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Verification of actual expenditure not required if per diem allowance is reasonable and not disproportionately high - says Karnataka High Court

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# Facts

- Symphony Marketing Solutions India Pvt. Ltd. (assessee) paid per diem allowance to its employees travelling for business purposes to USA and Europe at USD 50 and USD 75 respectively to cover meal, travel, laundry and other miscellaneous expenses.
- The assessee considered the allowance paid as exempt in the hands of the employees and accordingly, did not deduct tax at source<sup>1</sup> on the same.
- The Assessing Officer (AO) denied the exemption and held that per diem allowance was liable to tax withholding. In addition interest was leviable on the assessee for non-withholding of tax.
- Aggrieved by the AO's order, the assessee preferred an appeal before the Commissioner of Income-tax (Appeals) (CIT(A)). The CIT(A)<sup>2</sup> held that per diem allowance qualifies for exemption and the assessee was not in default for non-deduction of taxes. CIT (A)'s order was based on the following:
  - As per the Tribunal Rulings in the cases of Saptarshi Ghosh<sup>3</sup> and Madanlal Mohanlal Narang<sup>4</sup>, it was not open to the tax authorities to call for details of expenditure incurred unless the per diem allowance paid was disproportionately high compared to the salary of the employee or with respect to the duties performed by the employee. The Tribunal Rulings relied on the circular<sup>5</sup> issued by the Central Board of Taxes (CBDT) which clarifies that where the specific allowances are reasonable and not disproportionately high compared to the salary of the employees, no attempt will ordinarily be made to call for details of expenses actually incurred with a view to disallow a portion of the exemption.
  - Placing reliance on the circular issued by the Ministry of External Affairs (MEA)<sup>6</sup> which lays down the limits on daily allowances to be paid to Government employees during their business travel to various countries, CIT (A) came to the conclusion that the per diem allowance paid by the assessee to its employees on official trips to USA and Europe was reasonable compared to the limits laid down for business trips of Government officials.

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<sup>1</sup> Section 192

<sup>2</sup> First appellate authority

<sup>3</sup> 48 SOT 522

<sup>4</sup> 104 ITD 190

<sup>5</sup> No. 33 (LXXVI-5) dt.01 August 1955

<sup>6</sup> No. Q/FD/695/1/90 dt.11 November 1996 and No. Q/FD/695/3/2000 dt.21 September 2010

- The exemption is provided to meet the ordinary daily charges incurred by an employee on account of absence from normal place of duty. There is no monetary limit prescribed and unless such allowance is fictitious or abnormally high, there is no liability on the employer to deduct taxes.
- It is not practical to collate the supporting/bills for every minuscule expense and mere non-collation of supporting/bills cannot prevail over the fact of incurring such expenses.

References were also made to rulings on exemption provided under the Act for Leave Travel Concession wherein it was held that an employer was not bound to collect and verify proof of journey and actual expenditure prior to granting exemption to the employee.

Accordingly, no interest was leviable on the assessee for non-deduction of tax.

- The Tribunal confirmed the order of the Commissioner (Appeals) that in light of the circulars issued by the MEA, the per diem allowance paid to the employees on their official trips was reasonable and would be exempt under the Act<sup>7</sup>. The Tribunal further held that based on the earlier Tribunal Ruling, there was no requirement for the assessee to collect and verify proof of journey and actual expenditure incurred in respect of per diem allowance.
- Aggrieved by this Ruling, the Revenue authorities approached the High Court of Karnataka. The Ruling covers three Assessment Years (AY) – AY 2009-2010, 2010-2011 and 2011-2012.

## Issues before the High Court

- Whether the Tribunal was correct in placing reliance on the circulars issued by CBDT and the MEA when these circulars were not applicable in toto to the present case and do not fall into the category of the allowances covered under these circulars?
- Whether the Tribunal was right in relying on the decision of the Kolkata Tribunal in the case of Saptarshi Ghosh<sup>8</sup>?
- Whether the per-diem allowance paid to the employees as part of the salary was liable to tax withholding by the employer?

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<sup>7</sup> Section 10(14)

<sup>8</sup> 48 SOT 522

# Ruling of the High Court

The per-diem allowance is not taxable and the assessee is not liable to deduct tax on the same on account of the following:

- On the aspect of verification of actual expenses, the Tribunal has not only relied upon its own decision but also on the circulars issued by the Government. The resultant effect is that the amount is to be treated as by way of reimbursement of expenses.
- Payment of per diem by the assessee to its employees was not made as an allowance on par with the perquisites; rather the payment was made to meet the expenses incurred in the performance of duties.
- When the payment is made to meet the expenses incurred and when not taxable under the Act<sup>9</sup>, the character or nature of the payment would not be changed to treat the same as perquisite under the Act, merely because the actual expenses were not verified.

## Comments

The ruling of the High Court is welcome as it has not only confirmed the exemption from taxation of per-diem allowance but also re-affirms the other Tribunal rulings which have held that verification of actual expenditure by the officer is not required when the per diem allowance is reasonable and not disproportionately high as compared to the salary of the employee. Prior to taking benefit of this ruling, employers should ensure that all the conditions for claiming exemption as per the Act and the Rules<sup>10</sup> are satisfied and appropriate safeguards have been put in place. For example, the employee should be on tour or transfer, away from his normal place of duty, the expenses should have actually been incurred, etc. It is not clear from the Ruling if the assessee had obtained any declaration from the employees in support of expenses incurred or satisfied themselves in any other manner as regards expenses incurred.

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<sup>9</sup> Section 10(14)

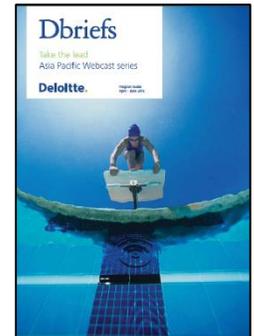
<sup>10</sup> Rule 2BB of the Income Tax Rules

Further, the circular relied upon by the assessee stating that where the allowances are reasonable and not disproportionately high to the salary, the tax officer is not required to verify the actual expenses incurred had been issued under the provisions of the erstwhile Income Tax Act<sup>11</sup>. The same has not been disputed by the Revenue or commented upon by the appellate authorities. While, the revenue authorities have raised a question that both the circulars issued by CBDT and MEA, are not applicable completely to the present case, the same has not been addressed by the High Court in the Ruling.

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<sup>11</sup> Indian Income - Tax Act, 1922

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