



# Tax Flash News



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## Interest free loans given by banks to their employees continue to qualify as fringe benefits and hence taxable

### Executive summary



Perquisites are defined<sup>1</sup> to include ‘any fringe benefit or amenity’ provided to employee. Where interest-free / concessional loan benefits are provided to employees, then the same is taxable as perquisite<sup>2</sup> if the interest charged by the bank is lower than the Prime Lending Rate (PLR) of the State Bank of India (SBI).

Staff Unions and officers’ association of various banks raised concerns about excessive delegation of legislative function to the Central Board of Direct Taxes (CBDT) with respect to the method of valuation of perquisite on interest free loans. It also argued that such method of valuation<sup>2</sup> was illogical and violated Article 14 of the Constitution by treating the PLR of SBI as benchmark for computation of such perquisite value. However, the Honorable Supreme Court (SC)<sup>3</sup> rejected these arguments, affirming the validity of the provisions<sup>1</sup> & <sup>2</sup>. SC in its ruling has said that loans given by banks to their employees at zero interest or concessional loans will be subject to taxation, as those are being categorised as fringe benefits, by applying SBI’s PLR prevailing at the beginning of the relevant tax year.

<sup>1</sup> Section 17(2)(viii) of the Income Tax Act, 1961 (the Act)

<sup>2</sup> 3(7)(i) of the Income tax Rules, 1962 (the Rules)

<sup>3</sup> CIVIL APPEAL NO. 7708 OF 2014- All India bank officers’ confederation v. The Regional Manager, Central bank of India, and others dated 07 May 2024.

## Facts of the case



- Definition of salary<sup>4</sup>, *inter alia*, includes wages as well as other payments paid to employees including perquisites. Thus, perquisites paid by the employer to the employee are taxable as 'salary'. The definition of perquisites<sup>1</sup> includes "any other fringe benefit or amenity" and "as may be prescribed".
- In terms of the power conferred<sup>1</sup>, the CBDT has enacted Rules<sup>2</sup> wherein it is prescribed that the value of interest-free or concessional loans is to be treated as 'other fringe benefit or amenity' and therefore, taxable as a 'perquisite'. Further, it prescribes the method of valuation of the interest-free / concessional loan for the purposes of taxation. Additionally, the rate of interest should be considered as charged by SBI vide their PLR as on 1st day of financial year.
- The above provisions<sup>1& 2</sup> of the Act along with the Rules were contested by Staff Unions and Officers' Associations (Appellants) of several banks located throughout India wherein the said provisions were challenged for the below issues:
  - Excessive and unguided delegation of essential legislative function to the CBDT.
  - Treatment<sup>2</sup> of the PLR of SBI as the benchmark instead of the actual interest rate charged by the bank from a customer on a loan.

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<sup>4</sup>Section 17(1) of the Act

## Appellant's contention



- Section 17(2)(viii) of the Act: The definition of perquisite<sup>1</sup> included the clause, “as may be prescribed”, which implies that any additional perquisite or fringe benefit would be subject to a rule imposed by the relevant body (CBDT in this case). The appellants argued that this clause was unduly and overly delegated to the CBDT.
- Rule 3(7)(i) of the Rules: As per the Rule, the value of interest-free loan benefits received by the bank employees from their banks would be subject to taxation as fringe benefit if the interest rate charged by the bank on these loans is lower than the interest rate determined by the SBI's PLR. Because the SBI PLR was used as the benchmark rather than the actual interest rate that the relevant bank paid a customer on a loan, the appellants claimed that this practice violated Article 14<sup>5</sup> of the Constitution.

## SC's observation and ruling



Basis certain judicial precedents<sup>6</sup>, SC addressed that 'perquisite' is a fringe benefit attached to the post held by the employee unlike 'profit in lieu of salary', which is a reward for past or future service. Such fringe benefits are related to employment and are in excess of / in addition to the salary. It is an advantage or benefit given because of employment, which otherwise would not be available.

Further, the SC had opined its analysis on the following two issues:

1. ***Does Section 17(2)(viii) and/or Rule 3(7)(i) lead to a delegation of the 'essential legislative function' to the CBDT?***
- The SC referred to a judgment<sup>7</sup> where in the assessee had challenged a resolution passed by the municipal corporation to levy three taxes, including a levy of tax on consumption or sale of electricity. The challenge was that the levy of tax by the Corporation was by way of excessive delegation and was therefore beyond one's legal power or authority. As per the said Ruling<sup>7</sup>, it was held basis the following:

<sup>5</sup> Equality before the law or the equal protection of the laws within the territory of India.

<sup>6</sup> Arun Kumar v. Union of India (2007) 1 SCC 732; Additional Commissioner of Income Tax v. Bharat V. Patel (2018) 15 SCC 670.

<sup>7</sup> Municipal Corporation of Delhi v. Birla Cotton, Spinning and Weaving Mills, Delhi and Another SCC OnLine SC 13 (1968)



- Whether the primary legislation has stated with sufficient clarity, the legislative policy and the standards that are binding on subordinate authorities who frame the delegated legislation.
  - Where a standard is laid down, the courts should not interfere with the discretion that undoubtedly rests with the legislature itself in determining the extent of delegation necessary in a particular case.
  - Given the said Ruling, the SC believed that the main legislation of Section 17(2) does not fall foul of the essential feature test. The Section<sup>1</sup> also do not modify an essential feature nor do they violate the condition of determining legislative policy. The SC was also of the opinion that the clause provides explicit advice to the rule-making authority and clearly reflects the legislative policy. Also, the enactment of Rules<sup>2</sup> is not a case of excessive delegation and falls within the parameters of permissible delegation.
  - Hence the SC opined that Rule 3(7)(i) is intra vires (within the powers of) Section 17(2)(viii) of the Act.
- 2. *Is Rule 3(7)(i) arbitrary and violative of Article 14 of the Constitution as it treats the PLR of SBI as the benchmark instead of the actual interest rate charged by the bank from a customer on a loan***
- SC was of the below view to hold that Rule 3(7)(i) is not violative of Article 14 of the Constitution:
    - The interest rates set by SBI, the biggest bank in India, affects other banks; hence having such a clear benchmark for calculating perquisites helps avoid arguments and lawsuit about usage of interest rates.
    - The Rule<sup>2</sup> makes things clear and fair for both taxpayers and authorities and helps everyone know exactly how much tax needs to be paid.
    - Further, the Rule is based on a fair principle and follows the values of the constitution.
    - The rule-making authority (CBDT in this case) has not treated unequal as equals by having SBI's PLR as the benchmark.

**Given the above, the SC held that the benefit enjoyed by bank employees from interest free loans or at a concessional rate is a unique advantage enjoyed by them and hence in the nature of a 'perquisite', and thus is liable to taxation. It also noted that the fixation of SBI's PLR as the benchmark is systematic and logical.**

## Our comments



The Honorable Supreme Court has affirmed that the interest-free or concessional loans provided by employer to their employees are considered as 'fringe benefits' and are subject to taxation. Further, it also confirmed on usage of SBI's PLR as the benchmark for computation of such perquisite value. This decision addresses the challenges to Section 17(2)(viii) and Rule 3(7)(i) concerning fringe benefits such as interest-free loans for bank employees. The decision affirms the legislative authority's power to define and tax perquisites in alignment with primary legislation, ensuring consistency and fairness in tax laws.

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