

# EY Tax Alert

## CBDT amends valuation rules for accommodation perquisite

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### Executive summary

This Tax Alert explains the Notification No. 65/2023 dated 18 August 2023<sup>[1]</sup> issued by Central Board of Direct Taxes (CBDT)<sup>[2]</sup>, which has substituted the existing Rule 3(1) (old rule) of Income Tax Rules, 1962 with the new Rule 3(1) (new rule) providing for valuation rules for accommodation perquisite.

In general, while the new rule continues to be largely based on the percentage of salary of the employee, however, it has rationalized the valuation in respect of employer-owned accommodation and also ensures that the increase in salary of the employee does not result in an artificial rise in the value of the perquisite beyond the inflation level in the country.

<sup>[1]</sup> Along with corrigendum dated 29 August 2023; Notification No. 72/2023

<sup>[2]</sup> The apex administrative body for direct taxes

# Background

## ▶ **Perquisite provisions relating to accommodation prior to amendment by Finance Act (FA), 2023**

- ▶ Section (S.) 17(2)(i) of the Income Tax Act, 1961 provides that the value of rent-free accommodation provided to the taxpayer by his/her employer shall be treated as perquisite. Valuation of such accommodation is governed by Rule 3(1) of the Income Tax Rules, 1962.
- ▶ S.17(2)(ii) provides that the value of any concession in the matter of rent relating to any accommodation provided to the taxpayer by his/her employer shall be treated as perquisite. The Explanations to this provision created a deeming fiction in respect of a concession to arise where rent recovery from employee is less than a specified rate (which was linked to valuation as per Rule 3(1)).

## ▶ **Legislative history with respect to Rule 3(1)**

- ▶ The perquisite valuation rules in relation to accommodation prior to 2001<sup>[3]</sup> was linked to fair rental value (FRV) of the accommodation provided.
- ▶ However, the CBDT, w.e.f. 1 April 2001, amended the rule to provide for a valuation mechanism linked to percentage of salary, disregarding FRV of the accommodation. This amendment was brought with an intention to curb the litigation that arose on determining FRV of accommodation, it being subjective in nature.
- ▶ The constitutional validity of the amended valuation rule linked to percentage of salary was upheld by decision of the Supreme Court (SC) in the case of Arun Kumar v. UOI<sup>[4]</sup>. The SC noted that the amendment in rules was intended to simplify the perquisite valuation since computing FRV of different properties was very cumbersome for private sector employees. Furthermore, the amendment was made based on recommendations of an expert group constituted to rationalize and simplify the tax laws.
- ▶ However, in relation to “concession” in the matter of rent, the SC held that “concession” is a jurisdictional fact to be established to trigger perquisite and there is no deeming fiction of “concession” in the matter of rent. Thus, if all employees are charged same rent by the employer for similar accommodation, there is no “concession”.

- ▶ The determination of “concession” was addressed by the parliament by inserting Explanations in S.17(2)(ii) by Finance Act (FA) 2007 with retrospective effect to deem the “concession” to exist if the rent recovered from the employee is less than the specified percentage of salary (linked to extant valuation rule).
- ▶ The old rule providing for a valuation mechanism linked to the percentage of salary, created a challenge for the taxpayers. Under the old rule, two employees, though provided with similar type of accommodation faced different perquisite taxation if their salaries were different. Furthermore, if the employee’s salary was increased, it resulted in an automatic increase in accommodation perquisite value, even though the employee continued in the same accommodation. Also, employees provided with employer-owned accommodation faced higher perquisite valuation as compared to employer-leased or rented accommodation. This was because the perquisite value in respect of employer-leased/rented accommodation was capped to the rent paid or payable by the employer.
- ▶ Thus, the switchover from FRV to percentage of salary-based valuation resulted in employer-owned housing becoming extremely tax disadvantageous as compared to employer-leased/rented accommodation or employee making his/her own arrangement for accommodation by availing house rent allowance (HRA) from the employer.
- ▶ In the wake of the above challenges, various stakeholders represented to CBDT to amend the valuation rules for accommodation to remove the inequity inherent in percentage of salary-based valuation.

## ▶ **FA 2023 amendments**

- ▶ Both S.17(2)(i) and S.17(2)(ii) were amended by FA 2023 with an intent of rationalizing the provisions, providing uniform methodology and making a clear distinction of the two categories of accommodation and to empower the Central Government to prescribe rules of valuation of rent-free accommodation and accommodation at a concessional rate.
- ▶ The Explanation to S.17(2)(ii) was also amended to provide for a deeming fiction of accommodation to have been provided at a concessional rate, if the value of accommodation computed as prescribed exceeds the rent recoverable from, or payable by the employee.
- ▶ The amendments are effective from tax year 2023-24.

<sup>[3]</sup> Notification No.S.O.940(E) dated 25 September 2021

<sup>[4]</sup> [(2006) 205 CTR 193 (SC)]

## CBDT Notification No. 65 of 2023 dated 18 August 2023

- ▶ In general, while the new rule continues to be largely based on percentage of salary of the employee, however, it has rationalized the valuation in respect of employer-owned accommodation and also ensures that the increase in salary of the employee does not result in an artificial rise in value of the perquisite beyond the inflation level in the country.
- ▶ There is no change in valuation rule for central/state government employees, which continues to be license fees determined by central/state government as reduced by the actual rent paid by the employee.
- ▶ A comparison between the old rule and new rule in respect of employer-owned and employer-leased accommodation, is tabulated below:

Circumstances	Valuation as per old rule	Valuation as per new rule
Where the unfurnished accommodation is provided by any employer other than the Central and State Government employer  (a) where such accommodation is owned by the employer	(i) <b>15%</b> of salary in cities having population exceeding <b>2.5m</b> as per 2001 census	(i) <b>10%</b> of salary in cities having population exceeding <b>4m</b> as per 2011 census
	(ii) <b>10%</b> of salary in cities having population exceeding <b>1m</b> but not exceeding <b>2.5m</b> as per 2001 census	(ii) <b>7.5%</b> of salary in cities having population exceeding <b>1.5m</b> but not exceeding <b>4m</b> as per 2011 census
	(iii) <b>7.5%</b> of salary in other areas, in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.	(iii) <b>5%</b> of salary in other areas, in respect of the period during which the said accommodation was occupied by the employee during the previous year as reduced by the rent, if any, actually paid by the employee.
(b) Where the accommodation is taken on lease or rent by the employer	Actual amount of lease rental paid or payable by the employer or <b>15%</b> of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee.	Actual amount of lease rental paid or payable by the employer or <b>10%</b> of salary, whichever is lower, as reduced by the rent, if any, actually paid by the employee.

- ▶ The new rule has inserted a cap in case of a furnished or unfurnished accommodation owned/taken on lease or rent<sup>[5]</sup> by the employer and provided to the same employee for more than one tax year to ensure that the increase in salary does not result in increase in perquisite value beyond the inflation level in the country (as indicated by the cost inflation index (CII) which is considered for computing long-term capital gains on transfer of capital asset). The formula prescribed for this purpose is as follows:

$$\text{Amount calculated for first tax year} \times \frac{\text{CII for the tax year for which the perquisite is calculated}}{\text{CII for the tax year in which accommodation was initially provided to employee}}$$

- ▶ The perquisite valuation for the second year/subsequent years shall be lower of (a) perquisite value computed as per the rules prescribed for furnished/unfurnished accommodation and (b) amount computed as per the above formula.
- ▶ The first tax year is tax year 2023-24 or the tax year in which the accommodation is provided to the employee, whichever is later.
- ▶ Illustration depicting the working of the above referred inflation-linked cap is provided in Annexure A at the end of this document.

<sup>[5]</sup> As added by Corrigendum dated 29 August 2023

- ▶ There was an ambiguity in the language of inflation-linked capping as per the new rule notified on 18 August 2023. While the initial part of the proviso refers to accommodation owned by the employer, the later part of proviso provides for capping in respect of both accommodation owned by the employer and accommodation taken on lease or rent by the employer.
- ▶ The CBDT has resolved such ambiguity by way of corrigendum dated 29 August 2023. As per the corrigendum, the inflation-linked capping shall also apply to an accommodation taken on lease or rent by the employer and the capping is not restricted to an accommodation owned by the employer. While the perquisite value in case of an accommodation taken on lease or rent by the employer is capped to the actual lease rental paid/payable by the employer, the new rule provides for a further inflation-linked cap.
- ▶ An illustration depicting the impact of inflation-linked cap to perquisite value from employer-leased or rented accommodation is provided in Annexure B.
- ▶ As per the existing provisions, perquisite value is NIL in case of any accommodation provided to an employee working at a mining site or an on-shore oil exploration site or a project execution site or a dam site or a power generation site or an off-shore site having plinth area not exceeding 800 sq. ft. and not less than eight kms away from the local limits of any municipality or a cantonment board or which is located in a remote area. As per the amended rules, the plinth area of such accommodation is increased to 1000 sq. ft.
- ▶ The existing provisions defined "remote area" as an area that is located at least 40 kms away from a town having a population not exceeding 20,000 based on latest published all-India census. The new rule has substituted this definition of "remote area" to mean any area other than the area located within local limits or located within a distance, measured aerially, of 30 kms from the local limits of, any municipality or a cantonment board having a population of 1,00,000 or more based on the 2011 census.
- ▶ **Effective date of new rule**
  - ▶ The new rule is effective from 1 September 2023. Thus, the reduction in perquisite value as per the new rule will be effective from 1 September 2023. Employers will be required to consider the new rule for accommodation perquisite valuation for salary withholding tax from 1 September 2023 onwards.

## Comments

The / partially addresses the challenges posed by the old rule which was based purely on percentage of salary of employee. The relief provided to the employees is by way of (a) reduction in perquisite value as percentage of salary and (b) introduction of a new inflation linked capping rule. This may partially address employees' difficulties of an artificial valuation rule which does not consider FRV of the property. It needs to be seen whether the above referred changes will encourage employees to avail employer-owned accommodation which, so far, was not attractive considering high perquisite taxation based on percentage of salary.

## Annexure A

Illustration depicting the computation of rent-free employer-owned accommodation perquisite value as per old and new rule

Particulars	Tax year 2024-25 <sup>[6]</sup>	Tax year 2025-26
Salary	20,00,000	30,00,000
CII (assumed)	350	360
Perquisite value as per old rule	15% <sup>[7]</sup> of 20,00,000 = 3,00,000	15% of 30,00,000 = 4,50,000
Perquisite value as per new rule without inflation linked capping	10% of 20,00,000 = 2,00,000	10% of 30,00,000 = 3,00,000
Perquisite value as per new rule after inflation linked capping	2,00,000	10% of 30,00,000 capped to following:  2,00,000/350 X 360  i.e., 2,05,714

## Annexure B

Illustration depicting the computation of rent-free employer-leased accommodation perquisite value as per old and new rule

Particulars	Tax year 2024-25 <sup>[8]</sup>	Tax year 2025-26
Actual lease rental paid by employer	240,000	360,000
Actual rent paid by the employee	NIL	NIL
Salary	30,00,000	40,00,000
CII (assumed)	350	360
Perquisite value as per old rule	Lesser of a) 240,000 b) 15% of 30,00,000 = 4,50,000  240,000	Lesser of a) 360,000 b) 15% of 40,00,000 = 600,000  360,000
Perquisite value as per new rule without inflation-linked capping	Lesser of a) 240,000 b) 10% of 30,00,000 = 3,00,000  240,000	Lesser of a) 360,000 b) 10% of 40,00,000 = 4,00,000  360,000
Perquisite value as per new rule after inflation-linked capping	240,000	240,000/350 X 360  i.e., 246,857

<sup>[6]</sup> Assumed to be the first year in which employer-owned accommodation is provided to employee

<sup>[7]</sup> Accommodation assumed to be city having population exceeding 4m as per 2011 census

<sup>[8]</sup> Assumed to be the first year in which employer-owned accommodation is provided to employee

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