

INCOME FROM SALARIES

Some Key Points : Recent Amendments

Sweat Equity Shares [Section 17(2)(vi)]

Finance (No.2) Act, 2009 substituted sub-clause (vi) to section 17(2) w.e.f. 01.04.2010. 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 is chargeable to tax as perquisite.

The value of any specified security or the sweat equity share shall be the **fair market value** of the specified security or sweat equity share as the case may be, on the date on which the **option** is exercised by the assessee. Any amount actually paid or recovered from the assessee shall be deducted and only the resultant is chargeable as perquisite.

'Fair market value' means the value determined in accordance with the method as may be prescribed.

'Option' means a right but not an obligation granted to an employee to apply for the specified security or sweat equity share at a predetermined price.

It may be noted that the Finance (No.2) Act, 2009 has inserted sub-section (2AA) to section 49 to cover capital gains arising from transfer of sweat equity shares by the employee after such allotment. The cost of acquisition of the specified security or sweat equity shares shall be the fair market value which has been taken into account for the purpose of computing perquisite value under section 17(2)(vi), at the time of allotment.

Contribution to Superannuation Fund [Section 17(2)(vii)]

The amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds Rs.1 lakh shall be chargeable to tax as perquisite.

Any other Fringe benefit or amenity [Section 17(2)(viii)]

The value of any other fringe benefit or amenity provided by the employer to the employee shall be chargeable to tax subject to the conditions and limits prescribed in rule 3 of the Income-tax rules, 1962.

Question 1

Mr. X is a Member of Legislative Assembly. He underwent an open heart surgery abroad in respect of which he received Rs.5 lakh from the State Government towards reimbursement of his medical expenses. The Assessing Officer contended that such amount is taxable as a perquisite under section 17. Discuss the correctness of the contention of the Assessing Officer.

Answer

The facts of this case are similar to the facts in *CIT v. Shiv Charan Mathur (2008) 306 ITR 0126 (Raj.)*. In the instant case, the High Court observed that MPs and MLAs are not employed by anybody. They are elected by the public, their election constituencies and it is consequent upon such election that they acquire constitutional position and are in charge of constitutional functions and obligations. The remuneration received by them, after swearing in, cannot be said to be salary within the meaning of section 15, since the basic ingredient of employer-employee relationship is missing in such cases.

Therefore, the remuneration received by MPs and MLAs are taxable under the head "Income from Other Sources" and not under the head "Salaries". When the provisions of section 15 are not attracted to the remuneration received by MPs and MLAs, the provisions of section 17 also would not apply as section 17 only extends the definition of salary by providing that certain items mentioned therein would be included in salary as "perquisites". Thus, reimbursement of medical expenditure (incurred for open heart surgery abroad) to an MLA cannot be taxed as a perquisite under section 17.

Applying the above ruling to the case on hand, the contention of the Assessing Officer is not correct.

Question 2

Raghav has been in the service of a private company since 1st January, 1993, in Kolkata. During the financial year ending 2010-11 upto the date of retirement, he received from the company, salary @ Rs.12,000 p.m. dearness allowance @ Rs.2,000 p.m., city compensatory allowance @ Rs.300 p.m., entertainment allowance @ Rs.1,000 per month and house rent allowance @ Rs.4,000 p.m. He resides in the house property owned by his HUF for which he pays a rent of Rs.4,500 p.m. He contributes Rs.1,400 p.m. to the recognised provident fund. The company is also contributing an equal amount.

Raghav retired from the service of the company on 31-12-2010 when he was paid a gratuity of Rs.80,000 and pension of Rs.6,000 p.m. He is not covered under the Payment of Gratuity Act, 1972. On 1-2-2011, he got one-half of the pension commuted and received Rs.1,80,000 as commuted pension. He also received Rs.3,00,000 as the accumulated balance of the recognised provident fund.

Compute his income under the head salary for the A.Y. 2011-12.

Answer

Computation of income under the head “Salaries” for the A.Y.2011-12

Particulars	Rs.
Salary (12,000 x 9)	1,08,000
Dearness allowance (2,000 x 9)	18,000
City compensatory allowance (300 x 9)	2,700
Entertainment allowance (1,000 x 9)	9,000
House rent allowance [See Note 1]	6,300
Pension (6,000 + 3,000 x 2)	12,000
Commuted pension (1,80,000 – 1,20,000) [See Note 3]	60,000
Gross salary	2,16,000
Less: Deduction under section 16 [See Note 5]	Nil
Income from salary	2,16,000

Note -

- As per section 10(13A), house rent allowance will be exempt to the extent of minimum of the following three amounts:
 - 50% of salary i.e. 54,000.
 - Rent paid minus 10% of salary i.e., $4,500 - 1,200 = 3,300 \times 9 = 29,700$
 - HRA received $4,000 \times 9 = 36,000$

Therefore, out of Rs.36,000, Rs.29,700 will be exempt and the balance Rs.6,300 will be included in Gross Salary.
- Gratuity of Rs.80,000 is fully exempt under section 10(10)(iii), being the minimum of the following amounts:
 - Actual gratuity received, i.e., Rs.80,000
 - Half month's average salary for every completed year of service i.e.,

$$\frac{\text{Average monthly salary}}{2} \times 18 \text{ i.e. } \frac{12,000 \times 18}{2} = \text{Rs. } 1,08,000$$
 - Notified limit i.e., Rs.10,00,000 (w.e.f. 24.05.2010)
- As Raghav is receiving gratuity, one-third of commuted pension will be exempt and the balance would be taxable. 50% of the pension commuted is Rs.1,80,000. Therefore, 100% would be Rs.3,60,000 and one-third of the same would be Rs.1,20,000. The

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taxable portion of the commuted pension would be Rs.60,000 (i.e. Rs.1,80,000-Rs.1,20,000).

4. Since employer's contribution to recognized provident fund is less than 12% of salary, it is not taxable. Accumulated balance of the recognized provident fund received is exempt from tax, since Raghav has rendered continuous service of more than five years.
5. Deduction under section 16(ii) in respect of entertainment allowance can be claimed only by Government employees. Therefore, Raghav is not eligible for any deduction in respect of entertainment allowance received by him.
6. Pension of January 2011 Rs.6,000 plus pension after commutation (Rs.6,000 less 50%) Rs.3,000 for February and March 2011. (Rs.6,000 + Rs.3,000 + Rs.3,000).

Question 3

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 1.8.2010:

	Amount in Rs.		
	Ford Car	Computer	Furniture
Cost of Purchase (July, 2008)	9,13,000	2,05,000	42,000
Sale Price	5,20,000	46,000	21,000

The assets were put to use by the company from the day they were purchased.

Answer

Computation of taxable value of perquisite

Sl. No.	Description of asset	Value of perquisite Rs.		
1.	Ford Car	64,320		
2.	Computer	5,250		
3.	Furniture	<u>12,600</u>		
	Total	<u>82,170</u>		

	Nature of Asset		
	Ford Car	Computer	Furniture
Rate of Depreciation	20%	50%	10%
Method of depreciation	WDV	WDV	SLM
Sale Price (B)	<u>5,20,000</u>	<u>46,000</u>	<u>21,000</u>
Cost of purchase (July, 2008)	9,13,000	2,05,000	42,000

Income From Salaries

Less : Normal wear & tear	<u>1,82,600</u>	<u>1,02,500</u>	<u>4,200</u>
Reduced actual cost (July 2009)	7,30,400	1,02,500	37,800
Less : Normal wear & tear	<u>1,46,080</u>	<u>51,250</u>	<u>4,200</u>
Reduced actual cost (July 2010) (A)	<u>5,84,320</u>	<u>51,250</u>	<u>33,600</u>
Taxable perquisite (A) – (B)	<u>64,320</u>	<u>5,250</u>	<u>12,600</u>

Note: According to Rule 3(7), the value of perquisite in respect of transfer of a movable asset shall be the difference between sale price and the actual cost as reduced by the **specified rate for normal wear and tear for each completed year of usage**.

Question 4

Mr. Padam is entitled to a salary of Rs.25,000 per month. He is given an option by his employer either to take house rent allowance or a rent free accommodation which is owned by the company. The HRA amount payable was Rs.5,000 per month. The rent for the hired accommodation was Rs.6,000 per month at New Delhi. Advice Mr. Padam whether it would be beneficial for him to avail HRA or Rent Free Accommodation. Give your advice on the basis of "Net Take Home Cash benefits".

Answer

Computation of tax liability of Padam under both the options

Particulars	Option I – HRA	Option II – RFA
Basic Salary (Rs.25,000 x 12 Months)	3,00,000	3,00,000
Perquisite value of rent-free accommodation (15% of Rs.3,00,000)	N.A.	45,000
House rent Allowance (Rs.5,000 x 12 Months) 60,000		
Less: Exempt u/s 10(13A) – least of the following -		
- 50% of Basic Salary 1,50,000		
- Actual HRA 60,000		
- Rent less 10% of salary <u>42,000</u> <u>42,000</u>	18,000	
Income taxable under the head "Salaries"	3,18,000	3,45,000
Less: Deduction under Chapter VIA	-	-
Total Income	<u>3,18,000</u>	<u>3,45,000</u>
Tax on total income	15,800	18,500
Add: Education cess@1% and SHEC @ 2%	474	555
Total tax payable	<u>16,274</u>	<u>19,055</u>

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Cash Flow Statement		
Particulars	Option I – HRA	Option II – RFA
Inflow : Salary	3,60,000	3,00,000
Less: Outflow: Rent paid	(72,000)	-
Tax on total income	(16,274)	(19,055)
Net Inflow	2,71,726	2,80,945

Since the net cash inflow under option II (RFA) is higher than in Option I (HRA), it is beneficial for Mr. Padam to avail Option II, i.e., Rent free accommodation.

Question 5

Examine critically in the context of provisions contained in Income-tax Act, 1961 as to the correctness of the action or the treatment given in each of the following case:

An amount of Rs.12,50,000 paid by XYZ Ltd., after approval by the board, to a hospital in UK for the heart surgery of its managing director was charged under medical expenses. The Assessing Officer, while completing the assessment of the company, taxed the amount so paid by the company as a perquisite in the hands of its Managing Director.

Answer

A Managing Director generally occupies the dual capacity of being a director as well as an employee of the company. In this case, assuming that the Managing Director is also an employee of XYZ Ltd., clause (vi) of the proviso to section 17(2) would get attracted.

Clause (vi) of the proviso to section 17(2) provides that any expenditure incurred by the employer on medical treatment of the employee outside India shall be excluded from perquisite only to the extent permitted by RBI. Therefore, the expenditure on medical treatment of the Managing Director outside India shall be excluded from perquisite to the extent permitted by RBI as per clause (vi) of the proviso to section 17(2). If it is assumed that the entire amount is permitted by RBI, there would be no perquisite chargeable in the hands of the Managing Director. Therefore, in such a case, the action of the Assessing Officer in taxing the entire amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

This question can also be answered by applying the ratio of the Allahabad High Court ruling in *CIT v. D.P. Kanodia (2008) 296 ITR 616*. In that case, the High Court observed that the reimbursement by the company of medical expenditure incurred outside India by the director cannot be considered as an amenity or benefit provided by the company to its director, and therefore the provisions of section 17(2)(iii)(a) would not be attracted. Therefore, such reimbursement was not a perquisite within the meaning of section 17(2)(iii)(a).

Hence, applying the ratio of the above case to the facts of this case, the action of the Assessing Officer in taxing the amount paid by the company as a perquisite in the hands of the Managing Director is incorrect.

Question 6

Ayush, an employee of a management consultancy firm, was sent to UK in connection with a project of the firm's client for two months in a previous year. In addition to his salary, the firm paid per diem allowance for the period when he worked in UK to meet expenses on boarding and lodging. Tax was not deducted at source from such allowance by the employer. Ayush did not include such allowance in computation of his taxable salary for the relevant assessment year. In course of assessment of Ayush under section 143(3), the Assessing Officer sent a notice to him asking him to explain why the per diem allowance received by him should not be charged to tax? Ayush sought your advice.

Answer

Per-diem allowance is exempt from tax under section 10(14)(i) read with Rule 2BB, as it is an allowance granted and spent to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty. Rule 2BB exempts the allowance granted to meet the ordinary daily charges incurred by an employee on account of his absence from his normal place of duty. In the given case, Mr. Ayush was posted for a period of 2 months outside his normal place of duty and the allowance was paid to meet the boarding and lodging. Therefore, the allowance would fall under section 10(14)(i) read with Rule 2BB and would hence be exempt.

Question 7

IT Limited, under its Employment Stock Option Plan, allotted 500 equity shares to its finance manager, Ms. Cynthia on 15th May, 2010, when she exercised her option. The option was granted on 15th January, 2009 and the shares vested with Cynthia on 15th January, 2010. The company's shares are quoted in Bombay Stock Exchange, where the opening price and closing price on the date of exercise of option were Rs.250 and 256, respectively. The company recovered Rs.50 per share from Cynthia. Compute the value of perquisite for the assessment year 2011-12.

Answer

Allotment of shares under the Employees' Stock Option Plan (ESOP) is liable to tax as perquisite in the hands of employees. The fair market value of shares on the date on which the option is exercised by the employee as reduced by the amount actually paid by or recovered from the employee in respect of such shares would be the value of perquisite.

As per Rule 3(8), in case of shares listed in one recognized stock exchange, fair market value means the average of opening price and closing price of the share on the said stock exchange as on the date of exercise of option.

Therefore, in this case, the fair market value would be $\frac{250 + 256}{2} = \text{Rs.}253$

Thus, the value of perquisite would be = $(253 \times 500) - (50 \times 500) = \text{Rs.}1,01,500$.

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Question 8

Simran Pharma Ltd., a manufacturer of drugs and pharma products, provides the following information relating to payments made to Mr. Ram its marketing manager in the financial year 2010-11:

- Salary @ Rs. 20,000 p.m.
- Motor-cycle purchased for Rs.45,000 in June, 2010 was given free of cost.
- Conveyance allowance of Rs.5,000 p.m. which was allowed to him as exempt under section 10(14).
- Tickets worth Rs.4,000 for a cricket match between India and England.
- Reimbursement of medical expenses actually incurred by him of Rs.17,500.

The company asks you to compute the total income chargeable to tax in the hands of marketing manager Mr. Ram.

Answer

Computation of total income of Mr. Ram	(Rs.)
- Salary	2,40,000
- Free Motor cycle	45,000
- Conveyance allowance exempt under section 10(14) for employee and totally tax free perquisite	Nil
- Free ticket of a cricket match	4,000
- Reimbursement of medical expenses (Reimbursement up to Rs.15,000 is exempt in the hands of the employee and the excess is taxable)	2,500
Total Income	2,91,500

Note

The value of gift voucher or token below Rs.5,000 in aggregate in a year received by the employee from the employer shall not be taxable as a perquisite. The free ticket of a cricket match could not be treated as gift and accordingly taxed in the above computation.

Question 9

Calculate the value of perquisite, if any, chargeable to tax in respect of free accommodation provided by the employer in a hotel to an employee, for the previous year ended 31.3.2011 :

- (i) For 10 days when he was transferred from Delhi to Mumbai.
- (i) Throughout the year as per contract of employment.

Answer

- (i) As per Rule 3, if the hotel accommodation is provided to the employee by the employer for a period not exceeding 15 days and such accommodation is provided on employee's transfer from one place to another, it is not a chargeable perquisite. In this case, the employer has provided accommodation in a hotel for a period of only 10 days. Hence, it is not a chargeable perquisite.
- (ii) The employee was provided under a contract, accommodation in a hotel free of charge for throughout the year and accordingly the value of perquisite will be 24% of salary of the employee or the actual charges paid or payable to the hotel, whichever is less. The calculation shall be for the period during which such accommodation is provided and the value shall be reduced by the rent, if any, actually paid or payable by the employee.

Question 10

Find out the taxable value of perquisite from the following particulars in case of an employee to whom the following assets held by the company were sold on 13.6.2010:

	Amount of Rs.		
	Car	Laptop	Furniture
Cost of Purchase (May 2008)	8,72,000	1,22,500	35,000
Sale Price	5,15,000	25,000	10,000

The assets were put to use by the company from the day these were purchased.

Answer

The assets transferred by the company shall be considered for the purpose of valuation of perquisites under section 17(2) of the Act read with Rules. The value of perquisite in respect of assets transferred is determined after allowing normal wear & tear for the period of use of such assets by employer.

	Car	Laptop	Furniture
Basis of Depreciation	WDV	WDV	SLM
Cost of asset to company – May 2008	8,72,000	1,22,500	35,000
Less: Normal wear & tear upto May, 2009 @ 20% - 50% - 10% respectively	1,74,400	61,250	3,500
	6,97,600	61,250	31,500
Less: Normal wear and tear upto May, 2010	1,39,520	30,625	3,500
Balance, in May, 2010	5,58,080	30,625	28,000
Less: Sale value on 13.06.10	5,15,000	25,000	10,000
Value of Perquisite	43,080	5,625	18,000

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Note: As per Rule 3(7) of Income-tax Rules, normal wear and tear has to be calculated at the aforementioned prescribed rates applying Straight Line Method (SLM) to Furniture and Written Down Value (WDV) method to all other assets.

Question 11

Babu joined a company on 01.06.2010 at Mumbai and was paid the following emoluments and allowed perquisites as under:

<i>Emoluments :</i>	<i>Basic pay Rs.25,000 per month</i>
	<i>D.A. Rs.10,000 per month</i>
	<i>Bonus Rs.50,000 per annum</i>

Perquisites:

- (i) Furnished accommodation owned by the employer and provided free of cost*
- (ii) Value of furniture there in Rs.3,00,000*
- (iii) Motor-car owned by the company (with engine c.c. less than 1.6 litres) along with chauffeur for official and personal use.*
- (iv) Sweeper salary paid by company Rs.1,500 per month*
- (v) Watchman salary paid by company Rs.1,500 per month*
- (vi) Educational facility for 2 children provided free of cost. The school is owned and maintained by the company.*
- (vii) Interest free loan of Rs.5,00,000 given on 1.10.2010 for purchase of a house. No repayment was made during the year.*
- (viii) Interest free loan for purchase of computer Rs.50,000 given on 1.1.2011. No repayment was made during the year.*

You are required to compute the income of Babu under the head "Salaries" in respect of assessment year 2011-12.

Answer

Computation of income from salaries of Mr. Babu for A.Y.2011-12

Basic pay	Rs.25,000 x 10	2,50,000
D.A.	Rs.10,000 x 10	1,00,000
Bonus		50,000
		4,00,000

Perquisites-

- (a) Rent free accommodation – assumed that D.A is not included for

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	superannuation benefits. 15% of (2,50,000 + 50,000)	45,000
(b)	Value of furniture 10% of Rs.3,00,000 for 10 months	25,000
(c)	Motor car Rs.2700 x 10 (As per perquisite rules)	27,000
(d)	Sweeper – Actual cost to company 1500 x 10	15,000
(e)	Watchman – Actual cost to company 1500 x 10	15,000
(f)	Educational facility for 2 children Assumed that the cost of education per child does not exceed Rs.1,000 p.m.	NIL
(g)	Interest free loan for purchase of house 10% p.a. (assumed that it is for term of 5 to 15 years) on Rs.5 lakhs for 6 months	25,000
(h)	Interest free loan for purchase of computer 16.50% p.a. of Rs.50,000 for 3 months (treated as personal loan)	2,062
Income from salary		5,54,062

Note :-

Motor car owned by employer used partly for official purpose and partly for personal purpose by the employee is taxable as perquisite. The cubic capacity of the engine is less than 1.6 litres. The perquisite value including driver salary is Rs.1800 + Rs.900 per month. The perquisite value is therefore Rs.27,000 (Rs.2,700 x 10).

Question 12

Write short note on the Employee's stock option scheme

Answer

As per section 17(2)(vi), the value of any specified security or sweat equity share allotted or transferred directly or indirectly, by the employer, or former employer, free of cost or at concessional rate is chargeable to tax as perquisite.

According to the Explanation to the section,

- (a) 'specified security' means the securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 and, where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme.
- (b) 'sweat equity shares' means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

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- (c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee (employee) as reduced by the amount actually paid by, or recovered from the assessee in respect of such security or shares.
- (d) 'fair market value' means the value determined in accordance with the method as may be prescribed.
- (e) 'option' means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.

Question 13

A, an individual, has income taxable only under the head 'salaries'. In the course of the previous year ended 31st March, 2011, he pays Rs.10,000 to an institution recognized by the prescribed authority under section 35CCA of the Income-tax Act.

Will A be entitled to any deduction under the Act and if so, in what an amount?. Discuss.

Answer

The question is whether the deduction of the amount paid to an institution recognised by the prescribed authority under section 35CCA is available to a person, deriving income under the head "Salary".

Section 80GGA permits the deduction to all assesseees, other than an assessee whose gross total income includes income chargeable under the head "profits and gains of business or profession". Mr.A fulfils this condition. Therefore, he is eligible for 100% deduction of the amount paid by him to the institution, on fulfillment of the conditions prescribed in section 80GGA.

Question 14

Ajay is employed as senior executive of Manu Ltd. Manu Ltd offers rights to its existing shareholders in the ratio 1:1 on 15th February 2011 at Rs.150 per share. Ajay was offered 500 shares at Rs.150, which he exercised. On these facts you are consulted by Ajay as to.

- (a) *The tax consequences for the assessment year 2011-2012 assuming that fair market value on the date of exercise of option is Rs. 300.*
- (b) *If Ajay is already as shareholder of 250 shares, allotted in public issue will it make any difference?*

Answer

- (a) As per section 17(2)(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 employee is taxable as perquisite. The

meaning of the terms 'specified security', 'sweat equity shares', 'fair market value' are dealt with in the Explanation given therein.

The fair market value of the shares so determined in accordance with the method as may be prescribed less the amount actually recovered from the employee, shall be the value of perquisite chargeable to tax.

The value of perquisite would be:

Fair market value of shares determined as per the prescribed method in Income-tax Rules, 1962 = 500 shares @ Rs.300 each	1,50,000
Less: Amount recovered from the employee @ Rs.150 per share	<u>75,000</u>
Value of perquisite chargeable to tax	<u>75,000</u>

As per section 49(2AA) the cost of acquisition of specified security or sweat equity shares referred to in section 17(2)(vi) shall be the fair market value which has been taken into account for the purpose of perquisite valuation.

- (b) In case the employee is a shareholder and was allotted shares in the same manner as was allotted to other shareholders by the company without any concession / reduction in value then the question of valuation of perquisite would not arise.