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TAX FLASH NEWS

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Notional interest on security deposit paid to landlord not to be considered in perquisite valuation of rent-free accommodation provided by employer

Background

The Income-tax Act, 1961 (the Act) recognises rent-free accommodation (RFA) provided by an employer to its employees as a perquisite taxable[1] in the hands of the employees. Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Vikas Chimakurty[2] held that, notional interest on security deposit paid by an employer, to a landlord in respect of the RFA provided to its employees, is not to be considered in the perquisite valuation of the RFA in the hands of the employees.

Facts of the case

- The taxpayer was provided with RFA by his employer which was taxed as a perquisite in his hands.
- The return of income filed by the taxpayer was taken up for scrutiny. The Assessing Officer (AO) assessed the income with an addition for notional interest at 12 per cent on security deposit paid by the employer to the landlord in respect of the accommodation provided to the taxpayer.
- On an appeal by the taxpayer, the Commissioner of Income-tax (Appeals) [CIT(A)] upheld the AO's order of considering the notional interest as taxable as a perquisite in addition to taxing the accommodation as a perquisite.
- Aggrieved by the CIT(A)'s order, the taxpayer preferred an appeal before the Tribunal that such notional interest is not taxable, relying substantially on the jurisdictional decision of the High Court of Bombay (the High Court) in the case of Shankar Krishnan[3].

High Court's ruling in the case of Shankar Krishnan

- In the case of Shankar Krishnan, the employer had provided RFA to one of its employees and had paid an interest-free, refundable security deposit to the landlord in respect of the said accommodation.
- The value of the RFA was computed as per Rule 3 of the Income-tax Rules, 1962 (the Rules) which was the lower of ten[4] of salary or actual rent paid in respect of such accommodation.
- The AO was of the opinion that notional interest at the rate of 12 per cent per annum on the security deposit paid by the employer was to be considered in the valuation of the accommodation provided and hence, enhanced the value of such perquisite to that extent.
- The High Court noted that perquisite valuation of accommodation provided by an employer was computed on the actual amount of lease rental paid or payable by an employer and not on a notional basis. Therefore, in view of the express words used in the Rule 3 of the Rules, notional interest on deposits paid by an employer to a landlord in respect of accommodation provided to its employees while computing the perquisite value of residential accommodation was not acceptable.

[1] Section 17(2)(i) of the Act read with Rule 3(1) of the Income Tax Rules, 1962
[2] Vikas Chimakurty v. DCIT (ITA No. 6591/Mum/2014) – Taxsutra.com
[3] CIT v. Shankar Krishnan [2012] 21 taxmann.com 61 (Bom)
[4] Presently, 15 per cent

Tribunal's ruling

- Following the above decision of the High Court, the Tribunal held that considering notional interest on deposit paid to the landlord by an employer in respect of accommodation provided to its employees while computing the perquisite value of such accommodation is not sustainable in view of the express words used in Rule 3.
- The Tribunal allowed the taxpayer's appeal and directed the AO to delete the addition made for such notional interest.

Our comments

This decision emanates from the language used in the Rules that the valuation of the perquisite in respect of accommodation is not to be made on a notional basis. Employers providing residential accommodation to employees is as much a common practice as paying the security deposit to the landlord in order to secure such accommodation.

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