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Pegging perquisite valuation to SBI-rate for bank employees' concessional loans, no 'hardship'

Background

The Income-tax Act, 1961 (the Act) seeks to tax[1] perquisites/benefits provided by employers as income from salaries and has also prescribed[2] the valuation rules. One such specified perquisite is grant of loans at a concessional rate of interest. The value of this perquisite is computed as the difference between the rate of interest charged by State Bank of India (SBI) on a specified date for the same purpose and the rate of interest at which the loan was granted by the employer (if lower than the SBI rate).

Recently, the Madras High Court (the High Court) in the case of All India Union Bank Officers Federation[3] has held that this valuation methodology does not create any 'hardship' and that the perquisite in the form of concessional rate of interest is subject to tax as prescribed.

Facts of the case

- Employees of banks other than SBI were granted loans by their employers at a concessional rate of interest which was less than the rate charged by SBI for the same purpose.

- The taxpayer challenged the constitutional validity of Section 17(2)(viii) of the Act and Rule 3(7)(i) of the Income-tax Rules, 1962 (the Rules) on the following grounds:

  - By using SBI rate as the basis for determining whether the grant of interest-fee or concessional loan to an employee is a perquisite or not, the Rule Making Authority has deprived the individual employees of their right to contest the jurisdictional fact of such loan not being a concession/benefit and that Rule 3(7)(i) of the Rules is *ultra vires* Section 17(2)(viii) of the Act;

  - Each bank fixes[4] its own rate of interest depending on its economies of operation. Without realising this, Rule 3(7)(i) of the Rules seeks to treat unequals as equals by pegging rate of interest charged by the individual banks to their employees with the SBI rate of interest. Hence, Rule 3(7)(i) violates Article 14 of the Constitution;

  - Rule 3(7)(i) of the Rules works out a hardship to the employees. Hardship is a ground on which a subordinate legislation can be tested; and

[1] Section 17(2)(vi) of the Income Tax Act, 1961 as amended by the Finance Act, 2004 which became Section 17(2)(viii) effective 1 April 2010

[2] Rule 3(7)(i) of the Income Tax Rules, 1962 as amended by Income Tax (First Amendment) Rules, 2004

[3] All India Union Bank Officers Federation vs Union of India, New Delhi [2016] 69 taxmann.com 371 (Mad)

[4] Notification dated 9 April 2010 and Master Circular dated 31 July 2015

- Rule 3(7)(i) is vitiated in as much as it tends to overrule an earlier judgment of the Supreme Court in the case of Arunkumar[5].

High Court ruling

The High Court observed the following in respect of the grounds on which the section and the rule were challenged:

Ground 1 – Whether Rule 3(7)(i) of the Rules is *ultra vires* section 17(2)(viii) of the Act

- This ground was based on some of the observations made in the decision of Arunkumar in relation to a perquisite pertaining to rent-free accommodation under Section 17(2)(ii) of the Act. The decision of Arunkumar related to concession in the matter of rent in respect of accommodation provided by the employer. The Supreme Court had held in that case that Rule 3 of the Rules was not arbitrary or inconsistent or *ultra vires* Section 17(2) of the Act or Article 14 of the Constitution.
- The High Court observed that the decision of Arunkumar was not applicable in the instant case since there was a need for adjudication as to what was a 'concession' in the matter of rent. In the instant case, the word 'concession' was not used in Section 17(2)(viii) of the Act and the only sine qua non for invocation of the section was the existence of a fringe benefit or amenity.
- In light of the above, Rule 3(7)(i) of the Rules is not *ultra vires* section 17(2)(viii) of the Act.

Ground 2 – 'Rule 3(7)(i) of the Rules violates Article 14 of the Constitution'

- Neither the Section 17(2)(viii) of the Act nor Rule 3(7)(i) of the Rules seek to treat unequals as equals. What is taxed is the concession which the difference between the SBI rate of interest and the rate of interest at which the loan was granted by an employer to its employees.
- The impact of Rule 3(7)(i) of the Rules will not be the same on all categories of employees, but would differ from person to person depending upon the income bracket, to which, he/she belongs and the rate of interest, at which, he/she is granted a loan by his/her employer.
- If the employees of different banks are in enjoyment of an interest free or concessional loan, paying different rates of interest such as six per cent, seven per cent or eight per cent, what is sought to be included in their salaries under Rule 3(7)(i) of the Rules, is only the difference between the rate of interest charged by SBI in respect of loans for the same purpose and the interest actually charged by their employer. Therefore, Rule 3(7)(i) of the Rules does not even make a classification between different categories of employees or between employees of different banks.
- Rule 3(7)(i) of the Rules does not seek to include an interest free or concessional loan taken by one set of employees to the exclusion of others. The rule does not also stipulate different methods of valuation of the perquisite. It does not seek to apply a uniform rate for different categories of persons irrespective of the huge difference in their pay pockets. Hence, there is no violation of Article 14 of the Constitution.

Ground 3 – Hardship under 'Rule 3(7)(i) of the Rules is a ground on which a subordinate legislation can be tested'

- A common man, either in business or in profession or in any employment other than in the banking sector, pays a higher rate of interest on the loan taken by him/her from a bank. But, by virtue of being an employee of the bank, if such employee receives an interest free or a concessional loan, then he/she is in enjoyment of a privilege. It is that privilege, which is sought to be taxed under Rule 3(7)(i) of the Rules.

[5] Arunkumar vs Union of India [2007 (1) SCC 732]

- Rule 3(7)(i) of the Rules decreases the value of the privilege given to an employee by an employer, perhaps to the maximum extent of about 30 per cent1. This can never be considered as a hardship.

Ground 4 – 'Rule 3(7)(i) of the Rules is vitiated since it tends to overrule the Arunkumar judgment of the Supreme Court'

- The decision of Arunkumar was delivered on 15 September 2006 pertaining to the Rules as they stood in 2001. After this, both Section 17(2) of the Act and Rule 3 of the Rules have undergone changes compared to 2001.
- However, Rule 3(7)(i) of the Rules was already a part of the legislature when the decision of Arunkumar was delivered. Therefore, it cannot be said that this rule was inserted to overrule the decision of Arunkumar.
- The taxpayer has placed reliance on the V M Salgaocar[7] decision where the Supreme Court held that charging of interest on a concessional rate may not be a benefit for the purpose of Section 17(2) of the Act. The reliance placed on the V M Salgaocar was misplaced since the decision related to a point of time when Section 17(2) was completely different (1979).
- The Supreme Court in the case of Herbertsons Ltd[8] observed that where the quantum of salary fixed and the amenities granted to the employees under a settlement, have to be looked at as a package. This rationale was in favour of the Revenue - if salary is taxable and some perquisite or benefit forms part of a package, the same should also be taxed. Therefore, the challenge to Section 17(2)(viii) of the Act as well as Rule 3(7)(i) of the Rules has to fail.

Our comments

The High Court in the instant case upholds the role of the rule making authority to draft valuation and administrative rules. The Supreme Court in the case of Arunkumar had held that Rule 3 of the Rules was not arbitrary or *ultra vires* Article 14 of the Constitution or Section 17(2) of the Act.

It reaffirms the meaning of a benefit provided by an employer to its employee and its valuation for the purpose of taxation. Whether there is a 'benefit' provided by an employer or not is determined based on a comparison to its availability of the same benefit to anyone in the larger population, i.e., the common man as against a specified, much smaller group of employees.

[6] Maximum rate of tax, excluding surcharge and cess
[7] V.M. Salgaocar vs CIT [(2000) 160 CTR 225]
[8] Herbertsons Ltd. vs Workmen [1976 (4) SCC 736]

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