Part A – Issues pertaining to taxation of Virtual Digital Assets

1. Relaxing compliance for withholding u/s. 194S in case of exchange transaction

1.1. Relevant provision of the Act

S.194S provides for levy of 1% TDS on consideration paid to a resident on transfer of VDA. The withholding is to be undertaken at the time of credit or payment whichever is earlier. In case where the consideration arises in kind or in transaction of exchange, the person responsible for paying consideration shall before releasing consideration ensure that tax has been paid in respect of such transaction.

1.2. Issue for consideration

(i) On a blockchain network, it is customary for users to exchange one VDA for another VDA. Such coins are stored in wallet of both buyer and seller on network or with a custodian in online manner. Such transaction takes place in an instantaneous manner.

(ii) Hence, given that the transaction takes place online and in a quick manner, it will be onerous for the deductor to pay tax before release of consideration on lines of existing TDS provision for lottery winnings u/s. 194B. But unlike lottery winnings, where the payment of lottery winnings in kind can be deferred till payment of tax, it is technologically not possible to ensure tax payment before release of consideration in barter of VDAs which happens instantaneously.

(iii) Rule 30 of the Income-tax Rules, 1962 prescribes the time limit for payment of TDS i.e. (i) TDS to be paid on the date of deduction if challan is not furnished and (ii) TDS deducted is required to be paid before 7 days from the end of the month when tax is deducted or 30 April when the income is credited or paid in month of March where challan is furnished. The proviso to S.194S prepones the date of payment of TDS in case of transactions on exchange of VDA by requiring the deductor to pay TDS before release of consideration.

1.3. Our Recommendation

It is recommended that in order to avoid practically difficulty to payer, condition of payment of TDS before release of consideration may be relaxed to provide that the tax can be paid on or before the due date for payment of TDS.

2. Clarification on application of TDS on transactions undertaken through crypto exchange

2.1. Relevant provision of the Act

S.194S provides that deductor is required to deduct tax at source at the rate of 1% on consideration arising from transfer of VDA at the time of credit or payment whichever is earlier.

2.2. Issue for consideration

On certain platforms, buyers are not aware of the identity of the sellers. Similar to recognised stock exchange or commodity exchange, the buyers and sellers are not directly connected to each other. Hence, difficulty may arise in hands of buyers as they are not aware of details of seller. Similar issue arose in the context of TDS under section 194Q, 194O and TCS under section 206C. Considering the practical challenges of identification of counterparty, the CBDT granted exemption[1] to certain transactions traded through recognised stock/commodity exchanges.traded through recognised stock exchange, recognised clearing corporation etc.

2.3. Our Recommendation

Since the buyer in a crypto-exchange may not be able to identify the seller of VDAs in crypto-exchange, an appropriate clarification should be provided for providing exclusion from TDS under Section 194S.

3. Exclusion of certain items from wide scope of definition of virtual digital asset (VDA)

3.1. Relevant provision of the Act

(i) The definition of virtual digital asset (VDA) u/s. 2(47A) is wide in nature. It covers any information, code, number, token which are generated through cryptographic means "or otherwise". It covers any item with digital representation of value or which functions as store of value or unit of account or used for investment purposes, with or without consideration. Such asset should be capable of being transferred or stored or traded electronically.

(ii) The provision empowers Central Government to exclude any digital asset from definition of VDA. Further, the Government is also empowered to notify assets which can be regarded as non-fungible tokens (NFTs) within the scope of VDA.

3.2. Issue for consideration

(i) In digital ecosystem, various companies like online gaming, payment systems, credit card or debit card, etc. generate reward points on usage of the platform or app. Such reward points or credit points are used by customers or app users while undertaking in-app activity. In most cases, the in-app reward points are not marketable in other platforms but can only be redeemed on the platform to which they pertain to. The reward points are stored in the wallet on the platform in digital manner.

(ii) The definition of VDA refers to wide terms like "information", "token", "code", "number". It seeks to cover elements which are generated through cryptographic means "**or otherwise**". Given such wide meaning of the terms, it is possible that such definition may be erroneously interpreted to cover various other items like loyalty points, airline miles, discount coupons, digital bullion, etc.

[1] *Circular No. 17/2020 dated 29 September 2020 and 13/2021 dated 30 June 2021*

(iii) The Budget Speech on Finance Bill 2022 and Explanatory Memorandum to Finance Bill 2022 state that the intent of the scheme of VDA taxation is to tax voluminous transactions which take place in recent times. Generally, tremendous volume of transactions take place in case of cryptocurrencies. In case of reward points or miles or gift cards, such items are given on a particular platform for undertaking some activity on the platform like using as payment gateway, purchase or sale of goods, availing of services. There is no voluminous trading in such loyalty points or gift cards.

(iv) The definition of VDA also seeks to cover assets which are digital representation of inherent value. Such wide definition may be erroneously interpreted to cover dematerialised shares or securities which are held with custodian as such shares and securities are digital representation of value. Likewise, unit of account for investment purposes may be erroneously interpreted to cover virtual investment instruments like Mutual Funds, Bonds, Gold ETFs. The above assets are presently taxable on disposal under capital gains chapter or business chapter depending on the circumstances. Where the same get covered under wide definition of VDA, there will be ambiguity whether taxation will arise under new regime or other chapters of the ITL. Additional issues may arise on which withholding provision to apply, treaty implications etc. Surely, it is not the Government's intention to change the taxation regime for such well-regulated capital market instruments. The wide definition of VDA is intended to cover new types of VDA which may emerge in future with disruption in technology. Hence, it is necessary to clarify that the definition of VDA does not extend to regulated capital market instruments.

3.3. Our recommendation

(i) It is recommended that the scope of VDA should be restricted only to cryptographic assets which are generated through block chain / distributed ledger system, with powers to CBDT to include other digital assets on case-to-case basis. Further considering the intent of the scheme of taxation of crypto-assets, following items may be clarified to be specifically excluded from the scope of VDA –

- Reward points, airline miles, gift vouchers etc.
- Shares/ securities held in demat account
- Online investment instruments like digital bullion, Gold ETFs, Mutual Funds
- Banking Apps, payment gateways which merely facilitate transactions in fiat currency.
- In-app notional Gaming points (though called 'coins') etc

4. Clarification on determination of cost of acquisition where VDA is held as inventory

4.1. Relevant provision of the Act

(i) S.115BBH(2)(a) provides that no deduction is allowable in respect of expense or allowance or set-off of any loss in computing income from transfer of VDA except for "cost of acquisition", if any.

(ii) The Hon. Minister of State for Finance has also clarified in Lok Sabha on 21 March 2022 that infrastructure costs incurred in mining of VDAs will not be treated as cost of acquisition as the same will be in the nature of capital expenditure which is not allowable as deduction as per the provisions of the Act.

4.2. Issue for consideration

(i) The exact scope of "cost of acquisition" not being defined can result in ambiguity. Taxpayers may hold VDA as capital asset or stock in trade – although s.115BBH does not make any such distinction.

(ii) S.49 and S.55 of ITA provide for determination of cost of acquisition of a capital asset. Incidentally, the term 'transfer' which was not defined in proposed s.115BBH as per Finance Bill 2022 has been defined at enactment stage by borrowing the meaning from s.2(47) regardless of whether VDA is held as capital asset or not.

(iii) In case of traders who hold VDA as stock in trade may treat the VDA as inventory in books of accounts under applicable accounting standards. Under ICAI AS-2, inventory is required to be measured at cost or net realisable value (NRV) whichever is less. Ind AS 2 also requires the inventory to be valued at lower of cost and NRV except in case of commodity broker-trader, where inventory is valued at fair value less cost to sell.

(iv) The Income Computation and Disclosure Standards (ICDS) notified u/s 145(2) are relevant for determining income computation under profits and gains from business or profession and income from other sources. S.145A(i) r.w. ICDS II provides for valuation of inventory at cost or NRV whichever is lower.

(v) In case of individuals who are not subject to tax audit, provisions of ICDS are not applicable..

4.3. Our recommendation

It may be clarified how "cost of acquisition" should be computed in respect of VDA.

As one possible alternative, for VDAs held as capital asset, it may be clarified that "cost of acquisition" will be determined as per s.49 and s.55. This will be consistent with meaning of 'transfer' borrowed from s.2(47)

In case where VDA is held as inventory, in order to provide consistency of tax treatment by all taxpayers, it may be clarified that cost of acquisition of such inventory has to be determined basis principles of S.145A(i) r.w. ICDS II rather than general principles of accounting – even if ICDS II is not applicable to such taxpayer (like individual not liable for tax audit).

5. Clarification on manner of computation of "cost of acquisition" referred to in S.115BBH(2)(a)

5.1. Relevant provision of the Act

(i) S.115BBH(2)(a) provides that no deduction is allowable in respect of an any expenditure or allowance or set-off of any loss in computing income from transfer of VDA except for the cost of acquisition, if any.

5.2. Issue for consideration

Since VDAs are stored in digital wallets, issue arises whether taxpayer is mandatorily required to apply FIFO method to determine 'cost of acquisition' or can taxpayer apply other basis like weighted average or LIFO

5.3. Our recommendation

Where VDAs are held in digital wallet, it may be clarified whether taxpayer has to adopt FIFO or can adopt any other method like weighted average or LIFO for the purposes of computing 'cost of acquisition'. Reference in this regard may be made to Section 45(2A) which mandates FIFO method for securities held in demat account..

6. Appropriate valuation rules to be prescribed for receipt of VDA as gift or inadequate consideration

6.1. Relevant provision of the Act

(i) Finance Act 2022 has amended definition of "property" under clause (d) of Explanation to S.56(2)(vii) to include VDA. Such definition of "property" is applicable in case of S.56(2)(x) by virtue of Explanation to S.56(2)(x).

(ii) S.56(2)(x)(c) provides for taxation of income where property is transferred for NIL or inadequate consideration as compared to fair market value (FMV). The difference between FMV and consideration in excess of Rs. 50,000 is considered as income in hands of recipient.

(iii) Explanation to S.56(2)(x) r.w. clause (b) of Explanation to S.56(2)(vii) defines fair market value of property as per prescribed method. Rule 11UA prescribes the manner of determination of FMV of property.

6.2. Issue for consideration

(i) The amendment provides for gift taxation of receipt of VDA in hands of recipient where the VDA is received for NIL or inadequate consideration. While VDA has been included within the definition of property u/s.56(2)(x), there is no valuation mechanism prescribed for determination of value of VDA under Rule 11UA.

(ii) In absence of valuation mechanism for determining FMV of VDA, it is difficult to determine income chargeable to tax under S.56(2)(x)(c).

6.3. Our recommendation

Considering the nature of VDA and volatile nature of pricing of VDA, it is recommended that appropriate valuation rules should be introduced in Rule 11UA for valuation of VDA after giving due consideration to current market practices and without casting unreasonable burden on the taxpayers.

7. Determination of cost of acquisition where VDA received as gift

7.1. Relevant provision of the Act

(i) S.56(2)(x) provides that where VDA is received for NIL or inadequate consideration, the difference between FMV and consideration will be taxed as income in hands of recipient.

(ii) On subsequent transfer of VDA, S.115BBH taxes income on transfer of VDA at the rate of 30%. While determining income from transfer of VDA, S.115BBH allows deduction of cost of acquisition of VDA.

7.2. Issue for consideration

(i) S.49(4) provides that *"where capital gains arises from transfer of property"* which is taxed u/s. 56(2)(x), the FMV determined u/s. 56(2)(x) r.w. Rule 11UA is taken as cost of acquisition. S.49(4) is triggered when property is held as a capital asset resulting in capital gains on transfer. Likewise, S.49(1) provides that where capital asset is acquired by way of gift, the cost to previous owner is considered as cost in hands of done.

(ii) In the case of VDA, income from transfer will be subject to 30% tax under S. 115BBH. Hence, issues may arise whether provisions of S. 49(4)/ 49(1) in the present form will apply to VDA transfer covered under S. 115BBH? If answer to above is negative, issue arises what should be considered as cost of acquisition of such VDA which is received under S. 56(2)(x)?

7.3. Our recommendation

It is recommended to clarify that in context of VDA, the FMV which is taxed in hands of recipient u/s. 56(2)(x) shall be treated as 'cost of acquisition'.

8. Determination of situs for non-residents earning income from transfer of Virtual Digital Asset (VDA)?

8.1. Relevant provision of the Act

(i) S. 5 provides for taxation of income of NR which accrues/arises/ deems to accrue or arise in India. Section 9(1)(i) of ITL ('source rule') provides that any income accruing or arising, whether directly or indirectly, through or from any business connection in India, through or from any property in India, or through or from any asset or source of income in India or through the transfer of any capital asset situated in India, shall be deemed to accrue, or arise in India.

(ii) Section 115BBH provides for taxation of income from the transfer of any VDA. Further, amended S. 56(2)(x) provides for taxation of receipt of VDA for no or inadequate consideration in the hands of recipient of such VDA.

8.2. Issue for consideration

(i) Taxation under the new provisions apply for both resident as well as NR taxpayers. However, for creating a charge in the hands of NR, it would be imperative that the income is taxable under S. 5/ 9 of the Act.

(ii) Issue arises in what circumstances VDA can be considered as located in India or having its situs in India, to trigger taxation under S. 5/ S. 9(1)(i) of the ITA. In other words, which place should be considered as of situs of a VDA?

(iii) To illustrate, the above issue will be relevant to determine tax charge in cases like –

- Where non-resident sells VDA through an Indian crypto exchange or
- where non-resident sells VDA directly to a resident of India or
- where the non-resident carries on trading in crypto assets through an Indian crypto exchange.
- For residents of India to declare a VDA as foreign asset in its tax return in India.

8.3. Our recommendation

(i) Situs of VDA can be related to one of the following places –

- Place of the residence of owner of VDA – This is supported by the HC rulings in India dealing with situs determination of intangible assets[2] as well as guidance of the UK HMRC guidance[3]
- Place of IP Address of Block which represents the VDA – Each VDA is stored on a Block in the Blockchain which will have a unique IP Address of the node where the Block is created. Considering the VDA will always be stored on the particular Block, locale of such IP Address may be considered as situs of the VDA.
- Place of underlying asset (where VDA is digital representation of an underlying asset] – As per UK HMRC Guidance, where a virtual currency is issued as a representation of beneficial interest in any underlying asset (e.g gold bullion), the location of virtual currency is determined by reference to the location of the underlying asset.
- Place of utilization/ exploitation of VDA (E.g. VDA frequently traded on a crypto-exchange or VDA used as payment made for services/ goods)

(ii) Unlike shares, VDA is neither issued by any particular entity nor it is held in any digital account in any specific country. VDA is held on a decentralised digital ledger (DLT) which is not based on any particular location, though it has a unique address/ number on a block chain and is also owned by a person. It is recommended that

- Situs of VDA may be linked to place of residence of owner of such VDA. Such parameter of situs will be certain, easily determinable and can be applied for all forms of VDA including NFTs, stable coins.
- As a second option, place of IP Address of the block may be considered which will be unique and determinable through the information on the DLT.
- It is recommended that the situs of VDA should not be place of exploitation which may vary at different points of time. Further, place of underlying asset may be relevant only for stable coins whose value is pegged to an underlying asset. This will also have additional consideration of finding situs of the underlying asset.

9. Scheme for Taxation of Non-Fungible Tokens (NFT's)

[2] CUB Pty Limited v. UOI & Ors. (2016) (71 taxmann.com 315) (Delhi HC); Followed in Mahyco Monsanto Biotech Ltd. v. UOI [74 taxmann.com 92]; Lal Products v. Intelligence Officer [WP © 13408/2009] [Kerala HC]
[3] CRYPTO22600 - Cryptoassets Manual - HMRC internal manual - GOV.UK (www.gov.uk)

9.1. Background and Relevant provision of the Act

(i) A non-fungible token (NFT) is a unique and non-interchangeable unit of data which is stored on a digital ledger termed as blockchain and can be traded with interested buyers [4].

(ii) The process of creation of NFT involves creating a digital record of the underlying asset on the blockchain. The underlying asset may be a physical asset such as a painting or a digital asset such as a music video. At times, a gas fee may be charged by the blockchain administrator/NFT marketplace for creation of the NFT on the blockchain.

(iii) An NFT is a proof, i.e. token of ownership of the underlying digital/physical asset, which is stored on a secured digital ledger, i.e. blockchain. It may be equated to a share certificate evidencing ownership of the share. An NFT may not have any independent attributable value which can be delinked from the underlying asset.

(iv) Many physical assets such as paintings and real estate[5] have been sold recently via NFTs and the NFT market has been booming recently. These NFTs can also be used for secondary transfers of the underlying asset or spreading the ownership of underlying asset amongst several persons who can then independently sell their fractional ownership.

(v) Prior to insertion of s.115BBH, tax implications on sale of NFT were dependent on the tax implications of the sale of the underlying digital/physical asset tagged to the NFT.

(vi) The sale of the underlying asset may be taxed under the head 'income from business or profession', 'income from capital gains' or 'income from other sources' depending on the intent of holding the underlying asset, nature of asset and nature of income earned. Additionally, a deduction may be possible for costs associated with minting, i.e. creation of the NFT (gas fees) and charges paid to the NFT marketplace on the sale of the NFT under the respective head of income.

(vii) In this background, considering that NFT is merely a title record of underlying property, in the context of the new scheme of taxation for VDA introduced vide s.115BBH, it may not be justified to accord the same stiff tax treatment as is introduced for VDAs like bitcoins. This is primarily because bitcoins and NFTs do not share the same attributes and risk profile for taxpayers and Government.

Relevant provision

As per amendment by Finance Act 2022 –

(viii) S.2(47A) is inserted to define the term 'virtual digital asset'. S.2(47A) (b) states that VDA means, inter alia, "a non-fungible token or any other token of similar nature, by whatever name called". The class of NFT to be covered by the VDA definition as per s.2(47A) will be notified by the Central Government in the Official Gazette (hereinafter referred to as 'notified NFTs'). But the definition also covers any other token which is similar in nature to notified NFTs without requirement of separate notification for such other NFTs.

[4] https://en.wikipedia.org/wiki/Non-fungible_token

[5] https://propy.com/browse/propy-nft/ https://www.thehindu.com/scitech/technology/internet/virtual-real-estate-plot-sells-for-record-24-million/article37656785.ece

(ix) S.115BBH states that any income from transfer of a VDA (and consequently NFTs) shall be taxed at 30 per cent with no deduction allowed except for cost of acquisition. No set of off loss incurred on transfer of a VDA (and consequently NFTs) shall be allowed against income computed under any provision, including that from other VDA.

(x) S.194S provides for withholding at 1% on transfer of VDAs (and consequently NFTs) to a resident person subject to certain specified conditions.

(xi) Receipt of a VDA (and consequently NFTs) for no consideration/ inadequate consideration attracts tax in the hands of the recipient under s.56(2)(x).

9.2. Issue for consideration

(i) In light of the fact that an NFT is merely a title record of ownership of an underlying asset on the blockchain without any independent existence of its own which is very well covered within the present taxation, there is no need to impose a strict tax regime by equating NFTs with other VDAs like bitcoins. For instance, there is no dispute that a physical painting held by an art connoisseur is a capital asset and triggers capital gains on transfer for the transferor and gift taxation u/s. 56(2)(x) for the transferee if received for NIL or inadequate consideration. It is also covered by existing TDS/TCS provisions of s.194Q or 206C(1H) on sale to resident. There is no sufficient rationale for changing such normal tax treatment to a more stiff tax treatment as per s.115BBH merely because the art connoisseur decides to tokenise such painting and sell NFT to one or more persons instead of physical painting. The same holds true for other digital assets like music album, poems, digital pictures, etc

(ii) From a tax policy perspective, NFTs may not be comparable to other assets covered under VDA definition as per s.2(47A) such as bitcoin, Ethereum, etc which are not backed by an underlying asset. VDAs like bitcoin, Ethereum represents the asset in itself. The basis for the determination of the value of the NFT is definite, i.e. the underlying asset and hence it is more stable in nature, whereas the market forces of demand and supply may tend to lend VDAs like bitcoin and Ethereum like assets more volatility and risky from tax policy perspective.

9.3. Our recommendation

The Government may use the power to notify digital asset as NFT very sparingly. This is because the present scheme of taxation can effectively deal with the tax consequences on sale of underlying digital or physical assets. Mere tokenization of the same should not attract stiff tax consequences such as higher rate of tax at 30%, no allowance for any expenditure other than cost of acquisition and no set off of losses against income computed under any other provision of the ITL.

Even if some digital asset is notified as NFT, clarification/guidance may be provided on the impact of such notification in view of expanded scope of definition viz. 'any other token of similar nature, by whatever name called'. For example, if NFT of Amitabh Bachhan's rendition of Madhushala is notified under s.2(47A) as NFT, it may be clarified how the extended scope should be interpreted viz. (a) whether all NFTs of Amitabh Bachhan will get covered or (b) whether digital rendition of all poems like Madhushala will be covered or (c) NFTs using the same technology as Amitabh Bachhan's rendition of Madhushala will be covered.

Part B – Issues pertaining to withholding on business perquisites u/s 194R

10. Rationalisation of TDS on business perquisites u/s. 194R @ 10%

10.1. Relevant provision of the Act

(i) S.28(iv) brings to tax value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession. This provision has existed in the Act since A.Y. 1964-65. The effect of insertion of s.28(iv) was explained by CBDT Circular No. 20D dated 7 July 1964 as follows :-

> *"The effect of the above-mentioned 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."*

Relevant provision of s.194R:

(ii) The new TDS provision u/s. 194R requires the payer of such benefit to deduct tax @ 10% on payments to residents.

10.2. Issues for consideration

(i) We appreciate that the new TDS on provision of business perquisites is intended to gather information by the Tax Department. It will also help the beneficiaries since the information will appear in their Form 26AS/AIS and nudge them to pay correct amount of tax thereon. However, the new TDS provision raises several practical challenges for the industry.

(ii) The new TDS provision creates compliance hurdles in relation to valuation of the benefits or perquisites so sought to be taxed. In absence of valuation rules for perquisites on lines of Rule 3 for salary perquisite, there is challenge on valuation of the perquisites to deduct tax. Circular No. 20D provides example of rent-free residential accommodation provided to lawyer as an instance of perquisite taxable u/s. 28(iv). The valuation rules for providing rent-free or concessional accommodation to employees has undergone changes from time to time and since 2001 it is linked to percentage of salary paid to the employees to avoid the practical difficulties of ascertaining the fair value of such accommodation. If same yardstick is used to value business perquisites (like percentage of professional fees paid), it can cause immense practical difficulty.

(iii) Separately, there is distinction between bonafide selling expenditure and personal benefits. A company may organise conference of its dealers at a resort to explain its business strategy, new products, set sales targets, etc. Predominant time may be spent on bonafide business activity. Leisure activity may be incidental. In such case, the whole of the expenditure incurred by the company is for official purposes.

(iv) In many cases, freebies given have a definite business purpose of sales promotion. For instance, an equipment (- say, printer) may be given free with the object that the recipient will buy the consumables (like toner) required to run such equipment from the taxpayer. The equipment is used for business purposes of recipient. In this

case, there is effectively no 'benefit' or 'perquisite' for the recipient. If on one hand the value of equipment is not taxed in the hands of the recipient, the recipient is also not entitled to depreciation on such asset in absence of any 'actual cost' incurred by him.

(v) Free medical samples distributed to doctors has been held by SC in the case of Eskayef Ltd. etc. (245 ITR 116) as a sales promotion measure. In FBT regime, it was clarified that free samples of medical and other products distributed to doctors, trade or consumers was liable to FBT. Similarly, it was clarified that freebies like tattoos, cricket cards or similar products, to trade or consumers was liable to FBT. The free samples are customary business practice to increase the awareness of the company's products. There is no element of personal benefit for the recipient like doctor who dispenses them to his patients. Similarly, the cost of freebies like tattoos, cricket cards or similar products is embedded in the price of the main product. They are akin to special discount for making a product popular.

(vi) CBDT in its Circular No. 8/2005 dated 29 Aug 2005 in context of erstwhile Fringe Benefits Tax had clarified that the following benefits constitutes ordinary selling expenses and/or reduction from sales price and hence not liable to FBT:-

- Sales discount or rebates allowed to wholesale dealers or customers from the listed retail price
- Incentives given to distributors for meeting sales targets (including free goods given as incentive to distributors for achieving certain sales and cash incentives adjustable against future supplies)
- Bonus points given to credit card customers

(vii) If interest free or concessional loan is given by parent to subsidiary or to a customer or vendor, issue arises whether it will be considered as benefit or perquisite liable to TDS. It may be recollected that similar issue arose in context of salary taxation in the past. The SC in Salgaocar v CIT [243 ITR 383] held that not charging interest to the employee-director to whom the company advanced interest-free loans cannot be regarded as a perquisite in absence of a specific provision. This decision is now superseded by Rule 3(7)(i) which treats interest free or concessional loan as a perquisite for salary taxation.

(viii) In the above case, the value of benefit from interest free loan is already taxed in the hands of the recipient since he does not claim any interest expenditure on the said loan and hence, his business income is higher to that extent. If there is additional imputation of income, it will result in double taxation. To provide a simple illustration if a parent provides interest free loan of Rs. 1 Cr to a subsidiary, the subsidiary does not recognise any cost towards interest expenditure and hence, its business income already captures the value of such benefit. Despite this, if an additional notional interest income – say, Rs. 10 lakhs is imputed in its hands, then logically the same income should be allowed as deduction in its hands since the loan is used for business purpose and s.36(1)(iii) grants deduction for interest paid on capital borrowed for business purposes. If such deduction is not granted, it will result in double taxation. This can be understood by considering a comparable example where in one case (SubCo1), the loan is given at 10% interest and in another case (SubCo2), the loan is given on interest free basis. In SubCo1's case, there will be no imputation of notional interest income u/s. 28(iv) and it is also entitled to claim Rs. 10 lakhs as deduction u/s. 36(1)(iii). In SubCo2's case, since no interest is paid, business income is already higher by Rs. 10 lakhs. If there is further

addition of Rs. 10 lakhs u/s. 28(iv), its income will rise to Rs. 20 lakhs resulting in double taxation.

(ix) Sometimes freebies like IPL tickets, holiday package, television sets, computers, mobile phones, etc. are given to distributors/agents being legal entities which are actually availed by individuals associated with entities like directors/ partners/ employees, etc. Issue arises in whose name tax should be deducted in such cases – legal entity or individuals availing the benefit?

(x) Generally, industry follows a conservative approach for TDS considering that the payee can claim TDS credit while filing return of income whereas the payer runs the risk of disallowance of expense u/s. 40(a)(ia) in addition to withholding tax default proceedings. Following similar approach on business perquisites will create commercial disputes with the vendors or customers since the beneficiaries may resist such TDS on the ground that there is no 'benefit' or 'perquisite'. The taxpayer company may need to gross up the tax to ensure TDS compliance which will increase the cost of compliance for the industry. Also, wherever the recipients who have suffered TDS desire to put up claim of there being no 'benefit' or 'perquisite', they will suffer litigation if they claim TDS credit without offering corresponding income to tax.

(xi) An ambiguity may also arise in cases wherein it may not be clear as to who exactly is the "provider" of benefits. For instance, if a manufacturer pays a third-party vendor, who in-turn supplies some goods free of cost to former's dealer/ retailer, it is not clear as to who will be liable to comply with section 194R

10.3. Our recommendation

(i) The existing provision of S.295(2)(c) gives power to CBDT to prescribe rules for determination of the value of any perquisite chargeable to tax under the Act in such manner and on such basis as appears to CBDT to be proper and reasonable. The CBDT can use this power to prescribe valuation rules for business perquisites on lines of Rule 3 for salary taxation.

(ii) While prescribing such valuation rules, the CBDT may also clarify the distinction between bonafide business expense and personal perquisite. For instance, in salary perquisites, the distinction between performance of official duties and personal benefit is well recognised in Rule 3. Refer following instances :-

- In case of travelling, touring, accommodation provided for holiday availed by employee, it is clarified that if official tour is extended as vacation, expenditure incurred on vacation will be treated as perquisite. If family member accompanies employee on official tour, expenditure on family member is treated as perquisite. Thus, expenditure incurred on official tour for employee is not treated as perquisite.
- Credit card expenses incurred wholly and exclusively for official duties is not treated as perquisite.
- Club payments incurred wholly and exclusively for official duties or health club, sports and similar facilities provided uniformly to all employees by the employer is not considered as perquisite.
- Use of employer's assets like laptops and computers is not considered as perquisite

- Expenses on telephone expenses including mobile phone is not considered as perquisite.

(iii) Sales discount or rebates allowed to wholesale dealers or customers from the listed retail price or incentives given to distributors for meeting sales targets (including free goods given as incentive to distributors for achieving certain sales and cash incentives adjustable against future supplies) or bonus points given to credit card customers or similar benefits and rewards may be clarified as not constituting benefit or perquisite since they are ordinary selling expenditure and/or represent discount to the selling price.

(iv) In case of provision of asset or interest-free/concessional loan, it may be clarified that it will be regarded as business perquisite only if the recipient does not use the asset or the loan for business purposes. Alternatively, with a view to avoid double taxation, it may be clarified the amount taxed as perquisite can be claimed as deduction by way of depreciation allowance for asset or revenue deduction for others.

(v) The SC in the case of Mahindra & Mahindra [2018] 404 ITR 1 (SC) held that monetary benefits are not covered by s.28(iv). Hence, it may be clarified that monetary benefits like trade discounts or rebates are not covered by TDS u/s. 194R.

(vi) It may also be clarified whether TDS u/s 194R applies on benefits provided by pharma companies to doctors employed by hospitals and if yes, whether TDS to be made in name of hospitals or doctors. This is because s.194R applies to benefits or perquisites provided arising from business or exercise of profession by the recipient. The employee doctors are not carrying on business or profession.

(vii) Further, whether deduction of tax is to be carried out in name of the individuals actually availing the benefit or the legal entity having business relationship with the payer may be expressly clarified. While providing such clarification, due consideration may be given to the fact that in some cases, the payer may simply give the benefit to the legal entity and leave it to the discretion of legal entity to identify the individuals who will actually avail the benefit. For instance, payer may give free television sets as perquisite to its dealer (a company or LLP or firm) and the dealer may decide the individuals (whether directors, partners or employees) to whom the free television sets will be distributed.

(viii) It is recommended to issue detailed guidelines on various instances covered under section 194R. Specific exceptions may also be notified which would not be covered as benefit or perquisite to make the law free from interpretation. Additionally, it is strongly recommended that the new TDS provision may be deferred till industry is provided full clarity on above referred issues. The guidelines may be issued after adequate public consultation.