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OPINION

There have been a number of occasions when some of my clients and some other entities have sought my opinion regarding the issue whether tax is required to be deducted at source, in respect of reimbursement of expenses, under the provisions of Chapter XVII-B of the Income-Tax Act, 1961 (the Act).

In this context, it may be stated that the income-tax authorities have been insisting that in view of Answer to Question No.30, as provided in Circular No.715, dated 8.8.1995, issued by the CBDT [*215 ITR (St) 12*], tax is to be deducted at source out of the gross amount of the bill, including the reimbursements. For the sake of ready reference, the aforesaid Question No.30 and Answer thereto, are reproduced as follows :

Question 30 : Whether the deduction of tax at source under section 194C and 194J has to be made out of the gross amount of the bill including reimbursements or excluding reimbursement for actual expenses?

Answer : Sections 194C and 194J refer to any sum paid. Obviously, reimbursements cannot be deducted out of the bill amount for the purpose of tax deduction at source.

From the aforesaid Question No.30 and Answer thereto, it may be seen that as per the CBDT, the tax is to be deducted at source, out of the gross amount of the bill, including reimbursements, because reimbursements cannot be deducted out of the bill amount for the purpose of tax deduction at source.

In order to overcome the aforesaid view of the CBDT, it is advisable that a separate bill is prepared in respect of reimbursement of expenses incurred by the person raising the bill for such expenses. In other words, the amount to be reimbursed should not be included in the same bill, which the person rendering certain services, raises in respect of fees for such services.

In this regard, a reference may also be made to the judgement of Delhi Bench of the Tribunal in the case of *ITO Vs. Dr.Willmar Schwabe India (P) Ltd. [2005] 95 TTJ 53 (Del).* One of the issues before the Hon. ITAT in the above case was TDS in respect of reimbursement of expenses where the consultant had raised a separate bill for such expenses. In this case, as per agreement between the assessee company and M/s.Indochem Techno Consultants Ltd, a vehicle was to be provided by the assessee company to the said consultant for attending to its work and thus, the assessee company was to bear the vehicle expenses actually incurred by the said party. Bills for such expenses incurred by the said consultant were separately raised on the assessee company, in addition to bills for fees payable on account of technical services.

It was held by the Hon. Tribunal that since the amount of bills so raised was towards the actual expenses incurred by the consultant, there was no element of any profit involved in the said bills. It was, thus, a clear case of reimbursement of actual expenses incurred by the consultant and the same, therefore, was not of the nature of payment covered by section 194J, requiring the assessee to deduct tax at source therefrom.

It was further held that CBDT Circular No.715, dated 8.8.1995, relied upon by the Assessing Officer (AO) in support of his case on the aforesaid issue was applicable only in cases where bills were raised for the gross amount, inclusive of professional fees as well as reimbursement of actual expenses and the same, therefore, was not applicable to the facts of the present case, where bills were raised separately by the consultant for reimbursement of actual expenses incurred by them.

In the light of the aforesaid reasons, it is advisable that the bill in respect of reimbursement of actual expenses incurred, should be separately raised and the same should not be included in the bill which is raised in respect of payment by way of professional fees, etc.

In order to address the issue whether tax is required to be deducted at source, in respect of reimbursement of expenses, it will be necessary to keep in mind the following two aspects, viz :

(i) Tax is deductible at source under Chapter XVII-B of the Act, only in respect of payment of income or other sum made by the person responsible for such payment, viz. tax-deductor to other person being the tax-deductee, and

(ii) Reimbursement of expenses does not partake the nature of income in the hands of the payee of such expenses.

Both the aforesaid aspects are discussed as follows :

I. Tax is deductible at source only in respect of payment of income or other sum comprising an element of income.

The relevant provisions of the Act, will clearly prove that tax is deductible at source only in respect of income. This view clearly emerges from the reading of the TDS provisions under the Act and also in view of the relevant legal precedents. The same are discussed as follows :

1. Section 4 – Charge of income-tax.

Section 4 of the Act is the charging section and the power to deduct tax at source is derived from the provisions of section 4(2) of the Act.

For the sake of ready reference, section 4 of the Act is reproduced as follows :

Charge of income-tax.

4. *(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions including provisions for the levy of additional income-tax of, this Act in respect of the total income of the previous year of every person :*

Provided *that where by virtue of any provision of this Act income-tax is to be charged in respect of the income of a period other than the previous year, income-tax shall be charged accordingly.*

(2) In respect of income chargeable under sub-section (1), income-tax shall be deducted at the source or paid in advance, where it is so deductible or payable under any provision of this Act.

From the aforesaid provisions of section 4(2), it is quite clear that income-tax is deductible at source, in respect of income chargeable to tax under section 4(1) of the Act. In other words, it is quite clear that tax is deductible at source, in respect of income, which is chargeable to tax under the Act.

2. Section 190 – Deduction at source and advance payment.

Section 190 falls under Chapter XVII-A and its heading is '*Deduction at source and advance payment'*. For the sake of ready reference, section 190 is reproduced as follows :

Deduction at source and advance payment.

190. *(1) Notwithstanding that the regular assessment in respect of any income is to be made in a later assessment year, the tax on such income shall be payable by deduction or collection at source or by advance payment or by payment under sub-section (1A) of section 192, as the case may be, in accordance with the provisions of this Chapter.*

(2) Nothing in this section shall prejudice the charge of tax on such income under the provisions of sub-section (1) of section 4.

From the aforesaid provisions of section 190, it is clear that tax is deductible at source, in respect of any income. Thus, the provisions of section 190 also make it clear that tax is deductible at source only in respect of an amount which partakes the nature of income and not otherwise.

3. *Section 191 – Direct payment*

Section 191 also falls under Chapter XVII-A and it deals with a situation where an assessee has to make payment of tax directly in respect of income, which is not subject to the provisions of TDS or where though it is subject to TDS provisions, but no TDS has been deducted at source in respect thereof. For the sake of ready reference, section 191 is reproduced as follows :

Direct payment.

191. *In the case of income in respect of which provision is not made under this Chapter for deducting income-tax at the time of payment, and in any case where income-tax has not been deducted in accordance with the provisions of this Chapter, income-tax shall be payable by the assessee direct.*

Explanation.—For the removal of doubts, it is hereby declared that if any person including the principal officer of a company,—

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of section 192, being an employer,

does not deduct, or after so deducting fails to pay, or does not pay, the whole or any part of the tax, as required by or under this Act, and where the assessee has also failed to pay such tax directly, then, such person shall, without prejudice to any other consequences which he may incur, be deemed to be an assessee in default within the meaning of sub-section (1) of section 201, in respect of such tax.

From the aforesaid provisions of section 191, it may be seen that in the case of income, in respect of which provision is not made under Chapter XVII of the Act, for deducting income-tax at source at the time of payment and in any case where income-tax has not been deducted in accordance with the provisions of the said Chapter, income-tax shall be payable by the assessee directly.

Thus, even from the provisions of section 191 of the Act, it is clear that tax is deductible at source only in respect of income.

4. ***Judgement of Karnataka High Court, in the case of Hyderabad Industries Ltd Vs ITO [1991] 188 ITR 749 (Karn)***

   It was held in this case that amounts exempt under section 10A of the Act, do not constitute income for the purpose of section 195 and therefore, no tax is deductible at source, in respect of such amount. The relevant observations of the Hon. High Court on page 752 of the Report are reproduced as follows :

   The construction sought to be placed by the respondents is based on a distinction which has no substance in it. It is not understandable as to why a benefit which will not be included in the total income of a person, should be considered as "income" for the purpose of deduction of tax at source at all. The purpose of deduction of tax at source is not to collect a sum which is not a tax levied under the Act. The interpretation put on those provisions by the respondents would result in collection of certain amounts by the State which is not a tax qualitatively. Such an interpretation of the taxing statute is impermissible.

   From the aforesaid observations of the Hon. High Court, it is clear that a benefit or amount which will not be included in the total income of a person, should not be considered as '*income*', for the purposes of deduction of tax at source, at all.

5. ***Vijay Ship Breaking Corporation Vs CIT [2009] 314 ITR 309 (SC)***

   It was, *inter alia*, held in this case that the assessee was not liable to deduct tax at source on usance interest paid on the purchase of vessels from outside India for the purpose of ship breaking, since it was exempt from payment of income-tax under the Act.

6. ***GE India Technology Centre P.Ltd Vs CIT [2010] 327 ITR 456 (SC)***

   It was held in this case that a person paying interest or any other sum to a non-resident is not liable to deduct tax, if such sum is not chargeable to tax under the Act.

From the aforesaid provisions of the Income-Tax Act, 1961 and the legal precedents, it is clearly established that tax is deductible at source, only in respect of income or any other sum which comprises an element of income.

Obviously, an expenditure incurred by the payee cannot partake the nature of income in his hands and therefore, no tax is deductible at source in respect of payment or reimbursement of such expenditure by the payer.

II. Reimbursement of expenses does not partake the nature of income in the hands of the payee of such expenses.

As already pointed out, an expenditure incurred by the payee cannot form part of income in his hands and therefore, no tax will be deductible at source therefrom, under the provisions of Chapter XVII-B of the Act.

In other words, no tax will be deductible at source at the time of payment or reimbursement of the aforesaid expenses by the payer or the tax-deductor to the payee or tax-deductee.

In support of the aforesaid stand, reliance is placed on the following legal precedents :

1. ***ITO Vs Dr.Willmar Schwabe India (P) Ltd. [2005] 95 TTJ 53 (Del)***

   In this case, one of the issues before the Hon. Bench of the Tribunal, was TDS in respect of reimbursement of conveyance expenses.

   As per agreement between the assessee company and Indochem Techno Consultants Ltd, a vehicle was to be provided by the assessee company to the said consultant for attending to its work and thus, the assessee company was to bear the vehicle expenses actually incurred by the said party. Bills for such expenses incurred by the said consultant were separately raised by him on the assessee company, in addition to bills for fees payable on account of technical services.

   It was held that since the amount of bills so raised was towards the actual expenses incurred by the consultant, there was no element of any profit or income involved in the said bills. It was, thus, a clear case of reimbursement of actual expenses incurred by the consultant and the same, therefore, was not of the nature of payment covered under section 194J, requiring the assessee to deduct tax at source therefrom.

2. ***Mahindra and Mahindra Ltd Vs Dy.CIT [2009] 313 ITR (AT) 263 (Mum)(SB) : 22 DTR (Trib) 361 (Mum)(SB).***

   It was, *inter alia*, held in this case that reimbursement of expenses cannot be considered to be in the nature of income and therefore, it is not income by way of fees for technical services.

   It was further held that when a particular amount of expenditure is incurred and that sum is reimbursed as such, that cannot be considered as having any part of it in the nature of income. Any payment, in order to be brought within the scope of income by way of fees for technical services under section 9(1)(vii) should, be or have at least some element of income in it. Such payment should involve some compensation for the rendering of any services which can be described as income in the hands of the recipient. In other words, the component of income

must be present in the total amount of fees paid for technical services to constitute an item falling under section 9(1)(vii). Where the expenditure incurred is reimbursed as such without having any element of income in the hands of the recipient, it cannot assume the character of income deemed to accrue or arise in India and accordingly, there was no obligation to deduct tax at source therefrom under section 195 of the Act.

3. ***JDIT (Int.Tax) Vs.KRUPP UHDE GmbH [2009] 26 DTR (Trib) 289 (Mum):[2010]1 ITR 614 (Mum)***

   It was, *inter alia*, held in this case that amounts received by the assessee towards reimbursement of expenses were not liable to tax as fees for technical services.

4. ***Nathpa Jhakri Joint Venture Vs ACIT [2010] 5 ITR (Trib) 75 (Mum)***

   It was held in this case that reimbursement of expenses was not income in the hands of the non-resident and therefore, not liable to TDS under section 195 of the Act.

   It was further held that it is axiomatic that tax is charged on income and not on receipts. The reimbursement of expenses by the Indian assessee to the non-resident was not taxable in the hands of the non-resident. Only if the sum paid or credited is chargeable to tax in the hands of the payee, the assessee is liable to deduct tax at source. If the assessee payer did not move application under sub-section (2) of section 195 of the Act, it could not be held that the liability to deduct tax at source had automatically arisen. As the reimbursement of expenses was not taxable in the hands of the payee, the assessee was not liable to deduct tax at source.

5. ***Expeditors International (India) P.Ltd Vs Addl.CIT [2010] 2 ITR (Trib) 153 (Del)***

   It was, *inter alia*, held in this case that the amount paid by the assessee company to its parent company, on account of reimbursement of expenses incurred in respect of global accounts manager, could not be treated as payment of salary, so as to attract the deduction of tax at source. It was a case of reimbursement of common expenses incurred by the parent company for the benefit of all the group concerns, including the assessee company, which do not attract any deduction of tax and disallowance could not be made by invoking the provisions of section 40(a)(iii) for non-deduction of tax from reimbursement.

6. ***Linklaters LLP Vs ITO (Int.Tax) [2011] 9 ITR (Trib) 217 (Mum)***

   It was, *inter alia*, held in this case that reimbursements received by the assessee were in respect of specific and actual expenses incurred by the assessee and do not involve any mark up. Besides, there was reasonable control mechanism in place to ensure that these claims were not inflated and the assessee had furnished sufficient evidence to demonstrate the incurring of expenses. There was, thus, no reason to make any addition to income in respect of the reimbursement of expenses.

III. Conclusion

In the light of the discussion in the preceding paras (I) and (II), it is clearly established that –

1. Tax is deductible at source only in respect of payment of income or other sum comprising an element of income.
2. Reimbursement of expenses does not partake the nature of income, in the hands of the payee of such expenses.

In view of the aforesaid reasons, tax is not deductible at source, in respect of payment or reimbursement of expenses incurred by the payee.

It may, however, be reiterated that the bill in respect of expenses required to be reimbursed should be separately raised on the payer thereof.

The aforesaid query raised by the various clients and other entities stands answered, accordingly.

Place : Pune (S.K.Tyagi)

Date : 6.3.2012