

# Salary taxable on accrual basis, despite subsequent waiver: Madras HC

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## Summary

As per provisions<sup>1</sup> of the Income-tax Act, 1961 (the Act), income from salary is taxable in the hands of an employee on accrual or on receipt, whichever is earlier. The Madras High Court (HC), in a recent decision<sup>2</sup>, has held that if provision for salary has been created in the employer's books of account and the employee follows the accrual basis of accounting, taxation on salary arises despite its subsequent withdrawal by the employer.

## Facts of the case

- The taxpayer was employed as the managing director of a company. During tax year 1998-99, the company created a provision in its books of account for the remuneration due to the taxpayer.
- However, owing to certain financial difficulties, the remuneration was not paid and a resolution for waiver of such remuneration was allegedly passed by the company.
- The tax officer held that as per the provisions under the Act, once a provision has been created in the employer's books, salary has accrued to the employee and the same shall be liable to tax.
- The tax officer's view was confirmed by the first appellate authority<sup>3</sup> and the Income Tax Appellate Tribunal (ITAT). The authorities further held that subsequent waiver of remuneration by passing a resolution would not reverse an already accrued income as the nature of resolution is prospective, not retrospective.

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<sup>1</sup> Section 15 of the Act which provides that 'any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not', shall be chargeable to income tax

<sup>2</sup> The Shri V. Ramakrishnan v. Deputy Commissioner of Income Tax (ITA No.424/Mds/2004)

<sup>3</sup> Commissioner of Income Tax (Appeals)

- Aggrieved by the appellate decision, the taxpayer filed an appeal before the HC.

## HC's decision

- The HC relied upon the ITAT's finding of fact that the taxpayer maintained his accounts on mercantile basis and therefore salary had accrued to him in the subject year.
- The HC noted that the taxpayer had failed to produce the resolution towards the withdrawal of managerial remuneration before the appellate authorities. In the absence of such evidence, the appellate authorities were not bound to take into account the effect of such resolution on the taxability of managerial remuneration in the hands of the taxpayer.
- Accordingly, the HC held that as per provisions of the Act, the taxpayer shall be liable to tax on salary on accrual basis despite it not being actually received.

## Our comments

Accrual of salary in the hands of an employee is a very fact-specific dispute, and the position may change based on the facts of the case. In a case where the salary of a director was restricted with the condition that the salary will not accrue or become due until the company is in profits and before paying such salary, an approval from a financial institution was required, the Hyderabad ITAT<sup>4</sup> held that no right to receive the salary had arisen and hence the salary was not held to be taxable under Section 15. Similarly, there are judicial precedents to support the view that till an absolute right in a benefit accrues, its taxation should not arise.

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<sup>4</sup> ITO v. Smt. (Dr.) B. Kalavathi [1994] 49 ITD 293 (HYD.)

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