

Financial Adviser, KSEB Ltd.

From: Member (Finance), KSEB, Pattom" <mfkseb@ksebnet.com>
To: <mkakseb@gmail.com>
Cc: <ajcaokseb@gmail.com>
Sent: Friday, December 12, 2014 11:20 AM
Attach: Income Tax.docx; Letter KSEB 20 11 2014.docx
Subject: Fw. Applicability of income tax on employee benefits-clarification.

OFFICE	
No.	34489
Received	12/12/14
Sent	

Sri.Biju

Please find attached opinion dtd 20th November 2014 on applicability of income tax on employee benefit submitted by M/s.PFCCL

Director (Finance)

----- Original Message -----

From: V.K.Jain
To: Member (Finance), KSEB, Pattom
Cc: Subir Mulchandani ; vineet agrawal ; khullar@bansalsinha.com
Sent: Thursday, November 20, 2014 12:17 PM
Subject: Sub: Applicability of income tax on employee benefits-clarification.

Sir,

Please find attached clarification on Applicability of income tax on employee benefits as per our attached letter herewith.

Regards

V.K.Jain
vp

अब तक अत्यंत आवश्यक न हो कृपया इस ई-मेल को प्रिंट न करें ।

इस इलेक्ट्रॉनिक संदेश में समाहित सूचना तथा संलग्नक केवल प्रेषिती के उपयोग के लिए हैं तथा उनके लिए प्रॉपराइटरी, गोपनीय अथवा विशेषाधिकृत सूचना हो सकती है। यदि आप वह व्यक्ति नहीं हैं, तो आप इस ई-मेल को प्रचारित, वितरित अथवा कॉपी न करें। कृपया प्रेषक को तुरंत नोटिफाई करें तथा इस संदेश की सभी प्रतियां तथा संलग्नक नष्ट कर दें।

चेतावनी: ई-मेल के माध्यम से कम्प्यूटर वायरस संप्रेषित हो सकता है। यद्यपि इसके लिए कंपनी ने पर्याप्त सावधानी बरती है कि इस ई-मेल में कोई वायरस न हो, तथापि प्रेषिती को भी यह जाँच कर लेनी चाहिए कि इस ई-मेल तथा संलग्नक में कोई वायरस नहीं है। कंपनी इस ई-मेल अथवा संलग्नकों के प्रयोग से हुई किसी भी हानि अथवा नुकसान का दायित्व स्वीकार नहीं करती।

To,
Director (Finance),
Kerala State Electricity Board Limited,
Pattom, Trivandrum

Sub: - Opinion on applicability of income tax on employee benefits

Sir,

Please refer your mail dated 28th October 2014 seeking opinion on applicability of income tax on employees' terminal benefits like terminal earned leave surrenders, commutation of pension etc., since before corporatization of the Board, income tax benefits were enjoyed by the employees as in the case of the Government employees in case of Terminal Earned Leave, Commutation of pension etc. In this regard we have studied the matter and advise regarding Gratuity, Earned Leave and Commutation of pension.

1. The relevant statutory provisions giving exemption to the amount of **gratuity** are given under section 10(10) of the Income Tax Act 1961 which are produced for the ease of reference as under (relevant extracts):

(10) (i) any death-cum-retirement gratuity received under the revised Pension Rules of the Central Government or, as the case may be, the Central Civil Services (Pension) Rules, 1972, or under any similar scheme applicable to the members of the civil services of the Union or holders of posts connected with defence or of civil posts under the Union (such members or holders being persons not governed by the said Rules) or to the members of the all-India services or to the members of the civil services of a State or holders of civil posts under a State or to the employees of a local authority or any payment of retiring gratuity received under the Pension Code or Regulations applicable to the members of the defence services ;

(ii) any gratuity received under the Payment of Gratuity Act, 1972 (39 of 1972), to the extent it does not exceed an amount calculated in accordance with the provisions of sub-sections (2) and (3) of section 4 of that Act ;

(iii) any other gratuity received by an employee on his retirement or on his becoming incapacitated prior to such retirement or on termination of his employment, or any gratuity received by his widow, children or dependants on his death, to the extent it does not, in either case, exceed one-half month's salary for each year of completed service, [calculated on the basis of the average salary for the ten months immediately

preceding the month in which any such event occurs, subject to such limit as the Central Government may, by notification in the Official Gazette, specify in this behalf having regard to the limit applicable in this behalf to the employees of that Government] :

2. The relevant statutory provisions giving exemption to the amount of **commuted pension** are given under section 10(10A) of the Income Tax Act 1961 which are produced for the ease of reference as under (relevant extracts):

(10A) (i) any payment in commutation of pension received under the Civil Pensions (Commutation) Rules of the Central Government or under any similar scheme applicable to the members of the civil services of the Union or holders of posts connected with defence or of civil posts under the Union (such members or holders being persons not governed by the said Rules) or to the members of the all-India services or to the members of the defence services or to the members of the civil services of a State or holders of civil posts under a State or to the employees of a local authority or a corporation established by a Central, State or Provincial Act ;

(ii) any payment in commutation of pension received under any scheme of any other employer, to the extent it does not exceed—

(a) in a case where the employee receives any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive, and

(b) in any other case, the commuted value of one-half of such pension,

3. The relevant statutory provisions giving exemption to the amount of **Accumulated Earned Leave Encashment** are given under section 10(10AA) of the Income Tax Act 1961 which are produced for the ease of reference as under (relevant extracts):

(10AA) (i) any payment received by an employee of the Central Government or a State Government as the cash equivalent of the leave salary in respect of the period of earned leave at his credit at the time of his retirement whether on superannuation or otherwise ;

(ii) any payment of the nature referred to in sub-clause (i) received by an employee, other than an employee of the Central Government or a State Government, in respect of so much of the period of earned leave at his credit at the time of his retirement whether on superannuation or otherwise as does not exceed [ten] months, calculated on the basis of the average salary drawn by the employee during the period of ten months immediately preceding his retirement whether on superannuation or otherwise, subject to such limit as the Central Government may, by notification in the Official Gazette, specify in this behalf having regard to the limit applicable in this behalf to the employees of that Government:

The comparative position of taxability of the above terminal benefits before and after corporatization of the Board has been summarized in the following table:

Terminal Benefits	Status as KSEB	Status as KSEB Ltd.
(1)	(2)	(3)
Gratuity	Any death cum retirement gratuity received by Central and State Govt. employees , Defence employees and employees in Local authority shall be exempt.	<p>(i) Any gratuity received by persons covered under the Payment of Gratuity Act, 1972 shall be exempt subject to following limits:</p> <p>(a) For every completed year of service or part thereof, gratuity shall be exempt to the extent of fifteen days Salary based on the rate of Salary last drawn by the concerned employee. (b) The amount of gratuity as calculated above shall not exceed Rs 10 Lakh.</p> <p>(ii) In case of any other employee, gratuity received shall be exempt subject to the following limits:</p> <p>(a) Exemption shall be limited to half month salary (based on last 10 months average) for each completed year of service</p> <p>(b) Rs. 10 Lakhs, whichever is less.</p> <p>Where the gratuity was received in any one or more earlier previous years also and any exemption was allowed for the same, then the exemption to be allowed during the year gets reduced to the extent of exemption already allowed, the overall limit being Rs. 10 Lakhs.</p> <p>As per Board's letter F.No. 194/6/73-IT(A-1) dated 19.6.73, exemption in respect of gratuity is permissible even in cases of termination of employment due to resignation.</p> <p>The taxable portion of gratuity will qualify for relief u/s 89(1).</p> <p>Gratuity payment to a widow or other legal heirs of any employee who dies in active service shall be exempt from income tax (Circular No. 573 dated 2 1.8.90).</p>
2.Commutation of Pension	In case of employees of Central & State Govt. , Local Authority , Defence Services and Corporation established under Central or State Acts, the entire commuted value of pension is exempt.	In case of any other employee, if the employee receives gratuity, the commuted value of 1/3 of the pension is exempt, otherwise, the commuted value of 1/2 of the pension is exempt.

Leave encashment	Any payment by way of leave encashment received by Central & State Govt. employees at the time of retirement in respect of the period of earned leave at credit is fully exempt. (ii) Leave Encashment during service is fully taxable in all cases, relief u/s 89(1) if applicable may be claimed for the same.	In case of other employees, the exemption is to be limited to the least of following: (a) Cash equivalent of unutilized earned leave (earned leave entitlement cannot exceed 30 days for every year of actual service) (b) 10 months average salary (c) Leave encashment actually received. This is further subject to a limit of Rs.3 Lakhs for retirements after 02.04.1998.
---------------------	--	--

5. It is also submitted that CBDT has issued a Circular No. 286 [F. No. 174/79/80-IT(A-I)], dated 17-11-1980, considering the judgment of Delhi High Court in case of C.K. Karunakaran v. Union of India [1980] 4 Taxman 178, which is produced as under:

70. Exemption of commuted pension - Extent thereof under clause (10A)(i)

1. Attention is invited to Board's Instruction No. 1191 [F. No. 174/29/77-IT(A-I)], dated 1-7-1978 on the above subject. Para 5 of the said Instructions clarify that in the case of a Government servant absorbed in a public undertaking on or after 24-7-1971, the amount that would qualify for tax exemption under the provisions of section 10(10A)(i), would only be the amount representing the commuted value of one-third of the pension. The remaining two-thirds amount received by the person by way of terminal benefit would be includible in the total income subject to relief under section 89(1) read with rule 21A of the Rules.

2. The issue has been recently decided by a Division Bench of the Delhi High Court in the case of C.K. Karunakaran v. Union of India [1980] 4 Taxman 178. The High Court, while allowing a writ petition, relied upon rule 37A of the Pension Rules, 1972, which provides for payment of lump sum amount to persons absorbed in public sector corporations. It has been held that rule 37A provides for payment of lump sum in lieu of the pension. The lump sum was bifurcated into two component parts under sub-clauses (a) and (b) of rule 37A(i) but the fact that it is bifurcated into two parts neither alters the nature of the payment nor does it cease to be a payment in lieu of pension. Therefore, by virtue of the language of section 10(10A)(i) which speaks of any payment under any similar scheme applicable to the members of the civil services of the Union, the entire commutation was held to be exempt under section 10(10A)(i).

3. The Board have been advised that the decision of the Delhi High Court is to be accepted.

4. In view of the above, Instruction No. 1191 stands withdrawn with immediate effect. All appeals/revision petitions/reference applications on this point may be conceded/withdrawn in the light of this circular.

6. Further in case of S. Ranganatha Rao v. Accountant General [1981] 129 ITR 130 (Kar.), the above said circular was explained with the following observations:

"... In para 3 of the said circular it is stated that the Board has been advised that the decision of the Delhi High Court is to be accepted and thereafter, it is further stated that in that view of the matter instruction No. 819 stands withdrawn with immediate effect. It is, therefore, clear that the petitioner's commuted pension is not liable to tax at all and if he is not liable to tax under the Act, then the Accountant-General has no jurisdiction to order deduction of the tax at source..." (p. 132).

The detailed judgment of Delhi High Court is also enclosed for your information and reference.

7. We have also had discussions with various state power utilities wherein the unbundling process has taken place. The treatment of taxability on the above subject by them based on discussions is mentioned below for your information:-

(a) In case of state of Bihar, Andhra Pradesh, Rajasthan, Uttar Pradesh and Uttarakhand, they are treating the terminal benefits at par as was prevailing before unbundling.

(b) However in case of state of Gujarat, Maharashtra, Karnataka and Orissa the taxability has been as per column 3 of table given in para 4 above.

We hope that the above will clarify the matter.

Thanks & regards

Vice President

PFC Consulting Limited