

Income From Salaries

Some Key Points : Recent Amendments

Ceiling for gratuity exemption raised to ₹ 10 lakhs

Section 10(10)(ii) exempts any gratuity received under the Payment of Gratuity Act, 1972, to the extent it does not exceed an amount calculated in accordance with the provisions of sub-sections (2) and (3) of section 4 of that Act. The limit specified under sub-section (3) of section 4 has been increased from ₹ 3,50,000 to ₹ 10,00,000 by the Payment of Gratuity (Amendment) Act, 2010 dated 17th May, 2010.

Thereafter, the Central Government has enhanced the notified limit under section 10(10)(iii) from ₹ 3,50,000 to ₹ 10,00,000 in relation to employees who retire or become incapacitated prior to such retirement or die on or after 24th May, 2010 or whose employment is terminated on or after the said date. In effect, the ceiling for gratuity exemption under section 10(10)(iii), which is relevant for employees not covered under the Payment of Gratuity Act, 1972, has also been increased to ₹ 10 lakh vide Central Government Notification No.43/2010 dated 11th June, 2010.

Increase in exemption limit for allowance granted to employees working in a transport system to meet their personal expenditure during the course of duty

Section 10(14)(ii) exempts any such allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at the place where he ordinarily resides, or to compensate him for the increased cost of living as may be prescribed and to the extent as may be prescribed.

The monthly limit of ₹ 6,000 given in Rule 2BB(2) has been increased to ₹ 10,000 with retrospective effect from 1st September, 2008. Therefore, with effect from 1st September, 2008, the exemption would be 70% of such allowance, subject to a maximum of ₹ 10,000 per month.

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

The 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 ₹1 Lac 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. M is working with MNO Limited for the last 10 years. He was granted an option on 1.7.2009 by the company to purchase 800 equity shares at a price of ₹ 250 per share. The period during which the option can be exercised to purchase 800 shares at a pre-determined price of ₹ 250 per share commencing on 1.7.2009 and ending on 31.3.2012. Mr. M exercised the option on 15.3.2011 to purchase 500 shares. Fair market value on the said date was ₹ 6490 on the Bombay Stock Exchange and ₹ 6500 on the National Stock Exchange. The NSE has recorded the higher volume of trading in that share.

The company has allotted him 500 shares on 24th April, 2011. The fair market value on the date of allotment was ₹ 7100 per share on NSE and ₹ 7110 on the BSE, that has recorded the higher volume of trading in that share. The option was granted for making available rights in the nature of intellectual property rights.

Determine the taxability of perquisite. Does it make any difference if the option was granted for providing technical know-how?

Answer

The perquisite of sweat equity shares shall be taxable in the previous year 2011-12 (assessment year 2012-13), being the previous year of allotment of such shares. The value of sweat equity shares shall be the fair market value of such shares on the date on which the

4.3 Direct Tax Laws

option is exercised by the assessee, as reduced by any amount actually paid by, or recovered from, the assessee in respect of such shares.

As per Rule 3(8) of the Income-tax Rules, 1962, the fair market value of a share on the date of exercising the option shall be the price of the share on the recognized stock exchange which records the highest volume of trading in such shares, in case the shares are listed on more than one recognised stock exchange.

Hence, the value of taxable perquisite for sweat equity shares

=	FMV on the date of exercising the option on the NSE (since it recorded higher volume than BSE)	(-)	Amount recovered from the employee
=	500 × ₹ 6500 (-) 500 × ₹ 250		
=	₹ 32,50,000 (-) ₹ 1,25,000		
=	₹ 31,25,000		

As per section 17(2)(vi), "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 technical knowhow or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Therefore, this provision is equally applicable whether the sweat equity shares option was granted for making available rights in the nature of intellectual property rights or for providing technical know-how.

Question 2

Ranjit has taken an interest-free loan of ₹10 lacs from his company. The amount is utilized by him for purchasing a house on 30-06-2010. The house is self-occupied. As per the scheme of the company, loan would be recovered in 40 equal monthly instalments recoverable immediately after the completion of 18th month from the date of purchase. The SBI lending rate of similar loan on 1-4-2011 was 9.75%. Calculate the perquisite value of such loan in the hands of Ranjit for the assessment year 2012-13. Is it possible to get deduction of perquisite value of interest under section 24(b)? Does it make any difference, if the house is given on rent?

Answer

First instalment will be due on 1st January, 2012. Amount of instalment will be:

$$₹ 10,00,000 \div 40 = ₹ 25,000.$$

Therefore, value for perquisite for interest-free loan will be calculated by applying the interest rate charged by the State Bank of India on the first day of the relevant previous year. on the outstanding amount of loan as reduced by the interest, if any, actually paid by the employee. Therefore, the value of perquisite will be as follows:

		₹
From April 11 to Dec. 11	$(10,00,000 \times 9.75\% \times 9/12)$	73,125
For the month of Jan. 12	$(9,75,000 \times 9.75\% \times 1/12)$	7,922
For the month of Feb. 12	$(9,50,000 \times 9.75\% \times 1/12)$	7,719
For the month of Mar. 12	$(9,25,000 \times 9.75\% \times 1/12)$	<u>7,516</u>
	Total	<u>96,282</u>

Therefore, the perquisite value of interest-free loan will be ₹ 96,282.

Interest on capital borrowed for the purchase, construction, re-construction, repair or renewals of house property is deductible under section 24(b). In this case, capital is borrowed from the employer without interest. There is no interest paid or payable in respect of the amount of loan of ₹ 10 lacs. Consequently, no deduction under section 24(b) would be available, whether the house is self-occupied or let out.

Question 3

Examine the correctness or otherwise of the following case in the context of provisions contained in the Income-tax Act, 1961 relevant/applicable for the assessment year 2012-2013:

Nargis, working as Regional Area Sales Manager of Pincer Marketing Ltd., was paid salary and a commission based as a percentage on the volume of sales effected by her. Nargis claimed the expenses incurred by her for earning the commission in the return of income, which were disallowed by the Assessing Officer.

Answer

The facts of this case are similar to the case decided by the Madras High Court in *CIT v. R. Rajendran* (2004) 135 Taxman 95, where it was held that since the assessee was employed as a regional sales manager and the commission paid to him is based on the volume of sales effected, such commission was obviously paid to the employee as an encouragement to effect a higher level of sales. The commission paid in addition to what the employee was getting as a fixed salary would also constitute/form part of salary. When the commission is chargeable as salary, then no deduction is allowable in respect of any expenditure incurred to earn the commission.

Therefore, in this case, the claim made by Nargis is not valid and the expenses incurred for earning commission are not allowable as deduction while computing her salary income.

Question 4

Discuss the taxability of the balance amount withdrawn by an employee from the recognized provident fund at the time of leaving the service.

Answer

The accumulated balance withdrawn from the recognised provident fund account would not be taxable in the hands of the employee, if any of the following conditions are satisfied -

4.5 Direct Tax Laws

- (a) the employee has rendered continuous service with his employer for a period of five years or more; or
- (b) the employee is not able to fulfill the above condition of such continuous service due to his/her service having been terminated by reason of his/her ill health, or by the contraction or discontinuance of the employer's business or due to some other reason beyond the control of the employee; or
- (c) on cessation of employment, the employee obtains another employment and the accumulated balance due and becoming payable to him, is transferred to his individual account in any recognized provident fund maintained by such other employer;

If the accumulated balance becomes taxable due to non-fulfillment of any of the aforesaid conditions, the total income of the employee will be recomputed by the Assessing Officer, as if the fund was not recognized from the beginning, and the employee shall be liable to pay the additional tax due along with the tax liability in the current year.

Question 5

Mr. X is a Member of Legislative Assembly. He underwent an open heart surgery abroad in respect of which he received ₹ 5 Lacs 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 6

Raghav has been in the service of a private company since 1st January, 1994, in Kolkata. During the financial year ending 2011-12 up to the date of retirement, he received from the

company, salary @ ₹ 12,000 p.m. dearness allowance @ ₹ 2,000 p.m., city compensatory allowance @ ₹ 300 p.m., entertainment allowance @ ₹ 1,000 per month and house rent allowance @ ₹ 4,000 p.m. He resides in the house property owned by his HUF for which he pays a rent of ₹ 4,500 p.m. He contributes ₹ 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 31-12-2011 when he was paid a gratuity of ₹ 80,000 and pension of ₹ 6,000 p.m. He is not covered under the Payment of Gratuity Act, 1972. On 1-2-2012, he got one-half of the pension commuted and received ₹ 1,80,000 as commuted pension. He also received ₹ 3,00,000 as the accumulated balance of the recognised provident fund.

Compute his income under the head salary for the A.Y. 2012-13.

Answer

Computation of income under the head “Salaries” for the A.Y.2012-13

Particulars	₹
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 (Uncommuted) (6,000 + 3,000 x 2) [See Note 4]	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 (Assuming the dearness allowance is not included in for superannuation benefits).
 - 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 ₹ 36,000, ₹ 29,700 will be exempt and the balance ₹ 6,300 will be included in Gross Salary.

4.7 Direct Tax Laws

2. Gratuity of ₹ 80,000 is fully exempt under section 10(10)(iii), being the minimum of the following amounts:
- (i) Actual gratuity received, i.e., ₹ 80,000
 - (ii) Half month's average salary for every completed year of service i.e.,
$$\frac{\text{Average monthly salary}}{2} \times 18 \text{ i.e. } \frac{12,000 \times 18}{2} = ₹ 1,08,000$$
 - (iii) Notified limit i.e., ₹ 10,00,000
3. 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 ₹ 1,80,000. Therefore, 100% would be ₹ 3,60,000 and one-third of the same would be ₹ 1,20,000. The taxable portion of the commuted pension would be ₹ 60,000 (i.e. ₹ 1,80,000-₹ 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 2012 ₹ 6,000 plus pension after commutation (₹ 6,000 less 50%) ₹ 3,000 for February and March 2012. (₹ 6,000 + ₹ 3,000 + ₹ 3,000).

Question 7

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 1.8.2011:

	Amount in ₹		
	Ford Car	Computer	Furniture
Cost of Purchase (July, 2009)	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 ₹
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, 2009)	9,13,000	2,05,000	42,000
Less : Normal wear & tear	<u>1,82,600</u>	<u>1,02,500</u>	<u>4,200</u>
Reduced actual cost (July 2010)	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 2011) (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 8

Mr. Kadam is entitled to a salary of ₹ 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 ₹ 5,000 per month. The rent for the hired accommodation was ₹ 6,000 per month at New Delhi. Advise Mr. Kadam 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 Kadam under both the options

Particulars	Option I – HRA (₹)	Option II – RFA (₹)
Basic Salary (₹ 25,000 x 12 Months)	3,00,000	3,00,000
Perquisite value of rent-free accommodation (15% of ₹ 3,00,000)	N.A.	45,000
House rent Allowance (₹ 5,000 x 12 Months) ₹ 60,000		
Less: Exempt u/s 10(13A) – least of the following -		
- 50% of Basic Salary ₹ 1,50,000		

4.9 Direct Tax Laws

- 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
Less: Deduction under Chapter VIA			-
Total Income			3,18,000
Tax on total income			13,800
Add: Education cess@1% and SHEC @ 2%			414
Total tax payable			14,214

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	<u>(14,214)</u>	<u>(16,995)</u>
Net Inflow	<u>2,73,786</u>	<u>2,83,005</u>

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

Question 9

Explain in the context of provisions of the Act, whether the income derived during the year ended on 31.03.2012 in the following case shall be subject to tax in the A.Y. 2012-13:

Mr. Ravi, an IAS Officer, was posted to USA by the Government of India on 11.07.11 for a period of three years. He was paid salary of ₹ 3 lacs for the period 01.04.11 to 10.07.11 and of ₹ 12 lacs for the period upto 31.03.12. He left India for USA in the night of 10.07.11 and did not come even for a day up till 31.03.12.

Answer

The salary drawn by an IAS Officer by virtue of his posting in USA, despite the fact that he was a non-resident in the previous year, shall be subject to tax in India as per section 9(1)(iii) which states that income chargeable under the head "Salaries" payable by the Government to a citizen of India for his services outside India shall be deemed to accrue or arise in India. Therefore, the total amount of salary of ₹ 15 lakh received by the IAS Officer in and outside India shall be subject to tax in India in the A.Y 2012-13.

Question 10

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

An amount of ₹ 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 0616*. 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 11

Explain in brief about the treatment to be given in the following case under the Income-tax Act, 1961 for A.Y. 2012-13:

Pankaj, a salaried employee, received from his employer medical allowance of ₹ 12,000 and reimbursement of ₹ 16,000 on account of medical facilities.

Answer

The medical allowance of ₹ 12,000 received by Pankaj from his employer shall be chargeable to tax under the head income from salary as per section 17(1).

However, according to clause (v) of proviso to section 17(2), out of reimbursement of ₹ 16,000 on account of medical facilities, an amount of ₹ 15,000 will be exempt and only the balance of ₹ 1,000 will be the chargeable value of perquisite.

Question 12

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 13

IT Limited, under its Employment Stock Option Plan, allotted 500 equity shares to its finance manager, Ms. Cynthia on 15th May, 2011, when she exercised her option. The option was granted on 15th January, 2010 and the shares vested with Cynthia on 15th January, 2011. 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 ₹ 250 and 256, respectively. The company recovered ₹ 50 per share from Cynthia. Compute the value of perquisite for the assessment year 2012-13.

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 $\frac{250 + 256}{2} = ₹ 253$

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

Question 14

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 2011-12:

- Salary @ ₹ 20,000 p.m.
- Motor-cycle purchased for ₹ 45,000 in June, 2011 was given free of cost.
- Conveyance allowance of ₹ 5,000 p.m. which was allowed to him as exempt under section 10(14).
- Tickets worth ₹ 4,000 for a cricket match between India and England.
- Reimbursement of medical expenses actually incurred by him of ₹ 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	(₹)
- 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 ₹ 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 ₹ 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 can not be treated as gift and accordingly taxed in the above computation.

Question 15

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 31.3.2012 :

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

4.13 Direct Tax Laws

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 16

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 13.6.2011:

	₹		
	Car	Laptop	Furniture
Cost of Purchase (May 2009)	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 2009	8,72,000	1,22,500	35,000
Less: Normal wear & tear upto May, 2010 @ 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, 2011	1,39,520	30,625	3,500
Balance, in May, 2011	5,58,080	30,625	28,000
Less: Sale value on 13.06.2011	5,15,000	25,000	10,000
Value of Perquisite	43,080	5,625	18,000

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 17

Babu joined a company on 01.06.2011 at Mumbai and was paid the following emoluments and allowed perquisites as under:

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

Perquisites:

<i>(i)</i>	<i>Furnished accommodation owned by the employer and provided free of cost</i>
<i>(ii)</i>	<i>Value of furniture there in ₹ 3,00,000</i>
<i>(iii)</i>	<i>Motor-car owned by the company (with engine c.c. less than 1.6 litres) along with chauffeur for official and personal use.</i>
<i>(iv)</i>	<i>Sweeper salary paid by company ₹ 1,500 per month</i>
<i>(v)</i>	<i>Watchman salary paid by company ₹ 1,500 per month</i>
<i>(vi)</i>	<i>Educational facility for 2 children provided free of cost. The school is owned and maintained by the company.</i>
<i>(vii)</i>	<i>Interest free loan of ₹ 5,00,000 given on 1.10.2011 for purchase of a house. No repayment was made during the year. SBI interest rate for similar loan to be taken as 10% p.a. on 01.04.2011</i>
<i>(viii)</i>	<i>Interest free loan for purchase of computer ₹ 50,000 given on 1.1.2012. No repayment was made during the year. SBI interest rate for similar loan to be taken as 16.50% p.a. on 01.04.2011</i>

You are required to compute the income of Babu under the head "Salaries" in respect of assessment year 2012-13.

Answer

Computation of income from salaries of Mr. Babu for A.Y.2012-13

Basic pay	₹ 25,000 x 10	2,50,000
D.A.	₹ 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 superannuation benefits. 15% of (2,50,000 + 50,000)	45,000

4.15 Direct Tax Laws

(b)	Value of furniture 10% of ₹ 3,00,000 for 10 months	25,000
(c)	Motor car ₹ 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 ₹ 1,000 p.m.	NIL
(g)	Interest free loan for purchase of house 10% p.a. on ₹ 5 Lacs for 6 months	25,000
(h)	Interest free loan for purchase of computer 16.50% p.a. of ₹ 50,000 for 3 months	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 ₹ 1800 + ₹ 900 per month. The perquisite value is therefore ₹ 27,000 (₹ 2,700 x 10).

Question 18

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.
- (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 19

A, an individual, has income taxable only under the head 'salaries'. In the course of the previous year ended 31st March, 2012, he pays ₹ 10,000 to an institution recognized by the prescribed authority under section 35CCA of the Income-tax Act, 1961.

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 assessees, 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 and not under section 35CCA.

Question 20

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 2012 at ₹ 150 per share. Ajay was offered 500 shares at ₹ 150, which he exercised. On these facts you are consulted by Ajay as to.

- (a) *The tax consequences for the assessment year 2012-2013 assuming that fair market value on the date of exercise of option is ₹ 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:

4.17 Direct Tax Laws

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

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.

Self-examination Questions

1. Define "Salary" and discuss the basis of charge of salary.
2. Distinguish between foregoing of salary and surrender of salary.
3. Write short notes on -
 - a) Profits in lieu of salary
 - b) Specified employees
4. Is retrenchment compensation received by workmen taxable under the Act? If yes, to what extent is it taxable?
5. When is provision of medical facilities or assistance by an employer not treated as a perquisite in the hands of the employee? Discuss.
6. Discuss whether the tax paid by the employer, on the non-monetary perquisites provided to its employees, constitutes an income in the hands of the employees.
7. Anirudh was working as a regional sales manager of a company. He was paid salary plus commission based on volume of sales effected by him. Anirudh claimed that the expenses incurred by him for earning the commission should be allowed as a deduction. Discuss the validity of his claim.

Answer

7. On this question the Madras High Court, in *CIT v. R. Rajendran (2004) 135 Taxman 95*, opined that since the assessee was employed as a regional sales manager and since commission paid to the assessee was with reference to the volume of sales, such commission was obviously to encourage the employee to effect a higher volume of sales. The commission so paid in addition to what the employer had fixed as a salary would also form part of salary and hence no deduction was allowable in respect of any expenditure incurred to earn the commission.

Therefore, in this case, it can be inferred that Anirudh's claim is not valid.