

Planning the Pay - Package of a Senior Executive

(Through a practical example an attempt has been made to plan pay-package of a Senior Executive, by using the various provisions of the I.T. Act & Rules, in such a manner that the incidence of tax is minimised)

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As is well known income-tax is deducted at source in respect of income from 'Salaries'. As the income of salaried tax-payers is fixed, they are more susceptible to inflationary pressures. Therefore, there have been progressive attempts on the part of the Legislature to grant more and more relief to salaried tax-payers. In order to subserve the aforesaid objective, a number of exemptions and deductions in respect of various allowances and other receipts, have been provided in the Income-Tax Act 1961, over a period of time.

Income under the head 'Salaries' is computed as per the provisions Ss 15,16 & 17. The valuation of perquisites is provided under rule (R) 3 of the I.T. Rules 1962. Besides, a number of exemptions are provided to salaried tax-payers U/s 10. There are a number of rules relevant to the determination of income under the head 'Salaries'. viz , rules 2A to 3A.

Most of the employers make best use of the aforesaid provisions in order to minimise the tax incidence in the case of their employees, so as to make the pay-package most attractive. In a given case, it is possible to so arrange the basic salary, allowances and perquisites, that the tax incidence is minimised. In other words, the pay-package of a salaried tax-payer can be planned in such a manner within the four corners of law that the I.T. payable is kept to the minimum. This is being illustrated by a practical example given hereinafter.

Practical example of a Senior Executive

In this illustrative case, certain assumptions are required to be made, viz:

- (i) the place of posting of the Executive is a city other than Delhi, Mumbai, Calcutta & Madras ,
- (ii) the basic salary is Rs 50,000 per month (p.m) ,
- (iii) rent payable by the employer for rent-free accommodation is Rs 30,000 p.m.

The basic salary at the rate of Rs 50,000 p.m is not variable, as the same has been approved by the share- holders of the employer / company. There is a limit in respect of the allowances and perquisites which is fixed as a percentage of the basic salary, say 150% of the basic salary i.e Rs 75,000 p.m. Therefore, the allowances and perquisites have to be adjusted within the aforesaid limit of Rs 75,000 p.m.

In the following paragraphs (paras) certain guide-lines have been laid down within the aforesaid parameters of basic salary and over-all limit of perquisites etc, so as to keep the tax incidence to the minimum. For this purpose the relevant provisions of the Income-Tax Act 1961, Income-Tax Rules 1962, Circulars/ Instructions of the Central Board of Direct Taxes (CBDT) and case-law ; have been kept in view.

1. Payment of any allowance to be avoided

There are certain allowances which are exempt from income-tax, whereas, the other allowances are taxable. All taxable allowances form part of "Salary" for the purpose of valuation of perquisites in respect of rent-free accommodation.. Therefore in order to keep the perquisite value for rent-free accommodation to the minimum, payment of allowances except the exempt ones, should be avoided. Instead, it is advisable to make reimbursement of expenses incurred.

2. Rent-free accommodation

As already stated the rent paid for the accommodation is 30,000 p.m. On examination of the Rules regarding house rent allowance (HRA) and rent-free accommodation it is observed that there is no material difference between the two options. Therefore, it would be better to go in for the option of rent-free accommodation, keeping in view the other benefits related thereto.

In case of a senior Executives (e.g. Executive Director or Managing Director etc) the employees and even customers of the employer company visit him at his residence before and after office hours and some times even on holidays regarding urgent matters. It is, therefore, advisable to earmark a portion of his house for office and visitors' room.

In other words , there should be an office-cum-study room for the senior Executive and another room for the visitors. This kind of arrangement is well recognised by the Income-tax Department.

If the rent payable for the accommodation is Rs.30,000 p.m. then as per Board's Circular No.374, dated 14.12.'83, the perquisite value of the same, will be worked out as follows;

- (a) if fair-rent is less than 10% of salary, fair-rent is the taxable value of the perquisite;
- (b) if fair-rent is 10% of salary or more but not more than 50% of salary, 10% of salary is the taxable value of the perquisite, and
- (c) if fair-rent exceeds 50% of salary, fair-rent minus 40% of salary is taxable

In the given case the, fair-rent i.e. Rs.30,000, exceeds 50% of salary i.e. Rs.25,000 and therefore, the value of perquisite will be fair-rent minus 40% of salary i.e. Rs.30,000 - Rs.20,000 = Rs.10,000 p.m..

If, however, the value of the rent in respect of office-cum-study and visitors' rooms, say Rs.5,000 p.m., is reduced from Rs.30,000 then fair-rent of the accommodation will be Rs.25,000 only. In that case the perquisite value of the accommodation will be 10% of salary i.e Rs.5,000 p.m. only.

Besides, the perquisite value of the accommodation may be further reduced, if we go by the decision of Bombay High Court in the case of **M.A.E. Paes Vs C.I.T, 230 I.T.R. P.60(Bom)**. As per this judgement of the Bombay High Court, fair rental value of accommodation is to be determined with reference **Standard Rent** payable under the Rent Control Act. It is further held that the word 'Fair' indicates that it is not prevailing market rent. Normally the standard rent may be taken as municipal valuation of a house property for levying property tax etc.. It is common knowledge that municipal valuation of a house property is much lower than the prevailing market rent. Thus if the municipal valuation of the house property is less than Rs.5,000 p.m. then the same will be taken as perquisite value of the accommodation. The aforesaid decision of the Bombay High Court is based on the decisions of the Apex court in the cases of,

- (i) **Dewan Daulat Rai Kapoor Vs N.D.M.C, 122 I.T.R p.700 (SC), and**
- (ii) **Sheila Kaushish Vs C.I.T, 131 I.T.R p.435 (SC)**

Note : As per the aforesaid Circular No. 374 of the CBDT, in case of rent free accommodation situated at Delhi, Bombay, Calcutta and Madras, the basis of valuation of the perquisite is as follows :

- (a) if fair rent is less than 10% of salary, fair rent is taken as the taxable value of the perquisite;
- (b) if fair rent is 10% of salary or more but not more than 60% of salary, 10% of salary is taxable value of the perquisite; and
- (c) if fair rent exceed 60% of salary, fair rent minus 50% of salary is taxable.

3. Furnishings in the accommodation

The perquisite value of furniture, which includes both **hard furnishings** as well as **soft furnishings**; is calculated as per Rule 3 (a) (iii) of the I.T. Rules. Hard furnishings include normal furniture like beds, dinning-table, chairs, sofa-sets etc, as well as television-sets, radio-sets, refrigerators, air-conditioning plant or equipment and other house hold appliances. Soft furnishings, on the other hand, include sofa-covers, curtains, bed-sheets, carpet etc.

The perquisite value of the furnishings is calculated @ 10% per annum (p.a) of the original cost of such furnishings or if such furnishings are hired from a third party, the actual hire charges payable therefor. Tax-planing in this regard, in respect of the case in hand, may be done as follows :

(a) Planing for soft furnishings

Provision for soft furnishing should not be at a very high figure. In normal course all the furnishing allowance will be treated as part of salary. Therefore, the better course is that soft furnishings are provided by the employer / company .The amount earmarked for soft furnishings may be kept at a figure of Rs 5,000 p.m or Rs 60,000 per annum. The soft furnishings may be so arranged that its

over-all cost is Rs 1,20,000. Then 50% of the furnishings may be treated to have been written-off every year.(The life of short furnishings may be taken as two years).

In this arrangement the employer/company will pay a sum of Rs 60,000 for replacement of soft furnishings every year, on the basis of a certificate from the Executive to the effect that such soft furnishings are required to be replaced. The employer / company may also choose to reimburse the Executive to the extent of Rs 60,000 every year for replacement of soft furnishings.

The perquisite value of such soft furnishings will be 10% of their original cost that is 10%, of Rs1,20,000 ,which works out to Rs 12,000 p.a. Thus though the reimbursement in respect of soft furnishings p.a is to the extent of Rs 60,000, its perquisite value will be Rs 12,000 p.m only.

(b) Planning for hard furnishings

The cost of **hard furnishings** is normally pretty high, say Rs 3 lakhs at the minimum. As the durability of such items is longer, we may, on the average, take their age as five years. The employer / company may replace such items to the extent of 1/5th or 20% thereof, or reimburse the Executive to that extent i.e Rs 60,000 p.a.

The perquisite value of such furnishings will be 10% of their original cost i.e Rs 30,000 p.a, as against annual reimbursement of Rs 60,000 in respect thereof.

4. Provision of domestic servants

The employer / company may provide a watchman, a sweeper and a gardener to the Executive for proper upkeep and security of the residential accommodation. The payment to all the aforesaid servants may be in the range of Rs.2,000 to Rs.2,500 p.m. each. The employer / company may choose to reimburse the Executive in respect of the aforesaid payment of Rs.6,000 to Rs.7,500 p.m. on the basis of a certificate given by the Executive to that effect.

The perquisite value in respect of each of the aforesaid servants will be Rs.120 p.m. per person, as per Rule 3(ba) of the Income Tax Rules 1962. Thus the total perquisite value in respect of the aforesaid three servants will be Rs.360 p.m. as against the payment or reimbursement to the extent of Rs.6,000 to Rs.7,500 p.m. in respect thereof.

5. Helper allowance

As per Rule 2BB(d) read with S.10(14), exemption from Income-Tax, is available in respect of an allowance granted to meet the expenditure incurred on a helper for the performance of the duties of an office or employment of profit. The employer/company has lot of elbow-room in this respect. I have already suggested that a part of the residential accommodation may be earmarked for an office-cum-study room and a visitors' room. In view of this reason, a helper may be posted at the residence

of the Executive. As the **Helper** has to assist the Executive. in the discharge of his official duties, his salary may be fixed at a higher amount also, say at the rate of Rs.4,500 to Rs.5,000 p.m.. The Executive will be free to appoint any person of his choice for this purpose and on the production of the necessary certificate by the Executive, the company may reimburse the expenses incurred on such a helper. As already pointed out the aforesaid allowance is exempt from income-tax.

6. **Provision of a car**

Provision of a car for the use of the Executive, partly for the performance of his duty and partly for his personal use, may be made by the employer / company. If the HP rating of the car does not exceeds 16, then perquisite value for the free use of car will be Rs 600 p.m and if the HP rating of the car exceeds 16 then it will be Rs 800 p.m. In addition, if a chauffeur is provided to run the motor car, the value of the aforesaid perquisite will be increased by a sum of Rs 300 p.m.

In this context, it is suggested that the Executive may be provided with a chauffeur, as the salary paid to the chauffeur may be as high as Rs 4,000 to 5,000 p.m, whereas the perquisite value in respect thereof will be only Rs 300 p.m

[**Note** : Please refer to Rule 3 (c) of the I.T. Rules 1962]

7. **Leave travel assistance (L T.A) - S. 10(5)**

The amount exempt U/s 10(5) is the value of any travel assistance received by or due to an employee for himself and his family in connection with his proceeding on leave to any place in India.

Family means:

- (a) The spouse and children of the individual.
- (b) The parents, brothers, and sisters of the individual who are wholly or mainly dependent upon him.

The amount of exemption is the amount of air economic fare of the National Carrier by the shortest route or the amount spent, whichever is less, in case of journey by air.

The exemption on the aforesaid basis is available in respect of two journeys performed in a block of four calendar years commencing from 1986. Where travel assistance is not availed of during any block of four years then the same may be availed of in the immediately succeeding year. From October 1998 the exemption is not available to more than two surviving children of the individual. In this respect the family of the Executive may so arrange its journeys that the total amount in each year does not exceed the allowance granted. In other words care has to be taken that every member of the family undertakes a journey every alternate year. However, if all the members

of the family wish to go on a holiday together, then in respect of some, the aforesaid option of availing the LTA in the immediately succeeding year may be exercised.

8. Reimbursement of medical expenses

As per proviso to S.17(2) reimbursement of expenses for the medical treatment of the employee or any member of his family will not be treated as perquisite if certain conditions are fulfilled.

In this respect the most important point is that the employee may claim the reimbursement for medical expenses upto a sum of Rs.15,000 in a year, only on the basis of a certificate submitted in that respect. Reimbursement of medical expenses over and above Rs.15,000 will be exempt only if the expenditure is incurred by the employee on his medical treatment or treatment of any member of his family in any hospital (including Dispensary/ Clinic/ Nursing home) maintained by the Government, local authority or in a hospital approved by the Government for its employees or in other such hospitals approved by the Chief Commissioner of Income Tax. It may be pointed out that any expenditure on medical treatment of the employee or any member of his family, **outside India** is also allowed subject to fulfilment of certain conditions, as per the aforesaid proviso.

As the medical expenses may not reach the limit fixed in this respect every year, it would be better if the rules in this respect are kept a bit flexible so that a deficit in a certain year may be allowed to be adjusted against an excess in another year.(This will be only for the internal working of the employer / company)

9. Supply of free gas, electricity and water

If free gas, electricity and water are supplied by the employer partly for official and partly for private purposes of the employee, then the perquisite in respect of the same is computed at the rate of 6.25% of salary, as per Rule 3(d).

As already suggested that a portion of the residential accommodation would be earmarked for office-cum- study and visitors' room, the supply of aforesaid items viz. Gas, Electricity, and Water, will be treated partly for official and partly for private purposes. The employer/company may, therefore, supply Gas, Electricity and Water to the Executive subject to an overall limit of expenditure in respect thereof. The expenditure on such items every month may be Rs.5,000 to Rs.10,000, whereas the perquisite in respect thereof, will be computed at the rate of 6.25% of Rs.50,000, which works out to Rs.3,125 p.m.

10. Children's education allowance

Fixed education allowance or reimbursement in respect thereof for the education of members of family of an employee, is taxable subject to the exemption under Rule 2BB r.w.S.10(14), of Rs.50 p.m. per

child as educational allowance and Rs.150 p.m. per child as hostel allowance (The number of children not to exceed two). In view of the aforesaid reasons the whole of educational allowance (subject to aforesaid exemption) or reimbursement in respect of educational expenses will be liable of tax.

In order to ensure that the payment under this head is not treated as a part of the salary, the payment in respect of the education of the children, should be made in the form of reimbursement of expenses incurred on their education.

Payment through an Educational Trust:

Payments made under a discretionary educational trust created by the employer for the benefit of the children of employees is not treated as income of the employee. In the case of **C.I.T Vs M. N. Nadkarni, 161 I.T.R. p.544 (Bom)**, the employer-company instituted a scholarship scheme for the benefit of the children of the managing staff. The grant of scholarship was at the discretion of the company and no member of the managing staff, had any right to claim such scholarship for his children.

It was held by the Bombay High Court that the amount paid as scholarship was not taxable as perquisite in the hands of the members of managing staff. In this connection it may be mentioned that no amount paid by an employer can be taxed in the hands of the employee, unless a vested interest therein accrues to the employee.-**C.I.T Vs L. W. Russel, 53 I.T.R p.91 (SC)**.

Lot of tax benefit may be obtained if a discretionary trust of the aforesaid type, is created by the employer.

Further, as per S.10 (16), any scholarship granted to meet the cost of education is exempt from income-tax. Therefore, such scholarship would not be liable to tax in the hands of the children of the employee also.

11. Club membership

If the Executive is admitted to a club as a member and all his club expenses including admission fees, are paid by the employer/company in order to promote the business interest of the employer/company, then the aforesaid amounts paid by the employer/company will not constitute a taxable perquisite.

The Bombay High Court in the case of **OTIS Elevator Company (India) Ltd. Vs C.I.T. 195 I.T.R. p.682**, has held that as the payment of the club fees was with a view to enable the assessee to improve its business relations and prospects, the same would be treated as business expenditure.

Similarly, in the case of Govind Glass Industries Ltd. Vs A.C.I.T., 93 Taxman (Mag.) p.174 (Ahd. Trib), the Ahmedabad Bench of the I.T.A.T., has held that expenses incurred on club membership in the name of directors of the company in order to entertain prospective buyers and for business conferences, were allowable as business expenditure. As a corollary the club fees etc. paid by the employer/company for the membership of a club in the name of the Executive., will not be treated as a taxable perquisite.

It would be better if it is a corporate membership of the club. In that case other senior officers of the company would also be able to avail of the benefit and such membership of club would provide officer better contact with persons in good position and would result in publicity for the products of the company.

12. Other general guidelines/suggestions

(i) Payment of rewards

In the case of Vijendra Prasad Gupta Vs I.T.O. 95 Taxman (Mag) p.161 (Del - Trib), a reward received by the employee from his employer in addition to his normal remuneration given to him in appreciation of his abilities was held not to be in the nature of taxable income. In the case of Voltas Ltd. Vs Dy C.I.T, 98 Taxman (Mag.) p.174, Bombay Bench of the I.T.A.T. has held that **performance rewards** were incentives for anticipated co-operation and performance wholly and exclusively for the purpose of business and therefore, admissible deduction. The Employer/Company may go in for a scheme of performance rewards.

(ii) Transport allowance

U/s 10(14) r.w. rule 2BB, any transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of residence and the place of his duty, is exempt upto a limit of Rs.800 p.m.

As per explanation to S.17(2)(iii) use of any vehicle provided by a company or an employer for journey by the assessee from residence to his office or other place of work or from such office or place to his residence **shall not be regarded as a benefit or amenity granted or provided to him free of cost** or at a concessional rate for the purposes of sub-clause.

If the Executive is provided with a car for his official as well as private use and if there is a possibility of his using a private vehicle and incurring expenditure thereon in order to reach his office (in case of the company car being used elsewhere by his family or break-down of the vehicle etc .) then he may be given transport allowance of Rs.800 p.m. and the same will not be liable to tax.

(iii) **Contribution towards Provident Fund**

Since employer's contribution towards a recognised P.F. is exempt from tax upto 12% of salary, such contribution must be kept at the maximum rate of 12%.

(iv) **Provision of housing loans to the employees**

The employer/company may provide housing loans etc to their employees by way of a welfare measure. Such loans may be provided for construction/purchase of a house or for the purchase of a vehicle, Some employers/ companies provide interest-free loans; some provide loans at concessional rate of interest whereas, some others reimburse a part of interest payable by their employees on such loans to financial institutions from which the employees themselves have taken such loans. The reimbursement of a part of interest on loans payable by employees to financial institution (F.I), has come to be popularly known as '**Interest- subsidy**'.

Any of the aforesaid benefits 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 'interest-subsidy', will not be taxable under the Income-Tax Act. This 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 Karnataka 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 Karnataka 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.

(v) **Other benefits**

As the perquisites in respect of subsidised lunch, residential telephone, free refreshments during the office hours, recreational facilities, are not taxable, employees may claim these benefits without adding to the income-tax payable by them.

(vi) **Broad approach of the Department regarding valuation of perquisites:**

As per an old circular of the CBDT (then CBR) No.33 (LXXVI-5) dated 1/9//55 (which is still in force), it is not the intention that a meticulous appraisal of each and every benefit is to be made, generally; it

should be possible for these matters to be settled by the I. T. Os on a broad basis in agreement with the assessee.

In this context it may also be stated that neither the Income Tax Act, nor the Income Tax Rules, provides for any substantial evidence to be produced by the employee to claim exemption for a particular allowance or reimbursement.

Conclusion

In the light of the aforesaid illustrative example and other guidelines, it has been amply proved that the pay package of senior Executives (like the Managing Director, Executive Director and other similarly placed Executives) may be planned within the given parameters of basic salary and over-all limit in respect of other allowances/ perquisites; in such a manner that the incidence of taxation is kept to the minimum.

It may, however, be emphasised here that a pay package to be planned for an Executive, will very much depend upon his personal preferences. All Executives cannot be treated alike. It is, therefore, necessary that the pay-package of an Executive is finalised after adequate discussion with him in respect thereof.

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