Taxability on Benefits and Perquisites – Impact on Food Processing Sector

Background and Legislative Intent

Section 28(iv) of the Income-tax Act, 1961 (the Act) was introduced in the Finance Act, 1964 to tax the value of any benefit or perquisite, whether convertible into money or not, arising from the business or exercise of the profession by the assessee. However, even after five decades, there was no mechanism available to tax administrators to track whether such benefits and perquisites were offered to tax by the recipients. In many cases, the tax administrators claim that such benefits or perquisites are not offered to tax.

To plug the lacuna in the law and to have an Audit Trail of the benefit and perquisite received by the assessee, a new Section 194R was inserted vide Finance Act, 2022 to provide for withholding tax on the value of the benefits or perquisites.

It is to be noted that the provisions regarding the taxability of benefits or perquisites arising during the course of business or profession always existed in the statute books. Thus, if something was not taxable earlier, it would not be taxable now as well.

The obligation for withholding tax under the newly inserted Section 194R of the Act has been cast upon the person providing such benefits or perquisites. The salient features of Section 194R of the Act are as follows:

- Section 194R of the Act states that the **person providing benefits or perquisites** to a person **carrying on business or profession** shall have Tax Deducted at Source **(TDS) at the rate of 10%** on the value of such benefits or perquisites, **provided** the value exceeds INR 20,000 during each financial year (this limit is per vendor for the year).
- The first proviso to Sub-section (1) states that the deduction has to be made in cases where **the benefit is in kind or cash**.
- Individuals and Hindu Undivided Families (HUFs) are exempt from withholding provisions if the total turnover from business in the previous year is less than INR 10 million. In the case of the profession, it is less than INR 5 million.

While the larger concern was to track the benefits/perquisites passed on in the medical industry, the language of the new provisions covers benefits/perquisites across all industries. Though there are not many benefits passed on in the Food Processing Sector, there are quite a few payments that may get impacted considering the newly introduced provisions such as:

- Distribution of free samples
- Reimbursement of expenses for accommodation/food
- Retailer/distributor incentives, etc.

Issues in applicability of provisions and clarifications issued [June 2022 and September 2022]

The Central Board of Direct Taxes (CBDT) issued clarifications which inter alia include valuation rules to effectively implement provisions relating to withholding of tax on benefits/perquisites. Some of the important clarifications, especially those impacting the Food Processing Sector, are provided below:

- The deductor is not required to check whether the amount is taxable in the hands of the recipient as a benefit or perquisite. Also, the benefit or perquisite provider is not required to check whether the benefit or perquisite is a capital asset such as a car, land, etc.

  The only obligation cast upon the benefit/perquisite provider is to ensure that 10% tax is deducted on the amount of benefit or perquisite provided. Tax is also required to be deducted whether the benefit or perquisite is in cash or in kind.

- TDS is not required to be deducted on sales discounts/cash discounts/rebates even though they are also benefits related to sales/purchases.

  However, an exemption from tax deduction is not available in case free samples are provided (the CBDT has clarified that withholding tax shall be deductible in cases where goods are distributed as free samples).

- It has also been clarified that in a case where the benefit or perquisite has been used by the owner/director/employee of the recipient entity, it shall be deemed that the benefit is received by the recipient entity only, although the benefit or perquisite would have been enjoyed by the owner/director/employee of the recipient entity.

  For example, if free samples are provided to an employee of a company, Section 194R would apply in the hands of the company and not the employee.

  The company may subsequently treat the said free samples as given to its employee and they will be taxable as a perquisite in the hands of such employee and thus, TDS under Section 192 will have to be deducted by the company. In such a case, the company would be tax neutral, and the real perquisite would get taxed in the hands of the employee.

  In the case of the Food Processing Sector, one may need to see how samples that are used to evaluate the products at mass to individual consumers and/or samples that are used by the chefs in the kitchen are treated for the purposes of withholding under section 194R of the Act.

- Where another person meets any expenditure of a person, it would amount to a benefit or perquisite in the hands of the first-mentioned person.

For example, a consultant provides a service to a company, and in turn, receives consulting fees. The consultant has to travel between different cities and pay for boarding and lodging expenses incurred exclusively for rendering his consulting services. The expenditure incurred on factory visits wherein the cost of stay, travel, and food expenses are initially incurred at source and subsequently reimbursed by the company would be subject to withholding tax where invoices are not in the name of the company and shall be treated as a benefit in the hands of the person who has incurred the said expenditure.

Further clarity on this aspect is provided in the scenarios below:

- If the invoice (of lodging and boarding) is raised in the name of the company, but the consultant initially pays the same and is later reimbursed from the company, the said reimbursement would not be treated as a perquisite in the hands of the consultant.
- However, if the invoice is not in the company's name, but the company makes direct payment or reimburses it, it is to be treated as a benefit or perquisite in the hands of the consultant for which TDS needs to be deducted under Section 194R of the Act.

It is also clarified that where tax has been withheld on out-of-pocket expenses as part of the entire consideration under Section 194J or 194C of the Act in accordance with Circular No 715 dated 8 August 1995, there is no further liability to deduct tax under Section 194R of the Act.

- The expenditure pertaining to dealer's meet/ business conference would not be considered as a benefit or perquisite where such conference is held with the prime objective of educating the dealers/customers about any of the following or similar concepts:
  - New products being launched and discussions as to how the product is better than others
  - Obtaining orders from dealers/customers and teaching sales techniques to dealers/customers
  - Addressing queries of dealers/customers
  - Reconciliation of accounts with dealers/customers

  Additionally, it is clarified that the expenditure would be considered as a benefit or perquisite where it is attributable to a leisure trip or leisure component, even if it is incidental to the dealer/business conference or incurred for the family members of the person attending the conference.
- In respect of conferences/seminars held for dealers/distributors to educate them regarding products of the company and other similar nature, it is clarified as follows:
  - It is not necessary that all dealers are required to be invited to a dealer/business conference for the expenses to not be considered as a benefit/perquisite for the purposes of tax deduction under Section 194R of the Act.
  - Stay for a day immediately prior to the actual start date of the conference and a day immediately following the actual end date of the conference would not be considered an overstay and the provisions of Section 194R shall not apply.

- It is clarified that if a benefit/perquisite is provided in a group and it is difficult to quantify such benefit against each participating individual, the benefit/perquisite provider may, at his option, not claim the corresponding expense as a deductible expenditure while calculating his total income. If the benefit/perquisite provider opts so, he will not be required to deduct tax under Section 194R on such benefit/perquisite and will not be treated as an assessee in default under Section 201 of the Act.
- Valuation has to be done as per the fair market value of the benefit or perquisite, except in the following cases:
- Where the benefit or perquisite is purchased from a third party, the purchase price shall be the value of the benefit or perquisite provided.
- Where the benefit or perquisite provider manufactures the items given as a benefit or perquisite, then the price it charges to its customers for such items shall be the value of the benefit or perquisite provided.

  Furthermore, no GST is to be included for the purposes of valuing the benefit or perquisite.

- It is clarified that the provision of Section 194R shall not be applicable on one-time loan settlements or waivers of loans granted to borrowers by specified banking institutions.
- In cases where a benefit is in kind or in cash, but the cash is not sufficient to meet the TDS obligation, the recipient of the benefit/perquisite is required to pay tax in the form of Advance Tax, and the said challan is required to be shared with the provider of the benefit or perquisite. The provider of the benefit or perquisite will be required to report the same in Form 26Q while filing the TDS return.

  Alternatively, the benefits provider may deduct the tax and pay it to the Central Government. In such a case, the TDS paid by the provider of the benefit or perquisite is also a benefit or a perquisite in the hands of the recipient. This also needs to be reported in Form 26Q.

Takeaway

The introduction of Section 194R is a significant development in the Indian tax landscape and is expected to widen the tax base and increase tax revenue for the government. Though the government has provided clarifications on a number of aspects, there are still some open points where difficulties may continue to persist, and compliances would be cumbersome, for which further clarifications may be issued.

Considering the legislative intent, small limits prescribed, and the fact that the onus is cast upon the deductors to ensure that the due taxes have been paid, it is imperative that both the deductors (such as FPS entities) and deductees (distributors/retailers) are educated about the provisions of Section 194R.

The payments towards sales promotion, sample distribution, conference charges, etc. shall be closely monitored by the government in the near future to ensure that there is no tax leakage and to decide on the allowability of such expenditure in the hands of companies.

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