TREATMENT OF PERQUISITES

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Introduction

FROM THE large number of advertisements appearing in the press promising attractive "perks and fringe-benefits" to the company executives, one can note the importance attached to perks by the employers as well as the employees. Considerable public interest was aroused some years back when a member of Parliament presented a working to show that if a private citizen were to lead the life of a minister, he would have to file a return of income of Rs. 4,40,000/ and yet be left with no wealth at the end of the year. This working may or may not be correct, but it does highlight the prevalence of perks at different levels. The layman has often wondered how company executives and directors live a life of luxury and exhibit their prosperity through such ostentatious living, inspite of the fairly stiff rules regarding 'perks' and high rates of taxation. One has to examine the point in some detail for a proper understanding of the situation.

Meaning of 'perquisites'

The dictionary meaning of the word covers a wide field and includes casual emoluments, profits attached to an office, or position or incidental and consequential benefits, left-overs, tips falling to one by right, *etc.* The legal concept is explained in *Owen* v. *Pook*[1] where Lord Pearce described 'perquisite' as "something that benefits a man by going 'into his *own* pocket'."[2] It does not, however, cover a mere reimbursement. The Indian Income-tax Act, 1961 defines perquisite at 2 places *viz* section 17(2) which is for the purpose of sections 15 and 16 (computation of income from salary) and item (*b*) of explanation 2 to section 40A(5). The former is inclusive, but the latter has no such appellation. Section 17(2) runs as follows:

17(2) "perquisite" includes—

(*i*) the value of rent-free accommodation provided to the assessee by his employer;

(*ii*) the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;

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1. 74 I.T.R. 147 (1969).
2. *Id.* at 158.

(*iii*) the value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases—

(*a*) by a company to an employee who is a director thereof;

(*b*) by a company to an employee being a person who has a substantial interest in the company;

(*c*) by any employer (including a company) to an employee to whom the provisions of paragraphs (*a*) and (*b*) of this sub-clause do not apply and whose income under the head "Salaries," exclusive of the value of all benefits or amenities not provided for by way of monetary payment, exceeds eighteen thousand rupees;

(*iv*) any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee; and

(*v*) any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund, to effect an assurance on the life of the assessee or to effect a contract for an annuity.

The definition in section 40A runs on similar lines but omits the word 'value', thus laying greater stress on the expenditure incurred by the employer rather than its value. It does not also make any distinction about the class of employees as mentioned in section 17(2) (*iii*). There is a wide divergence of opinion on the question whether these definitions meet the needs warranted by the situation.

Scope

In the case of the salaried employees, the various benefits are covered under section 17(2), though in the matter of valuation, some concession has been given. It is, however, to be noted that the businessman too is assessable on the value of the perquisites obtained in the course of business, or profession, as mentioned in sections 28(*iv*) and 2(24) (va). Similary the director of a company who is not an employee and getting the benefits and amenities from the company is liable to pay tax on the value of the benefit or perquisite in view of the definition of income under section 2(24) (iv). There is, however, no definition given of perquisite under the Income-tax Act for the purpose of section 28(iv).

History of the legislation

Upto 1955, there were no serious attempts to tax perquisites. In that year the law was amended expanding the scope of income of salaried persons receiving perks. Initially the valuations, exemptions, *etc.*, were

made through executive instructions. A part of these instructions got incorporated in rule 24A under the Income-tax Act, 1922 (now rule 3 under the 1961 Act). Sections 28(iv) and 2(24) (va) were enacted in 1964. Today we have to rely partly on rule 3 of the Income-tax Rule, 1961 and partly on executive instructions.

General principles

It is only the advantage gained, as an employee or the director of a company or as businessman, that can be valued. If A as a member of public stays close to his place of work or place of business and B does not, the advantage of A over B in the form of saving of time and money cannot be taken as perquisite. Similarly if A obtains a benefit or advantage which he is not authorised by express or implied contract, with the person from whom the benefit is taken, no perquisite can arise, as explained in *C. I. T.* v. *A. R. Adaikappa Chettiar and Another*[3] and *C. I. T.* v. *Kulandaivelu Konar*[4] because a receipt which one is obliged to return or repay to the rightful owner cannot be taken as benefit. The benefit need not, however, be only under a service contract. Even voluntary and non-recurring benefits are included. Thus, where a director of a company, whilst driving a company car on business, was in volved in a road accident and the company incurred legal expenses on his defence, it was held that the expenses were assessable as a perquisite[5]. Similarly, in *C. I. T.* v. *Nar Hari Dalmia*[6] it was held that where director and his wife went abroad on company expense, the expense in so far as it had no link with the business, was held to be taxable as a benefit though not perquisite. Where however, the required relationship does not exist, no perquisites are taxable[7]. Tips received by hotel waiters or taxidrivers from customers may be assessable under other sources and not under salary. Lastly, advantages and benefits offered but not accepted or availed of cannot be taxed on notional basis that the person could have taken it and if he did not take it, that is, a mere surrender after accrual. Even deferred benefits in which employee has no vested interest cannot be taxed as perquisites.

Valuation (general)

An advantage or benefit obtained in a consequential manner has no value. Thus, where an employee is sent for training at the cost of the employeer or is given travelling and daily allowances whilst primarily on company's duty, no element attributable to personal advantage can be said to have any value. It is this principle which enables company executives to live a posh life whilst on duty away from headquarters. Rule 6D

3. 91 I.T.R. 90 (1973).
4. 100 I.T.R. 629 (1975).
5. *Rendell* v. *Went* (*Inspector of Taxes*,) 58 I.T.R. 73 (1965).
6. 80 I.T.R. 454 (1971).
7. *C.I.T.* v. *Lakshmiyati Singhania*, 92 I.T.R. 589 (1973).

of the Income-tax Rules gives liberal allowance even to the employer as a deduction (in respect of employees getting over Rs. 1,000/-p.m.—Rs. 180/- per day for the bigger cities and Rs. 120/-for other places). Excessive allowance then permissible under section 10(14) may, however, become taxable. For the purpose of section 17, the value is not what has gone out of the pockets of the employer, but what the employee could realise. Thus, in the case of articles presented, it is the second-hand value that is to be taken.[8]

Where an option is granted and accepted by the employee, the value is equal to the difference between the market value and the price offered on the date of acceptance and not the date on which it is actually availed of.[9]

Valuation under rule 3

Initially in 1955, the monetary value of perquisites was made through executive instructions of the Central Board of Revenue. These were consolidated in rule 24A under the 1922 Act.[10] There are, however, still some concessions available only on the strength of executive instructions. Salary and fair rent have been defined in the rule itself. Salary includes pay, allowance, dearness allowance, bonus and commission payable monthly or otherwise, but does not include perquisites. Employer's contribution to the provident fund is also excluded. The definition is not a happy one. The exclusion of employer's contribution to the provident fund would suggest that but for such exclusion, it would have been included in 'salary'. If so, how are fees to be treated? How is interest on provident fund in excess of 7½ per cent or 1/3rd of salary which is taxable in terms of rule 6 of the Fourth Schedule) to be treated? Can these be branded as pay or allowance or bonus or commision ? Tax paid by the employer is taken as salary. In *C. I. T.* v. *C. W. Steel*,[11] income-tax, electricity charges and profession tax paid by the employer were held to be salary. Fair rent is what a similar accommodation would realise in the same locality or the municipal valuation whichever is higher. This definition has led one Bench of the Income-tax Appellate Tribunal to hold that what is paid by the employer as rent is not material. What one has to take in case of sublet properties is not what the subtenant pays to tenant, but what the tenant pays to the owner. It is an open secret that in the bigger towns, the difference is substantial and quite a few company executives are taking advantages of this provision.

Rent-free and concessional rent accommodation

For this purpose employees are classified into (a) government employees, (b) employees of the government undertakings and (c) others.

8. *Wilkins* v. *Rogerson*, 39 T.C. (1958-61).
9. *Abbot* v. *Philbin*, 44 I.T.R. 144 (1962).
10. Now rule 3 under the 1961 Act.
11. 86 I.T.R. 821 (1972).

Although there has been some protest from the (c) category complaining of discrimination in favour of the first two categories, actually the classification appears to have been made more for administrative convenience than for giving any benefits to these employees. The government employees are governed by certain rules.[12] There are practical difficulties in determining the fair rent of government buildings. It is for this reason that the rule provides that in the case of the government servants, the value will be taken in accordance with the rules framed by the government. Where the accommodation is provided by the semi-government organisations the value of rent free accommodation (unfurnished) is taken as equal to 10 per cent of the salary due, whether paid or not, in respect of the period during which the accommodation was occupied by the employee. In the case of private employees, however, the value of the unfurnished accommodation is taken as 10 per cent of the salary due to the assessee plus the difference between the fair rent and 20 per cent of the assessee's salary. The income-tax officer has the discretion to increase the figure of 20 per cent upto 30 per cent. In respect of big cities only, under executive instructions, the excess over 30 per cent of the salary is added to the basic 10 per cent. Where the employee can show and the income-tax officer is satisfied that the fair rental value itself is less than 10 per cent, the value is to be restricted to such fair rent. It is possible to have two employers, one giving lower salary providing rent-free accommodation and to save tax marginally. In the case of furnished accommodation, the value is first determined as if the accommodation is unfurnished and then such value is increased by the actual hire charges payable, by the employer, if hired by the employer or 10 per cent of the cost of furniture, if owned by the employer.

Where the sweepers or night watchmen are provided by an employer, it has been held that it would not be proper to take the entire salary as the value of the perquisite. Under executive instructions, since these employees are meant for protecting the property of the owner also, 50 per cent of the wages of night watchman or Rs. 60/- per month whichever is less, is taken as value of the perquisite. Sweeper's services are valued at 75 per cent of wages or Rs. 60/ p.m. No separate value is taken in respect of gardner, but the fact that a gardner has been employed is taken note of in determining the fair rent. In the case of tea plantations, lower value of 7.5 per cent is adopted. In the case of hotel employees who are required to live in the hotel premises and are provided free boarding, the value is taken as below:—

10 or 12½ per cent of the salary or the usual rent of the accommodation whichever is less, for lodging. For boarding, the value is taken as the hotel's actual rate of food, supplied by the employer. This concession

12. The Service Rules, rules 45A and 45B.

would be admissible only to *bona fide* employees and is not extended to the directors who have substantial interest in the hotels.

Conveyance

The next popular perk is represented by free use of conveyance kept at the disposal of the employee, either exclusively or through a pool, with authority to use the conveyance for private purposes. The value in such case is the actual expenditure attributable to private purposes or an adhoc value of Rs. 300/- p. m. for cars upto 16 horse power and Rs. 400/- p.m. for cars above 16 horse power. The value so determined is increased by Rs. 150/- p. m. where a chauffeur is also provided.

If an employee has an option to use two cars, the value is taken on the basis of higher horse power of the car. The repercussions of this perk are felt in the matter of deduction under section 16(i) being restricted to Rs. 1,000/-.

Where a car is owned or hired by the employer, but the expenses are borne by the employee, the value is Rs. 100/- and Rs. 150/- respectively, depending upon the horse power. Where, however, the car itself is owned by the employee and the expenses are borne by the employer, it is left to the income-tax officer to determine the value as reasonably as possible taking into consideration the actual expenditure and the expenditure attributable to the office use. Where these facilities are given at a concession, the value is taken as equal to the value that would have been taken if the facility was free minus the actual recovery made from the employees.

Other items

In India, under the executive instruction, relying on certain observation in *Ricketts* v. *Colquhoun*[13] it has been held that travel from residence to office is not travel in the performance of duties. Consequently, a person travelling from residence to office in employer's car is liable to have the deduction under section 16(1) reduced to Rs. 1,000/-.

As far as perquisites in other forms are concerned, the general principle is to see what would have been spent by the employee to get the facility, but for its being granted by the employer. Thus, club bills paid by the employer are taken as perquisite at the figures, of bills actually paid. Free transport facilities, in group conveyances, from residence to office, are not generally valued. Similarly, free transport facilities by transport undertakings, or free supply of gas, water and electricity for household consumption, by the employer himself producing the item, are not valued. But where the supply is made by an outside agency, the amount actually paid on that account by the employer is the value of the perquisite. Where the supply of gas is for official and domestic use and cannot be separated, the value is taken as equal to the actual amount or $6\frac{1}{4}$ per cent of the salary; whichever is lower.

13. 10 T C. 118.

Before closing this subject, one must refer to rule 3(i) (*g*) which says that any perquisite not separately marked above is to be valued in such a manner as the income-tax officer considers fair and reasonable.

Tax-free perks

The question now arises as to how inspite of such rigid rules of valuation, the employees still manage to get away with tax-free perks. The following perquisites have been considered as having NIL value.

(*i*) Provisions of ordinary medical facility or re-imbursement of expenses incurred for medical purposes, by the employee and his dependants ;

(*ii*) provision of refreshment provided during working hours. Full lunches during working hours are not free, but subsidised lunches are tax-free;

(*iii*) where a company has organised a function for distinguished visitors, incidental or consequential participation of the employees is generally not taken note of ;

(*iv*) group benefits on account of welfare expenses are generally tax-free. Similarly employer's contribution to the trustees of pension scheme or to the staff group insurance scheme for effecting insurance on the lives of the employees is not taxed as the employees do not acquire any vested right in the contribution so made in the year. Expenditure incurred in training employees or sponsoring him to a refresher course, is not a perquisite even if such expenditure includes boarding und lodging expenses. Group recreation facilities, are also not treated as perquisites. Telephone expenses paid by the employer in respect of residential telephone are also not touched, unless it is shown that there are private calls also. Generally speaking, as the stakes are not high, the certificate of the employee is taken as correct. Even payment of annual premium by the employer on the personal accident policy, is not a perquisite, if it is shown that it was the employer who effected the policy in order to meet the contingency of paying compensation and that the employee had not asked for it.[14]

Allowances

No discussion on the treatment of perquisites in the hands of employees can be said to be complete without reference to some of the allowances whose value is not taxed. Entertainment allowance is now exempted in the hands of very few employees who fulfil the conditions of section 16(*ii*). House rent allowance granted under section 10(13A), subject to limits mentioned in rule 2A and travel concession granted under section 10(5), subject to rule 2B are other examples. Any specific allowance granted to meet the cost of expenditure in connection with the duties is exempted

14. *C.I.T.* v. *Lala Shri Dhar*, 84 I.T.R. 192 (1972).

under section 10 (14) to the extent to which the amount is shown to be actually incurred for the purposes.

Perquisites for the purpose of s. 40A (5)

Section 40A (5) provides that where an expenditure is incurred (by an employer) which results directly or indirectly in the provision of any perquisite whether convertible into money or not or where the employer allows the use of his assets for the purpose of employees benefit (excluding items specified in proviso to section 40A (5) (a) amount in excess of 1/5th of salary of Rs. 1,000/- is disallowed, without prejudice to the principle regarding inclusion of the corresponding value in the assessment of the employee, former employee or director or person having substantial interest. It has been held by some tribunals that the words whether convertible into money or not, preclude inclusion of cash payments as a part of 1/5th to be considered for disallowance. The provisions do not apply in cases of employees getting less than Rs. 7,500/-p. a.

Epilogue

The law on the subject, represents a compromise between the desire to encourage indigenous talent to be at its best in India and the need for curbing the tendency to give excessive and unreasonable benefits. The Companies Act, 1956 now requires every company to incorporate, in its annual accounts a complete statement of salaries and perks above Rs. 3,000/- p.m. The fact that this list is quite long in most of the public companies shows that possibly the purpose can be achieved not so much by taxation as by creating conditions of healthy but stiff competition in the industries so that no company can afford to spend more than the barest minimum on its top executives. Today the extra salary and extra tax on account of disallowance under section 40 A(5) gets mostly passed on to the consumers. If the provisions promote the progress of the country and help in the welfare of the people, the object can be said to have been achieved.