Tax-treatment of payment by an employer to employees' pension scheme

289 ITR (Jour.) p.5 (Part-1)

-S.K. Tyagi

Of late it is becoming difficult for the employers to retain their top-level employees. Therefore, the employers are trying to provide additional benefits for such employees. In the present scenario most of the senior level employees are very much concerned about their post-retirement benefits viz. pension or some kind of other annuity after their retirement from service. In view of the aforesaid reasons, a number of employers are entering into contracts with insurance companies in respect of pension schemes for the payment of pension to the employees on their retirement.

In this connection a controversy has arisen whether sum payable by the employer to the insurance company for the purpose of the pension scheme for the benefit of the employees on their retirement, could be brought to tax as a perquisite in the hands of the employees in the year of payment thereof by the employer, under the provisions of section 17(2)(v) of the Income-Tax Act, 1961 (the Act). It may be stated in this context that there appears to be a conflict between the provisions of section 17(1)(ii) and section 17(2)(v) of the Act. The reason for the same is that as against the provisions of section 17(2)(v), '*salary*' includes any annuity or pension under the provisions of section 17(1)(ii) also. Thus, payment of annuity may be brought to tax under two sub-sections viz. sub-sections (1) and (2) of the same section viz. section 17 of the Act. Therefore, there is an apparent ambiguity in, or a conflict between, the provisions of section 17(1)(ii) and section 17(2)(v) of the Act.

In the aforesaid background, the provisions of section 17(1)(ii) and section 17(2)(v) may lead to double taxation of the same amount in the hands of the employee, because as per section 17(2)(v),the sum payable by the employer to the insurance company may be brought to tax as a perquisite in the hands of the employee and after his retirement the same amount could be brought to tax under section 17(1)(ii) as part of his income from salary.

Besides, as per the provisions of the charging section 15 of the Act, in addition to arrears of salary, the following items are chargeable to income-tax under the head '*salaries*'-

(a) any salary **due** from the employer or former employer to an assessee in the previous year **whether paid or not,**
(b) any salary **paid** or **allowed** to him in the previous year by or on behalf of an employer or former employer though not due or before it became due to him.

Prima facie, the sum payable by the employer to an insurance company in order to effect a pension scheme for the employees, cannot be treated either as **due** or **paid** or **allowed** to the employee from or by the employer, until he attains the age of superannuation or retires.

Thus, apparently, there is an ambiguity as regards the taxation of a sum payable by the employer to effect a contract with insurance company for a pension scheme for the benefit of the employees. In order to resolve the aforesaid ambiguity it would be necessary to deal with all the relevant provisions of the Act and the relevant legal precedents. In this connection, the meaning of the term '*annuity*' will also have to be examined. The same are discussed as follows:.

I. Meaning of the term 'annuity'

If we examine the provisions of section 17(1) of the Act, which defines the term '*salary*' it may be seen that as per clause (ii), salary includes any annuity or pension. The use of the terms '*annuity*' and '*pension*' separately, indicates that they have different meanings. In this context,, if we examine the provisions of section 17(2(v), it may be seen that the contract therein is for an annuity and not pension. This may imply that any sum payable by the employer to effect a contract with an insurance company in respect of pension for its employees, may not fall within the mischief of section 17(2)(v)of the Act.

However, if we look at the meaning of the term '*annuity*' on page 268 of Advanced Law Lexicon by Shri P.R. Aiyar, 3rd Edition, 2005, Book 1, it would be seen that annuities are mostly pensions provided by annuitants from out of their own funds. There are several meanings assigned to the term annuity. One of them which is apt in the present context, is reproduced as follows:-

----

A contract whereby a person pays a certain amount of money to an insurance company, either as a lumpsum or as instalments, and receives periodic payments in return for life or for a specified period. Annuities are generally linked to life assurances or pension schemes.

From the aforesaid meaning of the term '*annuity*', it may be seen that the terms '*annuity*' and '*pension*', are synonymous. Therefore, the aforesaid ambiguity or controversy remains unresolved.

II. Provisions of the Income-Tax Act, 1961

The provisions of the Act, which are relevant in the present context are sections 15,17, and 115WB(2) of the Act. The same are examined as follows:-

1. Section 15 - Salaries

For the sake of ready reference, section 15 is reproduced as follows:-

----

15. The following income shall be chargeable to income-tax under the head "Salaries"—

(a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;

(b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;

(c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

Explanation 1.—For the removal of doubts, it is hereby declared that where any salary paid in advance is included in the total income of any person for any previous year it shall not be included again in the total income of the person when the salary becomes due.

Explanation 2.—Any salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from the firm shall not be regarded as "salary" for the purposes of this section.

From the aforesaid provisions of section 15, it may be seen that in addition to arrears of salary, the following items are chargeable to income-tax under the head '*Salaries*'.

(a) Any salary **due** from an employer or former employer to an assessee in the previous year **whether paid or not**

(b) Any salary **paid or allowed** to him in the previous year by or on behalf of an employer or former employer though not due or before it became due to him.

As regards clause (a) above, it covers any salary **due** to the employee. The expression '*due*' followed by the qualifying clause '*whether paid or not*', shows that there shall be an obligation on the part of employer to pay that amount and a right on the employee to claim the same.

As regards clause (b), the expression '*allowed*' covers any credit made in the employer's account in favour of the employee. In other words, it may also mean '*fixed , taken into account, set apart, granted*'.

So far as the expression '*paid*' is concerned, there is no difficulty, for it takes in every receipt by the employee from the employer whether it was due to him or not.

From the aforesaid discussion, it is quite evident that only an amount **due, paid** or **allowed** to the employee from / by the employer is chargeable to tax under the head '*Salaries*'.

2. Section 17 – 'Salary', 'Perquisite' and 'Profits in lieu of salary' defined

Section 17 defines '*Salary*' for the purposes of sections 15 and 16.

Section 17(1) defines '*Salary*' in an inclusive manner. As per section 17(1)(ii), '*Salary*' includes any annuity or pension. Further, as per section 15 (1) (iv), '*Salary*' includes any fees, commission, **perquisites** or profits in lieu of or in addition to any salary or wages.

Section 17(2) defines '*Perquisite*' in an inclusive manner. For our purpose, clause (v) of section 17(2) is relevant and the same is reproduced as follows-

----

(2) 'Perquisite' includes:-

(v) any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund or a deposit-linked insurance fund established under section 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 (46 of 1948), or, as the case may be, section 6C of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (19 of 1952), to effect an assurance on the life of the assessee or to effect a contract for an annuity; and

----

From the aforesaid provisions of section 17(2)(v), it may be seen that section 17(2)(v) contemplates two classes of perquisites:-

(a) where a sum is payable by the employer to effect an assurance on the life of the employee-assessee; and

(b) where the sum is payable by the employer to effect a contract for an annuity payable to the employee-assessee.

The sum payable in either case may be paid by the employer either directly or through a fund, other than a recognized Provident Fund or Superannuation Fund or a Deposit Linked Insurance Fund, etc.

The sums referred to in aforesaid clauses (a) and (b) are to be regarded as '*Perquisites*' and are exigible to tax. But before such sums become so exigible, they shall either be paid to the employee or allowed to him by or due to him from the employer. In other words, the employee must have a vested interest therein, as held by the Apex Court in the case of *CIT Vs. L.W. Russel [1964] 53 ITR 91 (S.C.).*

3. Section 115WB(2)(E) – Fringe benefits r.w.s.17(2)(vi)

In the light of the aforesaid ambiguity or conflict between the provisions of sections 17(1)(ii) and 17(2)(v) of the Act, there may be a possibility that the Department may attempt to tax the aforesaid payment / benefit in the hands of the employee, under the residual clause (vi) of section 17(2) of the Act. For the sake of ready reference the aforesaid clause (vi) is reproduced as follows:-

----

17 (2) "perquisite" includes—

(vi) 'the value of any other fringe benefit or amenity (excluding the fringe benefits chargeable to tax under Chapter XII-H) as may be prescribed '.

From the aforesaid provisions of section 17(2)(vi), it may be seen that the fringe benefits chargeable to tax under Chapter XII-H, are excluded from the definition of '*perquisite*'.

In the present context, we may now refer to section 115WB(2)(E) of Chapter-XII-H. As per section 115WB(2)(E), fringe benefits shall be deemed to have been provided by the employer to his employees, if the employer has in the course of his business or profession, incurred an expense on or made any payment for employees' welfare.Thus, any payment made by the employer for the welfare of the employees will fall thereunder. The sum payable to effect a contract with an insurance company in respect of a pension scheme for the benefit of the employees, will definitely be a payment in the nature of employees' welfare and accordingly, the same will fall under section 115WB(2)(E) of Chapter XII-H of the Act.

If the aforesaid payment is covered under Chapter-XII-H, then the same will have to be excluded from the purview of '*perquisite*' as defined under section 17(2) of the Act. Therefore, the aforesaid payment cannot be brought to tax under residual clause (vi) of section 17(2) of the Act, in the hands of the employees.

In view of the aforesaid reasons, we have now to examine the provisions of sections 17(1)(ii) and 17(2)(v) of the Act, only and in order to resolve the conflict / ambiguity between the same, we will have to refer to the relevant legal precedents.

III. Legal precedents

There are a number of legal precedents in the form of the judgements of the Supreme Court and various High Courts, which support the legal proposition that contributions made by the employer to provide pensionary or deferred annuity benefit to its employees, cannot be taxed in the hands of the employees under section 17(2) of the Act, unless a vested interest therein accrues to or is due to the employees. In the present context, until the employee attains the age of superannuation or retires, he will not acquire any vested right in the employer's contribution towards the premia. Therefore, the employer's contribution towards the premia payable to the insurance company in respect of the aforesaid pension scheme, will not be a perquisite in the hands of the employee under the provisions of section 17(2)(v) of the Act. The aforesaid judgements or legal precedents are discussed as follows:-

1. CIT Vs. L.W. Russel [1964] 53 ITR 91 (S.C.)

This judgement has been rendered by the Apex Court in respect of the provisions of section 7(1) of the Indian Income-Tax Act, 1922 (old Act). Before we examine the aforesaid judgement in detail, it would be appropriate to look at the provisions of section 7(1) of the old Act, in order to see whether the same are *pari materia* with the provisions of section 15 r.w.s. 17 of the present Act. The material part of the aforesaid section 7(1), reads as follows:-

----

S.7(1)The tax shall be payable by an assessee under the head 'Salaries' in respect of any salary or wages, any annuity, pension or gratuity, and any fees, commissions, perquisites, or profits in lieu of, or in addition to, any salary or wages, which are allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of,………….a company……….

Explanation 1 – For the purposes of this section, 'perquisite' includes–

(v) any sum payable by the employer, whether directly or through a fund to which the provisions of Chapters IXA and IXB do not apply, to effect an assurance on the life of the assessee or in respect of a contract of annuity on the life of the assessee.[Page 96 of the Report]

From the aforesaid provisions of section 7(1) and clause (v) of Explanation 1 thereto, it may be clearly seen that the same are *pari materia* with the provisions of section 15 r.w.s. 17 of the present Act.

Now, we may discuss the aforesaid judgement. First of all, the relevant part of the head-note of the aforesaid judgement, on pages 91 and 92 of the Report may be referred to. The same is reproduced as follows:-

----

Held-

(i) *that until an employee attained the age of superannuation he did not acquire any vested right in the employer's share of the contributions towards the premiums: at best he had a contingent right therein;*

(ii) *that the expression "perquisites which are allowed to him by or are due to him, whether paid or not, from, or are paid by or on behalf of,……….a company" in section 7(1) of the Indian Income-Tax Act, 1922, applied only to such sums in regard to which there was an obligation on the part of the employer to pay and a vested right on the part of the employee to claim: it could not apply to contingent payments to which the employee had no right till the contingency occurred. The employer's contribution towards the premiums were not perquisites allowed to the employee by the employer or amounts due to him from the employer within the meaning of section 7(1) read with clause (v) of the Explanation thereof.*

Besides, the relevant observations of the Apex Court on pages 96 and 97 of the Report may also be referred to. The same are as follows:-

----

A combined reading of the substantive part of section 7(1) and clause (v) of Explanation 1 thereto makes it clear that if a sum of money is allowed to the employee by or is due to him from or is paid to enable the latter to effect an insurance on his life, the said sum would be a perquisite within the meaning of section 7(1) of the Act and, therefore, would be exigible to tax. But before such sum becomes so exigible, it shall either be paid to the employee or allowed to him by or due to him from the employer. So far as the expression "paid" is concerned, there is no difficulty, for it takes in every receipt by the employee from the employer whether it was due to him or not. The expression "due" followed by the qualifying clause "whether paid or not" shows that there shall be an obligation on the part of the *employer to pay that amount and a right on the employee to claim the same. The expression "allowed", it is said, is of a wider connotation and any credit made in the employer's account is covered thereby. The word "allowed" was introduced in the section by the Finance Act of 1955. The said expression in the legal terminology is equivalent to "fixed, taken into account, set apart, granted". It takes in perquisites given in cash or in kind or in money or money's worth and also amenities which are not convertible into money. It implies that a right is conferred on the employee in respect of those perquisites. One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payments to which the employee has no right till the contingency occurs. In short, the employee must have a vested right therein.*

Besides, there are other important observations of the Apex Court on pages 99 and 100 of the Report which are as follows:-

----

The principle laid down by the Court of Appeal, namely, that unless a vested interest in the sum accrues to an employee it is not taxable, equally applies to the present case. As we have pointed out earlier, no interest in the sum contributed by the employer under the scheme vested in the employee, as it was only a contingent interest depending upon his reaching the age of superannuation. It is not a perquisite allowed to him by the employer or an amount due to him from the employer within the meaning of section 7(1) of the Act. We, therefore, hold that the High Court has given correct answers to the questions of law submitted to it by the Income-Tax Appellate Tribunal.

----

2. CIT Vs. Tata Oil Mill Co. Ltd. [1990] 182 ITR 130 (Bom.)

This judgement related to the provisions of erstwhile section 40A(5) of the Act, whereunder, certain restrictions were laid down in respect of payment of salary and perquisite to the employees.

In this case, contribution was made by the employer for the purchase of deferred annuity policies on the lives of the directors. The annuity was payable to the directors at the time of their retirement or death. It was held that the aforesaid contribution did not represent present benefit or amenity to the directors, the annuity being receivable only upon retirement or death of the directors. Therefore, the same was not assessable as perquisite falling under the provisions of section 40A(5) of the Act.

3. J.H. Joshi Vs. CIT [1995] 212 ITR 211(Bom.)

This case also supports the aforesaid proposition. In this case, the observations about the order of the Income-Tax Officer are as follows:

Since under section 17(1) of the Income-Tax Act, 1961, "salary" includes any fees, commission, perquisites, or profits in lieu of or in addition to any salary or wages and under section 17(2) of the Act, "perquisite" includes the value of any benefit or amenity granted or provided free of cost or at concessional rate by a company to an employee who is a director thereof, the Income-Tax Officer held that the company had incurred expenditure of the said sum of Rs.45,000 in providing a deferred annuity payable to the assessee who was its managing director under the terms of his employment and the "deferred annuity" being a "benefit" to the assessee provided free of cost by the company, fell within the ambit and scope of clauses (iii) and (v) of sub-section (2) of section 17 of the Act and, as such required to be added as perquisite in the income of the assessee.[Page 216 of the Report].

On appeal by the assessee the Appellate Assistant Commissioner (AAC) held that the sum of Rs.45,000, could not be added to the income of the assessee as perquisite **due to him** during the year under consideration and ordered deletion of the addition thereof.

On further appeal by the Department, the Tribunal reversed the order of the AAC.

Thereafter, the assessee went in appeal to the Hon.Bombay High Court against the order of the Tribunal. The relevant observations of the Hon. High Court on page 217 of the Report are reproduced as follows:-

----

No "benefit" in respect of payment of premium made by the company for deferred annuity policy had accrued or became due to the assessee during the relevant previous year. The said amount,in the circumstances of the case, could not have been included in the salary of the assessee during the relevant previous year. In this view of the matter, the Tribunal was not justified in holding that the said sum of Rs.45,000, was includible in computation of the assessee's income for the assessment year 1974-75.

We, accordingly, answer the question in the negative, that is, in favour of the assessee and against the Revenue.

It may be noted here that this is a direct judgement in respect of the provisions of clause (v) of section 17(2) of the Act.

4. CIT Vs. J.N. Vas [1999] 240 ITR 101 (Bom.)

In this case, a retired employee was appointed as technical consultant for a company. The employer purchased a single premium annuity policy from LIC. The issue before the Hon. High Court was whether the premium paid to LIC was a perquisite includible in salary income of the assessee under section 15 of the Act. It was held that the amount of premium paid towards single premium policy did not vest in the assessee and therefore, the same could not be included in his salary income.

In this case, the relevant facts regarding the annuity recorded on page 103 of the Report are reproduced as follows:-

----

It was specifically provided that the policy would not be surrendered at any time and further annuity payments would not be commuted for realization. There was a special provision to the effect that in case the annuitant dies before the date on which the annuity vested in him the amounts due under the policy would be payable, if any, to the annuitant's wife, Smt. Maria Vaz. It was also provided that if before the date of vesting, the annuitant's wife predeceases him and the annuitant dies before the date of annuity, the amount was payable to the executors or administrators or other legal representatives of the annuitant.

The ITO included the amount of Rs.24,000, paid as premium by the said company to the LIC in the salary income of the assessee for the assessment year 1977-78. Similarly, for the assessment year 1978-79, the ITO included the amount of Rs.24,000, in the salary income of the assessee.

On appeal, the CIT(A) confirmed the aforesaid additions made by the ITO.

On further appeal to the Tribunal, the Tribunal came to the conclusion that in the facts and circumstances of the case, the premium of insurance policy paid by the said company was not **salary due** from the said company to the assessee, nor was it a **salary paid or allowed** to the assessee in the year under consideration and therefore, the same could not be taxed under section 15 of the Act.

On reference to the High Court by the CIT, the Hon. High Court has observed as follows:-

----

In the case on hand, as per the single premium annuity policy dated March 1, 1977, the annuity was to vest in the assessee on March 1, 1981, and it was to cease on the expiry of five years, from the date on which the annuity vested in the assessee. As per the second policy dated March 22, 1979, the annuity was to vest in the assessee on October 23, 1983. Therefore, in the previous years ending on March 31, 1977, and March 31, 1978, the amount of premium paid towards single premium insurance policy did not vest in the assessee. At best he had a contingent right therein. In our opinion, the above quoted judgements clearly cover the facts of this case and hence the said amounts cannot be included in the salary income of the assessee for the assessment years 1977-78 and 1978-79 [Page 105 of the Report].

In view of the aforesaid observations, the reference was answered in favour of the assessee and against the Department.

5. CIT Vs. Lala Shri Dhar [1972] 84 ITR 192 (Del.)

In this case, premium was paid by employer towards a policy of personal accident insurance of an employee. In this connection, the judgement of the Supreme Court in the case of L.W. Russel (*Supra*) has been heavily relied upon.

It was held that the payment of premium could not be assessed in the hands of the assessee as '*perquisite*', either under clause (iii) or clause (iv) of Explanation 1 to section 7(1) of the Indian Income-Tax Act, 1922.

6. CIT Vs. Vinay Bharat Ram [1981] 129 ITR 128 (Del.)

In this case, premium was paid by the employer on accident policies of employees. It was held that the premium paid was not a perquisite in the hands of the employees within the meaning of section 17(2) of the Income-Tax Act, 1961 and therefore, not taxable in their hands. In this case, the aforesaid judgement in the case of Lala Shri Dhar (*Syupra*) has been followed.

On page 129 of the Report, the Hon. High Court has observed that Explanation to 7(1) of the Indian Income-Tax Act, 1922, corresponds to the provisions of section 17(2) of the Income-Tax Act, 1961.

As already pointed out, in the case of L.W. Russel (*Supra*), the provisions of section 7(1) of the Indian Income-Tax Act, 1922 correspond to section 17(1) of the Income-Tax Act, 1961.Thus, the provisions of sub-sections (1) and (2) of section 17 are in *pari materia* with the provisions of section 7(1) r.w. Explanation 1 thereto, of the Indian Income-Tax Act, 1922.

Judgement of Patna High Court against the aforesaid view

In this context, we may also refer to a judgement of Patna High Court in the case of *CIT Vs. J.G. Keshwani [1993] 202 ITR 391 (Patna).* In this case, it was held that amounts spent by the company to purchase deferred annuity policies from LIC on the life of the director, was assessable as salary in the hands of the director under section 15 r.w. sections 17(1)(iv) and 17(2)(v) of the Income-Tax Act, 1961.

In this case, it has been observed that the provisions of section 15 r.w. sections 17(1)(iv) and 17(2)(v) of the Income-Tax Act, 1961, are materially different from section 7(1) of the Indian Income-Tax Act, 1922. The aforesaid observations are, however, not correct as the provisions of section 15 r.w.section 17(2)(v) of the Income-Tax Act, 1961, are totally in *pari materia* with the provisions of section 7(1) r.w. Explanation 1 thereto, of the Indian Income-Tax Act, 1922. This is clear from the reading of the aforesaid provisions. Besides, this view is also supported by the aforesaid judgement of the Delhi High Court in the case of *Vinay Bharat Ram (Supra).*

In view of the aforesaid reasons, the aforesaid judgement of Patna High Court, does not lay down correct legal principles in the present context, particularly in view of the aforesaid judgement of the Apex Court in the case of *L.W. Russel* and also in view of the reason that the provisions of section 15 r.w.s.17(2)(v) of the Income-Tax Act, 1961, are in *pari materia* with the provisions of section 7(1) r.w. Explanation 1 thereto, of the Indian Income-Tax Act, 1922.

There is another very important and relevant aspect in respect of the conflict between the provisions of section 17(1)(ii) and section 17(2)(v) of the Income-Tax Act, 1961, that an ambiguity in or a conflict between the provisions of taxing statute must be resolved in favour of the assessee. Besides, one has also to keep in view that it is a well settled legal principle that an amount cannot be taxed twice in the hands of the same person.

IV. Conclusion

In the light of the discussion in the preceding paragraphs (I) to (III), it is clear that there is an ambiguity in, or a conflict between, the provisions of sections 17(1)(ii) and 17(2)(v) of the Act. Further, it is also a well settled legal principle that an ambiguity in the provisions of taxing statute is always to be resolved or decided in favour of the assessee or tax-payer.

In view of the aforesaid reasons, it may be safely concluded that-

(i) No perquisite will be chargeable, as part of salary, in the hands of the employees under section 15 r.w. section 17(v) of the Act, at the time of payment of insurance premia by the employer to the insurance company in respect of the pension scheme for the benefit of the employees.

(ii) The pension receivable by the employees from the insurance company under the aforesaid pension scheme, on superannuation or retirement of the employee, will, however, be charageable to tax as part of salary under section 15 r.w. section 17(1)(ii) of the Act.

S. K. TYAGI
M.Sc., LL.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor

☎ Office : (020) 2613 3012
Fax : (020) 2612 1131
Residence : (020) 2665 2444
E-mail : sktyagidt@sify.com

Flat No.2, (First Floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE - 411 001