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TAX FLASH NEWS

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Tips collected by hotel from customers and paid to employees is not taxable as salary, and hence, tax withholding provisions are not applicable

Background

Recently, the Supreme Court in the case of ITC Ltd [1] (the taxpayer) held that tips collected by the hotel from customers and paid to employees is not taxable as salary under the Income-tax Act, 1961 (the Act). The tips are received by the employer from the customer in a fiduciary capacity as trustee which they disburse to their employees for service rendered to the customer. There is no reference to the contract of employment when these amounts are paid by the employer to the employee.

The Supreme Court observed that there was no vested right in the employee to claim any amount of tip from his employer. Tips being purely voluntary amounts that may or may not be paid by customers for services rendered to them would not, therefore, fall within the meaning of salary under Section 15(b) of the Act. Further, provisions of Section 192 of the Act would not get attracted because tips are received from customers and not from the employer. The Supreme Court also observed that the income by way of tips would be chargeable in the hands of the employees as income from other sources.

Facts of the case

- The taxpayer is engaged in the business of owning, operating and managing hotels. The taxpayer has been paying tips received from customers to its employees but not deducting taxes thereon.
- The Assessing Officer (AO) held that receipt by way of tips would be treated as salary in the hands of various employees, and the taxpayer would be liable to deduct tax from such payment under Section 192 of the Act. Since the taxpayer had not deducted tax, it would be treated as assessee in default under Section 201(1) of the Act and also liable to pay interest under Section 201(1A) of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] allowed the appeal of the taxpayer holding that the taxpayer could not be treated as assessee in default under Section 201(1) of the Act for non-deduction of tax on tips collected by them and distributed to their employees. The Income-tax Appellate Tribunal (the Tribunal) upheld the order of the CIT(A).
- The High Court held that tips would amount to 'profit in addition to salary or wages' and would

[1] ITC Ltd v. CIT (Civil Appeal Nos. 4435-37 of 2016) – Taxsutra.com

fall under Section 15(b)[2] read with Section 17(1)(iv)[3] and 17(3)(ii)[4] of the Act. The High Court held that when tips are received by employees directly in cash, the employer has no role to play and would, therefore, be outside the purview of Section 192 of the Act. However, the moment a tip is included and paid by way of a credit card by a customer, since such tip goes into the account of the employer after which it is distributed to the employees, the receipt of such money from the employer would amount to 'salary' within the extended definition contained in Section 17 of the Act.

- The taxpayer filed an appeal before the Supreme Court.

Supreme Court ruling

- Section 192 of the Act, indicates that 'any person responsible' for paying any income chargeable under the head 'salaries' is alone liable for tax deduction at source (TDS). The person responsible for paying an employee an amount which is to be regarded as the employee's income is only the employer.
- In the present case the person who is responsible for paying the employee is not the employer at all, but a third person namely, the customer. Also, if an employee receives income chargeable under a head other than the head 'salaries', then Section 192 of the Act does not get attracted.
- On reference to the decision of Emil Webber[5] it is clear that as income it is clear that as income from tips would be chargeable in the hands of the employees as income from other sources, such tips being received from customers and not from the employer, Section 192 of the Act would not get attracted at all on the facts of the present case.
- In the present case, there is no vested right in the employee to claim any amount of tip from his employer. Tips being purely voluntary amounts that may or may not be paid by customers for services rendered to them would not, therefore, fall within the meaning of Section 15(b) of the Act.
- On the facts of the present case, it is clear that the amount of tip paid by the employer to the employees has no reference to the contract of employment at all. Tips are received by the employer in a fiduciary capacity as trustee for payments that are received from customers which they disburse to their employees for service rendered to the customer. Therefore, there is no reference to the contract of employment when these amounts are paid by the employer to the employee.
- Section 17 of the Act is not attracted in the present case since under the provisions of Section 17 of the Act, payment must be by an employer whether such employer is a future employer or a past employer of the employee. When Section 17(3)(ii) of the Act uses the expression 'employer', it uses the said expression in the same sense as is used in Section 15 of the Act, as the opening line of Section 17 of the Act itself states that 'for the purposes of Section 15' salary includes profits in lieu of salary.
- In the present case, the Supreme Court approved the reasoning provided in the case of Wrottesley[6] and held that the payments of collected tips would not be payments made 'by or on behalf of' an employer. There is no ground for saying that these tips ever became the property of the employers.

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[2] The income shall be chargeable to income-tax under the head salaries i.e. any salary paid or allowed to employee in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him

[3] The term salary includes any fees, commission, perquisites or profits in lieu of or in addition to any salary or wages

[4] The term profits in lieu of salary includes any payment referred to in Section 10(10), 10(10A), 10(10B), 10(11), 10(12), 10(13), 10(13A) of the Act, due to or received by the taxpayer from an employer or a former employer or from a provident or other fund, to the extent to which it does not consist of contributions by the taxpayer or interest on such contributions or any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

[5] Emil Webber v. CIT [1993] 67 taxman 532 (SC)

[6] Wrottesley v. Regent Street Florida Restaurant [1951] 2 K.B. 277

- The decision of Karamchari Union, Agra[7] relied on by the tax department is distinguishable. Further, two English decisions[8] and one Australian decision[9] relied on by the tax department is also distinguishable on facts of the present case.
- The Supreme Court on a reference to U.K. Income-tax Act, 1918 observed that there is a difference in the language under the U.K. Income-tax Act and Sections 15 and 17 of the Act. In order to attract the provisions of U.K. Income-tax Act, there need not be an employer-employee relationship. Therefore, amounts chargeable under the U.K. Income-tax Act become taxable even if the said amount is paid by a third person. Accordingly, the tests applied by the English courts, being based upon the language of U.K. Income-tax Act, would not apply to the situations in India.
- The Supreme Court while referring to the decision of Eli Lilly and Company (India) Private Limited[10] observed that interest under Section 201(1A) of the Act can only be levied when a person is declared as an assessee in default. However, the taxpayer in the present case is outside the provisions of Section 192 of the Act, the taxpayer cannot be treated as assessee-in-default and hence no question of interest therefore arises.

Our comments

In the instant case, the Supreme Court has held that there is no withholding tax obligation of the employer on tips collected by the hotel from customers and paid to employees. The Supreme Court has rightly observed that there is no vested right in the employee to claim any amount of tips from his employer and tips being purely voluntary amounts that may or may not be paid by customers for services rendered to them. Accordingly, it would not fall within the meaning of 'salary'. Further, provisions of Section 192 of the Act would not get attracted because tips are received from customers and not from the employer.

[7] Karamchari Union, Agra v. Union of India [2000] 243 ITR 143 (SC)
[8] Calvert (Inspector of Taxes) v. Wainwright, [1947] 1 KB 526
Moorhouse (Inspector of Taxes) v. Dooland, [1955] 2 W.L.R. 96
[9] Kelly v. Federal Commissioner of Taxation 85 ATC 4283
[10] CIT v. Eli Lilly and Company (India) Private Limited [2009] 312 ITR 225 (SC)

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