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Going The Extra Mile

RENT FREE ACCOMMODATION: REVAMPING RULES

In a sweeping change, the Central Board of Direct Taxes ('CBDT') has unveiled amended regulations governing the provision of rent-free accommodation by employers to their employees. These changes, stemming from the Finance Act of 2023, have triggered an extensive revision of Section 17(2) of the Income Tax Act of 1961. The result is a profound reconfiguration of the relationship dynamics between employers, employees, and their tax obligations. The revised rule outlines below notable adjustments:

Employer-Owned Accommodation

(Reshaping Valuation Dynamics)

At the core of the transformative alterations lies a recalibration of how the valuation of employer-owned accommodations is determined. This recalibration is intricately linked to the population of the city in which the accommodation is situated, as recorded in the *2011 census. Varied valuation rates are now dictated by these population categories.

(in millions 'M')

Population	Previous Rate	Population*	New Rate
> 2.5M	15%	> 4M	10%
1M - 2.5M	10%	1.5M – 4M	7.5%
< 1M	7.5%	< 1.5M	5%

To summarise in cities with populations exceeding 2.5 million, a significant shift becomes apparent. Valuation rates take a step down from the previous 15 per cent to an appealing 10 per cent. As urban centres expand further, surpassing the 4 million marks, this reduction unfurls as a positive change.

The 10 per cent valuation rate remains, showcasing the meticulous planning of the CBDT which lead to a think through process of recalculating the taxes and see the liberty of reducing the taxes.

Diving deeper into urban landscapes, cities with populations between 10 to 25 million witness a noteworthy reduction, transitioning from the previous 10 per cent to a charming 7.5 per cent. Lowest in the category is below 1.5 million mark which now stands at 5 per cent in the valuation. As populations grow, embracing the 4.0 million brackets, the valuation rate retreats even more to a compelling 5 per cent reduction, solidifying the connection between urban growth and financial attractiveness.

Leased or Rented Accommodation

(Most Preferred)

For accommodations that are leased or rented by the employer, the amount that contributes to the taxable income of employees is now the lower of the actual rental payment or 10 per cent. The existing benchmark before the said amendment for measuring the valuation of taxable benefit of the employee's salary, is 15 per cent.

Applying the simple theory of calculation this will lead to straight reduction of value of benefit by 5 per cent, provided the value of benefit is accounted at lower than the actual rentals paid by the employer and will result in the basic tax benefit of 1.5 per cent (aside to surcharge & cess) of the value of rent-free accommodation, if taxed at maximum marginal rate.

Navigating Long-Term Accommodation Scenarios
(Regularly observed)

If the employer continues to provide the same accommodation to the employee for more than a year, the valuation of taxable benefits is equated with the indexed value of the first year's rentals. In other words, it's either the value calculated using the new rules mentioned above, or it's the value from the first year adjusted for inflation.

To calculate the indexed value, we use the Cost Inflation Index (CII). The CII for this purpose will remain the same which are available for the purpose of indexation of cost of asset under section 48 of the Income Tax Act, 1961 while calculating the capital gains. The motive behind is to make sure that the value of taxable benefits doesn't unfairly go up just because of inflation.

Illustrative Case Study

Consider the scenario of Mr. A, an employee who is provided accommodation by his employer in his first year of service. With an actual rental expense of $12K and a calculated benefit value of $10K (10% of his $100K remuneration), the taxable value of the benefit is set at $10K – the minimum of the two.

Furthermore, a shift in the paradigm of calculation is evident when Mr. A continues to inhabit the same accommodation in the subsequent year. With new rentals amounting to $14K and a calculated benefit value of $12K (10% of his $120K new remuneration), the lower value of $12K is considered for perquisite valuation.

As the subsequent year unfolds, the calculated $12K is now additionally compared with the adjusted value of $10.34K (Calculated on $10K on assuming a Cost Inflation Index of 360 for FY 2024-25 and 348 for FY 2023-24). The taxable benefit value will now be determined as the lower of the two, resulting in $10.34K.

Important Points to Remember

- New rules are effective from September 1, 2023.
- For valuations done prior to above date, the existing rules still apply.
- Cost of furnishing the place is to be added same way as before – it's based on the actual rent or 10% for company assets.
- It is still contentious in the notification that whether the benefit of indexation is available solely to employer-owned accommodation or extends to encompass leased accommodation as well.

What's Ahead

As the curtains rise on this new development, it is apparent that employers are likely to lean towards providing rent-free accommodations to their employees and may look into the cost benefit analysis, when compared with House Rent Allowance ('HRA'). This potential reduction in taxable benefits underscores the significance of these amendments, promising the prospect of reduced tax burdens for employees – Again, an outcome contingent on the calculated benefits remaining lower than the actual rents paid.

To sum up, these rule changes signify a substantial shift in the terrain of taxation, orchestrating novel ways of ascertaining benefits and taxes for employees who receive accommodation from their employers or getting paid for accommodation as an allowance.

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