

## Dear Employee - Enjoy the perk and avoid the Tax-net also.

(Whether Interest subsidy received by an employee from his employer is a taxable perquisite in his hands under the Income-Tax Act 1961)

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By S K Tyagi

Now-a -days most of the employers, especially the companies have been providing loans to their employees for the purpose of purchase / construction of a houses or purchase of vehicles. Such loans are either interest-free or at concessional rate of interest. These loans are being advanced in order to make the salary package more attractive as well as by way of a welfare measure. Of late, some companies have been framing different kinds of schemes for the above purpose. Under some of such schemes the employee may himself take a loan from banks or other financial institutions,. e.g. H.D.F.C. , L.I.C.- F.C., G.R.U.H - **Finance** etc; the employee is required to bear only a small percentage of interest between 4% to 6% and the balance of interest on such loans is reimbursed to the employee by the employer company. Such reimbursement has come to be popularly known as '**Interest -subsidy**'.

It is thus, clear that an employer may assist his employee in the purchase / construction of a house or the purchase of a vehicle, by providing:

- (i) interest free loan, or
- (ii) loan at concessional rate of interest, or
- (iii) interest subsidy in respect of the interest payable on loan

In such cases the employee would naturally be interested to know about the tax implications in respect of such loan transactions.

### **2.No taxable perquisite in respect of interest free loan or loan at concessional rate of interest.**

Where a concessional or nil interest is charged on housing loan provided by the employer, no perquisite value is considered under the Income-tax Act 1961. In this context, it is relevant to note that erstwhile S.17(2)(vi) was inserted by the Taxation Laws (Amendment ) Act 1984, with the particular object to tax salaried tax-payers by treating as a perquisite, interest free loans or loans for which interest charged was at a concessional rate, where the loan was advanced by the employer to enable to the construction of a house by the employee. This provision was deleted by S.6 of Finance Act 1985, with a clear statement that **deletion was necessary to grant relief to salaried tax-payers**. For this purpose the Central Board of Direct Taxes (C.B.D.T) had also issued Circular No.421 dated 12<sup>th</sup> June,1985. The relevant part of the Circular is reproduced as follows:

- “1. Under sub-clause (vi) of clause (2) of S.17 of the Income-tax Act., inserted by the Taxation Laws (Amendment ) Act, 1984, where the employer has advanced any loan to an employee for building a house or purchasing a site or a house and a site or for purchasing a motor car, and either no interest is charged by the employer on such loan or interest is charged at a rate which is lower than the rate of interest which the Central Government may specify in this behalf by notification in the Official Gazette, an amount calculated on the following basis is regarded as perquisite received by the employee and charged to tax accordingly:-

- (a) in a case where such loan is advanced without charging any interest, the amount of interest on such loan at the rate notified;
- (b) in a case where such loan is advanced by charging interest, at a rate which is lower than the notified rate, the amount of the difference between the interest on such loan at the rate notified and the interest charged by the employer.
2. This provision does not apply to employees of the Central Government or any State Government or an employee (not being a director of a company or a person who has a substantial interest in the company) whose income under the head “Salaries” (exclusive of all benefits and amenities not provided for by way of monetary payment) does not exceed Rs.18,000.
3. **As a measure of relief to salaried tax-payers, the Finance Act, 1985, has omitted the aforesaid provision with effect from the date of its insertion, namely, 1<sup>st</sup> April, 1985.** In consequence thereof, sub-clause(vi) of clause(b) in Explanation 2 to S.40A(5) of the Income-tax Act, which defines the term “perquisite” for the purposes of the said section to include the perquisite value represented by interest-free loans or loans at concessional rates of interest, has also been deleted.”

From the aforesaid Circular of the C.B.D.T. it is clear that there will be no perquisite value in respect of interest-free loan or concessional loan advanced by the employer to its employees, as a measure of relief to salaried tax-payers.

**Besides**, there are two direct judgements, one of Calcutta High Court and the other of Karnataka High Court in this respect. The Calcutta High Court in the case of **C.I.T Vs P. R. S. Oberoi, 183 I.T.R p.103**, was seized of the issue whether interest-free loan obtained by the director from the company, amounted to a benefit or perquisite for the purpose of S.2(24)(iv) of the Income-tax Act. The Hon. High Court referred to the deletion of sub-clause (vi) of S.17(2) by Finance Act 1985, and concluded therefrom that the Parliament did not intend to treat **interest-free loan or loan at concessional rate**, as a benefit or perquisite granted or provided by lender company to the director or employee, as the case may be.

Similarly in the case of **C.I.T. Vs M. K. Vaidya, 224 I.T.R. p.186**, the Hon. Karnataka High Court referred to the deletion of sub-clause (vi) of S.17(2) by Finance Act 1985 and also the Circular of the C.B.D.T, No.421 dated 12<sup>th</sup> June,1985 and concluded therefrom that **interest-free loan or loan at concessional rate** given to an employee for building a house, was not a perquisite within the meaning of S.17(2) and therefore, not taxable under the Income-tax Act.

Keeping in view the aforesaid judgements of Calcutta and Karnataka High Courts and C.B.D.T’s Circular No.421 dated 12<sup>th</sup> June,1985; it is evident that the market rate of interest or the difference between the concessional rate of interest charged by the company to its employees on housing loans and the market rate of interest, will not be taxable as a perquisite under the Income-tax Act, in the hands of the such employees, in case of interest free loans or the concessional loans respectively.

### **3. Whether interest subsidy is a taxable perquisite in the hands of the employee**

In the light of the deletion of erstwhile S.17 (2) (vi) - Vide Finance Act 1985, which was considered necessary to grant relief to salaried tax-payers; no benefit either in the form of interest free loan, or concessional loan is treated as taxable perquisite. The position in this respect has been made fully clear by Circular No. 421 dt: 12<sup>th</sup> June 1985, issued by the CBDT. Interest subsidy is a benefit of exactly same nature. It is only the form which is different, but the substance of such loan transaction along with the benefit derived therefrom is the same. Therefore as a natural corollary to the aforesaid Circular of the CBDT, even the interest subsidy has to be treated as a non-taxable perquisite.

**Besides**, on interest subsidy, there is a direct decision of the A.P. High Court in the case of **P. V. Rajagopal Vs Union of India, 99 Taxman p.475**. In this case this issue has been dealt with in great detail. The Hon'ble High Court examined whether interest subsidy could be treated as ;

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| (a) Part of Salary U/s 17(1)     | (b) Perquisite U/s 17(2)(iii),           |
| (b) Perquisite U/s 17(2)(iv); or | (d) Profits in lieu of salary U/s 17(3). |

After discussing each of the aforesaid provisions thread-bare, the High Court has held that interest subsidy is covered under none of the aforesaid provisions. The Hon. High Court has further stated that the interest subsidy which was given as a welfare measure to treat the employees of the Public Sector Undertakings on par with the Central Government Servants was never intended to be taxed.

The High Court has gone a step further and stated that one possible view is that interest subsidy is a perquisite as the employee gets it only because of his employment, as incidental to his service conditions. But the same benefit given indirectly has not been treated as a perquisite by the Revenue. If the employer takes a loan at a higher rate and advances it to the employee at a lower rate of interest, the difference is admittedly not treated as a perquisite. But where the loan is taken by the employee and the difference is reimbursed to the employee, it is sought to be treated as a perquisite. On the facts of the present case the benefit to the employee was the same whether given directly or indirectly. So when it is not taken as a perquisite in the first situation, it has to be considered in the same way in the second situation or otherwise it will be discriminatory.

**Further**, the High Court has also made a pointed reference to a letter of the Chairman C.B.D.T dated 13.7.'90, addressed to the Chairman of the Standing Conference of Public Enterprises, which makes the position very clear. The aforesaid letter is reproduced as follows:

“The question of taxation of public sector undertakings has been examined in great detail by the Board as well as by various other organisations and for a variety of reasons, the view that has emerged is that there is

no reason or justification to distinguish or discriminate between public and private sector in the matter of direct taxation.

Wherever an employer has advanced any loan to its employee for the purpose of building a house or purchase of a house or site, the question of taxing any ‘**subsidy**’ by way of lower interest charged than that at which the employer itself might have taken loans from financial institutions like HDFC, does not arise. In this connection,

I would draw your attention to sub-clause (vi) of clause (2) of S.17 which was inserted by the Taxation Laws (Amendment) Act, 1984, w.e.f. 1<sup>st</sup> April 1985 but was subsequently deleted by the Finance Act 1985 w.e.f. the same date. If any Assessing Officer has actually treated such a differential as a perquisite or taxable

income, he is clearly in error. If this is happening on a large scale, the Board will also consider issuing suitable instructions in this regard.”

**There** is another judgement on this issue by **Karnataka High Court** in the case of **P. Krishna Murthy Vs C.I.T, 224 I.T.R p.183**. In this case the employer company reimbursed its employees the interest paid on loans taken for building houses. It was held that the interest subsidy was not taxable in the hands of the employees in view of the deletion of sub-clause(vi) of S.17(2) of the Income-tax Act, by the Finance Act 1985 and also by virtue of the C. B. D. T’s Circular No.421 dated June 12,1985.

Keeping in view the aforesaid judgements of the A. P. and Karnataka High Courts, C. B. D. T’s Circular No.421 dated 12<sup>th</sup> June 1985 and the letter of the Chairman C.B.D.T dated 13.7.’90; it is evident that the interest-subsidy in respect of housing loans etc. is not a taxable perquisite. Therefore, part of interest borne by the employer out of the interest paid by the employees on housing loans taken from financial institutions like HDFC/LIC FC/GRUH-Finance etc., shall not form part of taxable income in the hands of such employees.

#### **4.Caution**

In the case of **C.I.T Vs P.R.S. Oberoi, 183 I.T.R p.103( Cal )**, the Hon. High Court has incidentally held, “The Tribunal had found that there was nothing on record to show that the company borrowed any money for making advance to the assessee and / or paid any interest on the over-drawn amount which, **but for such payment, would have been paid by the assessee.....** The interest free loans obtained by the assessee from the company were not benefits or perquisites within the meaning of S.17(2)(iv) of the Act”.

Here the High Court has made a reference to S.17(2)(iv) of the Act. It is, therefore, advisable that as an abundant caution the employer should avoid taking any loans specifically for advancing the same, at concessional rate of interest, to the employees for house building etc.

The employer may take loans for the general purpose of its business or capital requirements. As the advancement of housing loans etc. is a welfare measure such a loans will be very much, wholly and exclusively for the purpose of business of the employer .

Similarly in the case of **P. V. Rajagopal Vs Union of India, 99 Taxman p.475 (A.P)**, the Income-tax Department argued for including interest subsidy as a perquisite U/s 17(2)(iv), as a sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the employee. In this context the High Court held that a sum paid by an employer, to attract the aforesaid meaning would have to be

paid directly by the employer to a third person and not to the employee directly, and since interest subsidy is paid directly to the employee, it would fall outside the scope of S.17(2)(iv). In the light of the aforesaid observations of the Hon. High Court, direct payment of interest subsidy, to the HDFC etc., should be avoided.

## **5. Conclusion**

In the light of the aforesaid discussion, interest subsidy received by an employee from his employer, whether in the form of interest-free loan, loan at concessional rate of interest or in the form of reimbursement of part of interest paid by the employee on loan from financial institutions, will not be taxable.

To re-capitulate , the aforesaid view is supported by-

- (i) CBDT's Circular No. 421 dt: 12.6.1985,
- (ii) Letter of the Chairman CBDT dt: 13.7.1990,
- (iii) Decision of Karnatka High Court in the case of **C.I.T. Vs M K Vaidya 224 I.T.R. p.186**,
- (iv) Decision of Calcutta High Court in the case of **C.I.T. Vs P R S Oberoi, 183 I.T.R p.103**,
- (v) Decision of Karnatka High Court in the case of **P Krishna Murthy Vs C.I.T. 224 I.T.R. p.183**; and
- (vi) Decision of Andhra Pradesh High Court in the case of **P V Rajgopal Vs Union of India, 99 Taxman p.475**.

The most important point to be noted in this context is that there is no decision of any High Court against the aforesaid view .It may, therefore, be emphatically stated that the interest subsidy provided by an employer to its employee for the purchase / construction of a house or for the purchase of a vehicle, will not be liable to tax in the hands of the employee.

## **No TDS in respect of such interest subsidy**

As pointed out earlier, the aforesaid interest subsidy is not liable to tax in the hands of the employees. The employer will, therefore, not be required to deduct tax at source in respect of such interest subsidy. This view is supported by the decision of Andhra Pradesh High Court in the case of **C.I.T Vs Coromandel Fertilisers Ltd, 187 I.T.R. p.673**. It was held in this case that where the employee is not liable to pay tax under the head 'Salaries' on any part of the sum paid to him by his employer, there is no obligation on the employer to deduct tax at source U/s 192 (1) of the I.T. Act.

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