

# EY Tax Alert

**Supreme Court upholds constitutional validity of perquisite valuation of interest concession with reference to SBI prime rate of lending**

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## Executive summary

This Tax Alert summarizes a recent ruling of the Supreme Court (SC) in the case of All India Bank Officers' Confederation (Taxpayer)<sup>1</sup> in a batch of appeals filed by various associations of bank employees wherein the Taxpayer had challenged the constitutional validity of perquisite valuation of interest concession with reference to rate of interest charged by State Bank of India (SBI) to its customers.

Section (s.) 17(2)(viii) of Income-tax Act (ITA) provides that the value of any other fringe benefit or amenity as may be prescribed by Central Board of Direct Taxes<sup>2</sup> (CBDT) shall be included in "perquisite", taxable as Salary income, in the hands of taxpayer. Rule 3(7)(i) of Income-tax Rules, *inter-alia*, provides that the value of the benefit to the taxpayer resulting from the provision of interest-free or concessional loan for any purpose made available to the employee or any member of his/her household shall be determined by reckoning the interest rate charged by SBI as on the first day of the relevant tax year for similar loans.

The two issues formulated by the SC were (a) whether s. 17(2)(viii) and/or Rule 3(7)(i) lead to delegation of the "essential legislative function" to CBDT? and (b) is Rule 3(7)(i) arbitrary and violative of Article 14 of the Constitution of India insofar as it treats SBI rate as the benchmark?

The SC held both the issues in favor of tax authority. On the first issue, it held that s.17(2)(viii) and Rule 3(7)(i) do not lead to delegation of "excessive legislative function". They fall within the parameters of permissible delegation as s.17(2)(viii) clearly delineates the legislative policy and lays down standards for the rule-making authority, thereby satisfying the test of "essential legislative function". While s.17(2)(viii) delegates the power to CBDT to prescribe what constitutes fringe benefit or amenity and also provides for its valuation, the power is demarcated with the condition that anything made taxable by CBDT under this rule should be a "perquisite" in the form of "fringe benefit or amenity". On the second issue, the SC held that Rule 3(7)(i) is *intra vires* s. 17(2)(viii) and not violative of Article 14 of the Constitution. It provides for uniform basis of valuation for all employees. It does

<sup>1</sup> [TS-310-SC-2024]

<sup>2</sup> Apex Direct Tax Administrative body in India

not treat unequal as equal. The fixation of SBI rate as benchmark rate is neither arbitrary nor unequal exercise of power.

## Background

- ▶ The ITA contains provisions for taxation of perquisites as Salary income in the hands of employees. For this purpose, s.17(2) defines various types of perquisites like rent-free residential accommodation, concessional residential accommodation, meeting of personal expenses by the employer, employer's contributions to certain funds, etc. Rule 3 lays down valuation of different types of perquisites.
- ▶ S.17(2) contains a residual sub-clause (viii), introduced in 2001, which provides that the value of any other fringe benefit or amenity as may be prescribed by CBDT shall be included in "perquisite". In this regard, Rule 3(7) prescribes various types of fringe benefits or amenity like interest-free or concessional loan, travelling/touring/accommodation, free food and non-alcoholic beverages, gifts or vouchers, credit card expenses, club membership, use or transfer of movable assets and any other benefit or amenity, service, right or privilege. Rule 3(7) also provides the basis of valuation for such fringe benefits. Rule 3(7)(i), *inter-alia*, provides that the value of the benefit to the taxpayer resulting from the provision of interest-free or concessional loan for any purpose made available to the employee or any member of his/her household shall be determined by reckoning the interest rate charged by SBI as on the first day of the relevant tax year for similar loans.
- ▶ The present rule for computing the interest concession benefit by benchmarking with SBI rate was introduced in 2004. Prior to that, from 2001 to 2004, the interest concession was benchmarked to fixed rate of 10% p.a. for housing/motor car loans and 13% p.a. for other loans. Thus, the perquisite valuation was changed from a static benchmark of 10%/13% to a dynamic benchmark of SBI rate.
- ▶ The employees of banks other than SBI felt aggrieved by this change. Their primary contention was that interest concession perquisite should be valued on basis of "cost to employer" and hence, it should be computed with reference to their own employer's cost of borrowing and not SBI rate to customers.
- ▶ Hence, associations of different bank employees challenged the constitutional validity of s.17(2)(viii) and Rule 3(7)(i) before different High

Courts. The challenge was two-fold viz (a) s.17(2)(viii) results in excessive and unguided delegation of power to CBDT resulting in delegation of the "essential legislative function" to CBDT and (b) the fixation of interest concession perquisite valuation by benchmarking to SBI rate was arbitrary and violative of Article 14 of Constitution of India resulting in hostile discrimination between different classes of employees.

- ▶ The High Courts of Madhya Pradesh<sup>3</sup>, Madras<sup>4</sup> and Allahabad<sup>5</sup> rejected the contention of the bank employees and upheld the constitutional validity of s.17(2)(viii) and Rule 3(7)(i). Hence, the associations of bank employees filed further appeal before the SC.

## SC ruling:

The SC upheld the High Court rulings and constitutional validity s.17(2)(viii) and Rule 3(7)(i). It formulated two issues for consideration viz. (a) whether s. 17(2)(viii) and/or Rule 3(7)(i) lead to delegation of the "essential legislative function" to CBDT? and (b) is Rule 3(7)(i) arbitrary and violative of Article 14 of the Constitution of India insofar as it treats SBI rate as the benchmark? The SC analyzed the relevant provisions and decided the issues as follows:

- ▶ **Interest-free or concessional loans is a "fringe benefit" or "perquisite" as per common parlance meaning**
  - ▶ While enacting laws, the legislature can and does delineate the meaning of terms through explicit definitions. It is not necessary that all words or expressions must be explicitly defined. The legislature may adopt popular meaning which makes the statute simpler and easier for the common people to understand. By not prescribing a fixed and exact definition, the legislature ascribes prevalent meaning assigned to the word/expression in common parlance or commercial usage. This would include meaning assigned to technical words in a particular trade, business or profession, etc. when the legislation is concerning a particular trade, business or transaction. This rule equally applies to construing words or expressions in a taxation statute.
  - ▶ Section 17(2)(viii) is a residuary clause, enacted to provide flexibility. Since it is enacted as an enabling catch-within-domain provision, the residuary clause is not iron-cast and exacting. A more pragmatic and commonsensical approach can be adopted by locating the prevalent meaning of

<sup>3</sup> All India Punjab National Bank Officers' Association vs Chairman cum Managing Director, Punjab National Bank (2010)[321 ITR 324](MP)

<sup>4</sup> All India Union Bank Officers Federation vs. UOI [2016] 385 ITR 114 (Madras)

<sup>5</sup> P. N. Tiwari vs. UOI [2004] 265 ITR 224 (All)

'perquisites' in common parlance and commercial usage.

- ▶ The SC referenced different dictionary meanings of "perquisites" as also earlier case laws which support that it is incidental profit from service beyond regular salary and wages, the benefits which are attached to the office of employment, privilege or gain or profit incidental to employment in addition to regular salary or wages or a personal advantage, etc.
- ▶ The SC concluded that 'perquisite' is a fringe benefit attached to the post held by the employee unlike 'profit in lieu of salary', which is a reward or recompense for past or future service. It is incidental to employment and in excess of or in addition to the salary. It is an advantage or benefit given because of employment, which otherwise would not be available. From this perspective, the employer's grant of interest-free loans or loans at a concessional rate will certainly qualify as a 'fringe benefit' and 'perquisite', as understood through its natural usage in common parlance.
- ▶ **S. 17(2)(viii) and/or Rule 3(7)(i) does not lead to delegation of the "essential legislative function" to CBDT**
  - ▶ The SC referenced its earlier SC ruling in case of *Municipal Corporation of Delhi v. Birla Cotton, Spinning and Weaving Mills, Delhi and Another*<sup>6</sup> (Seven Judge Constitution Bench) which, in turn, had referred to a catena of earlier SC rulings for the judicial exposition of the test of delegation of "essential legislative function".
  - ▶ The SC held that the "essential legislative function" means the determination of the legislative policy and its formulation as a binding rule of conduct. Once the legislature defines the policy and sets the standards through legislation, it can delegate the remaining part to subordinate legislation. The subordinate legislation is supplementary to the primary statute and it aligns with the framework of the primary legislation as long as it is made consistent with it, without exceeding the limits of policy and standards stipulated by the primary legislation. The test is to determine whether the primary legislation has conveyed the legislative policy and the standards with sufficient clarity which will be binding the subordinate authorities who exercise the delegated power to frame the legislation.
  - ▶ If the legislative policy is enunciated with sufficient clearness or 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.

- ▶ The SC held that CBDT's power under s. 17(2)(viii) as rule-making authority, to prescribe "any other fringe benefit or amenity" as perquisite is not boundless. It is demarcated by the language of s.17(2). Anything made taxable by the rule-making authority under s.17(2)(viii) should be a "perquisite" in the form of "fringe benefits or amenity". The provision clearly reflects the legislative policy and gives express guidance to the rule-making authority.
- ▶ The SC held that while s.17(2) provides an inclusive definition of "perquisites" and enumerates certain specific types of perquisites, it also provides for a residual clause that includes "any other fringe benefits or perquisites" within the definition of "perquisites", as prescribed from time to time. The express delineation does not take away the power of the legislature, as the plenary body, to delegate the rule-making authority to subordinate authorities, to bring within the ambit of "perquisites" any other "fringe benefit" or "amenities" as "perquisite". The legislative intent, policy and guidance is drawn and defined. Pursuant to such demarcated delegation, Rule 3(7)(i) prescribes interest-free/loans at concessional rates as a "fringe benefit" or "amenity", taxable as "perquisites".
- ▶ An executive authority can be authorized by a statute to modify either existing or future laws but not in any essential feature. What constitutes an essential feature cannot be enunciated in exact terms. However, modification does not include a change in policy, since the "essential legislative function" consists of the determination of legislative policy and its formulation as a binding rule of conduct.
- ▶ Applying the above test in the context of s.17(2)(viii) and Rule 3(7)(i), the SC held that main legislation does not fall foul of the essential feature test. They do not modify an essential feature nor do they violate the condition of determining legislative policy or a binding rule of conduct.
- ▶ The SC finally concluded that the enactment of subordinate legislation for levying tax on interest free/concessional loans as a fringe benefit is within the rule-making power under s. 17(2)(viii). S. 17(2)(viii) itself, and the enactment of Rule 3(7)(i) is not a case of excessive delegation and falls within the parameters of permissible delegation. S. 17(2) clearly delineates the legislative policy and lays down standards for the rule-making authority. Accordingly, Rule 3(7)(i) is *intra vires* S. 17(2)(viii). It does not lead to an

<sup>6</sup> (1968) SCC OnLine SC 13.

excessive delegation of the “essential legislative function”.

- ▶ **Rule 3(7)(i) not arbitrary and violative of Article 14 of the Constitution insofar as it treats the SBI rate as the benchmark**
  - ▶ The fixation of SBI’s rate as the benchmark is neither an arbitrary nor unequal exercise of power. The rule-making authority has not treated unequal as equals. The benefit enjoyed by bank employees from interest-free loans or loans at a concessional rate is a unique benefit/advantage enjoyed by them. It is in the nature of a “perquisite”, and hence is liable to taxation.
  - ▶ SBI is the largest bank in the country and the interest rates fixed by them invariably impact and affect the interest rates charged by other banks. Rule 3(7)(i) postulates SBI rate as benchmark rate in comparison to interest rates charged by other banks for taxation of perquisites in the hands of employees. Rule 3(7)(i) is not arbitrary or irrational on this ground and adopting such rate would not be iniquitous, draconian or harsh on taxpayers. The uniform interest rate benchmarked to SBI rate promotes fairness, clarity and certainty for both taxpayers and tax authorities, thereby enhancing tax efficiency which avoids unnecessary litigation, making it beneficial for both taxpayers and tax authorities. In essence, these are all hallmarks of good tax legislation. Thus, Rule 3(7)(i) has a uniform approach and is premised on fair principles which aligns with constitutional values.
  - ▶ The fiscal and tax laws enjoy more flexibility as compared to other statutes<sup>7</sup>. The legislature should be allowed some flexibility as commercial and tax legislations tend to be highly sensitive and complex as they deal with multiple problems and are contingent.<sup>8</sup> A complex problem has been solved through a straitjacket formula, meriting judicial acceptance. Adopting any other view would lead to multiple issues and will override the legislative wisdom.
  - ▶ The SC finally concluded that the universal test adopted in Rule 3(7)(i) is pragmatic, fair and just and hence, it is *intra vires* Article 14 of the Constitution of India.

## Comments

The present SC ruling is a landmark ruling on constitutional validity of perquisite taxation of fringe benefits including interest-free or concessional loans to employees. It upholds the principle that delegated authority to CBDT to not only prescribe the various types of fringe benefits but also provide for valuation thereof is within the delegative power of legislature. This is particularly because the legislative policy and standards are well defined in s.17(2)(viii). At the same time, the SC has also clarified the boundaries of such delegated power viz. anything made taxable by CBDT under s.17(2)(viii) should be a “perquisite” in the form of “fringe benefits or amenity”.

It may be recollected that the legislature had originally intended to tax the benefit of interest-free or concessional loan as a “perquisite” in 1984 through an amendment by Taxation Laws (Amendment) Act, 1984. However, the amendment was immediately withdrawn by Finance Act 1985 from the date from which it was to take effect (1 April 1985). This was interpreted by SC in an earlier ruling in the case of *V.M. Salgaocar & Bros. (P.) Ltd. v. CIT*<sup>9</sup> as legislative intent of not taxing such benefit as a “perquisite”. The ratio of this ruling is not noticed by SC in the present ruling. To that extent, the observations of SC in the present ruling that employer’s grant of interest-free loans or loans at a concessional rate qualifies as a “fringe benefit” and “perquisite”, as understood in common parlance, may need to be read in the context that the present law specifically includes a provision to tax “fringe benefit” which is prescribed by CBDT.

<sup>9</sup> [2000] 243 ITR 383 (SC)

<sup>7</sup> Govt. of A.P. v. P. Laxmi Devi, (2008) 4 SCC 720.

<sup>8</sup> Swiss Ribbons (P) Ltd. v. Union of India, (2019) 4 SCC 17.

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