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PRE-BUDGET MEMORANDUM OF REPRESENTATIONS – 2023 - 2024: PERSONAL TAX

Sl. No	Section/Subject	Issue	Rationale with factual data	Recommendation
1	**Valuation of Company Owned Accommodation provided to employees under section 17(2) of the Act**	As per the current Income Tax Law read with the Income Tax Rules, the taxable value of residential accommodation owned by a company and provided to its employees (i.e. Value of Rent Free Accommodation or VRFQ) is taken @ 15% of "Salary" in cities having population exceeding 25 lakhs. In cities having population between 10 lakhs and 25 lakhs, it is taxable @ 10% of "Salary" and 7.5% of "Salary" in other cities. In case of leased / rented accommodation, value of the accommodation is taken at the stipulated percentages as above (or) lease rent paid by a company, whichever is lower. The definition of 'Salary' includes Basic, Bonus, Commission and all other taxable allowances excluding DA & Perquisites. With increase in 'Salary' due to career growth & inflation, the taxable value of VRFQ increases significantly year on year even though the employee may be	The above method of determination of the perquisite suffers from various inequities. For example, for the same employee staying in the same company owned accommodation, the perquisite value of VRFQ will increase with every salary increase. Again, for the same company owned accommodation, different employees with different salaries will be taxed on different perquisite value. Also, irrespective of the size/quality of company owned accommodation, the perquisite for a particular employee will be determined as a percentage of salary. A detailed note on the anomalies in the methodology presently being followed for taxing this perquisite along with the suggested methodology that can be adopted by amending the relevant Income Tax Rule is enclosed as **Annexure A.**	It is suggested that in case of company owned accommodation, the concept of fair value should be introduced for the purpose of determining perquisite value, so as to ensure that the employee is taxed on the right value of this perquisite. Fair Value should be defined as the comparable rent in the location concerned – suggestion in this regard is captured in **Annexure A.**

		staying in the same company provided accommodation. This increases the tax burden on the employees significantly over the years and acts as a demotivating factor.		
2	**Taxing of Employee Stock Options ("ESOPs") in the hands of the employees**	The current Income Tax Law, provides for taxation of ESOPs as a 'perquisite' under section 17(2) of the Act, consequent to the abolition of Fringe Benefit Tax (FBT). The section states that ESOPs issued free of cost or at concessional rates will be taxed on the date of exercise on the difference between the "*fair market value*" and the amount actually paid by the employee. The "*fair market value*" is to be determined based on stipulated methods which have been separately prescribed by the CBDT.	This methodology of taxation suffers from following drawbacks: (a) It seeks to tax a notional benefit at a time when the actual gain is not realised by the employee. In fact, it is possible that the actual sale of shares could result in a loss for the employee. Since the perquisite tax paid earlier cannot be set off against the capital loss, the employee suffers a double loss, namely tax outgo and loss on sale of shares. (b) The question whether the ESOPs are granted at a concessional rate is being determined with reference to the "*fair market value*" on the date of exercise of the options. Technically, this is an incorrect approach. If the ESOPs are granted at the prevailing market price on the date of grant, such share grant should be treated as "*non concessional*". This would be in line with the guidelines issued by SEBI. Any subsequent gain accruing to the employee due to favourable market movements by the date of vesting or exercise of option cannot be treated as a "*perquisite*" granted by the employer. (c) Due to the above approach of treating ESOP as perquisites at the time of 'vesting', a peculiar situation may arise. In a situation, where employees suffer 'perquisite tax' at the	It is suggested that the taxation of ESOPs as perquisite at the time of exercise/ allotment / should be removed for the reasons explained in the Rationale column. In other words, **ESOP should NOT be taxed at the time of exercise.** In any event, any appreciation in value should only be taxed at the time of sale/ realization by the employees concerned under the head "Capital Gains". Govt. of India has recently shifted the point of incidence of taxation of ESOPs for start-ups.

			time of exercise [since the market value at the time of exercise is more than the grant price], may still suffer a loss since the share price has subsequently declined at the time of sale. This is a double whammy adversely impacting the morale of the employees and goes against the concept of ESOPs as an incentive offered by employers to retain talent.	Such a relaxation should be extended to ESOPs issued by all employer companies.
			(d) Also, from the strictly legal angle, there are a number of differences between ordinary shares and ESOP shares. Therefore, they are not comparable. The taxation principles currently existing, result in discrimination. The market value is also strictly not applicable since there are lock-in periods applicable. A detailed note on these aspects is enclosed (**Annexure B).** (e) Since the actual sale of shares will attract capital gains tax, if applicable, it is unnecessary to subject the employee to perquisite tax. In fact, before FBT was imposed on ESOPs, specific provisions existed in the Income Tax Act for exempting the same from perquisites and subjecting it only to capital gains tax at the time of actual sale of such ESOP shares. (f) It may be noted that ESOPs have emerged over the years as a critical, motivational and retention tool for companies in a highly competitive market for talent. It is a very effective instrument for encouraging employees to perform and excel and is a win-win proposition for the employers / shareholders on one hand and the employees on the other. Hence, a uniform & fair methodology of taxing ESOPs would	

			go a long way in encouraging the Corporate sector in nurturing & retaining human capital.	
3	**Taxing of Employer's Contribution to Recognized Provident Fund and Superannuation Fund beyond Rs.7.5 lakhs u/s 17(2)(vii) of the Act and interest / income earned / accrued thereon u/s 17(2)(viia) of the Act.**	The Finance Act, 2020 had imposed tax on employees in respect of the Employer's Contribution to Recognized Provident Fund (PF) and Superannuation Fund (SAF) in excess of Rs.7.5 lacs along with the accretion by way of interest, dividend etc. pertaining to the said excess. The methodology prescribed for computing the said perquisite value is complicated and it is impossible for an employer to determine the correct perquisite value for the said contribution to PF & SAF beyond Rs.7.5 lakhs, prior to close of a financial year. At best, employers have to make an estimate for completing their salary processing and TDS obligation u/s 192 of the Act and only in the subsequent year they can determine the actual earnings attributable to the said contribution more than Rs.7.5 lakhs per annum. Added to this complexity is the expectation that income should be compounded year on year and included in the perquisite value.	It may be noted that there are various types of Superannuation Funds. In case of the new pension scheme and similar superannuation funds, the contributions made by the employer vests with the employee and he can transfer it from one employer to another. However, in other cases, contributions made by the employer to a Superannuation Fund do not accrue to the benefit of the employee till such time he retires upon superannuation, when the Fund is used to purchase annuities and/or to pay the commuted pension to the retired employee. Such contributions may or may not result in superannuation benefits to the employees since there are various conditions to be fulfilled by the employees like serving a stipulated number of years, reaching a certain age etc. Therefore, this should not be taxed as perquisite as per the ratio of decision laid down by the Hon'ble Supreme Court in **CIT vs. L W Russel [2002-TIOL-686-SC-IT]**. Further, the pension payments are subjected to tax at the time of actual receipt by the employee. Further, the methodology prescribed for determining perquisite value of income / interest earned or accrued on the said contribution over Rs.7.5 lakhs is very complicated and cannot determine the actual income prior to the close of a financial year for an employer to consider as perquisite and include the said amount for determining TDS u/s 192 of the	It is, therefore, recommended that the said contribution in excess of Rs.7.5 lacs as per section 17(2)(vii) of the Act should not be taxed as perquisite. Without prejudice to the above, if the decision is to continue taxing such excess PF/SAF contribution, then at least the interest / income earned or accrued thereon should be left out of the perquisite tax net.

			Act.	
4	**Deduction for Personal Tax Computation**	The Finance (No.2) Act, 2014 had fixed an overall limit to Rs.1.5 lakhs in respect of deduction under section 80C of the Act	Need to increase the standard deduction limit from Rs.1.5 lakhs that was fixed way back in 2014. With higher inflation, there is a need to revise the said ceiling u/s 80C of the Act to Rs.3.0 lakhs. This would act as a fillip to investments and also generate greater savings for the tax payer.	In the context of the current inflationary situation, it is suggested that this limit be increased to at least Rs.3 lakhs.
5	**Medical Reimbursements for Retired Employees (for hospitalization)**	Under section 17 of the Act, medical reimbursements received by employees from employers are not taxable in respect of expenditure incurred in approved hospitals and for prescribed diseases. Further, specific tax relief is also provided to employees in respect of medical treatment outside India for self and family.	However, such tax benefits allowed to serving employees are not available to retired employees, even if their former employers provide them with medical support post retirement.	It is suggested that the provisions of section 17 of the Act r/w relevant rules be amended to include retired employees as well for the tax benefit on medical reimbursements/hospitalization expenditure, both for domestic and foreign medical treatment.
6	**Leave Travel Concession/Assistance**	As per Sec. 10(5) of the Act, Leave Travel Concession/Assistance is eligible for tax relief for 2 calendar years in a block of 4 calendar years, that too, only for domestic travel expenses; foreign travel is not covered under LTA tax relief. Further, employees availing LTA will not only incur travel expenses but also accommodation expenses – currently, accommodation expenses are not	Since LTA is an allowance to employees to spend quality time with their family members, which in turn will improve their physical & mental health, Govt. of India, rightfully has provided tax relief on such LTA, subject to certain conditions, which were stipulated several years back. Since the tax relief is restricted only to domestic travel costs, many employees end up offering the excess LTA received for tax. Considering the increased pressure on employees in	(i) The concept of calendar year should be replaced with financial year (April – March) in line with the other provisions of the Income Tax Law. (ii) Tax relief should be granted annually and should include both domestic and foreign travel, to give a fillip to the Travel and Tourism Industry. (iii) Tax relief should be extended to

		covered under LTA tax relief.	the current day environment, it is suggested that Govt. should extend the tax relief for LTA to include within its fold (i) foreign travel and (ii) accommodation expenses.	cover even accommodation expenses apart from travel costs.
7	**Exemption from tax for payment of Leave Encashment to be raised to Rs.10 lakhs**	The exemption limit for payment of leave encashment is notified by the CBDT in accordance with the powers given under section 10(10AA) of the Act. The current limit of Rs. 3 lakhs is very old (since 2002) and needs to be raised substantially with immediate effect.	As per Sec 10(10AA) of the Act, entire leave encashment is exempt from tax in case of Govt. employees. Whereas, in case of non-govt. employees, there is a value cap of Rs.3 lakhs, which was fixed way back in 2002. There is an urgent to revise this figure upwards considering inflation and other factors.	It is suggested that similar to Govt. employees, Leave Encashment at the time of retirement be fully exempt even in respect of non-govt. employees. Alternatively, the value limit be increased to Rs.10 lakhs.
8	**Tax concessions to Senior Citizens**	The population in the current senior citizens' category did not have a robust social security / pension fund investment facility during their working life. As a result, they are hugely dependent on interest income from fixed deposits etc. The rate of interest has come down drastically in the past one year leaving the senior citizens in financial difficulty. Further, actual inflation is much higher than headline inflation numbers. This has added to their misery. Additionally, medical expenses shoot up	For the reasons captured under the 'Issues' column, It is recommended that beneficial tax measures should be introduced for senior citizens in the upcoming budget.	Minimum tax exemption limit for senior citizens (60 years age to 80 years age) should be increased to Rs. 7.5 lakh from the current threshold of Rs. 3 lakh. Very Senior Citizens who are aged above 80 years should be exempt from tax if their income is up to Rs. 12.5 lakh. There should not be any TDS from payment of interest to Senior and Very Senior Citizens. Ceiling for Health Insurance premium along with deduction for medical expenses for senior citizens

		heavily in the old age. Persons covered by Mediclaim insurance policies have to cough up very high insurance premia every 5 years and also after one or two claims. There should not be any TDS from payment of interest to Senior and Very Senior Citizens. Currently, the health insurance premium for a senior citizen is eligible for deduction to the extent of Rs 50,000.		as per the provisions of section 80D of the Act should be removed. Instead, entire premium paid by Senior Citizens towards health insurance should be allowed as a deductible expenditure u/s 80D.
9	**Contribution to National Pension Scheme (NPS)**	At present the voluntary contribution of Rs 50,000 is allowed as a deduction u/s 80CCD(1B) of the Act	Govt. of India should encourage contribution to NPS by even private sector employees, since it would provide a social security net during old age of such employees. Hence, it is recommended that the quantum of deduction u/s 80CCD of the Act should be increased for private sector employees to incentivize them contribute to NPS.	The deduction u/s 80CCD(1B) amount should be increased to Rs 1,50,000/-. Further, in case of employees of private companies who subscribe to NPS, 15% of the salary should be allowed as deduction u/s 80CCD(1) and 80CCD(2) of the Act, instead of the current 10%.

10	**Rationalization of tax rate for income of dividend earned by residents**	With the abolition of Dividend Distribution Tax (DDT) by Finance Act 2020, dividend is now taxed in the hands of shareholders at applicable slab rate. The payer is required to withhold taxes from dividend prior to making payment. Accordingly, resident shareholders are liable to pay tax on the dividend income, which could be as high as 35.88% (inclusive of the maximum surcharge capped at 15%). However, in case of non- resident shareholders section 115A of the Act provides for taxation @ 20%. Further, a non - resident shareholder may also be eligible to avail benefits under a tax treaty, where tax rate may be much lower, generally in the range of 10%-15%.	Dividend are declared out of tax paid profits. Therefore, levy of further tax on dividend received by the shareholder leads to double taxation of the same income. Hence, a concessional rate of 10% (or any other suitable rate) may be considered along with a basic exemption up to Rs. 1 lakh. This would also remove disparity in the taxation of dividend, between resident individuals and non-resident shareholders. Reduction in the base rate of tax on dividends in the hands of resident shareholders will encourage citizens to invest in the Stock Markets which would lead to broader financial inclusion and provide attractive source of fund raise to promoters. This would, in turn, lead to capital investments by the private sector, which is what the Govt. of India has been nudging them to do, especially in the prevailing economic situation, where the Govt. is looking to raise/ attract funds to invest in infrastructure and employment generating initiatives.	Similar to the reduction in surcharge on dividends to 15%, even the base rate of tax on Dividend Income should be capped at 10% (instead of the current 30%) in respect of resident shareholders.
11	**Covid related medical expenses – Not Taxable**	Vide an insertion of a proviso (ii)(c) to Sec 17(2)(viii) in Finance Act, 2022, the Govt. has carved out an exemption from perquisite tax, any sum paid by employers to employees in respect of his	Due to the delay in the amendment to the Act and notification of conditions by CBDT, neither the employer could avoid taxing such Covid related medical expenses as a perquisite nor the employees could claim exemption through their income tax returns. Further, the timeline for	Since the intent of the Govt. is to spare the employees from getting taxed as a perquisite, medical expenses relating to Covid treatment (or) ex-gratia received

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		medical treatment or any member of his family with effect from 1st April, 2020. Similarly, Sec 56(2)(x) has been amended to exempt any amount received from an employer by the family of a deceased employee (on a/c of Covid) or from any other person upto a limit of Rs.10 lakhs, subject to certain conditions. CBDT has recently on 5th August, 2022 come out with the conditions to be satisfied and also prescribed the forms to be submitted by the employees concerned to avail this exemption from tax. It may be noted that the Govt. had on 25th June, 2021, issue a press release announcing these tax exemptions. However, employers could not extend these tax exemptions to their employees (including their family members) in respect of medical expenses borne by the employer relating to Covid treatment, in the absence of amendment to Income Tax Act / Rules.	filing tax returns for FY 2020-21 (AY 2021-22) and 2021-22 (AY 2022-23) are long over.	by the family of a deceased person from his/her employer or from any other person, it is imperative that a special window be opened to enable such employees / their families to claim refund of income tax already paid by them on such amounts.

12	**Taxation for Individuals**	(a) Tax rates : Consequent to the reduction of corporate tax rates, the differential between personal and corporate tax has widened. The highest marginal rate for individuals has now gone up to 42.74% (highest slab) against the normal Corporate Tax Rate of 25.17%.	The high personal tax rate for individuals in India stands out as an exceptionally high rate as compared to other countries. For example, the maximum rates of personal income in Hongkong is 15%, Sri Lanka – 18%, Bangladesh – 25% & Singapore – 22%. Further, the huge gap in the tax rates as mentioned between individual and corporate tax rates is leading to several structuring decisions being adopted in favour of corporate model (for example, proprietorship business moving to company format).	It has become an urgent necessity to reduce the personal tax rates for individuals so that there is a degree of equity and fairness in relation to structuring decisions as well as being competitive with other countries.
		(b) Budget 2020 has ushered in an important change in terms of income tax regimes. There is a new tax regime that coexists with the old one.	With two tax regimes in place, income tax for individuals have become very complicated. Further, there are different rates of taxes depending upon the source of income. In addition to this, different rates of surcharge are applicable depending upon the total income and capital gains element in the total income both under the old and new tax regime. Under the new tax regime u/s 115BAC of the Act, wherein lower slab rates have been prescribed, the benefit of standard deduction has been taken away. The objective of providing standard deduction is that it allows salaried individuals to claim a flat deduction from income towards expenses that would be incurred with relation to his or her employment. Therefore, there is no rationale for not providing this deduction to the assessees opting for the tax rates prescribed u/s 115BAC of the Act.	It is suggested that the tax structure for individuals be simplified. This will also help in improving the compliance. Further, the standard deduction should be restored for employees opting for tax rates prescribed u/s 115BAC of the Act.

13	**Taxability issues for gratuity, leave encashment and other terminal benefits received by legal heirs of a deceased employee**	There is a lot of confusion in respect of TDS/taxability of various payments like gratuity, leave encashment and other terminal benefits received by the legal heirs of a deceased employee. The existing circulars on these subjects need to be updated based on the current Income Tax Law.	Detailed justification note is enclosed (**Annexure C)**.	This matter needs to be clarified urgently – suggestions in this regard captured in **Annexure C**.

Annexure A

PERQUISITE VALUATION UNDER SECTION 17(2) OF THE INCOME TAX ACT, 1961

IN REPSECT OF COMPANY OWNED ACCOMODATION PROVIDED TO EMPLOYEES

Background

As per Section 17(2) of the Income Tax Act, 1961, "Perquisite" includes value of rent-free accommodation provided to an assessee by his employer. The methodology for computing its perquisite value as prescribed under Rule 3(1) of Income Tax Rules (for private sector employees), is tabulated below:

*'**Salary**' for the above purpose includes: Pay, Allowances, Bonus or Commission or any other monetary payment but does not include DA, Employer's contribution to PF, allowances exempt from tax and value of perquisites*

Therefore, rent free accommodation to employees can either be an accommodation owned by the employer or an accommodation taken on lease by the employer.

Another way to compensate the employee for his stay is by paying him House Rent Allowance.

Basis of Valuation of Perquisites - Rent Free Accommodation

Population of City As per 2001 Census	Where Accommodation is owned by Employer	Where Accommodation is taken on Lease by Employer
Exceeding 25 lakhs	15% of Salary	Lease Rent Paid or Payable by Employer (or) 15% of Salary, whichever is lower *(less)* rent, if any, paid by the employee
Exceeding 10 lakhs but below 25 lakhs	10% of Salary	
Any Other	7.5% of Salary	

Issues

The aforementioned method of **determination of perquisite value in respect of company owned accommodation suffers from various inequities**, as summarised below:

1) The **perquisite value** and the consequent tax implication on a company owned accommodation is **NOT linked to the fair market rental value of the said property**; instead **it is linked to the Salary earned by the employee, which is not an equitable benchmark to determine the perquisite value of such accommodation** and results in the following anomalies:

a. **Employees with different salaries living in similar company owned accommodation**, **will have different perquisite value**. To clarify, assuming the Employer owns 2 similar flats in a residential complex offered to two of its employees, the tax implication would be adverse for the employee whose salary is more than the other one – again due to the linkage of perquisite value to the Salary than to the fair rental value of accommodation.

b. **Perquisite value in case of company owned accommodation is significantly more than on an accommodation** of a similar size / location if **taken on lease by an Employer.**

   Reason being, in case of a leased accommodation, as per Rule 3(1) – Table I: Clause (2)(b) of the Income Tax Rules, perquisite value represents "*actual amount of lease rent paid or payable by the employer or 15% of salary, whichever is lower as reduced by rent, if any, actually paid by the employee".*

c. **Where the salary of an employee increases** (considering inflation, performance of the company, employee etc.), who is **staying in the same company owned accommodation**, the **perquisite value and related tax implication will be much more as compared to another employee staying in a similar accommodation taken on lease by the employer. Increase in perquisite valuation** of such accommodation & related tax impact **happens mechanically**, without any correlation to the quality/size of accommodation provided to employees - **where the accommodation is owned by the employer**.

   In other words, in case of leased accommodation, perquisite value is linked to lease rent paid or payable, which would be invariably lower than 15% of Salary and so employees staying in leased accommodation would pay lower perquisite tax on this count. Whereas, in case of accommodation owned by employers, the perquisite valuation is determined basis only 'Salary' without any linkage to the fair rental value of such property.

2) When high performing employees staying in similar company owned accommodation **get performance incentives in a particular year or upgraded to the next level, this inequity accentuates** once their income tax slab changes. The impact of increase in amount of tax gets worse especially when the employee moves in to the highest tax slab which attracts higher surcharge[1] and cess, while there is no change in the accommodation or quality of life.

   In the aforesaid situation, **the increase in total tax would have an adverse impact on the employee's total post tax income and it may result in a situation where the take home salary after tax of the employees exhibiting superior performance could be lower than that of an employee, living in a similar accommodation, whose performance is mediocre.**

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[1] *While, base tax rate is 30%, surcharge varies from 10% for Income between Rs.50 L – 1 cr; 15% for Rs.1 cr – 2 cr, 25% for Rs.2 cr – 5 cr and 37% for Income above Rs.5 crores. So, marginal tax rate, including Cess @ 4%, moves from 31.2% to 34.32% to 35.88%, 39% with the highest being 42.744%.*

From the above analysis, it can be appreciated, **irrespective of the size or quality of company owned accommodation, the perquisite value** and the consequent tax implication **on the employees staying in company owned accommodation, increases significantly with every increase in salary**, since under the present law, **it is getting determined as a percentage of salary, without any correlation to the fair rental value of the said accommodation**.

3) <u>Definition of 'Salary' for Rent Free Accommodation significantly different from that for House Rent Allowance</u>:

It is pertinent to note that since the basis for computation of perquisite value u/s 17(2) is 'Salary', the definition of what constitutes 'Salary' is of paramount importance.

i) Section 17(1) read with Explanation 3 to Section 17(2)(ii) defines 'Salary' for the purpose of computing the perquisite value of rent-free accommodation. *'**Salary**' for the above purpose includes: Pay, Allowances, Bonus or Commission or any other monetary payment but does not include DA, Employer's contribution to PF, allowances exempt from tax and value of perquisites.* Consequently, the base figure on which perquisite value is determined is an all-inclusive figure due to which the aforementioned inequities arise.

ii) On the other hand, 'Salary' for the purpose of determining the taxable value of House Rent Allowance (**HRA**) granted by an employer to an employee u/s 10(13)A of the Income Tax Act read with Rule 2A of the Income Tax Rules is defined as follows --

"*Salary" shall have the meaning assigned to it in clause (h) of rule 2 of Part A of the Fourth Schedule"*

And, 'Salary' under Fourth Schedule: Part A - Rule 2(h) to Income Tax Act reads,

"Salary" includes Dearness Allowance, if the terms of employment so provide, but excludes all other allowances and perquisites.

It may be noted that there is a significant variance in the definition of 'Salary' for the purpose of computing perquisite value of rent-free accommodation of private sector employees Vs. the definition of 'Salary' for determining taxable HRA – which is the fundamental cause for inequity in taxation of private sector employees.

<u>Implications</u>

1) **Retention of skilled manpower is a critical requirement for a company** to be successful on a sustainable basis. One of the **motivating tools adopted by corporates is to provide a good quality residential accommodation** (typically owned & maintained by corporates) and related facilities to its employees & their families. However,

the perquisite valuation methodology currently prescribed under the Income Tax Act, **acts as a deterrent to employees** from willing **to accept and stay in company owned accommodation**.

Employees exhibiting superior performance and staying in company owned accommodation, are getting demotivated since their take home salary after tax, turns out to be lower than a moderate performing employee, due to higher tax outflow towards perquisite value of accommodation which is linked to their higher salary vis-à-vis a lower salaried employee, even though both are staying in similar type of company owned accommodation

2) The aforesaid **inequitable treatment also discourages corporates from investing in infrastructure, including residential projects**, across the country. It may be noticed that for this very reason, several corporates have been disposing of their residential properties across the country. At a time when the economy needs investments, it is submitted that the Govt. amends the perquisite valuation methodology for company owned accommodation such that corporates are incentivized to invest in the real estate sector and develop quality residential complexes to improve quality of life of their workmen.

3) The definition of '**Salary' for the purpose of determining perquisite value of rent-free accommodation owned by employers and provided to employees is NOT aligned with the definition of 'Salary' for determining taxable value of HRA**.

Recommendation

1) It is **suggested that in case of company owned accommodation, the concept of "fair rental value"**[2] be introduced in Rule 3 to ensure that equitable perquisite value is determined for tax purposes **instead of linking it only to Salary**. Therefore, perquisite valuation of company-owned accommodation be determined similar to leased accommodation prescribed under Rule 3 – Table I: Clause (2)(b), as modified below:

   "Actual amount of lease rental paid or payable by the employer or fair rental value of the property owned by the employer or 15% of salary whichever is lower as reduced by the rent, if any, actually paid by the employee."

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[2] *"Fair rental value" to be determined in line with the methodology prescribed in the Income Tax Portal at: https://incometaxindia.gov.in/Pages/faqs.aspx?k=FAQs%20on%20Income%20from%20house%20property – i.e.*

."Fair rental value" can be determined on the basis of rent fetched by a similar property in the same or similar locality (or) the municipal value of the property – i.e. for collection of municipal taxes, local authorities make periodic survey of all buildings in their jurisdiction'; such value determined by the municipal authorities in respect of a property, is called as municipal value of the property – relevant FAQs extracted in ***Annex 1.***

2) Consequently, the **existing Clause 2(a) in Table I of Rule 3 be deleted**. Similar modification be made to the methodology prescribed for 'furnished company-owned accommodation' provided by employer to an employee.

3) In addition, it is critical to amend the **definition of 'Salary'** for the purpose of determining perquisite value of rent-free accommodation owned by private sector employer provided to their employees [u/s 17(2)(ii)] **by aligning it with the definition of 'Salary' under Fourth Schedule: Part A - Rule 2(h) to Income Tax Act** – i.e. considered for determining taxable value of House Rent Allowance under Rule 2A of Income Tax Rules.

Proposed amendments to relevant provisions of Income Tax Act & Rules enclosed as ***Annex 2****.*

Annex 1

Extracted from Income Tax Portal "FAQs on Income from House Property"

How to compute income from a property which is let out throughout the year?

Income chargeable to tax under the head "Income from house property" in the case of a let-out property is computed in the following manner:

Particulars	***Amount***
Gross annual value	XXXX
Less:- Municipal taxes paid during the year	XXXX
Net Annual Value (NAV)	XXXX
Less:- Deduction under section 24	
➢Deduction under section 24(a)) at 30% of NAV ➢Deduction under section 24(b)) on account of interest on borrowed capital	(XXXX) (XXXX)
Income from house property	XXXX

https://incometaxindia.gov.in/Pages/faqs.aspx?k=FAQs%20on%20Income%20from%20house%20property

Gross annual value of a property which is let-out throughout the year is determined in the following manner :

Step 1: Compute reasonable expected rent of the property (for details refer to FAQ on computation of reasonable expected rent).

Step 2: Compute actual rent of the property (for details refer to FAQ on computation of actual rent).

Step 3: Compute gross annual value (Gross annual value will be higher of amount computed at step 1 or step 2).

Reasonable expected rent will be higher of the following:

- Municipal value of the property (Note 1); or
- Fair rent of the property (Note 2).

If a property is covered under Rent Control Act, then the reasonable expected rent cannot exceed standard rent (Note 3).

Note 1: Meaning of Municipal Value

For collection of municipal taxes, local authorities make periodic survey of all buildings in their jurisdiction. Such value determined by the municipal authorities in respect of a property, is called as municipal value of the property.

Note 2: Meaning of Fair Rent

It is the reasonable expected rent which the property can fetch. It can be determined on the basis of rent fetched by a similar property in the same or similar locality.

Note 3: Meaning of Standard Rent

It is the maximum rent which a person can legally recover from his tenant under the Rent Control Act. Standard rent is applicable only in case of properties covered under Rent Control Act.

Annex 2

Proposed Amendment[3] to Income Tax Act & Rules

I. Section 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;

Explanation. I – For the purpose of this sub-clause, concession in the matter of rent shall be deemed to have been provided if,-

(a) In a case where unfurnished accommodation is provided by any employer other than the Central Government or any State Government and-

(i) *[to be deleted]*

(ii) the accommodation is taken on lease or rent by the employer or is owned by the employer, the value of the accommodation being the actual amount of lease rental paid or payable by the employer or the amount the accommodation owned by the employer might reasonably be expected to let from year to year or fifteen percent of salary, whichever is lower, in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the rent recoverable from, or payable by, the assessee.

(b) ……..

[3] *Red colour represents deletion while Blue colour represents proposed inclusion/amendment*

(c) in a case where a furnished accommodation is provided by an employer other than the Central Government or any State Government and-

(i) *[to be deleted]*

(ii) the accommodation is taken on lease or rent by the employer or is owned by the employer, the value of the accommodation determined under sub-clause (ii) of clause (a) as increased by the value of furniture and fixtures in respect of the period during which the said accommodation was occupied by the assessee during the previous year, exceeds the rent recoverable from, or payable by, the assessee.

(d) …..

Explanation 2.- ………..

Explanation 3.- The existing explanation to be substituted with the following:

For the purpose of this sub-clause, "salary" shall have the meaning assigned to it under clause (h) of rule 2 of Part A of the Fourth Schedule

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Annexure B

ESOP shares vis-à-vis Market Shares

They are not comparable

1. ESOP shares are "issued" by the employer and "subscribed" to by the employee, whereas the shares acquired in the market ("market shares") are "transferred" from one shareholder to another. Consequently, while the market shares are goods, the ESOP shares do not become goods until they are allotted in favour of the subscribing employee.

2. It follows that the ESOP shares are not comparable with the shares that are already being traded. Therefore, it is incorrect to quantify any benefit to the employee with reference to the already trading shares or their so-called market value.

3. Even after allotment of the ESOP shares, the employee is prevented by law or the terms of the grant, from selling the shares during a lock-in period, whereas the shares bought in the market can be sold immediately without any restraint. The legal ability of disposition being one of the essential attributes of "property", the ESOP shares, unlike the market shares, are not property in the hands of the employee even after allotment.

4. When on the date of exercise, the shares are subject to a lock-in condition, they cannot be considered to be a benefit; and if it is a not a benefit, it ought not to be fictionally treated as benefit and brought under "perquisites". In ***CIT v. Infosys Technologies Ltd.,(2008) 2 SCC 272*, at page 277**, the Supreme Court held as follows:

   "During the said period, the said shares had no realisable value, hence, there was no cash inflow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs.165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options."

   The Court further, at page 279, held:

   "It is important to bear in mind that if the shares allotted to the employee had no realisable sale value on the day when he exercised his option then there was no cash inflow to the employee. It was not possible for the employee to know the future value of the shares allotted to him on the day he exercises his option."

It may be borne in mind that in the Infosys case, the Supreme Court dismissed the Government's appeal not only because the ESOP shares were not enumerated under "perquisites" in Sec. 17 (2) of the Act (which was subsequently included through an amendment), but also because it does not amount to a benefit.

5. For this reason as well, the ESOP shares and the market shares are not comparable, and the latter cannot afford any basis for determining any benefit that may have accrued to the employee on account of the ESOP shares.

Discrimination

6. When a listed company issues IPO or rights shares at a price less than the market value (or bonus shares), the difference between the issue price and the market price is not taxed. If in such a case the difference does not take the character of income, it cannot be income in the case of ESOP shares too.

7. And, if such difference (in the case of IPO/rights/bonus) does take the character of income, then taxing ESOP share alone lacks any intelligible differentia that can validly explain this classification.

8. If a distinction is suggested on the ground that in the case of ESOP shares the benefit takes the character of income forming part of 'salaries' (which is apparent from treating it as "perquisite"); which is not so in the case of market shares, it would be incorrect because such income, especially in the nature of salaries, would flow to the employee only when he realizes a gain upon the sale of the shares and not by mere allotment. Therefore, this is not a meaningful distinction.

Valuation

9. The "market value" is taken as on the date of exercise. But the ESOP shares are allotted after a lapse of time, when the market value may not be the same.

10. Even the market value on the date of allotment would not be relevant because the employee would not be able to realize that "value", being prevented from selling the ESOP shares during the lock-in period.

11. Further, the issue of ESOP shares results in expanding the capital base, and a consequent reduction in the intrinsic value of the existing shares. For this reason also, the alleged benefit flowing from ESOP shares cannot be reckoned with reference to the current value of the already existing market shares.

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Annexure C

TAXABILITY OF GRATUITY, LEAVE ENCASHMENT AND OTHER TERMINATION BENEFITS TO THE LEGAL HEIR(S) OF A DECEASED EMPLOYEE:

(a) **Regarding Leave encashment** –

There are CBDT circulars stating that leave salary paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his/her death is not taxable. The gist of two CBDT circulars are given below:

- Circular No. 35/1/65-IT(B), dated 5-11-1965 states if the legal representative of the deceased is to be taken to be the assessee, then the amount/proposed to be paid is certainly not due to him. It is an ex gratia payment on compassionate grounds. Thus, the payment is not in the nature of salary.

- Circular No. 309 [F. No. 200/125/79-IT(A-I)], dated 3-7-1981 states this receipt in the hands of the family is not in the nature of one from an employer to an employee. The deceased had no right or interest in this receipt. This payment is only by way of financial benefit to the family of the deceased Government servant, which would not have been due or paid had the Government servant been alive. In view thereof the amount will not be liable to income-tax.

  Based on the above 2 circulars it would seem that CBDT intends to exempt the leave encashment salary received by the legal heir of a deceased employee.

(b) **Regarding Gratuity** –

- There is a CBDT circular No. 573 dated 21.08.90 which states that a lump-sum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable as income under the Income-tax Act, 1961**. In fact, this circular will cover all other lumpsum termination benefits being paid to the legal heir of a deceased employee, who dies while still in active service.**

- Further, there are 2 case laws **Smt. L.K. Thangammal Vs. Third Income Tax Officer (1 ITD 762 – ITAT Madras**) and **First Income Tax Officer Vs. Smt. A.A.Talati (31-TTJ-245- ITAT Mumbai)** which clearly established the law [before introduction of Section 56(1)(v)] that **gratuity received by the legal heir of a deceased employee is not taxable , even after considering the provisions of section 10(10)(iii) of the Act.**

(c) However, Section 56(2) and section 2(24) of the Act have been amended with effect from AY 2005-06 to include gratuitous payments received by an Individual / HUF (any sum of money received not **exceeding** the prescribed amount without any consideration) with a view to widen the scope of Income. There are certain specific exclusion to such gratuitous receipts but such exclusions do not cover the leave encashment, gratuity or other termination benefits received by the legal heir of any deceased employee in connection with the services rendered by him.

Hence, due to the introduction of Section 56(2)(v)/(vi)/(vii)/(x) in the Act, leave encashment, gratuity and other termination benefits received by the legal heirs would now become taxable, though the above referred CBDT circulars (which were issued before the introduction of Section 56(2)(v)/(vi)/(vii)/(x) of the Act] had exempted such payments. As the earlier CBDT circulars have not been withdrawn, there is a confusion as to whether these payments to legal heirs are taxable income in their hands or not.

It is to be noted that in 2022, the Govt. inserted a proviso (XIII) under Sec 56(2)(x) of the Act to exclude from income any amount received by legal heirs from the employer of the deceased employee (without any monetary limit) and up to Rs.10 lakhs If received from any other person(s). It is recommended that this exemption be extended to all types of payments, gratuitous or otherwise, received from the employers by the legal heirs of deceased employees while in service.

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