# LESSON 5
# INCOME UNDER THE HEAD SALARIES - II

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## STRUCTURE



## 5.0 INTRODUCTION

We have learnt till now that all incomes of an assessee are classified into 5 categories namely salaries, house property, capital gains, business or profession and other sources. An income covered under a particular category will be taxed under separate head of income pertaining to that category. Hence, it is very important to know which incomes are covered in each head and the detailed income tax provisions to calculate taxable income.

In the previous lesson, we have learnt about the concept of salary income, its characteristics and three incomes forming part of salary, namely, basic salary, fees, commission, bonus and allowances. The present lesson describes in detail the other two components of salary income, namely, perquisites and retirement benefits along with the procedure of computation of income under this head.

## 5.1 OBJECTIVES

After reading this lesson, you should be able to understand:

- Concept of perquisites
- Classification of perquisites for their tax treatment
- Valuation of perquisites
- Various kinds of retirement benefits along with their tax provisions

- Procedure for computation of net income under the head “Salaries”

## 5.2 INCOMES FORMING PART OF SALARY - II

As already stated earlier, Section 17 broadly includes:

1. Basic salary
2. Fees, commission and bonus
3. Taxable value of cash allowances
4. Taxable value of perquisites
5. Retirement benefits

First three incomes are already explained in detail in the previous lesson. The other two incomes are explained here.

## 5.2.1 TAXABLE VALUE OF PERQUISITES

Perquisites are defined as any casual emolument or benefit attached to an office or position in addition to salary or wages. It denotes some thing that benefits a man by going into his pocket; it does not cover mere reimbursement of necessary disbursements. Such benefits are normally given in kind but should be capable of being measurable in money terms. Perquisites are taxable and included in gross salary only if they are (i) allowed by an employer to an employee, (ii) Allowed during the continuation of employment, (iii) directly dependent on service, (iv) resulting in the nature of personal advantage to the employee and (v) derived by virtue of employers authority.

As per Section 17 (2) of the Act, perquisites include:

1. Value of rent free accommodation provided to the employee by the employer.
2. Value of concession in the matter of rent in respect of accommodation provided to the employee by his employer.
3. Value of any benefit or amenity granted free of cost or at a 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 who has substantial interest in the company
c) by any employer to an employee who is neither a director, nor has substantial interest in the company, but his monetary emoluments under the head ‘Salaries’ exceeds Rs.50, 000.

4. Any sum paid by the employer towards any obligation of the employee.
5. Any sum payable by employer to effect an assurance on the life of assessee.

6. The value of any other fringe benefit given to the employee as may be prescribed.

## I. CLASSIFICATION OF PERQUISITES

For tax purposes, perquisites specified under Section 17 (2) of the Act may be classified as follows:

(1) Perquisites that are taxable in case of every employee, whether specified or not
(2) Perquisites that are taxable in case of specified employees only.
(3) Perquisites that are exempt from tax for all employees

### (1) Perquisites Taxable in case of All Employees

The following perquisites are taxable in case of every employee, whether specified or not:

1. Rent free house provided by employer
2. House provided at concessional rate
3. Any obligation of employee discharged by employer e.g. payment of club or hotel bills of employee, salary to domestic servants engaged by employee, payment of school fees of employees' children etc.
4. Any sum paid by employer in respect of insurance premia on the life of employee
5. Notified fringe benefits (on which fringe benefit tax is not applicable) – it includes interest free or concessional loans to employees, use of movable assets, transfer of moveable assets.

### (2) Perquisites taxable in case of Specified Employees only

The following perquisites are taxable in case of such employees:

1. Free supply of gas, electricity or water supply for household consumption
2. Free or concessional educational facilities to the members of employees household
3. Free or concessional transport facilities
4. Sweeper, watchman, gardener and personal attendant
5. Any other benefit or amenity

| |
|---|
| Specified employee is an employee who is either a director or has substantial interest in the company where he is employed or is drawing monetary salary of more than Rs.50, 000 during the previous year. |

### (3) Perquisites which are tax free for all the employees

This category includes perquisites which are tax free for the employees and also other perquisites on which employer has to pay a tax (called Fringe Benefit Tax) if they are given to the employees and so are not taxable for them.

1. Medical benefits (provided within or out of India) subject to limits.
2. Value of Leave Travel Concession in India.
3. Free meals provided to the employees during working hours.
4. Amount spent by the employer as its contribution to staff welfare schemes.
5. Laptops and computers provided for personal use.
6. Rent free official accommodation provided to a Judge of High Court or Supreme Court or an official of Parliament including Minister and Leader of Opposition in Parliament.
7. Health Insurance Premium of employee or member of household paid by the employer.
8. All such facilities (like motor car, lunch refreshments, travelling, touring, gift, credit cards, club etc.) provided by employer on which employer has to pay Fringe Benefit Tax.

> With effect from Assessment Year 2006-07, a Fringe Benefit Tax has been introduced, where companies giving certain fringe benefits to its employees are required to pay Fringe Benefit Tax on the expenditure incurred for the same. Hence, these benefits are tax free for the employees.

## II. VALUATION OF PERQUISITES

The perquisites which are taxable in the hands of employees are valued in accordance with the provisions laid down under the Income Tax Rule 3. These benefits can be provided to the employee or member of his household.

> Member of household shall include:
>
> (1) Spouse (2) Children and their spouses (3) Parents (4) Servants and dependents

### (i) Valuation of rent free accommodation

For the purpose of valuation of house, employees are divided into 2 categories:

a) Central and State Government employees: If accommodation is provided by the State or Central Government to their employees, the value of such accommodation is simply the amount fixed by the government (called the licence fees) in this regard.

**Illustration 5.1:**

Mr X, a Senior Officer in Delhi administration draws Rs.20, 000 per month as basic salary. The government has provided him with a rent free unfurnished flat whose market rent is Rs.3000 per month, though as per government rules, its licence fees is fixed at Rs.700 per month. Determine the value of perquisite in respect of rent free accommodation.

**Solution:**

In a case of government employee, the value of rent free accommodation is Rs.8, 400 (Rs.700 x 12) i.e. the licence fees fixed by the government.

b) Other Employees

The valuation of accommodation for this category of non government employees depends upon whether the accommodation given to the employee is owned by the employer or taken on lease.

1. Accommodation owned by employer

The value of accommodation is:

(i) 20% of salary in cities having population exceeding four lakhs as per 1991 census.

(ii) 15% of salary in other cities in respect of the period for which the accommodation was occupied by the employee during the previous year.

2. Accommodation is taken on lease / rent by the employer

The value of such accommodation is actual amount of lease rental paid or payable by the employer or 20% of salary, whichever is lower.

Definition of salary for rent free accommodation: Basic Salary + Taxable cash allowances + Bonus or Commission + any other monetary payment.

(It does not include dearness allowance if it is not forming part of basic salary for retirement benefit, allowances which are exempt from tax, value of perquisites specified under Section 17(2), employer's contribution to provident fund account of employees).

**(ii) Valuation of furnished accommodation** where the accommodation is furnished, 10% per annum of the original cost of furniture given to the employee shall be added to the value of unfurnished accommodation. If the furniture is taken on rent by employer, then actual hire charges are to be added to the value.
Rules for valuation of Rent free unfurnished Accommodation:

| **Nature of Accommodation** | **Accommodation in a city with population > 4 lakhs** | **Accommodation in any other place** |
|---|---|---|
| Where accommodation is owned by employer | 20% of salary | 15% of salary |
| Accommodation taken on lease / rent by employer | Amount of lease or 20% of salary whichever is less | Amount of lease or 20% of salary whichever is less |

**Illustration 5.2**

Mrs. X, a company employee gets Rs.1,20,000 as basic pay, Rs.24,000 as Commission, Rs.10,000 as Bonus, Rs.6000 as uniform allowance (60% utilized for uniform), Rs.3,600 as education allowance and Rs.12,000 as transport allowance. Her employer has paid income tax of Rs.6000 and professional tax of Rs.2000 on her behalf. A rent free unfurnished flat is provided in a place where population is a) more than 4 lakhs or b) less than 4 lakhs. Determine the taxable value of rent free flat.

**Solution**

Salary for this purpose:

| | Amount / Rs. |
|---|---|
| Basic Salary | 1,20,000 |
| Commission | 24,000 |
| Bonus | 10,000 |
| Uniform allowance (40% of Rs.6000) | 2,400 |
| Transport allowance (Rs.12000 – Amount exempt Rs.800 x 12) | 2,400 |
| Education allowance (Rs.3600 – amount exempt Rs.100 x 12 x 2) | 1,200 |
| **Salary** | **1,60,000** |

a) Where population is more than 4 lakhs
Value of rent free house = 20% of salary
= 20% of Rs.1, 60,000
= Rs.32, 000

b) Where population is less than 4 lakhs
Value of rent free flat = 15% of salary
= 15% of Rs.1, 60,000
= Rs.24, 000

**(iii) Sweeper, gardener or watchman provided by the employer**

The value of benefit of provision of services of sweeper, watchman, gardener or personal attendant to the employee or any member of his household shall be the actual cost to the employer. The actual cost in such a case is the total amount of salary paid or payable by the employer or any other person on his behalf for such services as reduced by any amount paid by the employee for such services.

If the above servants are engaged by the employer and facility of such servants are provided to the employees, it will be a perquisite for specified employees only. On the other hand, if these servants are employed by the employee and wages of such servants are paid / reimbursed by the employer, it will be taxable perquisite for all classes of employees.

**(iv) Free Supply of Gas, Electricity or Water**

The value of these benefits is taxable in the hands of specified employees, if the connection is taken in the name of the employer, and is determined according to the following rules:

a) If the employer provides the supply of gas, electricity, and water from its own sources, the manufacturing cost per unit incurred by the employer shall be the value of perquisite.
b) If the supply is from any other outside agency, the value of perquisite shall be the amount paid by the employer to the agency supplying these facilities.
c) Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value of perquisite calculated under (a) or (b).
d) Where the connection for gas, electricity, water supply is in the name of employee and the bills are paid or reimbursed by the employer, it is an obligation of the employee discharged by the employer. Such payment is taxable in case of all employees under Section 17 (2) (iv).

**(v) Free Education**

a) Cost of free education to any member of employees' family provided in an educational institution owned and maintained by the employer shall be determined with reference to reasonable cost of such education in a similar institution in a near by locality. For education facilities provided to the children of employee (excluding any other member of house hold), the value shall be nil, if the cost of such education per child does not exceed Rs.1, 000 per month.
b) Where free education facilities are allowed to any member of employees' family in any other educational institution by reason of his being in employment of that employer, the value of perquisite shall be determined as in (a).
c) In any other case: The value of benefit of providing free or concessional educational facilities for any member of the house hold (including children) of the employee shall be the amount of expenditure incurred by the employer.
d) While calculating the amount of perquisite in all in above cases, any amount paid or recovered from the employee in this connection, shall be deducted.

**(vi) Free Transport**

The value of any benefit provided by any undertaking engaged in the carriage of passengers or goods to any employee or to any member of his household for private journey free of cost or at concessional rate in any conveyance owned or leased by it shall be taken to be the value at which such benefit is offered by such undertaking to the public as reduced by the amount, if any, paid by or recovered from the employee for such benefit. In case of employees of the Railways and airlines, the value of transport facility shall be exempt.

**(vii) Valuation of Medical Facilities**

Medical facilities provided to employee are exempt from tax.

A. Medical benefits within India which are exempt from tax include the following:

a) Medical treatment provided to an employee or any member of his family in hospital maintained by the employer.
b) Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself and members of his family :
(i) in a hospital maintained by government or local authority or approved by the government for medical treatment of its employees.
(ii) In respect of the prescribed diseases or ailments in any hospital approved by the Chief Commissioner.
(iii) Premium paid by the employer on health insurance of the employee under an approved scheme.
c) Premium on insurance of health of an employee or his family members paid by employer.

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| *Limited Exemption:* If the ordinary medical treatment of the employee or any member of his family is done at any private hospital, nursing home or clinic, the exemption is restricted to Rs.15, 000. |

B. Medical Treatment outside India which is exempt from tax includes the following:

a) Any expenditure incurred by employer on the medical treatment of the employee or any member of his family outside India.
b) Any expenditure incurred by employer on travel and stay abroad of the patient (employee or member of his family) and one attendant who accompanies the patient in connection with such treatment, shall be exempt to the following extent :
(i) The expenditure on medical treatment and stay abroad shall be exempt to the extent permitted by the Reserve Bank of India.
(ii) The expenditure on travel shall be exempt in full provided the gross total income of the employee (including this expenditure) does not exceed Rs.2, 00,000.

**Illustration 5.3 (based on perquisites received by employee)**

Mr. X is a Purchase Officer in a Company in Kota. He has furnished the following particulars of his incomes to you for the previous year 2005-06. You are required to compute his gross salary.

Rupees

| | |
|---|---|
| Salary @ Rs.12500 per month | 1,50,000 |
| Leave Travel Concession for proceeding on leave (total expenditure on rail fare Rs.4100) | 3,800 |
| Tiffen Allowance (actual expenditure Rs.2700) | 4,000 |
| Reimbursement of medical expenses for treatment of X and his family in private clinic | 31,300 |

Besides, he enjoys the following perks:

- Free unfurnished flat at Delhi (rent paid by employer : Rs.80,000)
- The employer provided two watchmen (salary Rs.700 per month each).
- Free use of Maruti car for official use, car can be used for journey between office and residence and other private purposes (log book of car is not maintained).
- Free meal at place of works (Rs.70 per day for 210 days) Rs.14, 700.

**Solution:**

Computation of Income under the head salaries of Mr. X for AY 2006-07

| Particulars | Rupees |
|---|---|
| Basic Salary | 1,50,000 |
| Leave Travel Concession (exempted from tax) | - |
| Tiffin Allowance (fully taxable) | 4,000 |
| Reimbursement of medical expenses (Rs.31,300 – Rs.15,000) | 16,300 |
| Rent free unfurnished flat* | 30,800 |
| Two watchmen (Rs.700x2) | 16,800 |
| Free use of Maruti car | Nil |
| Free meals | Nil |
| **Gross Salary** | **2,17,900** |

* Salary for rent free unfurnished flat is 1, 54,000 (1, 50,000+4,000)

Value of rent free house is 20% of salary or rent paid by employer, whichever is lower (20% of 1, 54,000=30,800)

CHECK YOUR PROGRESS

**Activity A:**

Discuss the tax treatment of the following perquisites in case of specified and non specified employees:

| Nature of Perquisites | Is perquisite taxable if | |
|---|---|---|
| | **Specified Employee** | **Non specified Employee** |
| Rent free furnished or unfurnished | | |
| Services of sweeper, watchman, gardener, personal attendant provided to employee | | |
| Domestic servants' salary reimbursed to employee | | |
| Leave Travel Salary reimbursed to employee | | |
| Education facility provided to employee's children | | |
| Gas, electricity, water supply bills of employee reimbursed by employer | | |
| Use of laptop and computers to employees | | |
| Medical facilities provided to employee in employer's hospital | | |
| Health insurance premium of employee and family paid by employer | | |
| Free refreshments to employee | | |
| Motor car facility provided to employee | | |
| Transport facility provided to employee | | |
| Club facility provided to employee | | |
| Interest free loan provided to employee for purchasing car | | |
| Telephone bills reimbursed by employee | | |

**Activity B:**

"It is generally said that non specified employees pay less tax as compared to specified employees". Do you agree?

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## 5.2.2 RETIREMENT BENEFITS

These benefits are provided by the employer to the employee for his future, either while in service or on his retirement. These have different tax treatment. They include:

**a) Pension**

Pension is a payment made by the employer after the retirement or death of employee as a reward for past service. It is normally paid as a periodical payment on monthly basis but certain employers may allow an employee to forgo a portion of pension in lieu of lumpsum amount. This is known as commutation of pension. The treatment of these two kinds of pension is as under:

(i) Periodical pension (or uncommuted pension).

It is fully taxable in the hands of all employee, whereas government or non-government.

(ii) Commuted pension

For employees of government organisations, local authorities and statutory corporations, it is fully exempted from tax, hence not included in gross salary.

For other employees, commuted value of half of the total value of pension is exempted from tax. Any amount received over and above this amount is taxable, so included in gross salary.

If, however, the employee is also receiving gratuity (another retirement benefit) along with pension, then one third of the total value of pension is exempted from tax. Amount received in excess of this is taxable, so included in gross salary.

| |
|---|
| Pension received by employee is taxable under the head "Salaries". However, family pension received by legal heirs after death of employee is taxable under 'Income from other sources'. |

**b) Gratuity**

Gratuity is the payment made by the employer to an employee in appreciation of past services rendered by the employee. It is received by the employee on his retirement. Gratuity is exempted upto certain limit depending upon the category of employee. For the purpose of exemption, employees are divided into 3 categories:

(i) Government employees and employees of local authority:

In case of such employees, the entire amount of gratuity received by then is exempted from tax. Nothing will be added to gross salary.

(ii) Employees covered under Payment of Gratuity Act, 1972.

In case of employees who are covered under Payment of Gratuity Act, the minimum of the following amounts are exempted from tax:

- Amount of gratuity actually received

- 15 days of salary for every completed years of service or part thereof in excess of six months.

  (15 / 26 x [basic salary + Dearness Allowance] x No. of years of service+1 [if fraction > 6 months]).
- Rs.3, 50,000 (amount specified by government).

(iii) Other employees.

In case of employees not falling in the above two categories, gratuity received from the employers is exempt to the extent of minimum of following amounts:

- Actual amount of gratuity received.
- Half month average salary for every completed year of service
  (1/2 x average salary of last 10 months x completed years of service).
- Rs.3, 50,000 (amount specified by government).

**c) Leave Salary**

Employees are entitled to various types of leave. The leave generally can be taken (casual leave/medical leave) or it lapses. Earned leave is a kind of leave which an employee is said to have earned every year after working for some time. This leave can either be availed every year, or get encashment for it. If leave is not availed or encashed, it is allowed to be carried forward. This leave keeps getting accumulated and is encashed by employee on his retirement. The tax treatment of leave encashment is as under:

(i) Encashment of leave while in service. This is fully taxable and so is added to gross salary.

(ii) Encashment of leave on retirement. For the purpose of exemption of accumulated leave encashment, the employees are divided into two categories:

- State or Central Government employees.
  Leave encashment received by government employees is fully exempted from tax. Nothing is to be included in gross salary.
- Other employees
  Leave encashment of accumulated leave at the time of retirement received by other employees is exempted to the extent of minimum of four amounts.
  - Amount specified by Central Government (3, 00,000).
  - Leave encashment actually received.
  - 10 months average salary (10 x average salary of 10 months preceeding retirement).

Cash equivalent of unavailed leave.

- (Leave entitlement is calculated on the basis of maximum 30 days leave every year, cash equivalent is based on average salary of last 10 months).

**d) Provident Fund**

Provident Fund Scheme is a welfare scheme for the benefit of employees. Under this scheme, certain amount is deducted by the employer from the employee's salary as his contribution to Provident Fund every month. The employer also contributes certain percentage of the salary of the employee to the Fund. The contributions are invested outside in securities. The interest earned on it is also credited to the Provident Fund Account. At the time of retirement, the accumulated balance is given to the employee.

Tax treatment of provident fund depends upon the type of provident fund being maintained by the employer. Employee's provident fund may be of the following 3 types:

**(i) Statutory Provident Fund**

This is set up under the provisions of Provident Fund Act, 1925 and is maintained by Government and Semi-Government organisations, local authorities, railways, universities and recognised educational institutions.

**(ii) Recognised Provident Fund**

This is set up under the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 (PF Act, 1952) and is maintained by private sector employees. The establishments covered under PF Act, 1952 have two options; either to follow the same scheme at by the Government under the PF Act or draft their own scheme of PF but get recognition from Commissioner of Income Tax.

**(iii) Unrecognized Provident Fund**

If a provident fund is not recognized by the Commissioner of Income Tax, it is known as unrecognized PF.

Besides these 3 funds, a person can also become a member of Public Provident Fund.

**(iv) Public Provident Fund**

The Central Government has established the Public Provident Fund for the benefits of general public to mobilize personal savings. Any member of general public (whether salaried or self employed) can participate in this fund by opening a Provident Fund Account at the State Bank of India or its subsidiaries or other nationalised banks. A salaried employee can simultaneously become member of employees provident fund (whether statutory, recognized or unreconised) and public provident fund. Any amount may be deposited (subject to minimum of

Rs.500 and maximum of Rs.70, 000 per annum) under this account. The accumulated sum is repayable after 15 years. At present, it carries an interest rate of 8% per annum which is credited every year but payable only the time of maturity.

Tax treatment of these provident funds (i.e. the exemption and deduction available in respect of contributions to and payment from these funds) is summarised as follows:

| S. No. | Particulars | Statutory PF | Recognised PF | Unrecognised PF | Public PF |
|---|---|---|---|---|---|
| 1. | Employees Contribution to PF | Exempted from tax | Exempted upto 12% of salary excess of employer's contribution in included in gross salary | Exempted from tax | Employer does not contribute |
| 2. | Deduction under Section 80C on employee's contribution | Available | Available | Not available | Available |
| 3. | Interest credited to PF | Exempted from tax | Exemption upto notified rate (9.50%) per annum) Excess of interest included in gross salary | Exempted from tax | Exempted from tax |
| 4. | Lump sum payment given to employee on retirement | Exempted from tax | Exempted from tax (if rendered continuous service of more than 5 years | Lumpsum includes :<br>a) Own Contribution- Exempt<br>b) Interest on own contribution - taxable as income from other sources<br>c)Employer's contribution and interest thereon- taxable so included in gross salary | Exempted from Tax |

- Salary here means basic salary + dearness allowance / dearness pay (if terms of employment provide) + commission (if fixed as percentage of turnover achieved by employee).

CHECK YOUR PROGRESS

**Activity C:**

What are different kinds of Provident Funds of which a salaried person can be a member? Can he be a member of two Provident Funds simultaneously?

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______________________________________________________________________
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**Activity D:**

Classify these key words into the following three categories of salary.

Dearness allowance, medical facility, uniform allowance, gratuity, leave travel concession, overtime allowance, pension, free transport, servant allowance, gas, electricity, water supply facility, provident fund, education facility, hostel allowance, rent free house, telephone reimbursement.

1. Cash allowances ______________________________________________
   ______________________________________________________________
   ______________________________________________________________

2. Perquisites ___________________________________________________
   ______________________________________________________________
   ______________________________________________________________

3. Retirement benefits____________________________________________
   ______________________________________________________________
   ______________________________________________________________

# 5.3 DEDUCTIONS FROM GROSS INCOME

The income chargeable under the head salaries is computed after making the following deductions under Section 16:

1. Standard deduction [section 16(i)] of the Act: From assessment year 2006-07, standard deduction has been withdrawn.

2. Entertainment Allowance [section 16(ii)] of the Act as given earlier, entertainment allowance received from employer is first included in gross salary and thereafter, a deduction is allowed to government employees (State or Central Government) to the extent of least of following 3 amounts:

   (i) Rs.5000

(ii) 20% of basic salary

(iii) Amount of Entertainment Allowance actually received during the year.

3. Professional Tax [Section 16(iii)] of the Act.
Professional tax or tax on employment levied by a State under Article 276 of the Constitution is allowed as a deduction only in the year when it is actually paid. If the professional tax is paid by the employer on behalf of the employee, it is first included in gross salary as a perquisite (since it is an obligation of employee fulfilled by employer) and then the same amount is allowed as deduction on account of professional tax from gross salary.

**Illustration 5.4 (based on retirement benefits)**

Mr. X is working in a factory in Delhi since August 1970. He gets Rs.4000 per month as basic salary, Rs.400 per month as dearness allowance and Rs.500 per month as house rent allowance. He resides in his own house.

On 1st January, 2005 he retires and gets Rs.40, 000 as gratuity and Rs.50, 000 as accumulated balance from unrecognized provident fund. His own contribution and that of factory to the fund was equal. From January 2005 onwards, he starts getting pension of Rs.1000 per month.

Compute Net Income of Mr X for the Assessment Year 2006-07.

**Solution**

| Computation of Net Salary of Mr. X for the Assessment Year 2006-07 | |
|---|---|
| | Rupees |
| Basic Salary (Rs.4000 x 9) | 36,000 |
| Dearness Allowance (Rs.400 x 9) | 3,600 |
| House Rent Allowance (Rs.500 x 9) | 4,500 |
| (No exemption since X resides in own house) | |
| ½ Lumsum received from unrecognized provident fund | 25,000 |
| Pension Rs.1000 x 3 | 3,000 |
| Gratuity (Rs.40,000 – amount exempt Rs.68,000 | NIL |
| Gross Salary | 72,100 |

| | |
|---|---|
| Less deductions | - |
| **Net Salary** | **72,100** |

Amount of gratuity exempt is least of following 3 amounts for other employees:

1. ½ months salary for completed years of service (½ x 4000 x 34) = Rs.68, 000
2. Actual gratuity received (Rs.40, 000)
3. Limit by Central Government – Rs.3, 50,000

Amount exempt is Rs.68, 000; amount received is Rs.40, 000.
So, entire amount of gratuity is exempt.

CHECK YOUR PROGRESS

**Activity E:**

What are the differences between Public Provident Fund and Recognized Provident Fund?

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# 5.4 COMPUTATION OF INCOME FROM SALARIES

| Computation of Net Salary of Mr. X<br>for the Assessment Year 2006 -2007 | |
|---|---|
| | **Rupees** |
| **Particulars** | **Amount** |
| Basic Salary<br>Fees, Commission and Bonus<br>Taxable value of cash allowances<br>Taxable value of perquisites<br>Retirement Benefits<br>GROSS SALARY<br>Less: Deductions from Gross Salary<br>1. Standard Deduction<br>2. Entertainment allowance deduction<br>3. Professional tax deduction | |
| NET SALARY | |

**Illustration 5.5**

Mr. X is a lecturer in a private college in Chennai. During the previous year 2005-06, he gets the following emoluments: Basic salary Rs.10, 000 per month, dearness allowance: 10% of basic salary, city compensatory allowance: Rs.300 per month, children education allowance: Rs.500 per month (for 3 children), house rent allowance: 20% of salary (rent paid Rs.2000 per month). He gets Rs.18, 000.

a) Reimbursement from his employer in respect of medical expenditure incurred on treatment of his wife in a private clinic. Besides, he gets Rs.11, 400 as reimbursement from the employer in respect of books and journals purchased by him in discharging his official work.

   He contributes 11% of his salary to statutory provident fund to which a matching contribution is made by the employer. During the year, he spends Rs.15, 000 for maintaining a car for going to the college. Determine his net income under the head salaries.

| Computation of Net Salary of Mr. X<br>for the Assessment Year 2006 -2007 | |
|---|---|
| | **Rupees** |
| **Particulars** | **Amount** |
| Basic Salary (Rs.10, 000 x 12) | 1, 20,000 |
| Dearness allowance (10% of 1, 20,000) | 12,000 |
| City compensatory allowance (Rs.300 x 12) | 3,600 |
| Children education allowance (Rs.500 x 12 less amount exempt Rs.100 x 12 x 2) | 3,600 |
| House Rent Allowance (20% of 1, 20,000 less amount exempt Rs.12, 000) | 12,000 |
| Reimbursement of medical expenses (Rs.18, 000 - Rs.15, 000) | 3,000 |
| Reimbursement of expenses on books (not chargeable to tax) | - |
| GROSS SALARY | 1, 54,200 |
| Less Standard deduction | NIL |
| NET SALARY | 1, 54,200 |

Working Notes:

1. Amount of HRA exempt is least of 3 figures:

| | | |
|---|---|---|
| a) | 50% of Salary (1, 20,000) | 60,000 |
| b) | Actual HRA received (20% of 1, 20,000) | 24,000 |
| c) | Rent paid in excess of 10% of Salary | |
| | 2000 x 12 - 10 / 100 x 1, 20,000 | 12,000 |
| | Amount of HRA exempt is | 12,000 |

2. Expenditure on maintenance of car is an application of income, not deductible.

3. Contribution of employer towards employee's statutory provident fund is exempt upto 12%.

4. Reimbursement of medical expenditure by employer in private clinic is exempt upto Rs.15, 000.

5. Children education allowance is exempt to the extent of Rs.100 per month per child for maximum 2 children.

**Illustration 5.6**

Mr. X, a production manager of A Ltd. receives the following emoluments during the previous year 2005-06.

Basic salary Rs.12,000 per month, bonus : Rs.12,000 per annum, commission : Rs.6,000 per annum, entertainment allowance : Rs.4,000 per annum, A rent free house has been provided in Bombay, Lease rent of the house : Rs.1,50,000 per annum.

Employer has provided him free use of an optra car for official as well as personal use. Employer spent Rs.50, 000 on car, 30% of which is attributable to personal use. The employer pays a sum of Rs.400 on account of professional tax on behalf of X. A Ltd. gifts a computer to X on its founder's day (cost of computer Rs.24, 560). Employer's contribution towards recognized provident fund Rs.18, 000 per annum. Determine net salary of X for the Assessment year 2006-07.

| Computation of Net Salary of Mr. X<br>for the Assessment Year 2006 -2007 | |
|---|---|
| | **Rupees** |
| **Particulars** | **Amount** |
| Basic Salary (Rs.12, 000 x 12)<br>Bonus<br>Commission<br>Entertainment Allowance<br>Rent free house (See note 1)<br>Motor Car<br>Computer gifted by employer | 1, 44,000<br>12,000<br>6,000<br>4,000<br>33,200<br>NIL<br>NIL |
| Employer's contribution towards recognized PF (Rs.18, 000 - 12 / 100 x 1, 44,000) | 720 |
| Professional tax paid by employer | 400 |
| GROSS SALARY | 2, 00,320 |
| Less: Standard deduction | NIL |
| Less: Professional tax | 400 |
| NET SALARY | 1, 99,920 |

Working Notes:

1. Computation of value of rent free house
   Rent free salary
   Basic salary (1, 44,000) + bonus (12,000) + commission (6,000) + entertainment allowance (4,000) = Rs.1, 66,000

   Value of house in Bombay
   20% of Rent free salary (1, 66,000) = Rs.33, 200

2. Perquisite in respect of car and gift of computer to employees are chargeable to tax in the hands of employer under fringe benefit tax.

## 5.5 LET US SUM UP

1. Heads of Income: There are 5 heads of income into which income of persons can be divided namely Income from salary, house property, business or profession, capital gains and other sources.

2. Meaning of Salary: Any remuneration paid by an employer to an employee in consideration of his services is called salaries. It includes monetary value of those benefits and facilities which are provided by the employer and are taxable.

3. Income forming part of salary: They include basic salary, advance salary, fees, commission, and bonus, taxable value of cash allowances, perquisites and retirement benefits.

4. Allowances: These are of three types

(a) Taxable Allowances: Dearness allowance, Medical allowance, Servant allowance, Warden Allowance, Family allowance, City Compensatory allowance etc.
(b) Allowances exempt upto specified limit: House rent allowances, Entertainment allowance, Certain Special allowances, etc.
(c) Fully exempted allowances: Foreign allowance, sumptuary allowance to High Court / Supreme Court Judges, Allowances from U.NO.

5. Perquisites: These are of three types:

(a) Taxable perquisites for all employees: Facility of rent-free house or house at concessional rent, payment of employee's obligations, payment of life insurance premium of the employee, etc.
(b) Perquisites taxable in specified cases only: Facility of servant, gardener, gas, electricity, water, education, etc.
(c) Tax-free perquisites: Free Medical facility or reimbursement of medical expenses, free facility of refreshments, entertainment, telephone, family planning, scholarship, leave travel concession, free motor car, club facility, gifts etc.

6. Valuation of perquisites: See Rule 3 of Income Tax Rules.

7. Deductions: Following three deductions are admissible:

(a) Standard Deduction: This has been withdrawn from Assessment Year 2006-07.

(b) Entertainment Allowance:
  (i) Government employees – 1/5th of salary or Rs.5, 000, whichever is less.
  (ii) Others - Nil
(c) Employment Tax – Full Amount

8. Provident Funds: These are of four types:

(a) Statutory provident fund
(b) Recognized provident fund
(c) Unrecognized provident fund and
(d) Public provident fund

## 5.6 GLOSSARY

Terms used in the lesson are as explained herein:

1. Fringe Benefits - Means any privilege, service, facility, or amenity, directly or indirectly provided by an employer to his employee, also includes expense made by employer in the course of business on entertainment , hospitality, conferences, sales promotion, etc.

2. Encashment of Leave – Getting cash equivalent of leave which is not availed by an employee based on his salary.

3. Carried Forward – In context of earned leave, this means it can be taken over to next year if not availed during the year.

4. Substantial interest – a person who holds 20% or more of shares / voting power in a company is considered as having substantial interest in that Company.

## 5.7 SELF ASSESSMENT QUESTIONS

1. Mrs. X (Age: 29 years) is a part time lecturer in Delhi University. The details of her salary income are as follows:

| | Rupees |
|---|---|
| Basic Salary | 60,000 |
| Dearness Allowance | 2,400 |
| Education Allowance for 2 children | 3,600 |
| Hostel expenditure allowance for one child | 6,080 |
| House Rent Allowance | 8,000 |
| (Rent paid by Mrs. X is Rs.900 per month) | |

She is a member of statutory Provident Fund to which she contributes 12% of her salary and similar amount is contributed by the College. Besides, College reimburses Rs.21, 600 being expenditure incurred by Mrs. X on medical treatment of her daughter in a private clinic. She spent Rs.700 on purchase of books for teaching purpose. She has maintained a scooter for commuting to College and spends Rs.500 per month on it. Compute net salary of Mrs. X for assessment year 2006-07.

Ans. Net income from salary = Rs.77, 080

Hints: (1) Medical expenditure incurred in private hospital is exempt upto Rs.15, 000

(2) HRA taxable is Rs.4, 400

(3) No deduction is given for expenses incurred in earning salary income

2. Mr. X receives the following incomes during the year ending on 31st March, 2006

| | Rupees |
|---|---|
| Salary @ Rs.12,500 per month | 1,50,000 |
| Leave Travel Concession for proceeding on Leave (actual expenditure Rs.4,100) | 3,800 |
| Tiffin allowance (actual expenditure Rs.2,700) | 4,000 |
| Reimbursement of medical expenses of X and his family in private clinic | 31,300 |

Besides, X enjoys the following perks:

Free unfurnished flat in Delhi (rent paid by the employer Rs.80, 000)

The employer provides a watchman and a gardener / salary paid to both @Rs.7, 000 per month)

Free use of Maruti Car for private and official purposes. Expenditure incurred by employer Rs.30, 000

Free meal at place of work: Rs.14, 700 paid directly to the canteen by employer.

Determine the income under the head salaries.

Ans. Net income from salaries: Rs.2, 17,900.

Hints:
1. Leave Travel Concession is fully exempt from tax.
2. Tiffin allowance is fully taxable
3. Value of rent free flat is calculated as 20% of salary or lease rent paid by employer, whichever is less. [Value of flat: Rs.30, 800].
4. Free Car and free meals are taxable in the hands of employer as fringe benefits under fringe benefit tax and so are not taxable for employees who receive them.

3. Mr. X, an employee of A Ltd. receives the following salary and perquisites from his employer during the previous year 2005-06.
Basic salary Rs.96,000, Bonus Rs.4,500, Commission on Sales @ 2 percent of turnover (turnover of the year 2005-06 achieved by X Rs.4,50,000), advance salary of April, May and June 2006 received in March 2006 Rs.24,000, employer's contribution to recognized provident fund Rs.13,220, interest credited to the provident fund account @ 14.5 per cent Rs.8,700, rent free furnished house in Calcutta (lease rent of Rs.78,550 paid by employer, rent of furniture Rs.23,500). Free services of gardener (salary paid Rs.6, 000); watchman (salary Rs.7, 200) and cook (salary Rs.7000) were provided by the employer.
Determine taxable income of X for the Assessment year 2006-07.

Ans. Net income from salaries – Rs.1, 92,720.

Hints:

1. Advance salary is taxable on receipt basis, so is included in salary.
2. Employers' contribution to recognized provident fund is exempt to the extent of 12% of basic salary + commission – Rs.620.
3. Interest credited to the extent of 9.5 per cent is exempt, balance is taxable – Rs.3000.
4. Salary of watchman, gardener and cook is fully taxable.
5. Value of rent free house – Rs.21900.

## 5.8 SOURCES AND FURTHER READINGS


1. Singhania V.K. and Monica Singhania (2006), *Students Guide to Income Tax*, Taxmann Publications, and New Delhi.

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3. Mehrotra H.C. (2006), *Income Tax Law and Accounts,* Sahitya Bhawan, Agra.

4. Ahuja Girish and Ravi Gupta (2006), *Systematic Approach to Income Tax and Sales Tax*, Bharat Publication, Sahitya Bhawan, Agra.