.com 17 (Mum)
- Robert Bosch Engineering and Business Solutions (P.) Ltd. [2022] 137 taxmann.com 150 (Bangalore)

Decisions against assessee

- Agreenco Fibre Foam (P.) Ltd [2013] 38 taxmann.com 155 (Cochin)

Alternative approach supports favourable decisions? Can it be argued that this view is recognised as valid option which is clarificatory and was always available to assessee?

Depreciation on car

[Qs No 5]

Qs 5 of Circular II

Question 5: Company "A" gifts a car to its dealer "B" and deducted tax on this benefit under section 194R of the Act. Dealer "B" uses this car in his business. Will he get deduction for depreciation in calculating his income under the head "profits and gains of business or profession"??

- Once Company "A" has deducted tax on gifting of car in accordance with section 194 R of the Act (or released the car after dealer "B" showed him payment of tax on such benefit) and dealer "B" has included this benefit as **income in his income tax return**, it would be deemed that the "actual cost" of the car for the purposes of section 32 of the Act shall be the amount of benefit included by dealer "B" as income in his income-tax return. Hence, dealer "B" can get depreciation on fulfillment of other conditions for claiming depreciation.

Analysis

- Under general principles value adopted for TDS under section 194R should be taken as cost base of asset
 - CIT v Groz-Beckert Saboo Ltd [1979] 116 ITR 125 (SC)
 - Kalooram Govindram v. CIT, (1965) 57 ITR 335 (SC)
- Applying similar logic can doctor claim deduction of value taxed under section 194R on distribution of free sample as business deduction. This is on the basis that sample was administered to patient
- However, in case doctor is salaried, there is no provision to give deduction for depreciation or business deduction

TDS by Embassy/High Commission

[Qs No 6]

Qs 6 of Circular II

Question 6: Whether Embassy/High Commissions are required to deduct tax under section 194R of the Act?

- For the removal of difficulty it is clarified that the provision of section 194R is not applicable 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, legation, commission, consulate and the trade representation of a foreign state.

Analysis : Exemption is limited to section 194R? Does it mean aforesaid organisation is required to deduct tax under other provisions say section 194-I, section 192, section 194J etc?

Rights issue and bonus shares by WHC
[Qs No 7]

Qs 7 of Circular II

Question 7: Whether issuance of bonus share/right share is a benefit or perquisite if issued by a company in which the public are substantially interested as defined in clause (18) of section 2 of the Act and whether tax is required to be deducted under section 194R of the Act?

- It is clarified that the tax under section 194R of the Act 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 in clause (18) of section 2 of the Act**, where bonus shares are issued to all shareholders by such a company or right shares are **offered to all shareholders** by such a company, as the case may be.

Analysis

- Section 194R applies only when benefit or perquisite is provided in course of business or profession
- It is not clear how the issue of bonus shares or rights shares results in benefit or perquisite much less – provided in the course of business or profession
- Clarification applies only to WHC – whether similar transaction by closely held company attracts section 194R?
- Whether section 194R applies to the following transactions (whether by WHC or CHC)
 - Issue of shares on a preferential basis
 - Buy-back of shares at less than FMV
 - Capital Reduction - whether selective or otherwise

Thank You

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