

Income From Salaries

An income can be taxed under the head 'Salaries' only if there is a relationship of an employer and employee between the payer and the payee. The relationship of employer and employee shall be of master and servant. And this relation is said to exist only if there is control over the method of doing work of other person. A master is one who not only directs what and when a thing is to be done but how it is to be done, and the servant is bound to carry out the orders.

If there is no control over the method of doing work, then the relationship is said to be on principal to principal basis and the income is taxable under other heads.

Examples:

1. Lecturer of a College setting up the question paper and getting honorarium – This honorarium is taxable under the head 'Other Sources'
2. A Member of Parliament or state legislature is not a government employee and thus their remuneration is taxable under the head 'Income From Other Sources'
3. Any salary, bonus, commission or remuneration received by the partner of the firm is taxable under the head 'Profit and Gains of Business of Profession'.
4. Section 17(1) gives an inclusive definition of Salary which includes Basic Pay, Dearness Allowance, Commission, Wages, Pension, Gratuity, Leave Encashment and all other allowances.

Surrender of salary: Any salary surrendered by the employee to the Central Government, under the Voluntary Surrender of Salaries (Exemption from Taxation) Act, will not be included in his total income.

Tax Free salary: Tax free salary means employer himself pays the tax due on his employees. This tax is to be added to the salary of the employee.

Foregoing of salary: If an employee waive the right to receive his salary it will be considered as application of income and is taxable in his hands.

Basis of Charge [Section 15]

Following incomes shall be chargeable to income tax under the head 'Salaries':

1. Any salary due whether received or not
 2. Any salary received or allowed whether due or not
 3. Any arrears of salary not charged to tax in earlier years.
- If any salary paid in advance is included in the total income of any previous year, it shall not be included again in the total income of the previous when the salary becomes due.
 - Any salary, bonus, remuneration received by partner from its firm is not taxable under the head 'Salaries'. Instead such amount is taxable under the head PGBP.

Taxability of Allowances

Allowances are the payments given by the employer to the employee for some specific purpose and it is taxable subject to certain exemptions. Allowances are of three types:

1. Fully Taxable
2. Partly Taxable
3. Fully Exempt

Fully Taxable Allowances are:

- a) Dearness Allowance
- b) Overtime Allowance
- c) Medical Allowance
- d) City Compensatory Allowance
- e) Servant Allowance
- f) Family Allowance
- g) Project Allowance
- h) Non-practicing allowance
- i) Lunch/Tiffin Allowance
- j) Any other cash Allowance

Partly taxable allowances are:

1. House Rent Allowance (Section 10(13A), Rule 2A)
2. Specified Allowances (Section 10(14), Rule 2BB)

House Rent Allowance – Section 10(13A), Rule 2A

HRA is given by the employer to the employee for the specific purpose of taking house on rent. HRA is exempt to the extent of the least of the following:

1. Actual HRA received.
2. Rent Paid Less 10% of Salary.
3. 50% of the salary if house taken on rent is situated in metro cities else 40% of the salary.

Salary for the purpose of HRA includes:

1. Basic Pay
2. Dearness Allowance to the extent it forms part of salary for retirement benefits
3. Commission on Sales Turnover, if it has been paid as a certain percentage of Sales Turnover (As decided in Gestetner Duplicators Pvt Ltd (SC)).

Notes: Exemption in respect of HRA is based upon the following factors - Salary, Place of Residence, Rent Paid, HRA Received. If, during the year, there is change in any of the factors, then HRA exemption shall be separately calculated for that period.

Specified Allowances – Section 10(14), Rule 2BB

These allowances are of two types

1. Special allowance for performance of Official Duties [Section 10(14)(i)] – These allowances are exempt to the extent of amount received or amount spent whichever is less:

Allowance	Purpose
Travelling Allowance	Cost of travel on tour or on transfer of duty
Daily Allowance	Daily expenses on tour or on transfer
Conveyance Allowance	Conveyance in performing official duties
Helper Allowance	Helper engaged for the performance of official duty

CA Rahul Jain

Email: jain.carahul@yahoo.com; Ph: +91-9811613999

Academic Allowance	For academic, research and training
Uniform Allowance	For uniform

2. Special Allowance to meet personal expenses. [Section 10(14)(ii)] – These allowances are exempt to the extent of amount received or the limit specified whichever is less:

Allowance	Exemption
Children Education Allowance	Rs. 100 pm per child for max 2 children
Hostel Expenditure Allowance	Rs. 300 pm per child for max 2 children
Transport Allowance	Rs. 800 pm but for handicapped employee- Rs. 1600 pm
Tribal Area Allowance	Rs. 200 pm
Underground Allowance	Rs. 800 pm
Hill/ Border/ Remote Area Allowance	Rs. 300 pm to Rs. 7000 pm
Outstation Allowance to Transport Employees	70% of the allowance but max upto Rs. 10000 pm.

Fully Exempt allowances are:

1. Allowance given to Citizen of India, who is a Government Employee' rendering services outside India [Section 10(7)]
2. Allowances to High Court Judges
3. Sumptuary Allowance given to High Court and Supreme Court Judges
4. Allowance received by an employee of United Nation Organisation (UNO).

Deductions from Salary [Sec 16]

Entertainment Allowance [Section 16(ii)]

The deduction of entertainment allowance is allowed only to the Government Employee and it is exempt to the extent of the least of the following:

1. Entertainment Allowance Received
2. 20% of Basic Pay
3. Rs. 5000

Professional Tax (Tax on Employment) – Section 16(iii)

Any amount paid (Whether due, advance or arrears) by the employee towards professional tax shall be allowed as deduction in the year of payment. If professional tax of employee is paid by the employer then first it shall be included in the gross salary of employees and then deduction shall be allowed under section 16(iii).

Retirement Benefits**Gratuity – Section 10(10)**

For the purpose of computation of exemption of gratuity under section 10(10), the employees are divided into three categories:

1. Government employees and Employees of Local Authorities – Section 10(10)(i)

Entire Amount of Gratuity is Exempt.

2. Employees covered under Payment of Gratuity Act, 1972 [Section 10(10)(ii)]

Any gratuity received by such employees is exempt to the least of the following:

- a. Amount of Gratuity actually received
 - b. 15 days salary for every completed year of service or part thereof in excess of six months. (In case of an employee who is employed in seasonal establishment , exemption shall be 7 days wages for each season)
 - c. Rs. 10,00,000/-
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- Salary for this purpose means salary of the month preceding the month of retirement and shall include only basic salary and dearness allowance (in full).
 - To compute 15 days salary, number of days in a month will be taken as 26 working days.
 - Therefore, to calculate the 15 days salary, the monthly salary shall be divided by 26 and multiplied by 15.

3. Exemption of Gratuity received in case of Other Employees [Section 10(10)(iii)]

Any gratuity received by any other employees shall be exempt to the least of the following:

- a. Amount of Gratuity actually received
- b. Half month's average salary for every completed year of service. (In case of an employee who is employed in seasonal establishment , exemption shall be 7 days wages for each season)
- c. Rs. 10,00,000/-

Salary for this purpose means salary as calculated in case of House Rent Allowance i.e. it includes basic pay, dearness allowance (if it form parts of retirement benefits) and commission as a fixed percentage of sales turnover. Further, it will be average of the last ten months preceding the month of retirement.

Commuted Pension [Section 10(10A)]

Pension is a periodical payment but certain employers may also allow an employee to forego a portion of the pension and receive a lump sum amount which is called commutation of pension.

Treatment of commuted pension is:

- Commuted Pension received by the Government Employees or employees of local authorities or employees of statutory corporation is fully exempt under section 10(10A)(i).
- In case of other employees, exemption shall be allowed to the extent of commuted value of 1/3 of pension but if the employee is not getting any gratuity, exemption shall be allowed up to commuted value of 50% of pension.

Leave Salary [Section 10(10AA)]

If any employee has surrendered the leave allowed to him and has received some payment in lieu thereof, such amount is called leave salary.

Leave encashment to an employee while he continues to be in service with the same employer is fully taxable under section 17(1).

If any employee has encashed his accumulated leave at the time of retirement or resigning, taxability shall be as follows:

1. Leave Salary received at the time of retirement/resigning by the government employees is fully exempt. [Section 10(10AA)(i)]
2. In case of other employees, leave encashment of accumulated leave at the time of retirement/ resignation shall be exempt to the extent of the least of the following:
 - a. Leave Encashment actually received
 - b. 10 months average salary
 - c. Leave at the credit (in months) * average salary
 - d. Rs. 3,00,000

Salary for the above purpose is same as calculated for the exemption of House Rent Allowance. Average Salary is to be calculated on the basis of the salary for 10 months immediately preceding the retirement.

Leave at the Credit Means:

Leave Entitlement (Maximum one month per completed year)

Less: Leave Availed

Less: Leave Encashed

Leave at the Credit

Retrenchment Compensation [Section 10(10B)]

Compensation received by a workman at the time of his retrenchment is exempt to the extent of the least of the following:

1. Actual amount received
2. Amount computed under Industrial Disputes Act, 1947 (15 days average pay for every completed year of service or part thereof in excess of 6 months)
3. Rs. 5,00,000.

Voluntary Retirement [Section 10(10C)] Rule 2BA

Compensation received or receivable by the employee on voluntary retirement is exempt to the least of the following:

- a. Actual amount received
- b. Rs. 5,00,000
- c. Three months salary for each completed year of service
- d. Last drawn salary multiplied by the balance months of service left before the date of his retirement.

Salary for the above purpose is same as calculated for the exemption of House Rent Allowance.

Provident Fund**Statutory Provident Fund – [Section 10(11)]**

Statutory Provident Fund is mainly meant for Government/Semi Government Employees, university/ educational institutions or other specified institutions. Employer contribution and interest from this fund is fully exempt. Further, employee contribution to this fund is allowed as deduction under section 80C.

Recognised Provident Fund – [Section 10(12)]

- Employer's contribution is exempt to the extent of 12% of employee salary and excess over it is taxable.
- Interest on provident fund is exempt upto 9.5% pa and excess over it is taxable.
- Deduction under section 80C is allowed for employee contribution.
- Repayment from RPF is exempt under certain conditions.

Unrecognised Provident Fund

- Employer's contribution and interest on provident fund is not taxable every year but repayment from unrecognized provident fund is fully taxable (except the employee's contribution)
- No deduction under Section 80C
- Interest on employee contribution received at the time of repayment from URPF is taxable under the head sources.

Public Provident Funds

- Any member of the public, whether in employment or not, may contribute to this fund. It is a scheme where there is assessee contribution only.
- Deduction under section 80C is allowed upto Rs. 1,00,000/- per year
- Interest from PPF is fully exempt under section 10(11)

Approved Superannuation Fund [Section 10(13)]

These funds are established under trust by the employer for the purpose of paying pension to the employee on their retirement/ death etc.

- Contribution by the employer is exempt up to Rs. 1,00,000 per year per employee
- Interest on accumulated balance is exempt from tax.
- Deduction is allowed under section 80C for employee contribution.
- Repayment from this fund is exempt under certain conditions.

Perquisites [Sec 17(2)]

For the purpose of taxability, perquisites can be divided into following categories:

- A. Perquisites taxable in the hands of all employees
- B. Perquisites taxable in the hands of specified employees
- C. Perquisites exempt up to certain limits
- D. Tax free perquisites

A. Following perquisites are taxable in the hands of all employees:

1. Rent free accommodation or accommodation at concessional rent
2. Any sum paid by the employer in discharging the monetary obligation of the employee, which otherwise would have been paid by the employee
3. Sweat Equity Shares
4. Contribution to an approved superannuation fund
5. Any other benefit as prescribed.

1. Rent Free Accommodation (RFA) or Accommodation at concessional rent [Rule 3(1)]

a) In case of Government Employees:

- Perquisites Value for RFA shall be the license fee as determined by Govt rules.

b) In case of Other Employees:

- If the accommodation is owned by the employer, then RFA value shall be

Population of the city	RFA Value
> 25 Lakhs	15% of salary
10 Lakhs > <= 25 Lakhs	10% of salary
<= 10 Lakhs	7.5% of salary

- If the accommodation is taken on lease/rent by the employer, then RFA Value shall be lower of
 - 15 % of Salary or
 - Actual rent paid/payable by the employer

In case of (a) and (b) above:

- Perquisites value shall be reduced by the amount, if any, recovered from the employee.
- In case of furnished accommodation, 10% of the actual cost of assets shall be added to the perquisite value of RFA
- If such furniture is taken on rent by the employer, then hire charges of such furniture shall be added to the perquisite value of RFA.

c) Accommodation provided in hotel

- Perquisite value shall be lower of
 - 24 % of salary or
 - Actual charges borne by the employer
- Such perquisites value shall be reduced by the amount, if any, recovered from the employee.

Exemption from RFA of hotel: There shall be no perquisite value of hotel if

- Such accommodation is provided for not more than 15 days AND

CA Rahul Jain

Email: jain.carahul@yahoo.com; Ph: +91-9811613999

- It was provided on the transfer of the employee

d) Accommodation provided in two houses on transfer

- In case of transfer of employees from one place to another, perquisite value shall be calculated for only 1 house
- However, after 90 days, perquisite value shall be calculated for both the house

2. Monetary obligation of employee

Any sum paid by the employer in discharging the monetary obligation of the employee, which otherwise would have been paid by the employee

3. Sweat Equity Shares

Perquisite value of Specified security or sweat equity shares shall be the:

Fair Market Value of the shares on the date on which option is exercised by the employee as reduced by the amount recovered from the employee

4. Contribution to an approved superannuation fund

Contribution by the employer to an approved superannuation fund to the extent it exceeds Rs. 100000, is perquisite in the hands of employees.

5 . Any other benefit or amenities provided [Rule 3(7)]

[Rule 3(7)(i)] Interest Free Loan

Perquisite value in this case shall be the interest on loan provided to the employee or any member of his household by the employer or by any person on employer's behalf

- Interest means SBI Rate of interest on 1st day of relevant PY.

- Interest shall be calculated on the maximum outstanding monthly balance
- Any interest recovered from the employee shall be reduced from the perquisite value
- Member of his household include spouse, children and their spouses, parents, servants and dependents.

Exceptions: No perquisite value of interest free loan if:

- Loans in aggregate do not exceed Rs. 20000 or
- Loan is for medical treatment of specified diseases

[Rule 3(7)(ii)] Value of travelling, touring, accommodation or any other expenses on holiday

Perquisite value shall be:

- Any expenditure incurred by the employer on travelling, touring etc of employees or any member of his household on their holiday.
- However, when any member of his household accompany the employee on official tour, expenditure related to such member of household shall be taxable
- When the official tour is extended as vacation, expenses on such extended period of stay are taxable.

[Rule 3(7)(iii)] Value of free food or non-alcoholic beverages.

Perquisite value shall be the actual amount incurred by the employer.

Exceptions:

- Tea or snacks provided during working hours
- Free meals at remote area or an offshore installation
- Free meals at office premises or through paid vouchers upto Rs. 50 per meal. Excess over it shall be taxable.

[Rule 3(7)(iv)] Value of gift, voucher or token

Perquisite value shall be the value of gift etc received by the employee or member of his household, from the employer.

Exceptions:

- Gifts to the extent it does not exceed Rs. 5000. Excess over it shall be taxable.

[Rule 3(7)(v)] Expenses on Credit Cards

Perquisite value shall be the actual expenditure incurred by the employer.

However, if such expenditure is wholly and exclusively for official purpose, then there shall be no perquisite value subject to certain conditions.

[Rule 3(7)(vi)] Expenses in Clubs/ Club membership

Perquisite value shall be the actual expenditure incurred by the employer.

However, if such expenditure is wholly and exclusively for official purpose, then there shall be no perquisite value subject to certain conditions.

No perquisite value for use of health club, sports or similar facilities.

[Rule 3(7)(vii)] Use of moveable assets

Perquisite value shall be:

- 10% pa of the actual cost or
- rent/hire charges borne by the employer

No perquisite value in case of use of laptop, computers, telephone etc.

[Rule 3(7)(viii)] Transfer of any moveable assets

Perquisite value shall be the actual cost to the employer as reduced by certain percentage of cost for each completed year of use by the employer.

<u>Assets</u>	<u>Depreciation</u>	<u>Dep Method</u>
Computers and electronic items	50%	WDV
Motor Cars	20%	WDV
Any other Assets	10%	SLM

[Rule 3(7)(ix)] Any other benefit/amenity provided by the employer.

Perquisite value shall be the cost to employer as reduced by the amount recovered from the employee.

B. Following perquisites are taxable only in the hands of specified employees:

1. Use of Motor Car
2. Services of Sweeper, gardener, watchman, or personal attendant
3. Use of gas, water, electricity
4. Free or Concessional Educational Facilities to any member of employees household
5. Free or concessional journey given to the transport employees and their family members

Definition of Specified Employees [Sec 17(2)(iii)]

- Director of the company or
- Employee of the company carrying not less than 20% voting power in the company
- Employee having salary of Rs. 50000 or more. Salary includes all taxable monetary payments reduced by the deduction allowed u/s 16

1. Use of Motor Car [Rule 3(2)]

Car Owned by or hire charges paid by	Car used for	Perquisite Value	
Employer	<i>Exclusively for Official Purpose</i>	NIL (If specified documents are maintained)	
	<i>Exclusively for Private Purpose</i>	Actual Expenses incurred by the employer + 10%pa of Actual Cost of Car or hire charges	
	<i>For both official and private purpose</i>	Expenses borne by employer	<u>Upto 1.6 ltr</u> Rs. 1800pm+Rs 900(Driver)
			Above 1.6ltr Rs. 2400pm+Rs 900(Driver)
		Expenses borne by employee	<u>Upto 1.6 ltr</u> Rs. 600 pm+Rs. 900(Driver)
			Above 1.6ltr Rs. 900 pm+Rs 900(Driver)
Employee	<i>Exclusively for Official Purpose</i>	NIL (If specified documents are maintained)	
	<i>Exclusively for Private Purpose</i>	Actual Expenses incurred by the employer	
	<i>For both official and private purpose</i>	Expenses borne by employer	<u>Upto 1.6 ltr</u> Actual Exp (-) Rs. 1800 pm (-) Rs. 900(Driver)
			<u>Upto 1.6 ltr</u> Actual Exp (-) Rs. 2400 pm (-) Rs. 900(Driver)
		Expenses borne by employee	NIL

2. Services of Sweeper, gardener, watchman, or personal attendant [Rule 3(3)]

Perquisite Value shall be actual cost to the employer

CA Rahul Jain

Email: jain.carahul@yahoo.com; Ph: +91-9811613999

3. Use of gas, water, electricity [Rule 3(4)]

Conditions	Perquisite Value
Supply is made from <u>resources owned by the employer</u>	<u>Manufacturing cost per unit</u> incurred by the employer
In any other case	<u>Amount paid</u> by the employer to the outside agency

4. Free or Concessional Educational Facilities to any member of employees household [Rule 3(5)]

Conditions	Perquisite Value
In Educational institutions <u>owned and maintained by employer</u>	Fees <u>charged by similar institution</u> in same or near locality
In any other educational institution <u>by reason of employee being in employment of that employer</u>	Fees <u>charged by similar institution</u> in same or near locality

However, perquisite value shall be nil, if the cost of education provided to the children of the employee does not exceed Rs. 1000 pm per child.

5. Free or concessional journey given to the transport employees and to any member of his household [Rule 3(6)]

Conditions	Perquisite Value
Employees of <u>Airline or Railways</u>	<u>Nil</u>
<u>Other</u> Transport employees	Amount <u>charged to other public</u>

C. Following perquisites are exempt up to certain limits for all employees

1. Leave Travel Concession or Assistance (LTC/LTA)
2. Medical facilities

1. Leave Travel Concession or Assistance (LTC/LTA) [Sec 10(5)]

LTC or LTA is allowed for travel fare of employees and his family for travelling to any place in India

Journey	Exemption limit
Journey by <u>air</u>	<u>Economy fare</u> of national carrier by the <u>shortest route</u>
Journey by <u>any mode other than air</u> and if such places are connected by rail	<u>First AC Rail fare</u> by the <u>shortest route</u>
If Places are <u>not connected by rail</u>	If <u>recognized public transport system exists</u> then <u>1st class or deluxe class fare</u>
	Otherwise, <u>amount equivalent to first AC rail fare</u>

- Exemption for LTC is allowed only for two children. However, this rule will not apply in respect of children born before 1.10.1998 and also in case of multiple births after one child.
- Also, assessee can claim exemption in respect of any two journeys in a block of 4 years. Block of 4 year starts from calendar years 1986-1989.
- In respect of un-availed LTC of previous block of years, he can claim the exemption of first journey in the calendar year immediately succeeding the end of previous block.
- Family includes spouse, children, dependant parents, dependant brothers and sisters.

2. Medical Facilities of employee or his family [proviso to Sec 17(2)]**a. Medical treatment in India**

Medical Treatment	Exemption Limit
Any Treatment in a <u>hospital Maintained by</u> the <u>employer</u> or by the <u>Government</u> or by any <u>local authority</u> or in any <u>hospital approved by government</u> , or in any <u>hospital approved by CIT for specified disease</u>	<u>Fully</u> Exempt (<u>Whether incurred or reimbursed</u> by employer)
Health insurance premium	<u>Fully</u> Exempt (<u>Whether incurred or reimbursed</u> by employer)
Treatment in <u>any other hospital</u>	<u>Rs. 15000</u>

CA Rahul Jain

Email: jain.carahul@yahoo.com; Ph: +91-9811613999

b. Medical treatment outside India

Facilities	Exemption Limit
Expenses on <u>medical treatment</u>	As permitted by <u>RBI</u>
Expenses on <u>stay abroad</u> with <u>one</u> attendant	As permitted by <u>RBI</u>
Expenses on <u>travel of patient with one attendant</u>	Fully exempt if GTI <u>does not exceed Rs. 2,00,000</u> (Excluding such travel expenses)

3. Tax free perquisites

- Expenses on telephone incurred by the employer on behalf of the employee
- Rent free official residence provided to Supreme Court Judges, High Court Judges, Official of Parliament, Union Minister, or to a leader of opposition in Parliament
- Amount given by the employer to employee's child as scholarship is exempt u/s 16
- Perquisites provided outside India by the Government to its employees, who are Indian Citizen and posted outside India is exempt u/s 10(7)
- Use by the employee or any member of his household of laptops and computers of employer
- Conveyance facility provided to an employee to cover the journey between office and residence
- Use of Health Club, sports and similar facilities
- Premium paid by the employer on an accident policy affected by him on his employee
- Refreshment provided by the employer to the employees during working hours

Other Points

Relief when salary is paid in advance or arrears [Sec 89(1)]

Step 1: Calculate tax payable of the previous year in which the arrears/ advance is received on

- a) Total income inclusive of additional salary
- b) Total income exclusive of additional salary

The difference between (a) and (b) is the tax on additional salary included in the total income

Step 2: Calculate tax payable of the every previous year to which the additional salary relate

- a) On Total income including additional salary of that particular previous year
- b) On Total income exclusive of additional salary

Calculate the difference between (a) and (b) for every previous year to which the additional salary relates and aggregate the same.

Step 3: The excess between the tax on additional salary as calculated under step 1 and 2 shall be the relief admissible under Section 89(1). If the tax calculated in step 1 is less than tax calculated in step 2, the assessee need not apply for relief.

Profits in lieu of Salary [Sec 17(2)]

These payments are included under the head salary:

- **Terminal Compensation:** Compensation to assessee from his employer in connection with termination of his employment or modification of its terms and conditions.
- **Payment from unrecognized provident fund:** Any payment received from URPF, is taxed as 'profits in lieu of salary'. Interest on employee contribution is taxed as 'Income from Other Sources'
- **Payment under Keyman Insurance Policy:** Any amount, including bonus, due to or received by an employee under such policy.
- **Amount received before joining or after cessation:** Any amount due to or received by an assessee from any person before his joining or after cessation of his employment with that person.