

Tax Alert: Payment by manufacturer to dealer against free service coupons liable to TDS under section 194C

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Summary

The Mumbai bench of the Income Tax Appellate Tribunal (ITAT) in a recent case¹ has held that tax is deductible under section 194C of the Income-tax Act, 1961 (the Act) from payment made by the automobile manufacturer to dealers for free services provided by the dealers to the ultimate customers against free services coupons given to customers at the time of sale of vehicles. The ITAT observed that the service provided by the dealer is to discharge the obligation of the manufacturer. Accordingly, the ITAT held that since the taxpayer had failed to deduct at source from such payments, it is disallowable² under the Act.

The ITAT however restored the matter back to the tax officer to verify if the dealer has in turn included the receipts in his total income and paid taxes on it. If that be the case, disallowance would not be attracted.

Facts of the case

- The taxpayer is a vehicle manufacturer. While selling vehicles to the ultimate customers, it provided free service coupons³ which could be redeemed by the customer at any of the authorised dealers of the taxpayer.
- At the time of availing the free service, the customer would present the coupon to the dealer who in turn would provide the service to the customer for no charge.
- Subsequently, the dealer would present the coupon to the taxpayer, who in turn would pay a pre-determined sum of money to the dealer for the services rendered by the dealer.
- During AY⁴ 2007-08, it made certain payments without deduction of tax at source to the automobile dealers against free service given by them to the ultimate customers.
- The tax officer treated the payment to be pursuant to a contract as per which the dealer provided service on behalf of the taxpayer. Thus, the tax officer held that there was a principal-to-agent relationship between the taxpayer and the dealer on which tax was deductible at source on the payment made to the dealer under section 194C of the Act.
- Accordingly, the tax officer disallowed the payment² since the taxpayer had failed to

¹ Mahindra & Mahindra Ltd vs DCIT [ITA No 382/Mum/2017]

² Under section 40(a)(ia) of the Act

³ The service coupon enabled the ultimate customer to obtain certain number of services for their vehicle from any dealer forming part of the network of the dealers of the taxpayer across the country.

⁴ Assessment year

deduct tax at source from the payments made to the dealer.

- The first appellate authority⁵ held against the taxpayer and also observed that the Mumbai bench of the ITAT in the case⁶ of the taxpayer's sister concern has upheld the disallowance on similar facts.

Issue before the ITAT

- Whether tax is required to be deducted at source⁷ at the time of making payment to dealers towards service coupons
- Whether disallowance⁸ is to be made in a case where the taxpayer has not been held to be an 'assessee-in-default'⁹

Taxpayer's contention

- The taxpayer argued that payment made to the dealer towards service coupons was reimbursement of expenses incurred by the dealer for providing free services to the ultimate customers. Reimbursement of expenses did not attract any obligation to deduct tax at source.
- The taxpayer further argued that the service coupon charges were part of the sale price of the vehicle and hence it made a provision for service charges in its books of accounts.

- The taxpayer also contended that the relationship between the taxpayer and the dealer was on a principal-to-principal basis.
- Alternatively, it was submitted that since the taxpayer was not held to be an 'assessee in default'¹⁰, disallowance of expenses under the provisions¹¹ of the Act was not warranted.
- Moreover, the taxpayer, relying on High Court rulings¹², submitted that the disallowance, if any, should be restricted to 30% of the expenses only.

Held by ITAT

- The ITAT noted the business model of the taxpayer and the automobile industry in general and observed that the cost of free service obligation was factored in the sale price of vehicle at the time of sale. The customer at the time of purchasing the vehicle pays for the value of the service coupons which is embedded in the sale price itself.
- The ITAT further noted that since at the time of sale of vehicle, it is not ascertainable as to from which dealer the customer will avail the free services, the taxpayer enters into a back-up contract

⁵ Commissioner of Income Tax (Appeals)

⁶ M/s Mahindra Navi Star Automobiles Ltd v DCIT [ITA No 3324 & 4645/Mum/2013, dated 13 May 2016]

⁷ Under section 194C of the Act

⁸ Under section 40(a)(ia) of the Act

⁹ As per provisions of the Income-tax Act, 1961, where a person fails to deduct at source, he shall not be treated as an assessee-in-default' and consequently, disallowance under section 40(a)(ia) is not attracted if

the resident payee satisfies certain conditions viz (i) has furnished his return of income (ii) has taken into account such sum for computing income and (iii) has paid the tax due on the income declared by him.

¹⁰ First proviso to section 201(1) of the Act

¹¹ Section 40(a)(ia)

¹² CIT v Ansal Land Mark Township P. Ltd. [2015] 377 ITR 635 (Del)

with the dealers who are then obliged to provide free services for a vehicle sold by the taxpayer through any dealer. The dealer who renders the service is then paid by the taxpayer.

- The ITAT, on perusal of the agreement between the taxpayer and dealers, observed that the dealers are obliged to render free services to the customer on surrendering the free service coupons by them.
- The ITAT observed that as the taxpayer had already recovered the value of free services at the time of sale of vehicles, the dealer merely discharges the obligation of the taxpayer. In fact, the taxpayer is the actual beneficiary of the value of service provided by the dealer.
- Thus, the ITAT held that the payment made by the taxpayer is not in the nature of reimbursement of expenditure and is in fact in the nature of payment for consideration pursuant to a contract as per which the dealer provides such services to the ultimate customers on behalf of the taxpayer.
- Accordingly, the ITAT held that tax is deductible from such payments under section 194C of the Act.

- As regards the taxpayer's alternate ground of non-applicability of section 40(a)(ia) in the instant case, the ITAT held that if the taxpayer satisfies the prescribed conditions¹³, disallowance under the Act shall not be attracted. The ITAT accordingly, restored the matter back to the file of the tax officer for necessary verifications.

Our comments

Although the issue in the instant case is related to payment made by vehicle manufacturers to their dealers against free service coupons, this ruling could have implications in respect of transactions having a similar fact pattern. In particular, the ruling should be evaluated to analyse TDS implications in transactions involving back-to-back service arrangements, eg AMC contracts.

¹³ Under section 40(a)(ia) read with section 201(1) of the Act

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