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Tax paid by employer on behalf of employees qualifies as ‘non-monetary’ perquisite – exempt from tax

In brief

In a recent decision in the case of Sedco Forex International Drilling Inc and others¹, the Uttarakhand High Court (HC) held that income-tax paid by employer, on behalf of the employee, qualifies as a ‘non-monetary perquisite’ as payment is not made to the employee and such perquisite is exempt under section 10 (10CC)² of the Income-tax Act, 1961 (the Act).

¹ DIT (IT) v. Sedco Forex International Drilling Inc and others [TS-603-HC-2012 (UTT)]

² Section 10(10CC) of the Act reads as follows – “*in the case of an employee, being an individual deriving income in the nature of a perquisite, not provided for by way of monetary payment, within the meaning of clause (2) of section 17, the tax on such income actually paid by his employer, at the option*

Facts

- An agreement was entered between the employer and the employees providing that the tax on salary of the employees will be paid by the employer.
- Accordingly, in addition to the salary paid to the employees, the employer paid tax on such salary.
- The Revenue contended that tax paid by the employer was a monetary payment. Therefore, tax is payable on this amount paid by employer.

of the employer, on behalf of such employee, notwithstanding anything contained in section 200 of the Companies Act, 1956 (1 of 1956)”

- The employer (acting as agent of the non-resident employees) contended that tax paid by the employer qualified as a perquisite within the meaning of section 17(2)(iv) of the Act and that the same was not provided by way of monetary payment to the employees. Therefore, it qualified for exemption under section 10(10CC) of the Act.
- The Commissioner of Income-tax (CIT (A)) passed an order in favour of the department considering the tax paid by the employer as a monetary benefit in hands of the employees and thereby denying the exemption claimed under section 10(10CC) of the Act.
- On appeal to the Income-tax Appellate Tribunal (Tribunal) by the employer, the Tribunal, relying on the ruling of the Special Bench of Delhi Tribunal in case of RBF Rig Corp³, decided in favour of the employer, considering the tax paid by employer as non-monetary benefit and allowed the exemption claimed under section 10(10CC) of the Act.

Issue before the HC

Whether the tax paid by the employer on the salaries/remuneration of the employees would constitute non-monetary benefits and, as such, the same would be exempt under section 10 (10CC) of the Act?

Assessee's contentions

The assessee, relying on the favourable ruling of Special Bench of Delhi Tribunal in the case of RBF Rig Corp contended that tax paid on behalf of employees is a non-monetary perquisite in hands of the employees. Therefore, such perquisite will not form part of total income of the employees on account of application of section 10(10CC) of the Act.

Revenue's contentions

The Revenue contended that tax paid by employer is a monetary payment and is not covered under section 10(10CC) of the Act. Accordingly, tax is payable on the tax paid by the employer.

High Court Ruling

- Section 200 of the Companies Act, 1956 prohibits companies from paying remuneration free of income-tax. However, tax-free remuneration is different from payment of remuneration as well as tax payable thereon.
- Section 10(10CC) of the Act has provided that despite the provisions of section 200 of Companies Act, 1956, an employee shall be entitled to exclude from his total income, the tax paid by employer on perquisites, within the meaning of section 17(2) of the Act, not provided by way of monetary payment to him.
- The employer by entering into agreements with the employees had taken over an obligation to pay income-tax payable by the employees.
- Such tax paid by the employer will qualify as perquisite within the meaning of sub-clause (iv) of section 17(2) as it is a sum paid in respect of an obligation which, but for such payment, would have been payable by the employees.
- Tax paid on account of the employees is certainly a monetary payment. The same is not paid to the employee, but on his account to the income-tax department.
- Therefore, payment of tax on account of salaries of the employees, not by way of monetary payment to the employees concerned, but, for or on, their account would be a perquisite under section 17(2)(iv) of the Act, and such payment is to be excluded from the income of the employees under section 10(10CC) of the Act.

³ RBF Rig Corporation LIC v. ACIT [2007] 297 ITR 228 (Del)

- The HC while answering the question in favour of the employer, refused to interfere with judgement and orders of the Tribunal.

Conclusion

Inspite of the ruling of Special Bench of Delhi Tribunal in the case of RBF Rig Corp (above), the Revenue had continued to disallow the claim of exemption of tax on tax paid by employer. With this judgement, there will be clarity on this position and much needed relief to employers who have negotiated a net of tax salary package for employees.

A consequence of this ruling will be that employees will not be liable to pay tax on tax paid by the employer (referred to as 'multiple grossing-up') and thereby, leading to savings in overall tax costs for the employer.

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