BCC&I
THE BENGAL CHAMBER

POST BUDGET MEMORANDUM 2022-23

1. TDS Provision under Section 194R of the Income Tax Act, 1961 ('the Act')

Section 194R has been inserted to provide that the person responsible for providing any benefit or perquisite to a resident, whether convertible into money or not, arising from carrying out of a business or exercising of a profession by such resident, shall ensure that tax has been deducted in respect of such benefit or perquisite at the rate of 10% of the value of such benefit or perquisite.
However, there are certain issues in the provision which needs to be considered.

a. What is "Benefit or perquisite" for the purpose of this section?

The section does not define what will constitute a 'benefit or perquisite' for the purposes of Section 194R. It is to be noted that the term 'perquisite' has been defined inclusively in Section 17(2) of the Act in the context of employer-employee relationship. Certain judicial pronouncements have also tried to analyze the meaning of benefit or perquisite in the context of Section 28(iv) of the Act. However, in the absence of any definition in the proposed new section 194R, it is difficult to determine the scope and applicability of the proposed section and will lead of uncertainties and potential litigation with or by the Income Tax Department.

Recommendation

Please include a definition of the terms "benefit or perquisite" for the purpose of applicability of the proposed section 194 under the Act.

b. Business / Sales promotion activities should not be treated as benefit or perquisite:

Section 28(iv) of the Act provides that value of benefit or perquisite, whether convertible into money or not, arising from business or exercise of profession is to be charged as business income in the hands of recipient of such benefit or perquisite. The CBDT Circular explaining rationale for introduction of section 28(iv) in the Act reads as under-

"The effect of the abovementioned amendment is that in respect of an assessment for the assessment year 1964-65 and subsequent years, the value of any benefit or amenity, in cash or kind, arising to an assessee from his business or the exercise of his profession, e.g. **the value of rent free residential accommodation secured by an assessee from a company in consideration of the professional services as a lawyer rendered by him to that company** , will be assessable in the hands of the assessee as his income under the head 'Profits and gains of business or profession".

Therefore, this seem to indicate that a direct benefit which is given in lieu of consideration or a case where person giving and receiving knows from the very beginning that benefit given is a privilege which will benefit the recipient only should be considered for the purpose of section 28(iv) of the Act. Therefore, the proposed section 194R should not be made applicable to business or sales promotion activities which are purely for the purpose of the business of the assessees and cannot be termed as benefits or perquisites.

For instance, corporate entities, especially those having stockists/distributors/dealers, undertake various business or sales promotion activities in the form of providing brochures, banners, fliers etc. to the said distributors/dealers. Besides, some corporate entities also organize distributor / dealer conferences to discuss business/sales plan and targets to be achieved. Further, companies also incentivize their distributors/dealers to encourage them achieve the sales targets and towards the same, offer certain incentives. Such incentives are over and above the margins earned by the distributors/dealers, which are not known to them or do not accrue to them at the inception or cannot be quantified initially. Such business or sales promotion incentives are meant to increase sales and is not a profit margin to such dealers/distributors.

In a case where TDS is stated to be applicable on such business or sale promotion activities, the distributors/dealers might not agree to bear the TDS on such incentives. This might also lead to a situation where the corporates will have to bear tax on such business or sales promotion activities, thereby increasing the cost of doing business and added complexities in the functioning of supply chains. Further, sales incentive schemes are complicated, and corporates may not be aware of the ultimate beneficiaries, in cases where distribution channels involve multiple intermediaries.

Further, Indian corporates do invite customers including potential customers to their factories/offices to showcase their products/services which could entail expenses towards travel, accommodation, food & entertainment expenses, free samples etc. Such expenses are in also in the nature of business promotion expenditure and should not be construed as any benefit or perquisite extended to such recipients, since they may not renew their purchase order or even place orders if they are subjected to TDS and are to offer such amounts as income in their tax returns.

It is submitted that business or sales promotion activities, including incentives that may be offered by corporates to distributors/dealers, are undertaken primarily to increase sales throughput and are typically passed on by them as discounts to their customers. If such sales promotion incentives are to be taxed as income in the hands of the distributors/dealers by virtue of this TDS proposal u/s 194R, then the following consequences would follow:

a) Distributors/Dealers would not participate actively in the business promotion or sales promotion activities of corporates; thus business growth would get impacted for the private sector;

b) Distributors/Dealers would expect the corporates to pick up the entire tax implication on such sales promotion activities, which would significantly increase of cost of doing business – such a cost could be as high as 42% [though TDS is @ 10%, the recipient will need to pay tax on the said income; assuming maximum marginal rate for individuals/firms] of the total business or sales promotion budget of a company.

c) Eventually, consumers will suffer since discounts/promotion incentives would not be offered by corporates/dealers/distributors due to the high tax incidence on such sales promotion activities.

Recommendation

(i) It is recommended that the Govt. of India should specifically clarify that provisions of the proposed section 194R will not be applicable in the following cases:

a) business or sales promotion expenses/incentives incurred/paid by a corporate assessee, which are mostly passed on by their customers (i.e. distributors/dealers) to ultimate consumers as discounts or other offers on goods sold;

b) travel, accommodation, food & entertainment expenses including cost of free samples etc. incurred by an assessee in the course of promoting business or profession.

c. Valuation of Benefit or perquisite:

The proposed section does not specify what will be the value of a benefit or perquisite for the purpose of deduction of tax at source u/s 194R of the Act. This might create issues where the person deducting tax and the Income tax Department assess the value of a particular benefit or perquisite differently. Further, in some cases, certain payouts may have the characteristics of both business expenditure and benefit or perquisite; it may not be practical/possible to bifurcate such expenditure.

Recommendation

(i) An appropriate clarification should be issued regarding the methodology to be followed for valuing benefits or perquisites under the proposed Section 194R of the Act.

Conclusion:

Considering the complexities involved and the wider ramifications of the proposed provision u/s 194R of the Act, **it is recommended that the Govt. of India defer the date for introduction of this provision from 1st July, 2022 to 1st April, 2023**.

In the interim, it is earnestly requested that the Govt. / CBDT hold interactive sessions with the industry, understand on the ground issues and come out with clarifications / FAQs so that parties who are under obligation to deduct tax u/s 194R understand the implications and comply with the same.

2. Disallowance u/s. 37 of the Act

Explanation 1 to section 37(1) has been amended to prohibit deduction for any expenditure incurred by an assessee for any purpose which is an offence, or which is prohibited by law outside India as well. It has also been clarified that expenditure incurred by an assessee for any purpose which is an offence or which is prohibited by law will include compounding of an offence under any law for the time being in force outside India.

In various countries including India, settlement schemes are in place where an Indian resident entity can pay the demand under the scheme and settle the dispute, without prejudice to its rights and contentions. In these kind of settlement schemes, however, it is also recognized that mere settlement of the dispute does not amount to acknowledgment of having committed any offence or conceding the position taken by that person. Similarly, compounding fees paid to save time and costs over protracted litigation, that too on a without prejudice basis, should not be construed as unlawful and disallowed. Therefore, any payment under settlement schemes, including compounding fees, should not be considered as an expenditure for an offence which is prohibited by law and thereby disallowed.

If suitable clarification is not provided, Indian entities may be discouraged from settling disputes including in overseas jurisdictions, without prejudice to their rights & contentions. Consequently, Indian corporates may end up in protracted litigation and incur substantial domestic or overseas litigation costs, which are counter- productive to

the concerned assessee and also to India apart from clogging the Indian judicial system (in case of domestic litigation).

Recommendation

An appropriate clarification should be issued to exclude from the disallowance u/s 37 of the Act, payments that may be made by Indian entities under settlement schemes or compounding schemes that may be opted for in India or in overseas jurisdictions, without prejudice to their rights & contentions, by a party concerned in its own business or commercial interests.

3. Updated Return u/s 139(8A) of the Act

Section 139(8A) has been proposed to be introduced under the Act to enable assessees file an updated return at any time within a period of 24 months from the end of the relevant assessment year (AY), whether such person has filed an income tax return previously or not. An additional tax of 25% or 50% as applicable is proposed to be paid by such assessees while filing the updated returns. The following issues need to be addressed:

a. Updated return cannot be filed if any proceeding for assessment is pending:

The proposed provision does not define the words "proceeding for assessment is pending". The time limit for issue of notice u/s 143(2) of the Act is 6 months from the end of the assessment year. In such cases if the same is treated as pending assessment proceedings, most of the assessees who are selected for scrutiny assessment will not be able to make use of this provision to disclose inadvertently left out income.

Recommendation

Appropriate clarification must be issued to define the term "proceeding for assessment is pending" and specifically it should exclude scrutiny assessment proceedings u/s 143(2) of the Act.

b. No provision to update other forms having impact on return of income:
There are no corresponding amendments to allow updated filing of other forms viz. Tax Audit Report, Form 3CEB, forms filed for deductions under chapter VIA etc. This may pose practical challenges in filing updated return and may trigger adjustments under section 143(1) of the Act.

Recommendation

Suitable amendments must be made to allow filing of other related reports and forms that are essential for filing an Updated Return.

4. Amendments related to successor entity subsequent to business reorganization under Section 170A of the Act

Section 170A is proposed to be introduced under the Act to allow a successor company (in case of business reorganization) to modify its earlier filed return (before the date of the order of a High Court, Tribunal etc.) to give effect to the scheme of business reorganization which is from a preceding date. The return can be modified within 6 months from the end of the month in which the said order was issued.

However, the language of the section has been drafted in a way that it allows only the resulting/successor company to file the modified return. There is no provision to allow the old company (say amalgamating company) to file the modified return for the period prior to the appointed date of its amalgamation with the successor entity.

Recommendation

Suitable amendments must be made to allow the amalgamating / merging company to file modified returns for the period up its legal existence – i.e. appointed date under the Court / Tribunal Order.

5. Retrospective amendment in respect of deduction of Education Cess

The budget proposes to clarify that Education Cess on income tax is not allowable as a business expenditure u/s 37 of the Act. Further, the proposed amendment is retrospective from AY 2005-06.

While it is the Government's prerogative in making a tax provision prospective or retrospective, it is imperative that consequential implications are addressed suitably so that assessees are not put to additional burden or avoidable litigation with the Income Tax Department. Our submission is in the context of potential penalty implications that may be mounted by the Department against the assessees who have claimed tax deduction for Education Cess in their tax returns, based on the judicial precedents till date..

Recommendation

It is requested that the amendment be made applicable prospectively. Further, without prejudice, it should be specifically provided that penalty shall not be applicable to assessees who have claimed the expenditure in earlier years based on judicial precedents.

6. Exemption from tax towards Covid 19 related medical treatment expenses

While the Budget, in line with the Govt. of India's June 2021 press release, proposes not to include in 'taxable income' any payments made by an employer to an employee or his/her family towards medical treatment of Covid 19 with retrospective effect from 1st April, 2019, the following submissions are made to enable eligible assessees to get the full benefit of the intended proposal of the Govt.

Issues: Govt. of India is aware that the due dates for filing income tax returns for the financial year 2019-20 and FY 2020-21 have long expired – i.e. FY 2019-20 by 10th January, 2021 and FY 2020-21 by 31st December, 2021. In the absence of legislative clarity, corporates have treated any expenditure incurred on behalf of their employees / their families towards Covid 19 related medical treatment, as a taxable perquisite and have also deducted tax u/s 192 of the Act. Further, most of the employees have also filed their tax returns on the basis of Form 16 issued by their employers for these financial years, wherein Covid 19 related medical expenses have been considered as a taxable perquisite and related tax have been deducted.

Though the intent of the legislature is to extend the said relaxation retrospectively from 1st April, 2019, there is no scope for those eligible employees who have paid tax on such Covid 19 related medical expenditure, to claim a refund from the Income Tax Department, since the last dates for filing tax returns have long expired – both for FY 2019-20 and FY 2020-21.

Secondly, even for the ongoing FY 2021-22, employers may not be able to consider Covid 19 related medical expenses incurred on behalf of their employees or reimbursed to employees, as exempt from tax (i.e. not to be treated as a taxable perquisite) since Budget is yet to be passed. Hence, eligible employees may be suffering tax on such Covid 19 related medical expenditure even for the current financial year, in the absence of suitable clarification from the Govt. of India.

Lastly, employers have also incurred expenditure to get all their employees and their families vaccinated (irrespective of whether such employees suffered Covid 19 or not) to prevent spread of the disease and to ensure minimal interruption of their business activities. However, the Budget proposes to exempt only medical treatment expenses incurred on account of Covid 19 and not the vaccination expenses. It is submitted that the Govt. should extend the tax exemption even for Covid vaccination expenses, which otherwise will get taxed as a perquisite, by employers u/s 192 of the Act.

Recommendation

In view of the above, it is recommended that:

(i) Government of India should provide a special window or a process to enable eligible assessees to claim refund of tax that they have suffered on Covid 19 related medical expenses – from 1st April, 2019 – covering at least till 31st March, 2021.

(ii) For the FY 2021-22, Government of India may suitably advise employers to exempt from deducting tax u/s 192 of the Act, any expenses incurred or reimbursed to employees towards treatment of Covid 19, so that eligible employees need not suffer tax and then are asked to claim refund through their tax returns; rationale being, still 45 days are left before the end of the current financial year.

(iii) Lastly, Government of India should clarify that Covid 19 vaccination expenses (for employees and their families) as non-taxable in the hands of employees.

7. <u>No clarity on the provisions of Significant Economic Presence u/s 9 of the Act</u>

The concept of significant economic presence (SEP) introduced in the previous budgets and has become applicable from 1st April 2021 defines SEP to include transaction in respect of any goods or services carried out by a non-resident with any person in India.

As a result, it seems to cover even the transactions for import of goods in its ambit. Further, services availed outside India by a person resident in India (e.g. payment of commission by an Indian resident to a non-resident for services provided outside India), which were hitherto not taxable in India may also get covered under the ambit of this definition. While the intent of this explanation was to bring under the tax net digital economy / companies, its coverage has got extended to include even normal import of goods into India. This is a significant change in the taxation policy of international transactions and may impact bilateral trade apart from increasing cost of imported goods, especially of goods for which India is highly import dependent such as Crude Oil, Edible Oil etc.

Further, Explanation 2A to Section 9(1)(i) of the Act stipulates that only so much of income as is attributable to the transactions or activities covered under SEP shall be deemed to accrue or arise in India and so subjectable to tax in India. Assuming, even if tax is payable by a non-resident on income attributable to India as stated in the aforesaid Explanation, there is no clear methodology prescribed by CBDT how an Indian resident is expected to determine the said attributable income deemed to accrue or arise in India and deduct appropriate tax on the same. Absence of clarifications is posing significant compliance challenges to the assessees.

Recommendation

It is, therefore, recommended that:

(i) Import of physical goods should be kept out of the purview of Explanation 2A to Section 9(1)(i) of the Act;

(ii) No clarity has been provided in the 2022 budget in respect of the applicability of SEP provisions. Suitable clarifications/amendments may kindly be provided to give clarity to the assessees on the implementation of these provisions including specifically, the methodology to be followed for determining attributable income deemed to accrue or arise in India on which appropriate tax is to be deducted by the Indian party.

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