

# **Tax Free Incomes**

The following are 17 important items of income, which are fully exempt from income tax and which a resident individual Indian assessee can use with profit for the purpose of tax planning.

## **1. Agricultural income**

Under the provisions of Section 10(1) of the Income Tax Act, agricultural income is fully exempt from income tax.

However, for individuals or HUFs when agricultural income is in excess of Rs 5,000, it is aggregated with the total income for the purposes of computing tax on the total income in a manner which results into "no" tax on agricultural income but an increased income tax on the other income.

Agricultural income which fulfils the above conditions is completely exempt from tax. The manner of calculating tax on total income and agricultural income, is explained in the following illustration:

### **Illustration**

For FY 2008-09 (assessment year 2009-10), a male individual has a total income from trading in textiles amounting to Rs 1,52,000; besides, he has earned Rs 40,000 as income from agriculture.

The income tax payable by him will be computed as under:

- On the first Rs 150,000 of the taxable non-agricultural income: **Nil**
- On the next Rs 40,000 of agricultural income (falling under 10% slab): **Nil**
- On the next Rs 2,000 of taxable non-agricultural income @ 10 per cent: **Rs 200**
- Income tax on aggregated income of Rs 152,000 + Rs 40,000 = Rs 192,000: **Rs 200**

## **2. Receipts from Hindu Undivided Family (HUF)**

Any sum received by an individual as a member of a Hindu Undivided Family, where the said sum has been paid out of the income of the family, or, in the case of an impartible estate, where such sum has been paid out of the income of the estate belonging to the family, is completely exempt from income tax in the hands of an individual member of the family under Section 10(2).

## **3. Share from a partnership firm**

Under the provisions of Section 10(2A), in the case of a person being a partner of a firm which is separately assessed as such, his share in the total income of the firm is completely exempt from income tax since AY 1993-94.

For this purpose, the share of a partner in the total income of a firm separately assessed as such would be an amount which bears to the total income of the firm the same share as the amount of the share in the profits of the firm in accordance with the partnership deed bears to such profits.

#### **4. Allowance for foreign service**

Any allowances or perquisites paid or allowed as such outside India by the Government to a citizen of India, rendering service outside India, are completely exempt from tax under Section 10(7). This provision can be taken advantage of by the citizens of India who are in government service so that they can accumulate tax-free perquisites and allowances received outside India.

#### **5. Gratuities**

Under the provisions of Section 10(10) of the IT Act, any death-cum-retirement gratuity of a government servant is completely exempt from income tax. However, in respect of private sector employees gratuity received on retirement or on becoming incapacitated or on termination or any gratuity received by his widow, children or dependants on his death is exempt subject to certain conditions.

The maximum amount of exemption is Rs. 3,50,000; Of course, this is further subject to certain other limits like the one half-month's salary for each year of completed service, calculated on the basis of average salary for the 10 months immediately preceding the year in which the gratuity is paid or 20 months' salary as calculated. Thus, the least of these items is exempt from income tax under Section 10(10).

#### **6. Commutation of pension**

The entire amount of any payment in commutation of pension by a government servant or any payment in commutation of pension from LIC pension fund is exempt from income tax under Section 10(10A) of IT Act.

However, in respect of private sector employees, only the following amount of commuted pension is exempt, namely: (a) Where the employee received any gratuity, the commuted value of one-third of the pension which he is normally entitled to receive; and (b) In any other case, the commuted value of half of such pension.

It may be noted here that the monthly pension receivable by a pensioner is liable to full income tax like any other item of salary or income and no standard deduction is now available in respect of pension received by a tax payer.

#### **7. Leave salary of central government employees**

Under Section 10(10AA) the maximum amount receivable by the employees of central government as cash equivalent to the leave salary in respect of earned leave at their credit upto 10 months' leave at the time of their retirement, whether on superannuation or otherwise, would be Rs. 3,00,000.

#### **8. Voluntary retirement or separation payment**

Under the provisions of Section 10(10C), any amount received by an employee of a public sector company or of any other company or of a local authority or a statutory authority or a cooperative society or university or IIT or IIM at the time of his voluntary retirement (VR) or voluntary separation in accordance with any scheme or schemes of VR as per Rule 2BA, is completely exempt from tax. The maximum amount of money received at such VR which is so exempt is Rs. 500,000.

#### **9. Life insurance receipts**

Under Section 10(10D), any sum received under a Life Insurance Policy (LIP), including the sum allocated by way of bonus on such policy, other than u/s 80DDA or under a Keyman Insurance Policy, or under an insurance policy issued on or after 1.4.2003 in respect of which the premium payable for any of the years during the term of the policy exceeds 20 per cent of the actual capital sum assured, is fully exempt from tax.

However, all moneys received on death of the insured are fully exempt from tax. Thus, generally moneys received from life insurance policies whether from the Life Insurance Corporation or any other private insurance company would be exempt from income tax.

## 10. Payment received from provident funds

Under the provisions of Sections 10(11), (12) and (13) any payment from a government or recognised provident fund (PF) or approved superannuation fund, or PPF is exempt from income tax.

## 11. Certain types of interest payment

There are certain types of interest payments which are fully exempt from income tax u/s 10 (15). These are described below:

- (i) Income by way of interest, premium on redemption or other payment on such securities, bonds, annuity certificates, savings certificates, other certificates issued by the Central Government and deposits as the Central Government may, by notification in the Official Gazette, specify in this behalf.
- (iia) In the case of an individual or a Hindu Undivided Family, interest on such capital investment bonds as the Central Government may, by notification in the Official Gazette, specify in this behalf (i.e. 7 Capital Investment Bonds);
- (iib) In the case of an individual or a Hindu Undivided Family, interest on such Relief Bonds as the Central Government may, by notification in the Official Gazette, specify in this behalf (i.e., 9 per cent or 8.5 per cent or 8 per cent or 7 per cent Relief Bonds); (iid) Interest on NRI bonds;
- (iia) Interest on securities held by the issue department of the Central Bank of Ceylon constituted under the Ceylon Monetary Law Act, 1949;
- (iib) Interest payable to any bank incorporated in a country outside India and authorised to perform central banking functions in that country on any deposits made by it, with the approval of the Reserve Bank of India [\[Get Quote\]](#) or with any scheduled bank;
- (iv) Certain interest payable by Government or a local authority on moneys borrowed by it, including hedging charges on currency fluctuation (from the AY 2000-2001), etc.;
- (v) Interest on Gold Deposit Bonds;
- (vi) Interest on certain deposits are: Bhopal Gas victims;
- (vii) Interest on bonds of local authorities as notified,
- (viii) Interest on 6.5 per cent Savings Bonds [Exempt] issued by the RBI, and
- (ix) Stipulated new tax free bonds to be notified from time to time.

## 12. Scholarship and awards, etc

Any kind of scholarship granted to meet the cost of education is exempt from tax under Section 10(16). Similarly, certain awards and rewards, etc. are completely exempt from tax under Section 10(17A), for example, Lakhota Puraskar of Rs 100,000 awarded to the best Rajasthani author, every year under Notification No. 199/28/95-IT (A-I) dated 22-4-1996.

Any daily allowance received by a Member of Parliament or by an MLA or any member of any Committee of Parliament or State legislature is also exempt from tax under Section 10(17).

## 13. Gallantry awards, etc. -- Section 10(18)

The Finance Act, 1999 has, with effect from AY 2000-2001, provided for complete exemption for the pension and family pension of Gallantry Award Winners like Paramvir Chakra, Mahavir Chakra, and Vir Chakra and also other Gallantry Award winners notified by the Central Government.

## 14. Dividends on shares and units -- Section 10(34) & (35)

With effect from the Assessment Year 2004-05, the dividend income and income of units of mutual funds received by the assessee completely exempt from income tax.

## 15. Long-term capital gains of transfer of securities -- Section 10(38)

With effect from FY 2004-05, any income arising to a taxpayer on account of sale of long-term capital asset being securities is completely outside the purview of tax liability especially when the transaction has been subjected to Securities Transaction Tax (STT).

Thus, if the shares of any company listed in the stock exchange are sold after holding it for a minimum period of one year then there will be no liability to payment of capital gains. This provision would even apply for the old shares which are held by an assessee and are sold after the Finance (No.2) Act, 2004 came into force.

#### **16. Amount received by way of gift, etc -- Section 10(39)**

As per the Finance (No. 2) Act, 2004, gift, etc. received after 1-9-2004 by an individual or an HUF whether in cash or by way of credit, etc. is being subjected to tax if the same is not received from a stipulated relative. Section 10(39) provides that the amount received to the extent of Rs 50,000 will, however, be exempt from the purview of tax payment.

Similarly, amount received on the occasion of marriage from non-relatives, etc. would also be exempted. It may be noted that the gift from relatives, as specified in the section can be received without any upper limit.

#### **17. Tax exemption regarding reverse mortgage scheme -- sections 2(47) and 47(x)**

Any transfer of a capital asset in a transaction of reverse mortgage for senior citizens under a scheme made and notified by the Central Government would not be regarded as a transfer and therefore would not attract capital gains tax. The loan amount would also be exempt from tax. These amendments by the Finance Bill, 2008 apply from FY 2007-08 onwards.

*Thank You*