Devising a tax friendly salary package for FY2012-13-from S3 Solutions.. – Mar 30, 2012

DEVISING A TAX FRIENDLY EXECUTIVE REMUNERATION PACKAGE FOR COMPANY EMPLOYEES FOR FY2012-13

Introduction

The Central Government would seem to have completely disappointed the individual tax payers by providing for negligible increase in the exemption limits for FY2012-13, in the Budget presented on April 16, 2012. There has led to the widespread belief that, it is no longer possible for any great 'planning' to be made on executive remuneration and that, virtually, all payments to employees would come under the tax net. Is this true? Not, quite so. It is still possible for companies to structure the pay packages of their senior employees in such a manner that, while the employees pay lesser tax, the Companies themselves, do not contravene any statutory provisions. In fact, over the last few months, certain tax planning strategies have evolved and this piece is an attempt to discuss some of these… Many people confuse the CTC concept with the gross salary. We would submit that the cost to company method is a concept, which can include, any and every cost that a Company incurs on or on behalf of an employee.

However, the gross salary is all that an employee is legally entitled to, as part of the contract of employment and the gross salary is what is relevant for purposes of levy of tax under the Income tax Act. Car Lease as part of CTC – great tax saving toolProviding the highly paid employee with a car lease option, as part of his CTC, is a very efficient tax planning method. Let's see how this works…. Most lease agreements provide for the leased car to be sold to the employee by the leasing company, at the end of a fixed period. In a typical arrangement, the Company pays the monthly instalments to the car leasing company and treats these monthly instalments, as part of the employee's CTC. Additionally, the Company could also reimburse running expenses, the cost of the driver, reimbursement of repairs, etc., which are also treated as part of the CTC. In typical arrangements, the employee is allowed to use the car for official and personal purposes. However, for purposes of valuation of this perquisite, the Rules specify, interalia, that the value would be Rs 1,800/- per month if the cubic capacity of car is up to 1,600cc and for cars with higher cubit capacity, the perquisite value is Rs 2,400/- per month. Further, a value of Rs 900/- per month is also added if a chauffeur is provided. Moreover, the petrol/diesel costs can also be reimbursed to the employee concerned.

While the lease rentals could be significantly higher, the employee would still pay tax on minimal amounts and this is one of the most efficient tax planning methods for senior employees. Undoubtedly, this is a great tax saving device for the employees for FY2012-13. Company lease vs personal accomodation Senior employees can be given the benefit of getting House Rent Allowance or a company provided leased accommodation. In many cases, providing a lease accommodation (wherein, the rentals paid by the Company as part of the CTC of the employee concerned) could save a lot of tax for the employee, as the perquisite value is 15% of the taxable salary or the actual rent paid, whichever is lower. Fixing the HRA component Most Companies follow the practice of fixing a pre-determined portion of the gross salary as HRA. There is no need that all employees should have the same HRA component, calculated in terms of the percentage of the gross salary.

The tax exemption on HRA is computed as the minimum of following three conditions: i) Actual HRA received by the employee•

40%/50% of the employee's basic salary, depending on where the employee stays•

The rent paid in excess of 10% of the salary.•

A fair amount of tax planning is possible for senior employees, by fixing the right percentage of the HRA component. Lifestyle benefits Corporate club membership fee paid by the Company, in respect of the employees, is a tax free perquisite. Of course, this facility is usage also by the employee's relatives. If the club membership has been taken only for business purposes, the details of expenditures such as the date of expenditure, the nature of expenditure and the amount of expenditure are to be maintained. Consequently, the company would provide a certificate stating the same to the employee. The value of food coupons issued by the employer, redeemable only at eating joints, are exempt from tax as long as the value of the food coupons does not exceed Rs 100 per meal. There is no bar on an employee having more than a meal per day, depending on his official duties.

Reimbursement of telephone expenses incurred by the employees

In terms of Notification No. 94/2009 (F.No. 142/25/2009 SO (TPL) dated 18-12-2009), no upper limit has been fixed on the reimbursement of expenses actually incurred on telephones by the employees, including mobile phones, on behalf of the employer. Thus, it would be perfectly legal to take the view that the reimbursement of expenses incurred on telephone expenses including those installed in the house and mobile phones, without any upper limit, would not be treated as perquisites in the hands of the employees. Further, there is no need that the telephone connections should be in the names of the employees, as the aforesaid Notification makes no mention of this requirement.

Reimbursement of expenses for coming to or for going, from office A plain reading of the statutory provisions makes it clear that, when an employer reimburses the actual costs incurred by an employee for undertaking journeys from his residence to his office or other place of work or from such office or place to his residence, cannot be treated as a perquisite in the hands of the employee. This position of the law has been upheld by the Hon'ble Gujarat High Court in CIT (TDS) v.

Reliance Industries Ltd (2008) 175 Taxman 367 (Guj.), wherein it has been held that, even in cases where the vehicle is owned by the employee, if the expenditure on the use of such vehicle for the aforesaid purpose is met by the employer either directly or by way of reimbursement to the employees, there will be no taxable perquisite. In our view therefore, reimbursement of the expenditure incurred on vehicles used by the employees for commuting to the office from their residences and for returning to their residences from the office cannot be treated as a perquisite in the hands of the employees, notwithstanding Notification S.O. No. 395(E), dated 13-5-1998. Including the appropriate elements in the CTC It is critical that certain elements are invariably added as part of the gross salary, in order that the tax benefits can be claimed. Some of these are :

Leave Travel Assistance, which is exempt, subject to certain conditions•

Medical Reimbursement•

Gifts given once a year, in kind•

Allowance towards education and hostel stay of children•

Employer's contribution towards PF•

Liberal Group Mediclaim benefits for self and dependants•

It would be good for senior employees to have a 'variable pay' component to optimize the overall tax liability. We've only discussed some of the main tax planning methods, in the above paragraphs. It is quite possible for Companies help their employees save a lot of tax, by following the legally allowed methods, discussed above. Companies can remember that, all of this tax planning is legally permissible, with each of these amounts being treated as part of the CTC of the employees.