Contract of Service vs Contract for Service

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The recent judgement of Bombay High Court in CIT vs Dr Balabhai Nanavati Hospital (2025), brings back into focus one of the longest-standing disputes in the healthcare sector: Whether doctors in hospitals should be treated as “employees” or as “independent consultants”? This distinction is important because it impacts the TDS section. “Salary payments” fall u/s 192 of the Income-tax Act, 1961 / section 392 of the Income-tax Act, 2025, while “professional fees” fall u/s 194J of the Income-tax Act, 1961 / section 393(1) of the Income-tax Act, 2025. TDS officers check whether hospitals are wrongly treating the doctors as “consultants”. This has resulted in TDS litigation. The controversy is relevant not only for the healthcare sector but also for educational institutions. This is demonstrated by the latest decision in Brilliant Study Centre Pvt Ltd vs ITO (2026). If TDS u/s 194J of the Income-tax Act, 1961 / section 393(1) of the Income-tax Act, 2025 is applied by the payer, then it is important to demonstrate that the individual (payee) is a “consultant” (non-employee) in both ‘form’ and ‘substance’. The article discusses these issues in detail, including for the entertainment & media industry. The article also discusses the expectations from practising Chartered Accountants in relation to “Tax Audit Report”.

Introduction

The distinction between a “contract **of** service” (employment) and a “contract **for** service” (independent professional arrangement) has been one of the most debated issues in the income-tax law.

These phrases differ only by a single word (“of” *vs* “for”). However, this small difference is not mere wordplay; it determines the character of the income and the related TDS obligations.

Healthcare Industry

This issue is relevant for the healthcare industry where Senior Doctors examine patients in private hospitals for part of the day and, practice independently at their own clinics for the balance day.

In this connection, a question arises:

- Are these doctors, “employees” of the hospital?
- Or are they “independent consultants” to the hospital?

Why the distinction matters

The classification of the doctor affects the TDS rates:

- If a doctor is treated as an “employee”, TDS must be deducted u/s 192 of the Income-tax Act, 1961 / section 392 of the Income-tax Act, 2025. TDS on salary is to be applied based on the “average rate of income-tax” computed on the basis of the “rates in force for the concerned financial year”.
- On the other hand, if the doctor is treated as a “consultant”, then TDS is deductible u/s 194J of the Income-tax Act, 1961 / section 393(1) of the Income-tax Act, 2025 at the rate of 10%.

Incorrect classification of the doctor may lead to *demands* on the hospital for short-deduction of tax, interest and penalty.

CBDT Instructions to its field officers

The issue has been the subject matter of heightened scrutiny of hospitals by the “TDS Wing” of the Income-Tax Department. This is evident from the following:

- **CBDT Action Plan for 2014-15**

  The *action plan* states as follows:

  “In the cases of professionals, e.g., doctors etc., salary payments are misclassified as professional payments and tax is deducted by applying lower rates. This aspect needs to be examined”
- The Publication (July 2019) of the Income-tax Department titled **“Techniques of Investigation for Assessment”** discusses the controversy in detail.

The ‘Nanavati Hospital’ Case

One such hospital under scrutiny was *Nanavati Hospital, Mumbai*:

In its *TDS assessment*, the Revenue alleged as follows:

- Honorary Doctors should be treated as “employees”.
- TDS u/s 192 of the Income-tax Act, 1961 ought to have been

applied by the hospital instead of section 194J of the Income-tax Act, 1961.

However, the Bombay High Court [*CIT v. Dr Balabhai Nanavati Hospital* (2025) rejected the Revenue's position. The High Court held as follows:

- There was no "employer-employee" between the hospital & the honorary doctors
- Payments to doctors represented "professional fees", not "salary"
- Hence, TDS u/s 194J of the Income-tax Act, 1961 was correctly applied by the hospital

Judicial Tests: Whether doctors are "consultant" or" employee" of hospitals?

The Bombay High Court applied the following yardsticks to hold that the doctors were "independent professionals":

- **Variable remuneration:** The doctor's income depended on actual consultations or procedures performed - not on a "fixed monthly salary".
- **Revenue-sharing model:** The hospital retained a percentage of billing to cover infrastructure, facilities and administrative support.
- **Professional autonomy:** Doctors were free to practise at other hospitals or run their own clinics.
- **No employee benefits:** Hospitals did not provide PF, ESIC or perquisites normally associated with employment.
- **Flexible schedule:** Doctors were not bound by fixed working hours; their availability depended on patient requirements.
- **No control:** Hospitals did not exercise "real supervisory control" in respect of the work entrusted to the doctors.
- **Disclosure in income-tax return of doctors:** Doctors disclosed their income under the head "Profits and Gains of Business or Profession," not "Salaries."

What should hospitals do?

Considering the TDS disputes, it is advisable for the hospitals to ensure the following:

- The hospitals should review contractual arrangements with doctors.
- The hospitals should align its TDS position with the substance of the relationship with the doctors - and not merely with the nomenclature of the agreement with the doctors.
- The hospitals should maintain factual evidence of "judicial tests" discussed above in paragraph (6) above.

A proactive approach can reduce litigation risk for the hospitals

Is the TDS controversy restricted to hospitals?

The short answer is "No". The reasons are as under:

- Briefly speaking, whilst the doctor is subject to TDS rate of 10% u/s 194J of the Income-tax Act, 1961 / section 393(1) of the Income-tax Act, 2025, the TDS rate can be reduced to 2% if the "consultant" does not provide "professional services" but, inter alia, provides "management services, technical services, and consultancy services"
- Further, if an individual treats himself or herself as a "consultant" as opposed to an "employee", then he or she can claim a tax deduction for expenses, presumptive taxation *et al*. As opposed to this, a "salaried employee" hardly gets any tax deductions.
- Hence, the general temptation may be to "call" people as "consultants/ freelancers/ contractor" and to treat their remuneration as "non-salary"

However, there is a need for caution in light of below discussion.

Educational Institutions

The publication (July 2019) of the Income-Tax Department titled **"Techniques of Investigation for Assessment"** highlights the advance ruling of *Max Muller* (2004) for payments by educational institutes to **honorary part-time teachers**

In *Max Mueller*, an "educational institute" (El) engaged "part-time teachers" on a "contract basis". El controlled the teachers as under:

- EI prescribed the syllabus
- EI fixed the teaching period
- EI fixed responsibility on teachers for completion of their assignment to the satisfaction of El
- EI required the teachers to be punctual and regular in their duty
- EI mandated the teachers not to be absent without its permission
- EI reviewed the work of teachers

In this backdrop, the "Authority for Advance Rulings" held that the teachers were "employees" of El. This was inspite of the following facts:

- The agreement described the teachers as a "part-time casual honorary teacher"
- The agreement provided that the teachers would not have the status of an "employee" and shall not be entitled to avail the benefits of the "regular employees"

- The teachers were paid "honorarium" by EI for each semester
- The teachers were entitled to work simultaneously for other establishments, while working with EI.

However, in *Brilliant Study Centre Pvt Ltd vs ITO* (2026), the Cochin Tribunal held that the teachers were **not** "employees". In this decision, the teachers were initially treated as "salaried employees" but were shifted to "professional category" based on market considerations. There was only a verbal agreement between the teachers and the coaching centre. The teachers were paid on hourly basis and had to take classes for 5 to 7 hours daily. During this time, they were not allowed to take classes in any other coaching centre. Further, the teachers were supposed to be available for extra lectures. An attendance register was maintained. The teachers were free to teach in their own way subject to curriculum. The coaching centre did not exercise any control, intervention or direction over the exercise of duties by the teachers. The teachers were paid monthly and promised a yearly increase in the remuneration of 10%. The teachers were supposed to intimate their leave, one day prior to the date of leave. The coaching centre provided medical insurance and transport facility to the teachers. However, the teachers were not entitled to the benefits of PF, gratuity, bonus, medical reimbursement, leave encashment etc. The teachers filed their income-tax return disclosing the remuneration as "professional fees" (and not as "salary"). These returns were accepted by the Revenue. In this backdrop, the Tribunal rejected the Revenue's allegation that the teachers were "employees" of the coaching centre. The Tribunal held that the teachers did not cease to be "consultants" merely because the coaching centre had exercised some degree of control over the administrative and logistical functioning of the teachers.

Thus, there exists contrary jurisprudence in the educational sector.

Entertainment & Media Industry

TDS litigation has also arisen in the entertainment sector on account of unique arrangements with artists etc.

In *ITO vs Entertainment Network (I) Ltd* (2017), it was held that the "radio jockeys" (RJs) were earning "professional fees" (and not "salary") from a *FM Radio broadcasting company* (FMR). This was on account of the following facts:

- RJs were not required to provide services in compliance with the internal codes of FMR, unlike in the case of its employees.
- RJs were not required to report as per "duty hours for the employees".
- RJs were not required to sign the muster.
- RJs were not governed by the leave rules of FMR.
- RJs were incentivised based on their popularity.
- RJs did not have any "probation period".
- RJs were solely responsible for their acts.
- There was a full indemnification by RJs for injuries to FMR.
- FMR's liability was limited for any damages.
- RJ's compensation was not broken into basic allowances etc.
- RJs were not entitled to provident fund, gratuity, retirement benefits etc.
- The agreements with RJs were for a specific period and FMR was not bound to renew the same.
- RJs were free to take assignments from any company (except with any other radio broadcasting company). The individuals were not bound to act solely as RJs.
- RJs had shown their remuneration as "professional fees" in their respective returns, which had been accepted as such by the Revenue.
- RJs were liable to pay *service tax*.

Post this decision, the publication (July 2019) of the Income-Tax Department titled **"Techniques of Investigation for Assessment"** (see page 333)**,** raised an alarm for the film fraternity. This was because of the Tax Tribunal's decision in *Red Chillies Entertainment Pvt Ltd vs ACIT* (2025).

In this case, '*retainership fees*' were paid by a *film production company* (FPC) to an individual who was appointed as a "production manager" (PM). The payer classified the payment as a "consultancy fee" and applied TDS u/s 194J of the Income-tax Act, 1961. However, the Income-Tax Department alleged that there was an "employer-employee relationship". The Tribunal sided with the Revenue. This was due to the following facts:

- The individual was designated as a "production manager"
- PM was required to perform the duties that were assigned to him by FPC from time to time
- The remuneration was payable monthly and was of a 'fixed amount" (like a "salary")
- PM was provided with a company car and mobile phone
- PM was required to attend office daily to perform his

duties as may be assigned to him by PFC from time to time

- PM was provided with leaves of 30 days in a year. In other words, PM was required to attend office mandatorily for remaining days of the year
- There was a clause in the contract for "termination of employment"
- Identical contract was signed with other individuals who were designated as "production executive" and "production assistant"

The Tribunal was not influenced by the fact that PM was not paid PF, ESI, Gratuity & Bonus.

Thus, there exists contrary jurisprudence in the entertainment & media industry.

Tax Audit Report[1]

The *Tax Auditor* is required to report the following:

"Whether the assessee is required to deduct or collect tax……, if yes please furnish:

Column 1: Tax deduction and collection Account Number (TAN)

Column 2: Section

Column 3: Nature of payment

Column 4: Total amount of payment or receipt of the nature specified in column (3)

Column 5: Total amount on which tax was required to be deducted or collected out of (4)

Column 6: Total amount on which tax was deducted or collected at specified rate out of (5)

Column 7: Amount of tax deducted or collected out of (6)

Column 8: Total amount on which tax was deducted or collected at less than specified rate out of (7)

Column 9: Amount of tax deducted or collected on (8)

Column 10: Amount of tax deducted or collected not deposited to the credit of the Central Government out of (6) and (8)".

For this article, **column (8)** is relevant. In this connection, **The Guidance Note on Tax Audit issued by The Institute of Chartered Accountants of India (2025 edition, para 66.11)** states follows:

> "…….column (8) requires furnishing of the total amount, out of the amount deductible or collectible as mentioned in column (5), at which the tax was deducted or collected at the rate less than the specified rate out of Column (7). **The lesser deduction is required to be reported in this clause. This will include deduction at a lower rate than what is prescribed, application of wrong section for deduction of tax at source, etc.**……. In case, there is difference of opinion with regard to rate of deduction or applicability of a particular section, the auditor may appropriately report the difference of opinion…..... giving both the views".

Consequently, if the *Tax Auditor* finds that TDS u/s 194J of the Income-tax Act, 1961 / section 393(1) of the Income-tax Act, 2025 has been applied (2% or 10%), but the Chartered Accountant believes that the TDS u/s 192 of the Income-tax Act, 1961 / section 392 of the Income-tax Act, 2025 ought to have been applied, then the aforesaid guidance of **The Institute of Chartered Accountants of India** would be relevant (presuming that the "Effective TDS rate on Salaries" is higher than "TDS rate for Consultants")

In light of the above, the *Tax Auditor* is required to evaluate on whether the individual is in "employment" **or** is a "consultant". Now, can the *nature of the relationship* be determined solely based on the contract or agreement?

In *Vijay Mariappan Austin Prakash vs ACIT* (2026) an *individual assessee* (VM) was a "salaried employee" with a company, ZBL, till 30.09.2020. After termination of employment, VM was appointed by ZB as a "consultant". For this purpose, a "consultancy agreement" was entered into between VM and ZBL from 01.10.2020 to 30.09.2022. The nature of services provided by VM as an "employee on salary basis" and VM's "services as per the consultancy agreement" remain the same. Hence, the Revenue alleged that VM had changed the *source of income* from "salary" to "consultancy fees" w.e.f 01.10.2020, to avoid paying tax in India. However, the Tribunal did not accept Revenue's contentions. It held as under:

> "…observations of…..AO do not have any merit due to the fact that change of the employment to consultant is with regard to the agreement between the concerned parties. However, we find from the records, assessee has been appointed as a consultant based on the agreement for the period from 01.10.2020 to 30.09.2022"

With due respect, the agreement, by itself, may not be determinative of the nature of the relationship ("employment" or "independent professional engagement"). Ideally, the *Tax Auditor* must go beyond the contract (form). The following questions can be asked by the *Tax Auditor* to the company (payer):

i. Is the individual acting as an "independent contractor" on a principal-to-principal basis?

ii. Is there a "master-servant relationship"?

iii. Who controls the "work to be done" by the individual?

[1] *See Form 3CD of Income-Tax Rules, 1962 (similar to Form 26 of Income-Tax Rules, 2026)*

iv. Who controls the "manner in which such work should be done" by the individual?

v. Who determines the "place and time of the performance of the services"?

vi. Who provides the "tools and other resources" to the individual, for the performance of the services?

vii. To what extent does the individual have "professional autonomy"?

viii. Are the "intricacies of the services" to be performed by an individual, "specified in advance"? Or are the individual assigned duties that are not feasible to be defined in specific terms in advance?

ix. Does the individual have "formal designation"?

x. Is the remuneration "fixed" or "variable"? Does the "monthly remuneration" vary (increase or decrease) depending upon the "quantum of work"?

xi. Is the individual entitled to "social security benefits"?

xii. Does the individual get the "perquisites" (eg, company car or mobile) that are normally associated with an employment?

xiii. Does the individual have to undergo "annual or bi-annual evaluation of performance"?

xiv. Is the individual entitled to "annual increments and bonus"?

xv. Is the individual required to attend office on a "daily basis"?

xvi. Does the individual have a "flexible schedule"? Is the individual bound by a "fixed number of working hours" in a day?

xvii. Is the individual, "full-time" or "part-time"?

> " The hospitals should align its TDS position with the substance of the relationship with the doctors - and not merely with the nomenclature of the agreement with the doctors. "

xviii. Is the individual entitled to "annual leaves / national holidays"?

xix. Can the individual be absent "without permission"?

xx. Can "disciplinary sanctions" be imposed on the individual?

xxi. Is there a "right to suspend or dismiss" the individual?

xxii. Who bears the "risk and rewards" of the services? Is the individual "liable for damages"?

xxiii. What stand has the individual taken in the ITR ("Income from Salary" or "Profits and Gains from Business or Profession")?

xxiv. Is the individual liable to pay GST?

xxv. Does "Labour Laws" apply to the individual?

These are indicative questions which may vary depending upon the industry.

Conclusion

There is no set formula to decide whether a relationship is a "contract of service" (employment) or a "contract for service" (independent professional engagement). Everything turns on facts. The contract has to be read as a whole. The circumstances have to be looked at in totality. The "real relationship" matters more than the "label" used in the agreement. Lastly, but equally importantly, every organisation & individual must ensure that its arrangements & tax position pass the "basic smell test".

References

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