Tax Review/Taxation

Daily Alert Services

Huzaima & Ikram
September 03, 2013

This special email service from Monday to Friday, part of subscription package, is aimed at keeping you informed about tax and fiscal matters. It contains news, legislative changes, case-law, in-depth articles and analyses covering all areas of taxes at domestic and international level. On every Saturday evening, we email weekly compilation of the entire material. Every month, ***Taxation*** in printed form, is sent through post and digital version of ***Tax Review International*** is made available for download at www.huzaimaikram.com.

For subscription, please visit our website or contact offices mentioned below.

This service is available *only* for paid subscribers. If you are a subscriber of *Law and Practice of Income Tax* (LPIT), *Law and Practice of Sales Tax* (LPST), *Taxation* or *Tax Review International* but not receiving this service, please send your email address at sales@huzaimaikram.com quoting subscription number.

This issue contains:

Kind regards

Mrs. Huzaima Bukhari
Editor

Lahore
Office No. 14, Second Floor,
Sadiq Plaza, 69-The Mall,
Lahore 54000 Pakistan
Ph. (+9242) 36280015 & 36365582

Lahore
Mr. Shabbir Ali
0322-4291828
Mr. Shahbaz Ahmad
0300-4521453

Karachi
Ms. Sadaf Bukhari
0301-8458701

Other cities
Mr. Aftab Sajid
0305-5199004

Is the budget unravelling already?

by

*Dr. Hafiz A. Pasha**

The newly-elected government announced an ambitious budget on June 12, 2013 for 2013-14 soon after assumption of power. The budget envisaged an increase in tax revenues of over 23 percent, a doubling of the federal PSDP, increase in gross foreign aid inflows of $2.5 billion, 35 percent cut in subsidies and retirement of a big chunk of circular debt worth Rs503 billion before June 30, 2013. Consequently, the expectation is that the consolidated fiscal deficit will fall in 2013-14 by as much as 2.5 percent of GDP in one year, from 8.8 percent to 6.3 percent, with a small cash surplus being generated by provincial governments. Altogether, the picture presented is one of an economic revival coupled with substantial macroeconomic stabilization in 2013-14.

But, more or less, immediately after the presentation of the federal budget a number of events have unfolded which could lead to the unraveling of the budget. Some of these are external in nature while others are the consequences of recent decisions taken by the government.

The first such decision was the announcement of a 10 percent salary hike by the finance minister, following complaints by federal employees that they had not been granted an increase in the budget. Also, the Islamabad High Court passed a judgment in reference to the 20 percent increase in salary to Federal Secretariat employees granted by the previous prime minister. The court ruled that the decision by the outgoing government was discriminatory in nature and should be extended to all federal employees. These salary increases will add to the costs of running the government.

Presumably, the federal government proposes to cover most of the increase in salary expenditure by a 30 percent cut in non-salary expenditure. However, the budget documents do not provide any evidence of such a reduction.

The four provincial government budgets, which came after the announcement of the federal budget, also announced plans for major expansion in their Annual Development Plan (ADPs) in their first year, with a combined increase of almost 100 percent. Consequently, they have shown cash deficits adding up to Rs52 billion, with Punjab alone projecting a whopping deficit of Rs30 billion. Therefore, the assumption made by the federal government that the provinces will generate a combined cash surplus of Rs23 billion is far from validated. This is a classic example of lack of coordination between different levels of government.

---

* The writer is a former finance minister.

Further, the provincial governments also do not appear to have made any provision for salary increases, with current expenditure anticipated to increase by only 8 percent in 2013-14, more in less, in line with the projected rate of inflation. But, following the precedent set by the federal government, they have also had to announce increases of 10 percent to 15 percent, with the collective cost running over Rs40 billion. This will add further to the projected cash deficits. Already, by the end of the first week of August, the provincial governments of Punjab and Khyber-Pakhtunkhwa are running an overdraft with the SBP of Rs10 billion and Rs1 billion respectively.

The third shock came in early July when the Federal Board Revenue (FBR) revealed that it had actually collected revenues of Rs1,942 billion in 2012-13, 65 billion less than the revised estimate by the federal government of Rs2,007 billion. This implies that revenues will have to grow even faster at over 27 percent if the target for 2013-14 is to be achieved. Given that tax revenues grew by only 3 percent last year, such a large increase appears highly unlikely. It now appears that there could be a large shortfall in FBR revenues of up to Rs100 billion. Already, in the first month of July, revenues have fallen short of the monthly target by Rs10 billion.

Further, there have been a series of decisions with budgetary implications. First, a subsidy has been given initially to PIA of Rs7 billion, which could increase during the year as the previous government had agreed earlier to make a larger subvention to PIA. Second, more recently, the Pakistan Steel Mills has been promised Rs12 billion by the Economic Committee of the Cabinet, while Pakistan Railways is also in the queue for a bigger handout than originally budgeted.

The increase in oil prices internationally will also have a negative impact on the budget. Already, the last increase in POL prices was cushioned partly by a reduction in the Petroleum Levy, which could, if maintained, reduce revenues in 2013-14 by over Rs12 billion. Further, if the furnace oil price continues to rise, partly because of the depreciation of the rupee, then the tariff differential subsidy will have to be a bigger increase implemented in power tariffs.

Down the road, there are other major liabilities. If the government decides to strengthen the security and intelligence apparatus to more effectively tackle terrorism in the country then budgetary allocations under this head will have to be raised. Already some announcements to this effect have been made by the prime minister and the home minister.

If raising interest rates is one of the prior actions agreed with the IMF for access to the Extended Fund Facility then this will also mean higher costs of debt servicing, especially as short-term domestic debt rolls over. In addition, as the Rupee depreciates, interest payments on external debt will be larger.

All the above mentioned factors indicate that revenues could be significantly lower and current expenditures higher. The consolidated fiscal deficit could be larger by almost

Rs250 billion, equivalent to almost 1 percent of GDP in 2013-14. That is, the deficit could approach 7.3 percent of GDP.

Apparently, the government has made a commitment to the IMF to bring the consolidated deficit down to 6 percent of GDP, with the provincial governments generating cash surpluses. The additional fiscal adjustment of about 1.3 percent of GDP can only be achieved by additional taxation and/or cutbacks in expenditure.

The option of minibudgets, with new taxation proposals, must be avoided. Already, the 2013-14 budget has increased the tax burden, especially on existing taxpayers. Coupled with the large increase in power tariffs this will bring the already slow-growing economy to a virtual standstill.

In the event of large slippages in the budget, the likelier path that will be followed is a substantial cut back in development expenditure, by both the federal and provincial governments. This has already been the case over the last few years. The ambitious plans for implementation of major new projects in a bid to kick start economic revival will have to be postponed. In effect, macroeconomic stabilization will once again mean the sacrifice of growth under the aegis of a fund programme.

The Ministry of Finance must preserve its credibility and highlight the emergence of negative factors, which are making the process of fiscal adjustment more difficult in the short run. Commitment to an impossible target for the fiscal deficit could make Pakistan once again a Ôfirst-tranche-onlyÕ country with the IMF and precipitate a financial meltdown.- *Courtesy The News*

Tax collection: Next IMF tranche in jeopardy as FBR misses target again

Pakistan may get the $6.6-billion bailout package from the Washington-based International Monetary Fund (IMF) but qualifying for the next tranche may not be an easy goal, as the country has so far struggled to fulfil a key performance criterion – tax collection.

The Federal Board of Revenue (FBR) managed to collect almost Rs145 billion worth of taxes in August, showing a healthy growth rate of 17% over the corresponding month's collection last year. But despite such an encouraging growth, the collection was not enough to hit the monthly target of Rs159 billion. The provisional results showed that the FBR fell short of the monthly tax target by Rs14 billion.

It is the consecutive second month when the FBR has not been able to achieve the target. In July, the FBR marginally missed its Rs136 billion target and collected Rs134 billion, said Finance Minister Ishaq Dar last week. With that the accumulative shortfall in collection widened to Rs16 billion.

The cumulative collection in the first two months (July-August) of fiscal year 2013-14 remained at Rs279 billion against the target of Rs295 billion. The collection in the first two months was 11.3% of the total annual target of Rs2.475 trillion. Fiscal year 2013-14's tax collection target is set 28% higher than the last year's target of 1.936 trillion.

Under the IMF programme, achieving this year's revenue target is the key performance criteria in addition to the budget deficit target, which again largely hinges on the tax collection. The executive board of the IMF will meet on Wednesday in Washington to consider Pakistan's request for a three-year $6.6-billion bailout package.

Contrary to Pakistan's request for releasing every tranche before the quarterly review of the IMF programme, the management of the lending agency has so far not agreed to approve a "front-loaded" programme, according to sources in the finance ministry. The release of every next tranche will be linked with successful achievement of the structural benchmarks and performance criteria, they added.

If the trend of missing the tax target continues in the coming months, the IMF during its quarterly review meetings may ask

Islamabad to levy more taxes to achieve the annual target. The IMF will not accept any shortfall against the quarterly and annual collection targets.

Any shortfall in the revenues of the FBR will also undermine the federal government's understanding with the provincial governments for saving Rs117 billion by the federating units to keep the overall budget deficit at 6% of the gross domestic product, as agreed with the IMF. According to the finance ministry, the provinces have linked savings with the FBR's ability to generate Rs2.475 trillion.

Last week, FBR Chairman Tariq Bajwa said that the annual target was "steep and very big" but vowed to achieve it through a combination of measures. He said that new revenue measures of about Rs200 billion announced in the budget, hopes of increase in economic activities and increasing inflation that will fetch more revenues and broadening the tax base will be FBR's tools to achieve the annual target.

Under a commitment with the IMF, Pakistan had to send notices to 100,000 tax evaders before June 30, 2013 and bring them in the tax net. During the first two months of the fiscal year, the FBR has delivered notices to over 21,000 people, according to the FBR officials.

The IMF has also set a structural benchmark of reviewing the existing regime of statutory regulatory orders (SROs) – legal documents ascribing changes in the tax laws. The facility has grossly been misused in the past to give benefits to the affluent people. The IMF wants Pakistan to review the regime till December and withdraw the individual-industry specific SROs.

Finance Minister Dar has estimated collecting additional Rs300 billion by withdrawing such SROs. – *Courtesy The Express Tribune*

CNG outlets to get tax exemptions

The Ministry of Finance has allowed the Federal Board of Revenue to issue Statuary Regulatory Order (SRO) for exemption to CNG stations from 5 percent extra sales tax and one percent 'further tax' to avoid sudden increase in the prices of the CNG. Sources told here on Monday that the FBR has obtained clearance of the Ministry of Finance for issuance of the necessary notification for the CNG industry. The FBR will issue the SRO in this regard.

According to the FBR, the government is undertaking a drive to broaden the tax base by identifying prospective taxpayers through policy initiatives and third party sources. In this regard three key measures were taken in the Budget 2013-14 with a view to increasing the sales tax registration. Firstly, the extra sales tax @ 5 percent on unregistered industrial and commercial consumers of electricity and gas having monthly bill in excess of Rs 15,000. This scheme was notified vide SRO 509(1)/2013 and a special procedure for its collection and payment was also evolved under SRO 510(1)/2013.

Secondly, another important measure is the levy of further tax @ 1 percent by virtue of section 3(1A) of the Sales Tax Act, 1990, on supplies made to unregistered persons. Third measure is the withholding and payment of complete amount of sales tax on purchases made by registered persons from unregistered persons under Sales Tax Special Procedure (Withholding) Rules, 2007 as amended vide SRO 505(I)/2013 dated June 12, 2013.

The FBR said the scheme of imposition of extra tax @ 5 percent on unregistered commercial and industrial consumers of electricity and gas having monthly bill in excess of Rs 15,000 was primarily aimed at increasing the sales tax registration. However, it may have adverse implication for the CNG users. The CNG sector is generally operating without sales tax registration. The supply of CNG is governed under the Sales Tax Special Procedure Rules, 2007 where the CNG stations pay 9 percent tax (besides normal sales tax @ 17 percent) in lieu of value addition upfront with the gas bills. It is pointed out that the issue of 9 percent value addition on supply to gas stations is already under judicial scrutiny before the Supreme Court.

The special procedure requires these CNG stations to get sales tax registration and file quarterly returns, but majority of them are still unregistered. As such, these ‘unregistered gas stations would attract 5 percent extra tax and 1 percent further tax. It is safe to presume that they would pass this on to the consumers. Resultantly, the price of CNG would be increased by these stations causing a stir in the general public. Considering the element of price sensitivity, the government has already exempted the petroleum products from the levy of 1 percent further tax vide SRO 648(1)/2013 dated July 9, 2013. It is, therefore, proposed that CNG stations may be exempted from the levy of 5 percent extra and 1 percent further tax, the FBR added. – *Courtesy Business Recorder*

Advance/WHT targets: FBR implements enforcement plan 2013-14

The Federal Board of Revenue Monday implemented a national enforcement plan (2013-14) to meet assigned targets of advance/withholding taxes in budgetary measures from educational institutions, dealers, commission agents and arhtis, etc. The FBR has issued instructions to field formations, here on Monday for constant evaluation of collection in respect of new withholding measures introduced by Finance Act, 2013.

Sources said the enforcement plan (2013-14) pertaining to advance tax covers collection from 236D - Advance tax on functions and gatherings; 236E - Advance tax on foreign-produced films, TV plays and serials; 236F - Advance tax on cable operators and other electronic media; 236G - Advance tax on sales to distributors, dealers and wholesalers; 236H - Advance tax on sales to retailers; 236I - Collection of advance tax by educational institutions and 236J - Advance tax on dealers, commission agents and arhtis, etc.

The effective monitoring of taxes from the said areas would result in major jump in revenue collection in 2013-14, sources added. According to the FBR, in order to achieve budgetary target, the FBR is heavily relying on the introduction of new revenue measures introduced through Finance Act, 2013. In these new measures there is a change in the rates and amendments to the law, however, this enforcement plan is specifically about the newly introduced withholding provisions from Sections 236-D to 236-J of the Income Tax Ordinance 2001. For the constant monitoring of the collection made in these sections on monthly basis the tax authorities have approved the parameters and guidelines.

The FBR has further directed the RTOs to share success stories and any innovative method applied in order to share them with the rest of the field formations. Information on account of new withholding revenue measures introduced vide Finance Act, 2013, to be reported by the RTOs, would cover name of withholding agent; relevant provisions, 236-D, 236-E, 236-F, 236-G, 236-H, 236-I, 236-J; intimation issued/facilitation made; withholding statement status, filed, not filed; in case of non-filing action taken; and withholding tax contribution in July 2013 and August 2013, sources added. – *Courtesy Business Recorder*

Dar due

Finance Minister Ishaq Dar is scheduled to convene a meeting on September 3 (today) with the high-ups of Inland Revenue and customs departments at Karachi. The Finance Minister will kick off his official tour from Overseas Investors Chamber of Commerce and Industry (OICCI) and later he will address Inland and customs officers. – *Courtesy Business Recorder*

Smuggled goods worth Rs 20 million seized

Anti Smuggling Organisation (ASO) of Model Custom Collectorate (MCC), Quetta on Monday claimed to have seized smuggled goods worth Rs 20 million. According to sources, the anti-smuggling squads, headed by Assistant Collector Preventive Amanullah Tareen, conducted three major anti-smuggling operations and foiled attempts to smuggle 28,000kgs of plastic granule (Dana) of Iranian origin; seized over 15,000 litres of smuggled Iranian high speed diesel (HSD) and huge quantity of Afghan Transit goods including ghee, foreign origin tyres and other Iranian food items.

They said that department had taken all seized goods into custody and added that street value of these smuggled goods was estimated to Rs 20 million. They said that the seizure of plastic granules was one of the biggest seizures of its type in recent years in Balochistan and the customs authorities despite poor law and order situation were engaged in carrying out successful anti-smuggling raids. Amanullah Tareen said that special anti-smuggling squads were deployed at all check-posts located at Dera Allahyar in Jafferabad District, Rakhni in District Barkaan, Zaraband in District Qilla Abdullah and Kuchlak in District Quetta. – *Courtesy Business Recorder*

Revenue loss: DTRE scheme a high-risk area: AGP

The Auditor General of Pakistan (AGP) has declared Duty and Tax Remission for Exports (DTRE) scheme for exporters as high-risk area involving inefficiency of the Input Output Co-efficient Organisation (IOCO) and DTRE Cells at the Customs Collectorates responsible for causing revenue loss due to massive misuse of the scheme.

It is learnt on Monday that the AGP's latest report (2012-13) on DTRE scheme has exposed different techniques used by certain exporters to misuse the scheme. Similarly, the report detected loopholes in the customs department and IOCO which failed to effectively monitor and regulate the DTRE scheme.

The report said that according to the provisions of rule 298(4) of DTRE rules, IOCO or, as the case may be, the EDB upon receipt of a reference from the Regulatory Collector, shall determine input-output ratios and wastages, as may be deemed appropriate, and forward ‘their findings to the regulatory collector within a period of thirty days, or such shorter period as may be specified by the regulatory collector in any specific case.

MCC Export Karachi granted 28 DTRE approvals in 15 cases on a provisional basis but approved 100 percent of the quantity applied by the users without imposing the restriction of 25 percent of the quantity applied for as provided in the rules and referred the cases to the Input Output Co-efficient Organisation (IOCO) for determination of input-output ratios and wastages. The finalisation of cases by the IOCO regarding the input-output ratios and wastages in all these cases were awaited till the date that the MCC had conducted the post-exportation audit of these cases and issued NOCs/released indemnity bonds/post-dated cheques, etc. This resulted into irregular/unlawful import of input goods to the extent of 75 percent involving government revenue of Rs 63.77 million during the period 2008-09 to 2010-11.

Similarly, the MCC Exports Karachi issued provisional DTRE approvals to 10 users allowing the input-output ratios and wastages provisionally in 19 cases. In all these cases, neither the lOCO/EDB finalised the provisionally allowed input-output ratios and wastages nor did the regulatory collectorates remind the IOCO for taking timely action in this regard. This has almost become a normal practice of the IOCO and the Collectorates not to finalise the provisionally allowed input-output ratios! Wastages and the final/actual input-output ratios/wastages were not being determined in ‘such cases.

Audit requires proper monitoring, implementation of internal controls and enforcement of relevant laws and rules to improve the internal controls of the department in order to make the DTRE scheme more effective, it said. According to the report, the goods imported under DTRE are released free of duty and taxes under security instrument furnished by the DTRE users. The liability of a DTRE user to pay duty and taxes under a security instrument shall not be discharged unless post-exportation audit is carried out and completed satisfactorily within a period of three months after the period specified in rule 305 or after filing of reconciliation statement under rule 307D, whichever is earlier.

The objectives of audit were to review the system of DTRE to determine efficiency of system and leakage of government revenue. DTRE is a high risk area and it was specially focused and audited on test check basis during January to June 2012 for the periods 2009-10 & 2010-11. This revealed that DTRE cells of the department were not working efficiently and effectively for watching the interest of public exchequer, the report said.

It said that the customs department failed to conduct mandatory audit of DTRE approvals involving duty and taxes of Rs 4,426.03 million. According to rule 307-E (1) of the Customs Rules 2001, the liability of a DTRE user to pay duty and taxes under a security instrument furnished by him under this sub-chapter, shall not be discharged unless post-exportation audit is carried out and completed satisfactorily within a period of three months.

Post exportation audit of 1020 cases were pending either with the concerned DTRE branch or with Post Clearance Audit. The cases pertained to 2002, 2005, 2006, 2007, 2008 and 2009, so the security instruments furnished by the DTRE holders stood expired. The inaction of the department has endangered duty and taxes of Rs 4,426.03 million.

It pointed out the unauthentic export to Afghanistan involving government taxes of Rs 1,339.71 million. According to para 7(2)(i) of the Export Policy Order 2008-09, the proof that goods exported from Pakistan have reached Afghanistan shall be verified on the basis of copy of import clearance documents by Afghan customs authorities across the border.

Certain DTRE approval holders exported approved goods to Afghanistan. However, the relevant Afghanistan customs clearance documents were neither produced by the DTRE holders nor verified by the department. In the absence of Afghanistan customs clearance documents, the export cannot be considered authenticated involving government taxes of Rs 1,261.10 million.

According to rule 307-D of the Customs Rules 2001, within sixty days of the expiry of utilisation period allowed under this sub-chapter, or earlier after export, a DTRE user shall file to the Regulatory Collector a reconciliation statement in the form as set out.

During scrutiny of DTRE files, it was observed that neither the DTRE users had submitted the reconciliation statement nor the Collectorate had pursued the matter despite lapse of considerable time. Moreover, no PaCCS data was provided as required under the rules meaning thereby that no exports had been made. The DTRE holders were thus liable to pay remitted amount of duty and taxes of Rs 860.62 million which was not realised. The original PDCs and indemnity bonds were also missing in some files which show that same had been returned to users without audit of DTRE. The lapse shows weak internal control and inefficiency of departmental audit, the report said.

According to rule 300(2) of the Customs, Rules 2001, the amounts suspended by the Regulatory Collector in respect of leviable customs-duties, excise duty, sales tax and withholding tax shall be secured for a period of thirty months. Certain manufacturers were granted DTRE approvals for import of Polyester Staple Fiber (Hs Code 5503 .2010). The goods were classified under Hs Code 5503.2010 and liable to CD @10 percent. PDCs, Indemnity Bonds and Bank Guarantee were required to be obtained accordingly. It was, however, observed that PDCs were furnished and accepted against custom duty calculated @ 6.5 percent or 4.5 percent under SRO.567(1)/2006 dated 05.06.2006 (S.No 124). The said SRO was not valid for import under DTRE. The lapse was not checked by the department and PDC, indemnity bond and B.G. for a lower amount were accepted. Resultantly, the government revenue of Rs 53.44 million remained unsafe which reflect weak internal controls and inefficiency.

The report further said that as per rule 302 (1) of the Customs Rules 2001, a DTRE user shall Be entitled to acquire input goods without payment of customs duty, excise duty, sales tax or withholding tax in accordance with his DTRE approval. During scrutiny of DTRE approval and audit files it was observed that the DTRE approvals were granted in favour of two DTRE users in 06 cases for import of duty/tax free import of input goods for the manufacture of export goods. However, the import/export GDs and documents were in the name of persons other than the DTRE users. Resultantly the DTRE approvals were not used by the genuine users but by the persons other than the actual DTRE users. Hence the remission of duty and taxes in these cases was irregular causing non-realisation of government revenue amounting to Rs 8.33 million.

According to rule 307-A (2) (C) of the Customs Rules 2001, a DTRE user may with the permission of the Regulatory Collector dispose of the input goods through local sale on payment of duties and taxes leviable at the time of such sale. Certain DTRE approval holders failed to utilise the local & imported raw materials for the approved purpose within the prescribed period. The DTRE user was liable to pay duty & taxes on un-consumed quantity which was not recovered. This resulted in short-realisation of government revenue of Rs 5.69 million.

The report said that certain DTRE users had submitted reconciliation statement but the relevant bank credit advices along with bank statement were not provided for verification. In the absence of BCAs, actual export of the goods was not evidenced. Either all the bank credit advices along with bank statement be provided for verification or the remitted amount of duty and taxes Rs 48.92 million be recovered along with penalty and default surcharge. According to the provision of Customs Rules 2001, DTRE approvals are issued subject to fulfilment of prescribed conditions. Certain DTRE users had claimed excess wastage of input goods against that approved/allowed by the IOCO Karachi. The DTRE user were required to pay duty and taxes on excess wastage amounting to Rs 29.82 million which were neither demanded nor recovered by the concerned regulatory collector. – *Courtesy Business Recorder*

Fiscal year 2014 taxation measures: FBR minutely analysing revenue impact

The Federal Board of Revenue is strictly analysing the revenue impact of major taxation related enforcement/administrative measures taken in budget (2013-14) with focus on new capacity taxation on beverage industry and imposition of one percent 'further tax' on supplies to unregistered persons.

Sources told on Monday that the Board has picked some key revenue measures in income tax, sales tax and federal excise duty taken in budget (2013-14) to ensure estimated collection during the first two months of the current fiscal year. According to the sources, the Board has asked the tax officials to manage revenue measures of income tax introduced through Finance Act, 2013. The withholding statements filed for July 2013 have to be thoroughly scrutinised in the light of provisions introduced through Finance

Act, 2013. In this regard, comparisons may be made, with sales tax returns for the tax period July 2013.

Sources said field formations have to manage revenue measures of sales tax, introduced through Finance Act, 2013 particularly withdrawal of exemption against international tenders. Field formations are also checking the measures of sales tax introduced through Finance Act, 2013 particularly imposition of further tax @ 1 percent on supplies to unregistered persons. The relevant data has been retrieved from the system for further analysis to arrive at case-wise default. Last year's data would be used by field formations for revenue projection of this provision.

Sources said the field formations would manage revenue measures of sales tax, introduced through Finance Act, 2013 - Addition of items with sales tax on retail' price basis. Field formations must ensure compliance of STGO 28 of 2013 by the concerned registered persons. Scrutinise the returns for the periods of June and July 2013 with the help of production data filed in compliance of SRO 863 of 2007. In this context the field formations should also obtain consumer price lists, sources maintained.

Under the STGO 28 of 2013, the applicable rate of sales tax was increased from 16 percent to 17 with effect from June 13, 2013. The list of items chargeable to sales tax on retail price basis has also been expanded from June 13, 2013. The manufacturers of items specified in Third Schedule to the Sales Tax Act, 1990, may face difficulty in printing retail price on their existing stocks of packing material which have already been printed with sales tax @ 16 percent of the retail price or has been printed without retail price. The Board, recognising the enormity and impracticability of the task of printing and re-printing of retail price and sales tax amount, allowed the use of existing packing material for a period of two month starting from June 13, 2013, subject to fulfilment of laid down conditions.

The Board should also manage revenue measures of sales tax, introduced through Finance Act, 2013 - Expansion of withholding tax regime of sales tax. Field formations would obtain case-wise details of value of supply to unregistered persons and withholding of tax thereon for further action.

Sources said the field formations should also manage revenue measures of FED, introduced through Finance Act, 2013 - Capacity taxation for beverage industry. In this regard, the concerned officials would prepare a comprehensive report on the revenue implications of the new regime along with objective recommendations on beverage industry. The Board is also monitoring revenue measures of FED, introduced through Finance Act, 2013 - FED @ 16 percent on remaining financial services. Tax officials would prepare a comprehensive report, after taking feedback from the concerned taxpayers' bank regarding non-compliance/ non-payment by the concerned taxpayers.

The field formations would check cases of non-filing of returns for the tax periods June and July, 2013 by registered persons and corresponding special returns under section 27 of the Sales Tax Act 1990. This requires enforcement of sales tax returns for the tax periods June and July, 2013. In cases of audit for pending case of previous years and Tax Year 2011, the Board directed field formations for prompt disposal of cases selected for audit for Tax Year 2011 and previous years, sources added. – *Courtesy Business Recorder*

2013 TRI 1478 (Trib. Ind.)

INCOME TAX APPELLATE TRIBUNAL
BANGALORE "C" BENCH, BANGALORE

N. Barathvaja Sankar, Vice President and N.V. Vasudevan, Judicial Member

FACTS/HELD

Law on s. 192 TDS obligation on medical reimbursement & LTC explained

1. The assessee recruited employees under a contract of employment which provided the salary as a 'cost to company' or 'CTC'. Having determined the CTC, the employee was permitted to choose what would be the various components of his salary and for this purpose a basket of allowances was made available for the employee to choose from. The maximum allowance for each such allowance was fixed by the assessee. The said allowances included a component towards medical expenditure & leave travel concession (LTC). If the employee submitted proof of having incurred the expenditure towards medical treatment, he was allowed exemption to the extent provided in proviso (iv) to s. 17(2) of the Act. Likewise, if the employee submitted proof regarding leave travel, he was allowed exemption u/s 10(5) read with Rule 2B. The AO held that as Proviso (iv) to s. 17(2) and s.10(5) used the expression "actually incurred", the exemption towards medical reimbursement and LTC could be conferred only for amounts paid as reimbursement after they were incurred by the employee and not before. She held that as the assessee was paying medical reimbursement & LTC as a component of salary every month, without the employee having incurred expenditure, the same had to be considered as salary disbursement for purposes of TDS u/s 192. The assessee was accordingly treated as being in default. On appeal by the assessee, the CIT(A) reversed the AO. On appeal by the department to the Tribunal, HELD dismissing the appeal:

   Though TDS has to be effected at the time of payment of salary, s. 192(3) permits the employer to increase or reduce the amount of TDS for any excess or deficiency. Even assuming that the case of the AO that at the time of payment the assessee ought to have deducted tax at source is sustainable, the assessee, on a review of the taxes deducted during the earlier months of the previous year, is entitled to give effect to the deductions permissible under proviso (iv) to s.17(2) or exemption u/s10(5) of the Act in the later months of the previous year. What has to be seen is the taxes to be deducted on income under the head 'salaries' as on the last date of the previous year. The case of the AO that LTC and Medical reimbursement should be paid at the time the expenditure is incurred or after the expenditure is incurred by way of reimbursement and not at an earlier point of time and that if it is so paid, then, even though the payment would not form part of taxable salary of an employee, the employer has to deduct tax at source treating it as part of salary, is contrary to s.192(3) and cannot be sustained. The reliance placed by the AO on the expression "actually incurred" in s.10(5) & Proviso (iv) to s.17(2) cannot be sustained. In any event, the interpretation of the word "actually paid" is not relevant while ascertaining the quantum of tax that has to be deducted at source u/s192. As far as the assessee is concerned, his obligation is only to make an "estimate" of the income under the head "salaries" and such estimate has to be a bona fide estimate. The primary liability of the payee to pay tax remains. In a situation of honest difference of opinion, it is not the deductor that is to be proceeded against but the payees of the sums. On facts, as the assessee had granted exemption towards medical expenditure and leave travel after verifying the details and evidence furnished by the employees, it could not be treated as an assessee-in-default.

Appeals dismissed.

ITA Nos.1390 & 1391/Bang/2012 (Assessment Years : 2007-08 & 2008-09).

Heard on: 21st June, 2013.

Decided on: 28th June, 2013.

Present at hearing: Etwa Munda, CIT-III(DR), for Appellant. H.Padamchand Khincha, C.A., for Respondent.

JUDGMENT

Per Bench

These are appeals by the Revenue against the common order dated 23.8.2012 of CIT(A)-II, Bangalore, relating to A.Y. 07-08 & 08-09.

2. The Assessee is a company. It is engaged in the "Business of "Process Outsourcing" (BPO). A survey u/s.133A of the Income Tax Act, 1961 (the "Act") was conducted at the business premises of the Assessee. The salary structure of the employees of the Assessee was examined by the Officers carrying out Survey in the light of the obligations of the Assessee as employer to deduct tax at source at the time of making payment of salaries to its employees.

3. Section 192(1) of the Act casts an obligation on the part of person responsible for paying income chargeable under the head "salaries" to deduct tax at source, at the time of payment. Section 192 (1) of the Act reads as under:–

> "192. Salary.-(1) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made on the estimated income of the assessee under this head for that financial year."

4. A perusal of section 192 of the Act clearly indicates that the person responsible for paying any income chargeable under the head "Salaries" shall be liable to deduct income-tax at source at the time of payment of such salary. The items of income that are chargeable to tax under the head income from "Salaries" is laid down in Sec.15 to 17 of the Act. Sec. 15 of the Act provides that income described therein shall be chargeable to tax under the head "Salaries". The income described therein consists of salary from the employer or former employer falling in three categories. Sec.16 of the Act contains deductions to be made from salaries. Section 17 of the Act contains an inclusive definition of "salary" for purposes of Section 15, Section 16 and Section 17 of the Act which, along with other items, includes "perquisite" and these terms are also separately defined therein. Sec.17 of the Act, which defines "Salary", "perquisite" and "profits in lieu of salary" in so far as it is relevant to the present appeal reads thus:

> "For the purposes of sections 15 and 16 and of this section–
>
> (1) "Salary" includes–
>
> (i) to (iii)……

(iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;

(v) to (viii)…….

(2) "perquisite" includes–

(i) to (ii)……

(iii) …..

(iv) any sum paid by the employer in respect of any obligation which but for such payment, would have been payable by the assessee; and

(v) to (vii)……

Provided that nothing in this clause shall apply to,–

(i) to (iv)…..

(v) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family other than the treatment referred to in clauses (i) and (ii); so, however, that such sum does not exceed fifteen thousand rupees in the previous year.

(vi)…."

5. The dispute in these appeals are regarding the obligation of the Assessee to deduct tax at source on "Leave Travel Concession (LTC)" and "Medical reimbursement". It is not in dispute that the amounts paid as LTC and Medical Reimbursements are in the nature of perquisite falling with the definition of perquisites as given in sec.17(2) (iv) and (v) of the Act, respectively.

6. As far as Medical reimbursement is concerned, if the amount paid by an employer to the employee for medical treatment of the employee or his family is Rs.15,000 or less per annum, then the same will not be perquisite as laid down in Sec.17(2)(v) of the Act and therefore need not be considered as part of "salary" for the purpose of deducting tax at source at the time of payment by the employer to the employee. In other words, expenditure actually incurred on medical treatment to the extent of Rs.15,000/- is exempt and the remaining is taxable.

7. As far as "Leave Travel Concession is concerned, Section 10(5) of the Act lays down that any leave travel concession granted to an employee by the employer to the following extent shall not be included in the total income.

"In the case of an individual, the value of any travel concession or assistance received by, or due to, him,–

(a) from his employer for himself and his family, in connection with his proceeding on leave to any place in India;

(b) from his employer or former employer for himself and his family, in connection with his proceeding to any place in India after retirement from service or after the termination of his service,

subject to such conditions as may be prescribed (including conditions as to number of journeys and the amount which shall be exempt per head) having regard to the travel concession or assistance granted to the employees of the Central Government;

Provided that the amount exempt under this clause shall in no case exceed the amount of expenses actually incurred for the purpose of such travel.

Explanation : For the purposes of this clause, "family", in relation to an individual, means–

(i) the spouse and children of the individual; and

(ii) the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual;"

8. Rule 2B of the Income Tax Rules, 1962 (the 'Rules') lays down the conditions to be satisfied for the for the purpose of availing exemption under section 10(5) of the Act. It reads thus:

"(1) The amount exempted under clause (5) of section 10 in respect of the value of travel concession or assistance received by or due to the individual from his employer or former employer for himself and his family, in connection with his proceeding,–

(a) on leave to any place in India;

(b) to any place in India after retirement from service or after the termination of his service,

shall be the amount actually incurred on the performance of such travel subject to the following conditions, namely:–

(i) where the journey is performed on or after the 1st day of October, 1997, by air, an amount not exceeding the air economy fare of the National Carrier by the shortest route to the place of destination:

(ii) where places of origin of journey and destination are connected by rail and the journey is performed on or after the 1st day of October, 1997, by any mode of transport other than by air, an amount not exceeding the airconditioned first class rail fare by the shortest route to the place of destination; and

(iii) where the places of origin of journey and destination or part thereof are not connected by rail and the journey is performed on or after the 1st day of October, 1997, between such places, the amount eligible for exemption shall be–

(A) where a recognised public transport system exists, an amount not exceeding the 1st class or deluxe class fare, as the case may be, on such transport by the shortest route to the place of destination; and

(B) where no recognised public transport system exists, an amount equivalent to the air-conditioned first class rail fare, for the distance of the journey by the shortest route, as if the journey had been performed by rail.

(2) The exemption referred to in sub-rule (1) shall be available to an individual in respect of two journeys performed in a block of four calendar years commencing from the calendar year 1986:

Provided that nothing contained in this sub-rule shall apply to the benefit already availed of by the assessee in respect of any number of journeys performed before the 1st day of April, 1989 except to the extent that the journey or journeys so performed shall be taken into account for computing the limit of two journeys specified in this sub-rule.

(3) Where such travel concession or assistance is not availed of by the individual during any block of four calendar years, an amount in respect of the value of the travel concession or assistance, if any, first availed of by the individual during first calendar year of the immediately succeeding block of four calendar years shall be eligible for exemption.

(4) The exemption referred to in sub-rule (1) shall not be available to more than two surviving children of an individual after 1st October, 1998 :

Provided that this sub-rule shall not apply in respect of children born before 1st October, 1998, and also in case of multiple births after one child.

Explanation : The amount in respect of the value of the travel concession or assistance referred to in this sub-rule shall not be taken into account in determining the eligibility of the amount in respect of the value of the travel concession or assistance in relation to the number of journeys under sub-rule (2)."

9. To the extent LTC is exempt as laid down in sec.10(15) of the Act, the same need not be included as income under the head "Salary" for the purpose of deducting tax at source.

10. The Assessee in the present case recruits employees under a contract of employment. The contract of employment details the consideration for employment. The total 'cost to company' or (CTC) as a result of the employment is agreed upon. CTC is the expenditure borne by the assessee in respect of each employee. Having determined the CTC, the employee is permitted to choose what would be the various components of his salary. For this purpose, a basket of allowances is made available for the employee to choose from. The maximum allowance for each such allowance is fixed by the Company.

11. The payments to employees of the assessee include a component towards medical expenditure. Towards this, employees are paid a sum every month. This sum, when paid is considered as part of taxable salary. If the employee submits proof of having incurred the expenditure towards medical treatment, the sum spent towards medical treatment or Rs. 15,000/-, whichever is less, is excluded from salary. The exclusion is on the basis of the proviso (iv) to section 17(2) of the Act. If the amount spent towards medical treatment is in excess of Rs. 15,000/- the excess (beyond Rs. 15,000) is considered not considered as a deduction. Effectively, the excess amount spent continues to remain taxable. If no proof of having incurred the expenditure towards the medical treatment is produced by the employee, the entire sum paid is considered as a perquisite. Tax under section 192 of the Act is deducted accordingly.

12. As far as LTC is concerned, the payment of salary by the Assessee to its employees every month includes a component towards leave travel. If the employee submits proof regarding utilization of the component towards leave travel and subject to the conditions laid down in Sec.10(5) of the Act read with Rule 2B of the Rules, the Assessee does not consider the leave travel to the extent exempt as salary for the purpose of deduction of tax at source.

13. **Annexure-I** to this order is a statement giving month wise details of amount paid towards medical expenditure and leave travel, amount for which bills were submitted by the employees and the amount considered as "salary" for the purpose of deduction of tax at source.

14. The AO has in a very elaborate order running about 68 pages discussed various aspects and case laws relating to the relevant statutory provisions and ultimately concluded that the Assessee was an "Assessee in default" in respect of that portion of LTC and Medical Reimbursement paid to its employees which were considered as exempt and hence not treated as part of income under the head "Salaries" for the purpose of deducting tax at source. We have culled out the reasons for the AO to come to the above conclusion, which can be summarised as follows:

1. As far as LTC is concerned, Sec.10(5) of the Act refers to "Concession or Assistance" for leave travel. According to the AO, the Assessee was including in payments made every month a

component towards leave travel. In other words, the payment was made irrespective of the status of the utilisation for the purpose of leave travel, which is not in the nature of a reimbursement. The point of time at which the payment to qualify to be called LTC should be at the time of incurring of the expenditure by the employee or after such expenditure is incurred, by way of reimbursement. Since the Assessee was paying LTC as a component of salary every month, without the employee having incurred expenditure, the same had to be considered as salary disbursement which is sought to be set off against expenditure incurred for leave travel and exemption claimed u/s.10(5) of the Act.

2. As far as medical reimbursement is concerned, the AO was of the similar view that what is contemplated by proviso (iv) to Sec.17(2) of the Act was any sum paid by the employer in respect of any expenditure "actually incurred" by the employee on his medical treatment or treatment of any member of his family. Since the Assessee was paying medical reimbursement as a component of the monthly payment to the employee and later claiming that it was not perquisite to the extent of Rs.15,000, the same had to be considered as salary and not exempt perquisite. The reasoning is the same that the payment should not precede the actually incurring of the expenses and it should be only by way of reimbursement.

15. The AO accordingly considered the Assessee as an "Assessee in default" u/s.201(1) of the Act, in respect of the portion of exemption claimed in the statement annexed to the order towards LTC and Medical reimbursement for the both the AY 07-08 & 08-09. The AO also levied interest u/s.201(1A) of the Act, on tax not deducted, from the date on which tax ought to have been deducted till the date on which the tax not deducted is paid over to the credit of the Government.

16. On appeal by the Assessee, the CIT(A) cancelled the order of the AO treating the Assessee as an "Assessee in default" u/s.201(1) of the Act and also levying interest u/s.201(1A) of the Act, holding that amount paid even as reimbursement ought to be considered as perquisite. In coming to the above conclusion, the CIT(A) relied on the Circular of the CBDT, viz., Circular No.603 dated 6.6.1991, wherein the CBDT has opined that the value of the perquisite arising by way of payment or reimbursement by an employer of expenditure on medical treated will not be included in the taxable salary of the employee. The following were the relevant observations of the CIT(A):–

> "3.6 The fact remains that, whenever an amount is paid, where either the employer has not availed of actual travel or has availed of the allowance over and above the allowable exemption in the financial year and, therefore, is disentitled to the benefit

of exemption, tax has been deducted at source. No instance has been brought on record by the AO that the employer has disbursed the amount without deduction of tax within the financial year in cases where the benefit is not backed by bills or in excess of amount allowable under the I.T. Act. The only case of the AO is that the intention of employer is to disburse the said sum irrespective of whether an exemption will be allowed to an employee or not and, therefore, it is simply an allowance and not a 'concession' or 'assistance' as envisaged in the I.T. Act.

3.7 In my view, the basic requirements of the I.T. Act read with the relevant rules are met i.e.

i) No disbursement not backed by bills/proof is treated is not taxable.

ii) No disbursement in excess of I.T. Rules has been treated as exempt during the financial year.

iii) Any excess/shortfall in TDS deducted month to month has been made good by the employer at the end of the financial year as per section 192(3).

3.8 The interpretation of the AO is too narrow and technical and in terms of a welfare measure allowed to employees across the salaried strata cannot be the correct interpretation. The appellant, an employer of tens of thousands of employees, has stated that it is taking into account 'salary' in terms of 'cost to company' as is the norm in the private sector and this merely does not mean that it is an allowance and not a reimbursement. The said benefit would clearly fit into the meaning of 'assistance' in sum and substance. As can be seen from the submissions made by the appellant, care has been taken by the employer to see that there is no irregularity in making payments under the LTA Scheme. In my opinion, the AO was not justified in treating the appellant as an 'assessee-in-default'. Hence, the demand raised and interest charged u/s 201(1) and 201(1A) are uncalled for and they are, therefore, cancelled."

4. MEDICAL REIMBURSEMENT

…….

4.3 I have carefully considered the appellant's submissions and perused the AO's order. The employees are paid up to Rs.15,000/- per annum split into monthly disbursements. This amount is treated as exempt under the provisions of I.T.Act only if supported by bills. Wherever bills are not provided the amount is treated as a taxable salary and tax is deducted during the financial year end.

4.4 On the facts of the case, I find that:

a) No instance has been brought on record to suggest that, in the case of any employee, the benefit or allowance has been allowed without TDS during the financial year if it is not backed by actual expenditure.

b) In such a case, the benefit provided clearly fits into the ambit of the exemption provided in the proviso to section 17(2) which says:

"(v) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family other than the treatment referred to in clauses (1) and (ii); so, however, that such sum does not exceed *fifteen thousand rupees, in the previous year;"

[increased from 'ten thousand rupees' with effect from 1/4/1999]

c) The Board's Circular No.603 dated 6/6/1991 reads as follows:

d) Moreover, in the present case, the amount of Rs.15,000/- per employee per annum is too small for any other interpretation.

4.5 It is clear, therefore, that in effect there is no infringement of the tax provisions allowable to the employees by the employer appellant. Merely because the same is taken into account at the beginning of the year or at the time of deciding his/her salary, which itself is in terms of cost to company, it cannot be said that it ceases to be a perquisite and, therefore, not entitled to exemption u/s 17(2). Perquisite in any case also forms part of taxable salary. The employer has clarified that, wherever the said disbursement is not backed by bills, it is liable to TDS and this liability is not denied or infringed.

4.6 Therefore, in my view, the view of the AO is a very narrow and technical interpretation and in respect of a welfare measure to the employees across the salaried strata it cannot be the correct interpretation."

17. Aggrieved by the order of the CIT(A), the revenue is in appeal before the Tribunal. The following are the grounds of appeal raised by the revenue (which is common for both the A.Y.):–

"1) The CIT(A) has erred in not according the AO an opportunity of being heard as envisaged u/s 250(1) and 250(2) of the I.T.Act.

2) The CIT(A) has erred in holding that no instance has been brought on record that an employee was conferred the benefit without TDS if it is not backed by actual expenditure.

3) The CIT(A) has erred in not appreciating the fact that the nature of income is to be determined at its source.

4) The CIT(A) has erred in not appreciating the fact that the application of funds cannot determine the nature of income.

5) The CIT(A) has erred in not appreciating the fact that an exemption granted or the application of funds cannot determine a type of income which is to be determined at source.

6) The CIT(A) has erred in holding that the perquisite also being a taxable income could constitute a part of cost to the company.

7) The CIT(A) has erred in holding that the order was based on narrow and technical interpretation in respect of a welfare measure.

8) The CIT(A) has erred in holding that a component of the salary paid on month to month basis could form part of salary which would be exempt under proviso to section 17(2).

9) The CIT(A) has erred in being guided by the quantum of exemption granted per employee rather than the entitlement as per law.

10) The CIT(A) has erred in holding that a component of the salary paid on month to month basis could form part of salary which would be exempt under section 10(5).

11) The CIT(A) has erred in accepting the contention that a subsequent event of travel could determine an exemption.

12) The CIT(A) has erred in holding that an amount paid irrespective of whether employee had availed travel or not would not have any bearing on the exemption accorded by the employer.

13) The CIT(A) has erred in not appreciating the fact that the employer has itself not considered these amounts as perquisite in the Form 12BA issued to the employees.

14) The CIT(A) has erred in not taking cognizance of the fact that an employer cannot consider a disbursement as a perquisite only for the purpose of exemption, and not for the purposes of Form 12BA.

15) The CIT(A) has erred in not considering the fact that every contention of the deductor has been addressed elaborately while the AO's contentions and findings have not been reasoned against.

16) The CIT(A) has erred in passing an order which allows employees who enjoy unintended benefits as per the existing provisions of law.

17) The CIT(A) has erred in not considering the distinctions drawn in respect of the judicial decisions relied upon by the deductor.

18) The CIT(A) has erred in not considering the fact that the AO has studied the Board's Circulars and their applicability as evident from the order passed.

19) The CIT(A) has erred in not considering the fact that such exempted income was not admitted by the employee on the basis of the Form 16 and 12BA issued.

20) The CIT(A) has erred in not considering the fact that the provisions of Sec.191 also are not been followed due to such issue of erroneous certificates in Form 16 and 12BA.

21) The CIT(A) has erred in not considering the term "actually incurred" in the proviso to Sec.17(2) of the I.T. Act.

22) For these and other grounds that may be urged during the course of appeal, the order of the AO may be restored."

18. The learned DR reiterated the stand of the revenue as reflected in the grounds of appeal and relied on the order of the AO.

19. The learned counsel for the Assessee reiterated the stand of the Assessee as put forth before AO and CIT(A) and relied on the order of the CIT(A).

20. We have considered the rival submissions. We shall first see the sequence of events that lead to the passing of the order u/s.201(1) and 201(1A) of the Act. There was a Survey u/s.133A of the Act at the business premises of the Assessee on 5.10.2010. Based on the findings in the course of survey show cause notice dated 3.2.2011 was issued by the AO. The contents of this show cause notice throws light on the exact grievance of the AO and therefore the same is being reproduced.

"To

The Principal Officer,
M/s Infosys BPO Ltd.,
Electronics City, Hosur Road,
Bangalore-560 100

Sir,

Sub: Show cause notice u/s 201(1) in your case F.Y 2006-07 to 2010-11 – reg.

****

A survey u/s 133A of the Income-tax Act was conducted at the premises of M/s Infosys Technologies, Hosur Road, Bangalore on 05.10.2010 to verify the compliance of TDS provisions. Based on the findings, the salary structure of the employees of M/s Infosys BPO was also examined. Based on the same issues, certain information was called for from your company relating to the receipt of pay and other allowances by your employees. It was noticed that the employees were in receipt of pay and other allowances. It was explained that 40% of the pay constituted allowances, the break-up of which was as per the option exercised by the employee. It was explained that the basket of allowances could be changed at any point of time by the employee. Evidently a fixed amount was entered by the employee against each of the allowances irrespective of the fact as to whether such expenditure was incurred by him or not. Such allowances admittedly, would constitute part of taxable salary and the employee ought to have been subjected to provision of section 192 on this entire amount. However, it has been explained that any bills produced subsequently has been accepted to be a reimbursement and has been excluded from the purview of section 192. Verification of the returns of income filed by the employee as well as the TDS certificate issued by you do not quantify this to be taxable income resulting in taxes not being deducted at source nor being offered for taxation by the employee.

As per the provisions of Income-tax Act, any allowance forms part of salary u/s 17 and such a component of salary is liable for taxation. The provision of section 10(5) provides for the benefit of the value of any travel concession or assistance in connection with his proceeding on leave. The allowance provided by a company is a fixed monetary benefit which an employee is entitled to irrespective of the fact as to whether any leave is sanctioned or not. Such an allowance forms part of salary and is not a benefit or reimbursement provided in addition to salary. Therefore exemption u/s 10(5) provided to LTA cannot be justified and the entire allowance is to be brought to tax.

Year	Allowance	Exemption
F.Y 2006-07	2381842.77	2381842.77
F.Y. 2007-08	4294568.00	4294,568.00
F.Y. 2008-09	691129.00	691129.00
F.Y 2009-10	4897131.00	4897131.00
F.Y 2010-11	691129.00	691129.00
TOTAL		1,29,55,799.77*

* Amount on which tax is to be deducted.

Further the company is extending the benefit of Medical allowance, which forms 25% of basket of allowance and allowed exemption u/s 17(2) of IT Act on medical bills submitted by your employees upto a maximum of Rs.15000/- as perquisite exempt u/s 17(2). The employees are in receipt of medical allowance u/s

> 17(1) of IT Act and out of which they have considered the medical bills presented by employees as exemption u/s 17(2). Since any amount received u/s 17(1) do not constitute for exemption u/s 17(2), the claim of the employees had to be disallowed. This would not come under the purview of medical reimbursement as per the terms and conditions laid down in the Act. It is proposed to bring these amounts also to tax."

21. A perusal of the show cause notice clearly shows that the fact that bills/evidence to substantiate incurring of expenditure on medical treatment up to Rs.15,000/- and the availing of the LTC by the employees and the fulfilment of the conditions contemplated by Sec.10(5) of the Act for availing exemption by the employees so availing LTC, have not been disputed by the AO. The grievance of the AO appears to be that 40% of the pay to the employees constitutes allowance and that the allowance so given every month is not earmarked for any particular purpose but the employee was free to use the allowance in any manner and later claim that the allowance was used for LTC or medical reimbursement. Therefore, according to the AO, at the time of payment the allowances would constitute part of salary and therefore even the allowances should be considered as part of salary for the purpose of deduction of tax at source. In other words, according to the AO, LTC and Medical reimbursement should be paid at the time the expenditure is incurred or after the expenditure is incurred by way of reimbursement and not at an earlier point of time. If it is so paid, then, according to the AO, even though the payment would not form part of taxable salary of an employee, the employer has to deduct tax at source treating it as part of salary. In support of the stand taken by the AO, she relies on the expression "actually incurred" in proviso (iv) to Sec.17(2) which allows exemption of medical reimbursement up to Rs.15000/- to an Assessee. As far as LTC is concerned, the AO relies on the expression "value of travel concession or assistance received by an employee in connection with his proceeding,–

> (a) on leave to any place in India;
>
> (b) to any place in India after retirement from service or after the termination of his service,

shall be the amount "**actually incurred**" on the performance of such travel", found in Sec.10(5) of the Act.

22. The Assessee in this regard, among other things, relied on CBDT Circular No.603 dated 6.6.1991 extracted in the order of the CIT(A). The AO has however held that the said circular does not help the case of the Assessee for the following reason:–

> "6.2.2.2 The circular evidently makes it clear that payment or reimbursement of expenses actually incurred for medical treatment is alone exempted from the purview of taxation. The

circular at no point even remotely suggest that an allowance could be granted which if adequately evidence with medical bills could be reduced from the taxable salary of an employee. In fact the Board Circular concisely puts across the provisions of the statute which have been articulated at length in this order to drive home the fact that no application of fund could determine the taxability or exemption of any income let alone salary. Therefore, the Circular is in fact in support of the view taken and doesn't lend any credence to the arguments of the deductor.

6.2.2.3 In the instant case, the leave travel allowance is disbursed to an employee irrespective of the fact as to whether:

a) the employee has any intention to proceed on leave or not

b) the employee has any intention to travel or not

c) the employee has already availed the benefit in the previous calendar year or financial year

Therefore, undisputedly and admittedly the disbursement of leave travel allowance is a lump sum monetary benefit provided to the employee without any nexus to any of the statutory or prescribed conditions. The only precondition is that the employee ought to have opted for this allowance at the beginning of the Financial Year. The subsequent occurrence of an event of travel which may or may not occur and even if it occurs, may or may not fulfil the conditions such as once in two calendar years etc., would in no way alter the nature of payment that has been effected. Therefore, an allowance such as the one granted in the instant case would not be a concession or assistance. Therefore, the reliance placed on the Circular is misplaced and is in fact against the case of the deductor."

23. The AO has also taken a stand that there is a difference between "Allowance" and "LTC and Medical Reimbursement". An allowance according to the AO can be given in advance whereas LTC and medical reimbursement are not in the nature of allowance and therefore cannot be given like an allowance before they are incurred. The AO's further case is that at the time of disbursement by the employer the same assumes the character of salary and its later application for purposes which are exempt will only be application of income and therefore accrual of income in the form of salary takes place on which tax had to be deducted at source.

24. To appreciate the stand taken by the AO, we have to look at the relevant provisions of Sec.192 of the Act in so far as the same is relevant for the present case.

"192. Salary.-(1) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made on the estimated income of the assessee under this head for that financial year

(2)……

(3) The person responsible for making the payment referred to in sub-section (1) or sub-section (1A) or sub-section (2) or subsection (2A) or sub-section (2B)] may, at the time of making any deduction, increase or reduce the amount to be deducted under this section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year."

25. Section 192(1) of the Act, requires tax to be deducted at average rate of income-tax in force on estimated income under the head salaries. The person making payment has to make an honest of income under the head salary payable by him to his employee at the time of payment. The person making the payment has to take into consideration various deductions permitted under the Act under Chapter VIA of the Act, as also exempt income under Sec.10 of the Act. Rebate available under sections 88 and 88B can be considered by the employer. Employer should obtain the proof of investment made by the employee and should not rely on simple declaration or oral assurance. Certain employees who are entitled to relief under section 89(1) can furnish the information in prescribed form to the employer, and in such cases employer can adjust the amount of TDS by allowing relief available under section 89. It is for the employer to prove the allowances and perquisites given to the employee are tax-free and not to be included in the salary.

26. It is no doubt true that TDS is to be made at the time of payment of salary and not on the basis of salary accrued. Sec.192(3) of the Act permits the employer to increase or reduce the amount of TDS for any excess or deficiency. We have already noticed that the fact that bills/evidence to substantiate incurring of expenditure on medical treatment up to Rs.15,000/- and the availing of the LTC by the employees and the fulfillment of the conditions contemplated by Sec.10(5) of the Act for availing exemption by the employees so availing LTC, have not been disputed by the AO. Even assuming the case of the AO, that at the time of payment the Assessee ought to have deducted tax at source, is sustainable; the Assessee on a review of the taxes deducted during the earlier months of the previous year is entitled to give effect to the deductions permissible under proviso (iv) to Sec.17(2) or exemption u/s.10(5) of the Act in the later months of the previous year. What has to be seen is the taxes to be deducted on income under the head 'salaries' as on the last date of the previous year. The case of the AO is that LTC and Medical reimbursement should be paid at the time the expenditure is

incurred or after the expenditure is incurred by way of reimbursement and not at an earlier point of time. If it is so paid, then, even though the payment would not form part of taxable salary of an employee, the employer has to deduct tax at source treating it as part of salary, is contrary to the provisions of Sec.192(3) of the Act and cannot be sustained. The reliance placed by the AO on the expression "actually incurred" found in Sec.10(5) of the Act and proviso (iv) to Sec.17(2) of the Act, in our view cannot be sustained. In any event, the interpretation of the word "actually paid" is not relevant while ascertaining the quantum of tax that has to be deducted at source u/s.192 of the Act. As far as the Assessee is concerned, his obligation is only to make an "estimate" of the income under the head "salaries" and such estimate has to be a bonafide estimate.

27. The primary liability of the payee to pay tax remains. Section 191 confirms this. In a situation of honest difference of opinion, it is not the deductor that is to be proceeded against but the payees of the sums. To reiterate, the payment towards medical expenditure and leave travel is made keeping in view the employee welfare. The exclusion in respect of payment towards medical expenditure and leave travel is considered after verifying the details and evidence furnished by the employees. No exemption is granted in the absence of details and/or evidence. The exemption in respect of medical expenditure is restricted to expenditure actually incurred by the employees, or Rs. 15,000/- whichever is lower. The exemption is granted even if the payment precedes the incurrence of expenditure. The requirements/conditions of section 10(5) and proviso to section 17(2) are meticulously followed before extending the deduction/exemption to an employee. No tax can be recovered from the employer on account of short deduction of tax at source under section 192 if a bona fide estimate of salary taxable in the hands of the employee is made by the employer, is the ratio of the following decisions.

CIT vs. Nicholas Piramal India Ltd (2008) 299 ITR 0356 (BOMBAY);

CIT v. Semiconductor Complex Ltd [2007] 292 ITR 636 (P&H)

CIT vs. HCL Info System Ltd. [2006] 282 ITR 263 (Del)

CIT v Oil and Natural Gas Corporation Ltd [2002] 254 ITR 121 (Guj)

ITO v Gujarat Narmada Valley Fertilizers Co. Ltd [2001] 247 ITR 305 (Guj)

CIT v Nestle India Ltd (2000) 243 ITR 0435 (DEL)

Gwalior Rayon Silk Co. Ltd. v. CIT [1983] 140 ITR 832 (MP)

ITO v G. D. Goenka Public School (No. 2) [2008] 306 ITR (AT) 78 (Del)

Usha Martin Industries Ltd. v. ACIT (2004) 086 TTJ 0574 (KOL)

Nestle India Ltd. v. ACIT (1997) 61 ITD 444 (Del)

Indian Airlines Ltd. v ACIT (1996) 59 ITD 353 (Mum)

28. In the present case, as already detailed, the exemption in respect of medical expenditure and leave travel is considered after collecting and verifying the details and evidence furnished by the employees. Policies and controls are in force to ensure that the requirements of rule 2B are fulfilled. The details filed before the TDS officer explains the policies adopted to fulfill the requirements of rule 2B and the process adopted in considering the exemption under section 10(5) and proviso to section 17(2). The assessee is a law abiding Company. Internal controls are in place to discharge the statutory obligation under section 192. Honest and bona fide estimate of taxable salary is made in the process of deducting tax at source under section 192. Every effort is made by the assessee to comply with the requirements of section 192. The assessee is not benefited by allowing employees to claim exemption. The order passed by the AO under section 201(1) & 201(1A) is therefore bad in law and rightly quashed by the CIT(A).

29. In the light of the admitted position that the conditions for grant of exemption u/s.10(5) of the Act to the employees in respect of LTC and also the fact that up to Rs.15,000 per employee medical reimbursement paid by the Assessee satisfies conditions contemplated by the proviso (iv) to Sec.17(2) of the Act, can the AO deny to the employee in their assessment, exemption u/s.10(5) or relief under the proviso to (iv) to Sec.17(2) of the Act? The answer admittedly is 'no', because the AO does not dispute non-fulfilment of conditions for allowing exemption u/s.10(5) of the Act or proviso (iv) to Sec.17(2) of the Act. The liability of the person deducting tax at source cannot be greater than the liability of the person on whose behalf tax at source is deducted. The AO has ignored this aspect and has proceeded to pass the order u/s.201(1) and 201(1A) of the Act. His order was rightly held to be unsustainable by the CIT(A).

30. In the grounds of appeal raised by the revenue, we find that among other grounds there are grievances regarding lack of opportunity to the AO before CIT(A) and grounds challenging the finding that there is no dispute that the Assessee has satisfied itself that the employees were entitled to exemption u/s.10(5) as well as relief under proviso (iv) to Sec.17(2) of the Act. As far as lack of opportunity is concerned, we find that the CIT(A) has only called for break-up of the figures regarding medical reimbursement and LTC which was actually paid to employees and that which was considered not forming part of salary by the employee on production of evidence by the employee. In fact, the figures so given are the same figures on the basis of which the AO has passed order u/s.201(1) and 201(1A) of the Act. As far as the grievance regarding

finding that there was no dispute that the Assessee has satisfied itself that the employees were entitled to exemption u/s.10(5) as well as relief under proviso (iv) to Sec.17(2) of the Act, we have already reproduced the show cause notice issued by the AO u/s.201(1) & 201(1A) of the Act, in which the AO has not disputed these facts. In our view the relevant grounds have no basis and cannot be factually sustained.

31. Arguments were advanced that employees have filed their returns of income and offered to tax income under the head salaries received from the Assessee and therefore no order u/s.201(1) & 201(1A) of the Act can be passed against the Assessee. In this regard our attention was drawn to the following decisions:

> *Hindustan Coco Cola Beverage Pvt.Ltd. vs. CIT* 293 ITR 226 (SC)
>
> *CIT vs. Eli Lilly & Co.* 312 ITR 225 (SC)
>
> Decision of Hon'ble Karnataka High Court in the case of *CIT vs. Tata Elxsi* ITA No.82 of 2003 dated 23.1.2008.

We have not examined the above argument for the reason that the assertion of the assessee in this regard has not been examined either by the AO or CIT(A).

32. For the reasons given above, we do not find any grounds to interfere with the order of the CIT(A). Consequently, these appeals by the Revenue are dismissed.

33. In the result, the appeals are dismissed.

Pronounced in the open court on this 28th day of June, 2013.