

## TDS ON AWARD BASED ON COMPETENCE & MERIT CONTEST



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### INTRODUCTION

**1.1.01** Tax Deduction at Source (TDS) is normally required to be deducted on any lottery or award given to anybody. However, there are many competition and awards where prizes are given to organisations or individuals based on the merit or performance. It has been legally debated whether TDS should be deducted against such awards.

**1.1.02** The provisions of Section 2(24)(ix) read with Section 194B of the Income Tax Act, 1961 require that TDS should be deducted against any prize money or award given to anybody in a game of 'lottery' or any other game whatsoever. In this context the issue arises whether award money given to various candidates/entities for their merit will also be subjected to TDS. For instance, if a Chamber of Commerce or Trade Association grants award to the best entrepreneur or innovator

in a particular field, will such payment attract TDS provisions under Section 194B, or an NPO is awarded prize money for best presented annual report will attract TDS provisions ? In this article we shall discuss the TDS implications on those awards which are not based on 'chance' or 'lottery'.

**1.1.03** In this issue we shall concentrate on the law and controversies in this regard. A summarized overview is provided as under :

- (a) Any award or lottery based on participation fee and chance is subject to TDS under section 194B of the Income Tax Act, 1961.
- (b) However, awards given based on merit and performance may not fall under the provisions of section 2(24)(ix) read with section 194B.
- (c) The short listing of such award process should be based on the merit and past work/performance of the applicant. In other words, the process should only unravel the pre-existing or inherent merit and competence. The participants should not win through lot or chances.
- (d) Such award money is not covered by the definition of "income" section 2(24)(ix), as it cannot be considered as a lottery or game of any sort, with or without an element of chance.
- (e) Section 194B is not applicable where the money is given in recognition of pre-existing or inherent merit and competence.
- (f) The award given to the winners should be treated as voluntary grant towards advancement of the objectives.
- (g) For the purposes of TDS, in our opinion there is no other provision which applies to voluntary grants given to the winners of this particular event.
- (h) The TDS provisions shall remain the same even for grant given by commercial organisations though deductibility of such award as business expenditure might be a subject matter of case to case applicability.

### **DOES SUCH AWARD MONEY FALL UNDER SECTION 2(24)(IX)**

**1.2.01** The first important issue to be understood in this regard is whether the award money given to the awardees, falls within the definition of income as defined under Section 2(24)(ix) in order to attract TDS provisions of Section 194B. The text of Section 2(24)(ix) is as under :

*"[(ix) any winnings from lotteries, crossword puzzles, races including horse races,*

*card games and other games of any sort or from gambling or betting of any form or nature whatsoever;]*

*[Explanation : For the purposes of this sub-clause,—*

*(i) “lottery” includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;*

*(ii) “card game and other game of any sort” includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game;]”*

**1.2.02** Section 2(24)(ix) was amended by the Finance Act, 2001 effective from the assessment year 2002-03. The scope of the section was broadened by insertion of two explanations. The explanation (i) to Section 2(24)(ix) states that *“lottery” includes winnings, from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;* In the instant context the question arises whether the words **“or in any other manner whatsoever”** could in any way be implicated to deem that the awards given on merit are income for the purposes of Section 2(24)(ix).

**1.2.03** **In our opinion the explanation (i) to Section 2(24)(ix) is confined to the term “lottery” irrespective of the fact whether it is awarded through lots or chance or any other manner.** Therefore, any award or prize money given to deserving candidates which is not based on equal chance of winning, should not fall within the scope of Section 2(24)(ix). In this context the important thing to note here is that equal chance of winning and equal opportunity of winning are two distinct issues.

**1.2.04** It may also be noted that the Memorandum and the Notes to the Finance Bill, 2001 wherein the amendments to Section 2(24)(ix) were made, also clarify that the section applies only to “lottery” or any other game whatsoever. After the amendment the widened scope of Section 2(24)(ix) now includes any kind of lottery or game whether played on “chances” or otherwise.

## **IS THE AWARD A CHARITABLE ACTIVITY**

**1.3.01** When the award is given by a charitable organisation it is important to ensure that such award can be considered as a charitable activity towards advancement of general public utility. The issues which makes a merit based award distinct from a lottery or a game are as under :

- The participation is not open to all, only participants fulfilling the criteria of competence and merit can participate.

- The award money is provided without any consideration and the participants do not pay any participation fees. Therefore, it will be analogous to a grant or voluntary contributions.
- The identification of the winners is done through objective and scientific processes where all the participant do not have equal chance of winning. **They have an equal opportunity of winning but the chance of winning is not equal.** It is more like unravelling a pre-existing fact. A winner is declared based on a pre-existing or inherent attribute/skill.

**1.3.02** The methodology of selecting or shortlisting the awardees may create an illusion of a chance based scheme. Even then, in our opinion, the methodology used for selecting winners cannot override the overall charitable purpose. The more important issue is whether the programme can be treated as a charitable activity and whether the awardee can be treated as valid beneficiaries of a charitable programme. There is no plausible infirmity on both counts.

**1.3.03** Further under the current definition of “Charitable Purpose” there is no scope for engaging into lottery or game (the way it is defined under the income tax act) for advancement of charitable activities. Therefore, if the award money were to fall under section 194B then the larger question of charitable nature of the organisation/activity will arise.

## WHEN TDS UNDER SECTION 194B IS DEDUCTED

**1.4.01** Any entity should deduct tax at source under section 194B if it is engaged in (i) lottery (ii) crossword puzzles (iii) card games or any other game of any sort any form or nature whatsoever.

**1.4.02** A merit based award should not be called as “other game of any sort” nor could it be called as “lottery” or “crossword puzzle” or “card games”.

**1.4.03** The statutory provisions are fairly unambiguous regarding the applicability of Section 194B. In our opinion Section 194B is not applicable and TDS is not required to be deducted. There are some case laws which are cited below to understand the legal ratio of the issue.

**1.4.04** In the case *Income tax officer v. Malayala Manorama Co. Ltd. (2005) 94 ITD 195 (Cochin-Trib)*, the assessee conducted contest ‘World cup Football Forecast Contest’ and did not deduct tax at source on the winners who were selected on draw only. The facts related to assessment year 1998-99 and at that time the Explanation to

section 2(24)(ix) was not there in the statute. Only the Finance Act, 2001 inserted the Explanation to section 2(24)(ix), explaining the term “lottery”. The Tribunal hence held that for to be categorized as a lottery there must be two ingredients, viz., distribution of property by chance or lot among the participants and the participants have either paid or agreed to pay a valuable consideration for the privilege of participation in the scheme. In this case it clear that section 194B applies only to “lottery” and “games” were there is an element of chance and there is a consideration flowing from the participants.

**1.4.05** In the case *Sampanna Kuries (P.) Ltd. v. ITO* [2004] 141 Taxman 615 (Ker.) the essential elements of ‘lottery’ were discussed and the following was held : (i) a prize or some advantage in the nature of a prize; (ii) distribution thereof by chance; and (iii) consideration paid or promised for purchasing the chance. Thus, unless all the three elements are satisfied, the prize scheme cannot be considered as a lottery. A price must be charged for participating in the draw. The chance of a person getting the prize could not be treated as part of the bargain unless independent consideration was there with respect to the prize awarded. Similar views were also taken in the case *Canaan Kuries & Loans (P.) Ltd. v. Income-tax Officer* [2005] 142 TAXMAN 249 (KER.).

## **IS TDS REQUIRED TO BE DEDUCTED ON GRANT OR VOLUNTARY CONTRIBUTIONS**

**1.5.01** The payment made to the awardees in case of a merit based award, in our opinion, is a voluntary contribution in the absence of any *quid pro quo* or any contractual rights on the part of the recipient. Here again the issue arises should TDS be deducted on payment of grant or voluntary contributions. In the case *Addl. CIT v. K. Ramabrahmam & Sons (P.) Ltd.* [1978] 115 ITR 369 (AP), it was decided that any gift or voluntary payments which were not bound by any obligation were not subject to TDS. The relevant extract is as under :

*“Payments were voluntarily made by the assessee in connection with its business. The payments represented cash receipts in the hands of the recipient and there was no contractual obligation on the part of the assessee to make payments; nor was there any right on the part of the non-residents to receive these amounts.*

*In these circumstances, these payments could not be regarded as income chargeable under the Act. There was no obligation on the part of the payer, and no right to receive the same by the recipient. Payments did not arise out of any contract or obligation between the assessee and the recipients. There was no obligation either by virtue of a contract or in law to make these payments. They*

*were made voluntarily by the assessee towards entertainment of the crew. Therefore, it was held that 195(1) was not attracted in the instant case.”*

**1.5.02** It may be noted that this case pertains to the period when gifts were not included under section 56 as income but from a TDS perspective this case is still relevant. The TDS provisions shall remain same even for grant given by commercial organisations though deductibility of such award as business expenditure might be a subject matter of case to case applicability

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Published by **Mr. Sanjay Patra** on behalf of  
**FINANCIAL MANAGEMENT SERVICE FOUNDATION**  
C-56/47, 3rd Floor, Sector-62, NOIDA-201307,  
Tel. : 91-120-4773200, website : fmsfindia.org,  
e-mail : fmsf@fmsfindia.org



**Voluntary Action Network India (VANI)**  
BB-5, Greater Kailash Enclave Part - II,  
New Delhi - 110048  
www.vaniindia.org