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HC holds in favour of expatriate taxpayers on taxability of several items

In brief

The Delhi High Court (HC) has recently delivered a judgement in the case of Yoshio Kubo and others[1] (the assessee) that favours expatriate employees in respect of several tax issues. These cases were ones in which the Revenue appealed against an earlier verdict. The grounds of appeal were similar in each case. The HC ruled that:

- Taxes borne by an employer on behalf of their employees are a non-monetary perquisite and are covered under Section 10 (10CC) of the Income tax Act, 1961 (the Act). Therefore, no multiple grossing-up is required. Furthermore, such taxes need not be included in the employee's salary for the purposes of calculating the housing perquisite.
- Contributions made by employers to an employees' home country's mandatory social security, pension and medical insurance schemes are not perquisites in the hands of an employee.
- Hypothetical taxes deducted by an employer do not constitute income and need not to be added back.
- Excess tax paid by an employer and later refunded to an employee never belonged to the employee, and therefore cannot be taxed in the employee's hands.
- Consultant's fees paid by employers in relation to tax filing assistance in respect of expatriate employees do not constitute a perquisite in the hands of employees.

[1] Yoshio Kubo *v.* CIT [2013] 36 taxmann.com 1 (Delhi)

Facts

In the cases involved, employers had paid the tax liability of their expatriate employees as part of operating a tax equalisation policy. Under this policy, hypothetical taxes were deducted from the employees and the actual tax liability was borne by the employers. In accordance with section 10(10CC) of the Act, no grossing up of the tax was carried out in the hands of employees. Section 10(10CC) of the Act provides that taxes borne by an employer on non-monetary perquisites need not be included within the income of employees. However, an employer is not able to receive any deduction of such taxes by virtue of Section 40(a)(v) of the Act which was introduced contemporaneously with Section 10(10CC).

In addition, in these cases, the employers contributed to the expatriate employees' home country's mandatory social security, pension and insurance schemes and these contributions were not offered to tax by the employees, as no benefit was vested in the employees at the time the contributions were made. In the cases in question, the employers generally engaged the services of tax consultants to administer the tax equalisation processes and, as a part of these procedures, the expatriate employees were provided with tax filing assistance.

Issue

The Revenue challenged the applicability of section 10(10CC) to the tax borne by the employer and also the non-taxability of the above-mentioned benefits (viz., contribution to social security, hypothetical taxes, etc.) in the hands of employees.

High Court Ruling

The table below sets out the questions which were analysed by the HC and the ruling it delivered in respect thereof:

S. No.	Questions	Revenue's contention	Assessee's contention	Ruling
1.	**Are the taxes borne by an employer on behalf of an employee non-monetary perquisites, and do they consequently fall within the scope of Section 10(10CC) of the Act?** **Is multiple grossing up under 195A applicable where tax liability on salary income is borne by the employer?** **Are the taxes borne by an employer to be excluded when calculating the perquisite value of rent free accommodation (RFA) provided to an employee, in view of Rule 3 of the Income Tax Rules, 1962?**	Taxes borne by an employer are a monetary payment in the overall scheme of the Act and Section 10(10CC) of the Act should not be looked at alone. Furthermore, the bearing of the tax by the employer is the discharge of an employee's obligation and is a perquisite under section 17(2)(iv) of the Act. Taxes borne by an employer are a monetary perquisite and, therefore, further tax on those taxes should be added to the employee's salary through the multiple stage grossing up process.	The assessee argued that there was a distinction between non-monetary and monetary payments. Payment of actual money to an employee is a monetary payment rather than something equivalent to such payment or a transfer of the money's worth. Simply because a benefit has monetary worth and is received directly or indirectly by an employee, this would not make it a monetary payment. The assessee also highlighted the legislative intent of introducing Section 10(10CC) of the Act, and the disallowance of such taxes in the hands of employers under Section 40(a)(v) of the Act.	The HC agreed with the assessee's contention and ruled that taxes paid by an employer on behalf of an employee are a non-monetary perquisite and thus are covered under Section 10 (10CC) of the Act. The payment of taxes to the government, being a non-monetary payment, are eligible for benefit under Section 10(10CC) and hence no grossing up is required. Rule 3 of the Income tax Rules, 1962, specifically excludes perquisites from the definition of salary for the valuation of housing perquisites. Taxes borne by an employer, being a non-monetary perquisite, would therefore be excluded from the salary when calculating the perquisite value of RFA.

S. No.	Questions	Revenue's contention	Assessee's contention	Ruling
2.	**Are contributions for social security/ pension/ medical insurance made in the home country by the employer for an employee seconded to India taxable as part of the salary (perquisite)?**	There is no specific exclusion for such contributions under the Act, as there is for contributions to approved superannuation funds etc.. Contributions are taxable as a perquisite as they are a benefit vested in an employee even if the occasion or event for their enjoyment was postponed. Undue importance should not be given to the wording about the payment being vested in the employee used in the Supreme Court (SC) ruling in the case of *L .W. Russel*[2].	Relying on the SC ruling of *L.W. Russel*[2], the assessee argued that contingent payments to which an employee has no right until the contingency actually occurs cannot be considered to constitute a taxable benefit.	The HC held that such contributions are not a perquisite as no benefit is vested in the employees at the time the contributions are made. The HC opined that the judgment of the SC in *L.W. Russel*[2] applied. The HC said that the SC ruling spelled out a wider fundamental principle, i.e. when an amount does not result in a direct present benefit to an employee but assures him of a future benefit in the event of a contingent occurrence, the payment made by the employer is not vested in the employee. The HC also relied on its judgement in the case of *Mehar Singh Sampuran Singh Chawla*[3]
3.	**Is the hypothetical tax deducted from an employee allowed to be deducted while computing the taxable salary?**	Even though the tax liability borne by an employer is included in the taxable salary, the hypothetical taxes deducted from that salary should also form part of the taxable salary.		Relying on the decisions in the cases of *Jaydev H. Raja*[4] and *Dr. Percy Batlivala*[5], it was held that the hypothetical tax amount was not received from the employer and did not constitute income. As the employees were only paid a net salary and the taxes borne by the employer were already included in the taxable salary, deduction of hypothetical taxes would be allowed.
4.	**Are excess taxes deposited by an employer which are then received as a refund by an employee, in cases where the tax liability was borne by the employer, exempt or taxable?**	The amounts which were paid over and above the amount due were taxable as a perquisite under Section 17(2)(iv) of the Act. Once the amounts had passed into the possession of the employee, thereafter what the employee did with the amounts was irrelevant for taxation purposes.	Taxes were borne by the employer and, in accordance with the terms of employment, the employee was contractually bound to refund any excess taxes deposited by the employer. Therefore, no benefit accrued to the employee.	The HC held that the receipt of money or property which one is obliged to return or repay to a rightful owner cannot be taken as a benefit or a perquisite. The amounts paid in excess by the employer, and refunded to the employees, never belonged to the employees and therefore could not be taxed in the hands of the employees.

[2] CIT *v.* L.W.Russel (AIR 1965 SC 49)
[3] CIT *v.* Mehar Singh Sampuran Singh Chawla [1973] 90 ITR 219 (Del)
[4] CIT *v.* Jaydev H. Raja [2012] 211 Taxman 188 (Bom)
[5] CIT *v.* Dr. Percy Batlivala [IT Appeal No. 1308 of 2008, dated 16-12-2009]

S. No.	Questions	Revenue's contention	Assessee's contention	Ruling
5.	**Is the amount paid by an employer to a consultant as fees towards their services taxable as a perquisite in the hands of an employee?**	The employer hired the consultant's services and the employee derived an advantage from the services. Therefore, the amount paid was a taxable perquisite.	It was the obligation of the employer to secure the tax benefits and to ensure that proper returns were filed. The employer hired the consultant and secured its services for its own comfort.	The HC held that even if the benefit of the consultant's services ultimately went to the employee, this could not mean that the payment formed part of the employee's income.

Conclusion

This is a welcome ruling and reaffirms the tax positions already decided in the earlier judicial precedents[6] on these matters, viz., Section 10(10CC) benefits, the taxability of contributions to social security and hypothetical taxes. This will certainly boost confidence of the taxpayers to review the tax positions considered in their tax returns to explore some savings where such benefits were offered to tax.

[6] DIT(IT) *v.* Sedco Forex International Drilling Inc and others [2012] 252 CTR 448 (Uttaranchal) and RBF Rig Corporation *v.* ACIT [2008] 297 ITR (AT) 228 (Delhi) (SB)

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