Date: 1.11.2019

# VRS and Tax relief

A] Over the years it has been advanced by the political economists that efficiency of the public sector enterprises may be increased by reducing the number of staffs on their payroll. Such premises are taken for granted even if the substantive evidences suggest otherwise, the reason obviously may be political; the only eyesore is that the government who is supposed to reduce unemployment favours such policy. So, in order to weed out surplus staff the Voluntary Retirement Scheme (VRS) is introduced with certain compensation as *ex gratia* such that the cold process of retrenchment gets euphemised as 'Golden Handshake'.

B] Though VRS would have been in vogue in India but for the first time it was given a standard legal shape by Office Memorandum (OM) No. 2(36)/86-BPE (WC) dated 5 Oct 1988. This was recast vide Department of Public Enterprises OM No. 2(32)/97-DPE (WC)/GL-XXII dated 5 May 2000 which carried the ex gratia benefits to be given on voluntary retirement as follows:

"3. Enterprises that make marginal profits or loss-making enterprises may adopt the revised scheme of VRS, which is modelled on the Scheme that exists in the State of Gujarat. The details of the scheme are set out hereunder:

(i) The compensation will consist of salary of 35 days for every completed year of service and 25 days for the balance of service left until superannuation. The compensation will be subject to a minimum of Rs. 25,000/- or 250 days salary whichever is higher. However, this compensation shall not exceed the sum of the salary that the employee would draw at the prevailing level for the balance of the period left before superannuation.

(ii) Salary for purpose of VRS will consist of basic pay and DA only.

(iii) Arrears of wages due to revision etc. will not be included in computing the eligible amount.

(iv) Payment of bonus should conform to the provisions in the Bonus Act; Casual Leave may be encashed in proportionate measure up to the date of VRS."

C] This amount of compensation termed as ex gratia was fully exempted from Income Tax till 31.3.1993 but by amendment to Income Tax Act 1961 Sec 10(10C) wef 1.4.1993 the amount of exemption was limited to Rs.5 lakh; though this was against the common law principle that a solatium on cessation is in the nature of capital receipt hence not amenable to income tax affirmed in Commissioner of Income-tax, Bengal v Shaw Wallace & Co. AIR 1932 PC 138 in appeal from [1932] 6 ITC 178 (CAL.) = AIR 1931 CAL 676 and followed in Commissioner of Income-tax v B.J. Fletcher AIR 1937 PC 261 = [1937] 5 ITR 428 (PC) to the effect that any sum in the nature of a solatium for cessation from the service of the government is a capital receipt in the hands of an employee and hence not amenable to tax as income. This principle was relied on in C.K. Karunakaran v. Union of India [1980] 4 Taxman 178 (Delhi) against which the appeal filed by the revenue was dismissed by the Supreme Court.

D] This injustice gets further aggravated when one sees that the ex gratia exempt from tax is still Rs.5 lakh which is far from being satisfactory for the simple reason that since 1.4.1993 the price index has gone virally upward. The exemption limit, therefore, need to be revisited at least for the upward change in inflation. If one considers the Cost Inflation Index relied by the Income Tax Department for calculation of capital gain then one may observe change in index at different time period as follows: CII 1993-94 – 244 (Base Year 1981-82); CII 2016-17 – 1125 (Base Year 1981-82); CII 2016-17 – 254 (Base Year 2001-02); CII 2019-20 – 280 (Base Year 2001-02). So, 1125 / 244 x 280/254 x 5 Lakh = 25.41 Lakh (Say Rs.25 Lakh). Thus one may see that the initial sum of Rs.5 Lakh on 1.4.1993 is simply equal to Rs.25 Lakh of today.

E] In order to avail this limited exemption of Rs.5 Lakh, however, one need to fulfil the following legal conditions:

a) The amount is received or receivable by an employee of: (i) a public sector company ; or (ii) any other company ; or (iii) an authority established under a Central, State or Provincial Act; or (iv) a local authority ; or (v) a co-operative society ; or (vi) a University or a Deemed University; or (vii) an Indian Institute of Technology; or (viia) any State Government; or (viib) the Central Government; or (viic) an institution, having importance throughout India or in any State or States, notified by the Central Government; or (viii) such institute of management notified by the Central Government, on his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company, a scheme of voluntary separation [IT Sec 10(10C)].

b) The schemes of the said companies or authorities or societies or Universities or the Institutes governing the payment of such amount are framed in accordance with prescribed guidelines (including inter alia criteria of economic viability) [IT Sec 10(10C) First Proviso].

c) Where exemption has been allowed to an employee under this clause for any assessment year, no exemption thereunder shall be allowed to him in relation to any other assessment year [IT Sec 10(10C) Second Proviso].

d) Where any relief has been allowed to an assessee under IT Sec 89 for any assessment year in respect of any amount received or receivable on his voluntary retirement or termination of service or voluntary separation, no exemption under this clause shall be allowed to him in relation to such, or any other, assessment year [IT Sec 10(10C) Third Proviso].

e) The amount shall be exempt only if the scheme of voluntary retirement framed by the aforesaid company or authority or co-operative society or University or institute, as the case may be or if the scheme of voluntary separation framed by a public sector company, is in accordance with the following requirements, namely: (i) it applies to an employee who has completed 10 years of service or completed 40 years of age; (ii) it applies to all employees (by whatever name called) including workers and executives of a company or of an authority or of a co-operative society, as the case may be, excepting directors of a company or of a co-operative society; (iii) the scheme of voluntary retirement or separation has been drawn to result in overall reduction in the existing strength of the employees; (iv) the vacancy caused by the voluntary retirement or separation is not to be filled up; (v) the retiring employee of a company shall not be employed in another company or concern belonging to the same management; (vi) the amount receivable on account of voluntary retirement or separation of the employee does not exceed the amount equivalent to three months' salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation [IT Rule 2BA].

f) Requirement of completed 10 years of service or completed 40 years of age mentioned in IT Rule 2BA(i) would not be applicable in case of an employee of a public sector company under the scheme of voluntary separation framed by such public sector company [IT Rule 2BA First Proviso].

g) The term 'salary' includes dearness allowance, if the terms of employment so provide, but excludes all other allowance and perquisites [IT Rule 2BA Explanation read with IT Fourth Schedule Part A Rule 2 (h)].

G] University means a University established or incorporated by or under a Central Act, a Provincial Act or a State Act, and includes any such institution as may, in consultation with the University concerned, be recognised by the Commission in accordance with the regulations made in this behalf under this Act [University Grants Commission Act 1956 Sec 2 (f)].

H] Deemed university is an institution for higher education other than a University which has been declared so by the Central Government, on the advice of the Commission, by notification in the Official Gazette [University Grants Commission Act 1956 Sec 3].

I] Indian Institute of Technology means any of the Institutions mentioned in Institutes of Technology Act 1961 Sec 2 and includes the Indian Institute of Technology, Kharagpur [Institutes of Technology Act 1961 Sec 3(g)].

J] Till AY 2001-02 prior approval of voluntary retirement scheme in case of other companies and cooperative societies was a requirement of law and was mandatory [Jodhiraj Singh v UOI

(2000) 244 ITR 786 (Del)]; but by dint of amendment through Finance Act 2000 in IT Sec 10(10C) First Proviso effective from 1.4.2001 such requirement has been omitted.

K] The provisions regarding income-tax exemption on the amount receivable on account of voluntary retirement are separate from the provisions which govern taxation of provident fund, gratuity, pension, etc. [Circular No. 640 dated 26.11.1992]. Thus income tax exemption on the ex gratia amount of voluntary retirement is available even when the amount payable is in addition to normal retirement benefits such as provident fund, gratuity, commuted pension etc. payable under the terms of employment. These terminal benefits cannot be brought within scope of 'amount received' under IT Sec 10(10C) [SAIL DSP VR Employees Association 1998 v Union of India (2003) 262 ITR 638 (Cal)].

L] Where an assessee fails to claim exemption on the compensation received on voluntary retirement it may be treated as mistake apparent from the record and may be rectified by the assessing officer [Koshti v CIT (2005) 276 ITR 165 (Guj)].

M] The amount of ex gratia under IT 10(10C) may be received in different years in instalments. Exemption is for the amount receivable and not what is received in any single year. Total exemption, however, shall be limited to Rs.5 Lakh [ITO v Dhan Sai Srivas (2009) 315 ITR 318 (Chhattisgarh)].

N] The exemption will be available even when the scheme of voluntary retirement impliedly satisfies the conditions laid out in IT Rule 2BA [Chandra Ranganathan v CIT (2010) 15 SCC 395].

O] As an epilogue it may be submitted that the behaviour of the revenue in allowing even this small exemption has been discouraging. The point that such income is a capital one finds no prominence in the eye of the revenue in view of the explicit statutory provision. It is highly desirable, therefore, on the part of the legislature to enhance the amount of exemption to the current rate of inflation at least because the fast pace of economic adjustments will force the public as well as private enterprises to downsize the redundant manpower and hire the competitive ones and justice requires that such redundant ones shall not be left to the mercy of the nature but be given an opportunity for up gradation of skills so that they may also add value to the national economy in a respectable manner, and this of course will require monetary support.