

# Note



## Definition of 'remuneration' under Companies Act, 2013: why it requires your attention?

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Nivedita Shankar  
Corporate Law Division

[nivedita@vinodkothari.com](mailto:nivedita@vinodkothari.com)

[corplaw@vinodkothari.com](mailto:corplaw@vinodkothari.com)

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## Definition of 'remuneration' under Companies Act, 2013: why it requires your attention?

### Note

As the financial year 2014-2015 approaches its end, companies are gearing up to meet the “many” requirements pertaining to preparation of board’s report in line with the new Companies Act, 2013 (‘Act, 2013’). Amongst the other requirements of section 134, managerial remuneration is one area that requires a lot of attention. In this regard, we take you to back to the basics of managerial remuneration – the definition of ‘remuneration’ to unveil the surprise that the Act, 2013 in store for us. The Act, 1956 was however without any such hassle since it did not define ‘remuneration’ at all except for the purpose of Schedule XIII.

#### Definition of ‘remuneration’ under Act, 2013

Section 2(78) of the Act, 2013 defines ‘remuneration’ as follows:

*“means any money or its equivalent given or passed to any person for services rendered by him and includes **perquisites** as defined under the Income-tax Act, 1961”*

It is clear from the definition above that any money or money’s equivalent paid to a person will be remuneration under Act, 2013. Additionally, any perquisite paid to a person as defined under IT Act, 1961 will also be taken to be a part of remuneration.

#### ‘Perquisites’ under IT Act, 1961

Further, according to section 17(2) of Income Tax Act, 1961 (‘IT Act, 1961’), ‘perquisite’ includes the following:

- (i) *the value of rent-free accommodation provided to the assessee by his employer;*
- (ii) *the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer*
- (iii) *the value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases—*
  - (a) *by a company to an employee who is a director thereof;*
  - (b) *by a company to an employee being a person who has a substantial interest in the company;*
  - (c) *by any employer (including a company) to an employee to whom the provisions of paragraphs (a) and (b) of this sub-clause do not apply and whose income under the head “Salaries” (whether due from, or paid or allowed by, one or more employers), exclusive of the value of all*



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- benefits or amenities not provided for by way of monetary payment, exceeds fifty thousand rupees*
- (iv) any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;*
  - (v) any sum payable by the employer, whether directly or through a fund, other than a recognised provident fund or an approved superannuation fund 87[or a Deposit-linked Insurance Fund established under section 3G of the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948 (46 of 1948), or, as the case may be, section 6C of the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 (19 of 1952)], to effect an assurance on the life of the assessee or to effect a contract for an annuity*
  - (vi) the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.*
  - (vii) the amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds one lakh rupees; and*
  - (viii) the value of any other fringe benefit or amenity as may be prescribed.*

**Provided** that nothing in this clause shall apply to,

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- (v) any sum paid by the employer in respect of any expenditure actually incurred by the employee on his medical treatment or treatment of any member of his family [other than the treatment referred to in clauses (i) and (ii)]; so, however, that such sum does not exceed<sup>2</sup>[fifteen] thousand rupees in the previous year*

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The provisions relating to 'perquisites' in IT Act, 1961, evidently provide that the entire quantum/component of perquisites paid is not taxable for example superannuation fund, medical reimbursements etc.

### **Perquisites and Managerial Remuneration under the Act, 2013**

In pretext of the above definitions, the following can be deduced pertaining to the definition of 'remuneration' under Act, 2013:

- i. perquisites paid by a company as per IT Act, 1961 forms a part of the remuneration;



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- ii. the entire quantum of the perquisites, irrespective of the taxable value will be a part of 'remuneration'. On an apparent reading of section 2(78) of Act, 2013, it may seem that only the taxable value of the perquisites paid will be taken to be a part of remuneration. However, a closer examination of the definition of 'remuneration' will show that the section only states that perquisites paid as defined under IT Act, 1961 will be included. It does not make any reference to the quantum or valuation or taxable component of the perquisites. Thus the entire amount of perquisites paid or agreed to be paid will form part of remuneration. The taxable value as prescribed under IT Act, 1961 will have no bearing on the calculation of 'remuneration' under Act, 2013.

This reasoning is further strengthened by the definition of 'remuneration' under Section IV of Part II of Schedule V of Act, 2013 which reads as follows:

*A managerial person shall be eligible for the following perquisites which shall not be included in the computation of the ceiling on remuneration specified in Section II and Section III:—*

- (a) *contribution to provident fund, superannuation fund or annuity fund to the extent these either singly or put together are not taxable under the Income-tax Act, 1961 (43 of 1961);*
- (b) *gratuity payable at a rate not exceeding half a month's salary for each completed year of service; and*
- (c) *encashment of leave at the end of the tenure.*

Looking at clause (a) above, it is clear that any contribution made to provident fund, superannuation fund or annuity fund in excess of taxable limits under IT Act, 1961 shall not be included for the purpose of calculation of managerial remuneration in the event of inadequate profits or nil profits. Law herein clearly prescribes what value of perquisites shall not be considered as part of remuneration in cases of inadequate profits. Further, had the intent of law been to include only taxable amount of perquisites in the definition of 'remuneration' under section 2(78), then this clause would have been rendered meaningless. Thus, one can safely presume that where the intent was to specifically cover taxable value of perquisites law has been drafted clearly with the respect.

Therefore, to conclude, for the purpose of calculation of remuneration:

- i. **in the event of adequacy of profits** – the entire value of perquisites as per IT Act, 1961 will have to be considered.



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- ii. **in the event of inadequacy of profits of nil profits** - only the taxable amount of perquisites should be considered. This is relevant only in case of managerial person.

### **Preparation of Board' Report under Act, 2013**

The definition of 'remuneration' is of particular importance when it comes to preparation of Board's Report since Rule 5 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 requires a listed company to make a number of disclosures pertaining to remuneration of not just directors, but also of key managerial persons and other employees. The definition of 'remuneration' under section 2(78) does not distinguish between a director, key managerial person or any other employee. Thus, while preparation of board's report, the discussion above will be relevant for the purpose of calculation of remuneration of every director, key managerial person and other employee of the company.

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