SECTION 194C: PAYMENTS TO CONTRACTORS AND SUB-CONTRACTORS

(1) Section **194C** provides for deduction of tax at source from the payment made to contractors and sub-contractors.

(2) Any person responsible for paying any sum to a resident contractor for carrying out any work or supplying labour for carrying out any work (including supply of labour for carrying out any work) in pursuance of a contract between the contractor and the Central Government, a State Government, local authority, statutory corporation, a company, cooperative society, any statutory authority dealing with housing accommodation, any society registered under the Societies Registration Act, 1860, any trust or any university or any firm must deduct income-tax at the prescribed rate from such sum at the time of credit or payment, whichever is earlier. Scope of TDS provisions expanded **w.e.f. 1.6.2007** to cover contract payments by specified individuals/HUFs also. Payments made by Individuals/ HUFs to a contractor to attract TDS if their total sales/turnover exceeds **Rs.40 lakhs** (in case of business) and gross receipts exceed **Rs.10 lakhs** (in case of profession) in the immediately preceding financial year. However, relief has been provided in respect of payments made by individuals/HUFs to a contractor exclusively for personal purposes.

(3) The prescribed rate is **1%** in the case of advertising and **2%** in any other case.

(4) A contractor, not being an individual or a Hindu undivided family, will in the following cases, be required to deduct tax at the rate of **1%** at the time of credit or payment, whichever is earlier, to a resident sub-contractor -

(i) Where the contractor enters into an agreement with the sub-contractor for carrying out or for the supply of labour for carrying out the whole or any part of his work.

(ii) Where the contractor enters into an agreement with the sub-contractor for supply of labour, either wholly or partly, which the contractor has undertaken to supply.

(5) The expression "**contractor**" shall also include a contractor who is carrying out any work (including supply of labour for carrying out any work) in pursuance of any contract between the contractor and the Government of a foreign state or a foreign enterprise or any association or body established outside India.

(6) Where any sum referred to in this section is credited to any account, whether called "**Suspense Account**" or by any other name in the books of account of the person liable to pay such income, such crediting shall be deemed to be credit of such income to the account of the payee and the provisions of this section shall apply accordingly.

(7) The expression "**work**" shall also include:
(a) Advertising;
(b) Broadcasting and telecasting including production of programs for such broadcasting or telecasting;
(c) Carriage of goods and passengers by any mode of transport other than by railways;

(d) Catering.

(8) No deduction will be required to be made if the consideration for the contract does not exceed **Rs.20,000**. However, to prevent the practice of composite contracts being split up into contracts valued at less than **Rs.20,000** to avoid tax deduction, it has been provided that tax will be required to be deducted at source where the amount credited or paid or likely to be credited or paid to a contractor or sub-contractor exceeds **Rs.20,000** in a single payment or **Rs.50,000** in the aggregate during a financial year.

(9) No deduction is required to be made from the sum credited or paid or likely to be credited or paid during the previous year to the account of an individual sub-contractor, who has not owned more than two goods carriages at any time during the previous year, during the course of the business of plying, hiring or leasing goods carriages.

(10) However, for this purpose, it is necessary to produce a declaration within the prescribed time to the concerned person paying or crediting such sum. Such declaration should be in the prescribed form and manner.

(11) Further, the person responsible for paying any such sum to the sub-contractor should furnish to the prescribed income-tax authority or the person authorized by it, the prescribed particulars in the prescribed form within the prescribed time.

(12) Goods carriage means -
(i) Any motor vehicle constructed or adapted for use solely for the carriage of goods; or
(ii) Any motor vehicle not so constructed or adapted, when used for the carriage of goods.

(13) The substance of the provisions is explained hereunder:
(i) The deduction of income-tax at source from payments made to non-resident contractors will be governed by the provisions of **Section 195**.

(ii) The deduction of income-tax will be made from sums paid for carrying out any work or for supplying labour for carrying out any work. In other words, the section will apply only in relation to '**works contracts**' and '**labour contracts**' and will not cover ***contracts for sale of goods***.

(iii) Contracts for rendering professional services by lawyers, physicians, surgeons, engineers, accountants, architects, consultants etc., can not be regarded as contracts for carrying out any "**work**" and, accordingly, no deduction of income-tax is to be made from payments relating to such contracts under this section. Separate provisions for fees for professional services have been made under **Section 194J**.

(iv) The deduction of income-tax must be made at the time of credit of the sum to the account of the contractor, or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier.

(v) The question whether a deduction under this provision will be made with reference to **the gross payment due to the contractor or the net payment** i.e., gross payment minus deductions if any, on account of materials supplied by the Government or other specified persons will have to be decided in the light of the terms of the particular contract and the conduct of the parties thereto. Where the contractor has undertaken to construct a building or a dam, and the Government or other specified person has undertaken to supply all or any of the materials necessary for the work at stipulated prices, the deduction will have to be related to the gross payment without excluding any adjustments on account of the cost of materials. Where however, the contractor has undertaken only to provide the labour for the work, the ownership of the materials supplied remaining at all times with the Government or other specified person, the sum payable to the contractor in respect of the contract will only be the amount paid for such labour or services and will not include the price of the materials supplied by the Government or other specified person.

(vi) The rate of deduction of income-tax from payment made by the Government or other specified person to any contractor will be **1%** or **2%** (as the case may be) of the gross payment or, as the case may be, the net payment, depending on the terms of the contract, as explained in item **(v)** above.

(vii) Where a contractor, not being an individual or a Hindu undivided family, is engaged in carrying out any work or supply of labour for carrying out such work by the Central Government or a State Government, a local authority, a corporation established under a Central, State or Provincial Act or a company has, in turn, engaged any subcontractor

(a) For carrying out the whole or any part of the work undertaken by the contractor, or

(b) For the supply of labour to carry out such work or

(c) For supply of labour which the contractor had under taken to supply, he will be required to deduct income-tax at source from the payment to the sub-contractor at the rate of 1% of such payment. The provisions governing payments to contractors as set forth at items **(iv)** and **(v)** will apply **mutadis mutandis** to payments made by contractor to sub-contractors.

(viii) The amount of tax to be deducted at source should be rounded off to the nearest rupee.

(ix) The tax deducted on behalf of the Government should be paid to the credit of the Central Government on the same day by **book adjustment**. In other cases, the tax deducted should be paid to the credit of the Central Government within one week from the last day of the month in which the deduction is made.

(x) The person responsible for making any payment to contractor, or sub-contractor, as the case may be, should issue a certificate showing therein particulars of the payment, the amount of tax deducted at source and the date of credit etc.

(xi) Circular No.13/2006, dated 13.12.2006 - Applicability of TDS provisions of section 194C on contract for fabrication of article or thing as per specifications given by the assessee.

The CBDT has clarified the issue regarding the applicability of TDS provisions of section 194C on contract for fabrication of article or thing as per specifications given by the assessee. The CBDT observed that before taking a decision on the applicability of TDS under section 194C on a contract, it would have to be examined whether the contract in question is a contract for work or a contract for sale. The CBDT clarified that the provisions of section 194C would apply in respect of a contract for supply of any article or thing as per prescribed specifications only if it is a contract for work and not a contract for sale as per the principles in this regard laid down in **para 7(vi) of Circular No. 681, dated 8-3-1994. Para 7(vi) of Circular No.681** clarifies that where the property in the article or thing so fabricated passes from the fabricator contractor to the assessee only after such article or thing is delivered to the assessee, such contract would be a contract of sale and would, therefore, fall outside the purview of section **194C**.