



Retention bonus is allowable as business expenditure

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of SAIC India Private Limited¹ (the taxpayer) held that retention bonus paid by the taxpayer to retain the erstwhile employees of the transferred company, are revenue in nature and allowable as business expenditure.

The Tribunal did not accept that the retention bonus is a part of amalgamation expenditure. Further, it did not accept that 4/5th portion of the expenditure is to be disallowed under Section 35DD of the Income-tax Act, 1961 (the Act).

Facts of the case

- The taxpayer is engaged in engineering and technology application solutions and provides software development services to its group entities.
- During the year under consideration, the taxpayer company was acquired by SAIC USA. Pursuantly, the branch of SAIC USA in Bangalore (the branch) was taken over by the taxpayer company.
- The taxpayer paid the retention bonus to the erstwhile employees of the transferred company.
- The Assessing Officer (AO)/Dispute Resolution Panel (DRP) considered the retention bonus paid as part of amalgamation expenditure and invoked provision of Section 35DD of the Act to disallow 4/5th of such amount to be amortised over four succeeding years. Further, the retention bonus paid is not in the nature of normal business expenditure but is in the nature of expenditure which had enduring benefit.

Tribunal ruling

- The business of the branch was transferred to the taxpayer and shares were issued to SAIC USA as a consideration therefor.
- Transfer of the branch to the taxpayer was not in the nature of amalgamation. Pursuantly, treatment of retention bonus payment as amalgamation expenditure was rejected.
- The DRP had contradicted its own observations. On one hand, DPP stated that incentives such as ESOP and retention bonuses are common HR strategy in this industry to ensure continuity and retention of talent to save training and recruitment costs incurred by companies. On the other hand, the DRP observed that retention bonus is not in nature of normal business expenditure but an expenditure resulting into enduring benefit.
- The retention bonus paid to arrest attrition rate certainly goes to enhance the profitability of the company. Further, retention bonus is an incentive to the employee as per Explanation 2 to Section 15 of the Act and partakes the character of salary payable for the purposes of business and is to be treated as revenue expenditure.
- Since the retention bonus has been paid before filing of return of income, it is allowed as an expenditure under Section 37 of the Act.

Our comments

The corporates and other entities have been providing incentives in the form of a retention bonus, ESOP, etc. to retain talent in the organisation. The issue with respect to taxability/allowability of retention bonus

¹ SAIC India Private Limited v. DCIT (ITA No.6464/Del./2012) order dated 27 June 2016 – Taxsutra.com

This decision also covers other issues, however, this Flash news only deals with the issue pertaining to the treatment of retention bonus and resultant allowability of the expenditure.

has been a subject matter of debate before the courts. The courts² have dealt with the issue of payment of retention bonus as salaries and subject to tax deducted at source. The courts, based on the facts of the case, have held that retention bonus is taxable as salary in the hands of an employee.

In the instant case, the Delhi Tribunal observed that retention bonus partakes the character of salary for the purpose of business and is to be treated as revenue expenditure. Accordingly, the retention bonus has been allowed as business expenditure under Section 37 of the Act.

This decision may help taxpayers who are facing issues with respect to the allowability of retention bonus as business expenditure.



² CIT v. Eli Lilly & Co. (India) (P.) Ltd [2009] 178 TAXMAN 505 (SC); CIT v. S.G. Pgnatale [1980] 4 Taxman 79 / 124 ITR 391

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