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Subject: Income Tax Theory Law and Practice

Class: III B.Com.

Income from Salary (Section 15 to 17)

Definition of Salary

Any remuneration received by an employee in consideration of services rendered by his/her employer is called salary. It included all the monetary benefits and facilities provided by the employer which are taxable.

Taxable Incomes under Salary Head

As per section 15, the following incomes are taxable under head salaries.

1. Due salary from the employer or former employer
2. Salary paid or allowed to an assessee in the previous year
3. Any arrears of salary paid or allowed to the assessee in the previous year
4. Salary received from the present or past employer
5. To avoid the double taxation, when the assessee received income as a salary is to taxed in advance.

Computation of Income from Salary Head

Basic Salary	XXX
Bonus	XXX
Commission	XXX
Cash Allowances	XXX
Perquisites	XXX
Profit in lieu of Salary	XXX
Arrears of Salary	XXX
Advance Salary	XXX
Retirement Benefits:	
1. Gratuity	XXX
2. Leave encashment pension	XXX
3. Commuted pension	XXX
Gross Salary	XXX
Less: Deductions u/s 16	XXX
1. Standard Deduction 16(ia)	XXX
2. Entertainment Allowance 16 (ii)	XXX
3. Employment / Professional Tax 16 (iii)	XXX

Chargeable Salary	
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Tax Treatment Provident Fund

Provident means to provide for the future. Therefore, provident fund means provide the fund for the future of employee. This fund is created by deducting any amount from the salary of the employee every month at a certain rate and the employer also makes his own contribution to this fund. These contributions are invested to earn interest and it credited to employee's provident fund account. At the time of retirement, the employee gets the provided fund on lump sum basis with the interest.

Types of Provident Funds

1. Statutory Provident Fund (SPF): It is regulated by the provident funds act 1925. It applies to employees of government, semi-government organisations, local bodies, universities and recognised educational institutions.

2. Recognised Provident Fund (RPF): A recognised provided fund is governed by the provident fund act 1952. It recognised by the chief commissioner of income tax. This fund maintained by scheduled banks, factories and several business houses. So this is private sector undertaking provident fund.

3. Unrecognised Provident Fund (URPF): It is neither statutory nor recognised provided fund. Any institution or organisation can maintain this fund. It is recognised by the P.F. commissioner not by the commissioner of income tax. This type of fund maintained by the private sector organisations.

4. Public Provident Fund (PPF): It is operated under public provided fund act 1968. This type of fund is open to everyone so it is suitable to self-employed people. Under this scheme, an account operated in State Bank of India and Subsidiary groups or at a branch of any 13 nationalised banks authorised for this purpose by the central government. The amount along with interest is to be payable after 15 years of contribution is made.

Tax Implications of Provident Fund

Particulars	Employer's Contribution	Employee's / assessee Contributions	Interest on Provident Fund	Repayment of lump sum amount on retirement or termination or resignation
SPF	Fully exempted from tax	Full qualification deduction u/s 80C	Fully exempted from tax	Fully exempted from tax
RPF	1. Exempted upto 12% of salary (Basic + DASB + Commission on turnover) 2. Excess of 12% is	Full qualification deduction u/s 80C	1. Exempt upto 9.5% p.a. 2. Excess of 9.5% p.a. is	Exempt subject to certain conditions

	taxable		taxable.	
URPF	Ignore for the time being	Does not qualified for deduction u/s. 80C	Ignore for the time being	1. Accumulated employee's contribution is not taxable. 2. Accumulated employer's contribution + Interest on employer's contribution is taxable as profit in lieu of salary. 3. Interest on employee's contribution is taxable as income from other source
PPF	Not applicable as there is only assessee's own contribution.	Fully qualifies for deduction u/s. 80C	Fully exempted from tax	Fully exempted from tax

Meaning of salary for Provided fund: Basic Salary + Dearness Allowances (taken for service benefits) + Commission on Turnover or Sales.

Accumulated balance due to employees participating in a recognised provided fund shall be exempted on satisfying the following conditions.

1. The employee rendered his/her services for the period of 5 years or more or
2. If the employee has not rendered continuous service by the reason of his/her ill health or by discontinuous of the employer's business or other causes beyond the control of the employee.
3. If on the cessation of his/her employment the employee obtains employment with any other employer and the accumulated balance due to him is transferred to his account in recognised fund maintained by such other employer.

Allowances

Fully Exempted Allowances

1. Allowances received by the government employee for rendering services in outside India
2. House rent allowances to judges of High Court and Supreme Court
3. Allowances received by the UNO employees
4. Allowances paid to the High Court Judges
5. Transport and Sumptuary allowances given to chairman and members of UPSC

Fully Taxable Allowances

1. Dearness Allowances, Additional Dearness Allowances, High Cost of Living Allowances
2. City Compensatory Allowances
3. Capital Compensatory Allowances
4. Lunch Allowances

5. Tiffin Allowances
6. Marriage Allowances
7. Family Allowances
8. Deputation Allowances
9. Wardenship Allowances
10. Non Practicing Allowances
11. Project Allowances
12. Overtime Allowances
13. Fixed Medical Allowances
14. **Entertainment Allowances**
 - a. Entertainment Allowance for non-government employees
 - Fully Taxable and no deduction is allowed irrespective of the amount spend
 - b. Entertainment Allowance for Government Employees
 - The least amount of the followings is deducted from the entertainment allowances u/s 16 (ii)
 - i. Statutory limit of rupees 5000
 - ii. 1/5th of basic salary only
 - iii. Actual entertainment allowance received in the previous year

Taxable Entertainment Allowance = Allowance Received – Least Amount
15. Water and Electricity Allowance
16. Servant Allowance
17. Holiday Trip Allowance

Partially Taxable Allowances

A. When exemption depends upon actual expenditure incurred by the employees sec 10(14)

1. Travelling allowance
2. Daily allowance
3. Conveyance allowance
4. Helper allowance
5. Academic allowance
6. Uniform allowance

B. When exemption does not depend upon expenditure

1. **Composite Hill Compensatory/High Altitude/Uncongenial Climate/Snow Bound Area/Avalanche Allowance**
 - Exemption allowed upto Rs. 300 p.m. to Rs. 7000 p.m.
2. **Border Area/Remote Area/Difficult Area/Disturbed Area Allowance**
 - Exemption allowed upto Rs. 200 p.m. to Rs. 1300 p.m.

3. Compensatory Field Area Allowance

- Exemption allowed upto Rs. 2600 p.m.

4. Compensatory Modified Field Area Allowance

- Exemption allowed upto Rs. 1000 p.m.

5. Counter Insurgency Allowance/Compensatory Field Area Allowance

- Exemption allowed upto Rs. 3900 p.m.

6. High Active Field Area Allowance

- Exemption allowed upto Rs. 4200 p.m.

7. Underground Allowance given to Coal Mine Workers

- Exemption allowed upto Rs. 800 p.m.

8. Island Duty Allowances given to Armed Forces posted in Andaman & Nicobar and Lakshadweep group of Islands

- Exemption allowed upto Rs. 3250 p.m.

9. Allowance given to retired Chairman and Members of UPSC: The least amount is exempted

- Allowances given to secretarial assistant on contract basis or
- Amount Rs. 14000 p.m.

10. Transport Allowance

- Rs. 1600 p.m. and excess is taxable for government as well as private employees
- Rs. 3200 p.m. is exempted if handicapped with disability if lower extremities or blind employees

11. Tribal Area Allowance

- Exemption allowed upto Rs. 200 p.m. in the state of Madhya Pradesh, Tamilnadu, Uttar Pradesh, Karnataka, Tripura, Assam, West Bengal, Bihar and Orissa.

12. Any Running Flight Allowance: the least amount is to be exempted

- 70% of allowances or
- Rs. 10000 p.m.

13. High Altitude Allowance : It is given to armed force operating in high altitude areas

- Altitude of 9000-15000 feet ----- upto Rs. 1060 p.m.
- Altitude above 15000 feet ----- upto Rs. 1600 p.m

14. Children Education Allowance

- Exempted upto Rs.100 p.m. per child for maximum of 2 children only

15. Hostel Expenditure Allowance

- Exempted upto Rs.300 p.m. per child for maximum of 2 children only

16. Any Special Allowance

- Counter insurgency allowance given to member of armed force operating area away from their permanent location for the period of more than 30 days. Exempted upto Rs. 3900 pm

17. House Rent Allowance (HRA): When the employer does not provide the rent-free accommodation but pay some amount of cash to compensate the expenses incurred by the employee to meet out the rent. The amount of cash paid is called as House Rent Allowance. The exempted portion of HRA is calculated as follows.

The least of the following is deducted from the actual HRA received.

- i. 50% of salary – if employee living in Chennai, Mumbai, Delhi and Calcutta otherwise 40% of salary – if employee living in all other cities.
- ii. Actual House Rent Allowance received
- iii. Excess rent paid over 10% of salary (Rent paid – 10% of Salary)

$$\text{Taxable HRA} = \text{Actual HRA Received} - \text{Least Amount}$$

Salary for HRA calculation: Salary = Basic Pay + DASB + Commission on Turnover or Sales

18. Perquisites Sec 17(2): It is any casual emolument, fee, or profit attached to an office or position in advantage and benefits a person by going 'into his pocket'. It may be granted to an employee, whether present, past or future as a substitute for his regular remuneration or in addition to it. It may be given voluntarily or under some contract in the form of cash or in kind.

The perquisites are of the following types

1. The value of rent-free accommodation provided to the assessee by his employer
2. The value of accommodation given at concessional rate
3. Value of benefits given free of cost or at concessional rate to a specified employee
 - i. Specified Employee is
 - An employee is a director of the company
 - Employee has a substantial interest in the company
 - The monetary payment of the employee is exceed Rs. 50000
4. Sum paid by the employer on behalf of the employee for any obligation payable by the employee
5. Sum paid/payable by the employer towards insurance on the life of the individual or annuity payments for the benefits of the individuals.
6. With effect from 2010-11, value of sweat equity shares allotted or transferred by the employer at free of cost or at concessional rate.
7. With effect from 2010-11, amount contributed by employer to an approved superannuation fund in excess of Rs. 1,50,000.

– **Perquisites Exempted from Tax for All Employees**

1. Free medical facilities or reimbursement of medical expenditure for self, family members and dependents.
 - i. If treatment was taken from the hospital is maintained by the employer

- ii. If treatment was taken from the hospital which is maintained by the central, state or local authority or a hospital approved by the government for purpose of medical treatment of its employee
- iii. If treatment taken in respect of prescribed diseases or ailments specified in Rule 3A, in any hospital approved by CCTI
- iv. In case of treatment taken from a private or unrecognised hospital, the benefit is exempted from tax upto Rs.15000 p.a.
- v. In case employer under a scheme approved by the Central Govt. pays medical insurance premium of employees
- vi. In case any health insurance premium is paid by the employer to General Insurance Corporation under notified scheme (Mediclaime u/s 80D) to insure the health of its employees and members of their families.
- vii. In case of treatment is taken outside India.
 - The expenses on stay any treatment of patient and stay if one attendant shall be exempted upto foreign exchange allowed by RBI; and
 - Attendant shall be fully exempted provided gross total income of employee does not exceed Rs. 200000 p.a.

2.Free refreshment during working hours

3.Free recreational facilities

4.Provision of telephone whether basic or cellular if exclusive for official work

5.Free meals provided in remote area or at offshore installation

6.Free education, training or refresher course for employees

7.Goods sold at concessional rates

8.Free ration received by members of armed forces

9.Perquisites allowed by Govt. to its employees posted aboard\

10. Rent free house provided to an officer of parliament, a union minister and leader of opposition in parliament

11. Conveyance facilities to judges of supreme court and high court

12. Free conveyance provided by the employer to employee for going to or coming from place of employment

13. Any amount contributed by employer towards pension or deferred annuity scheme.

14. Employer's contribution to staff group insurance scheme

15. Computers, laptops given to (not transferred) an employee to official/personal use

16. Transfer of a moveable asset (computer, car or electronic items) which are more than 10 years old without consideration.
17. Accident insurance premium paid by employer for his own benefits
18. Interest free loan or loan at concessional rate of interest taken by employee from employer if amount of loan does not exceed Rs. 20000 or loan is taken for medical treatment
19. Value of any shares or debentures given free of cost or at concessional rate to employees under stock option scheme approved by Central Govt.

– **Perquisites Taxable for all employees**

1. Rent Free House

i. Value of Unfurnished House:

- In case of transfer of an employee from one place to another and he is allowed to maintain two accommodation at two places, for a period not exceeding 90 days, the value of one accommodation with lower value shall be taxable. But if the period is exceeds 90 days the value of both the accommodation shall become taxable with effect from the day 90 days are over.
- Nature of accommodation: Owned by employer/Hired or leased by employer
- Meaning of Salary for rent free house: Pay + DASB + Fee + Commission of all types + Statutory Bonus + All Fully Allowances except D.A. which does not enter + Taxable portion of all other allowances + Salary in lieu of leave only if it relates to encashment of current years leave.
- It shall not include DA (which does not enter), arrears, advance salary, provident fund excess, gratuitous bonus, value of other perks and profits in lieu of salary. In case salary is received from more than one employer, salary from all employers is to be taken.

Rules for calculating Rent Free House

a) Owned by the Employer

- **Govt. Employees:** The value of house is rent fixed (license fee) by the govt. for such house. It can be rent charged by Govt. from another employee of same status for similar type of house.
- **Other Employees:** Value of house is calculated in the following manner.

- i. In cities, population is more than 25 lakhs: 15% of employee's salary
- ii. Population is exceeding 10 lakhs but not exceeding 25 lakhs: 10 % of employee's salary
- iii. In all other places: 7.5% of employee's salary
- iv. Hotel accommodation (for more than 15 days on transfer from one place to another): 24% of salary for the period of stay in hotel or actual hotel bill whichever is less is taxable.

b) Hired by the Employer

- Actual rent paid by employer or 15% of salary whichever is less is taxable in all cities.

ii. **Value of Furnished House**

- In case of all types of employees calculated value of unfurnished house.
 - i. If furniture is owned by the employer add 10% of cost of these items
 - ii. If furniture is hired – actual hire charges are added.

2. **Concessional Rent House:** Calculated value of rent free house as per above and deduct rent paid by employee.

3. **Obligations of employee met by employer:** In case of the following payment is made by employer these are fully taxable. These are:

- i. Gas and electricity bills issued on the name of employee but paid by the employer: actual expenses met by employer are taxable
- ii. Education of Children – Bills issued on the name of employee but paid by the employer: actual expenses met by the employer are taxable. Reimbursement of tuition fee of children is also fully taxable.
- iii. Income tax, Professional tax of employee paid by the employer: actual expenses met by employer are taxable
- iv. Salary of domestic servants employed by employee but paid by employer: actual expenses met by the employer are taxable.

4. **Life insurance Premium:** On the life of employee or any members his family, if paid by the employer is fully taxable. But accident insurance premium paid by employer if policy is for employer's benefit then it is not taxable. ULIP paid by employer is also fully taxable but interest is fully exempted.

5. Value of specified security or sweat equity shares allotted or transferred

6. Contribution to approved superannuation fund of the employee in excess of Rs. 150000

7. Other fringe benefits:

- i. Interest free or concessional loans
- ii. Travelling, touring and accommodation facility
- iii. Food or beverage facility
- iv. Gifts or vouchers
- v. Credit card facility
- vi. Club facility
- vii. Use of moveable assets
- viii. Transfer of moveable assets
- ix. Any other fringe benefit/amenity

- **Perquisites Taxable for Specified Employees only** : Following perks are taxable only if employee is either a director of company or has substantial interest (20% or more equity shares) or his salary is more than Rs.50000 p.a. This salary means all monetary emoluments, which are taxable under the head salary after deduction u/s 16.

1. Car Facilities

i. **Motor car is owned by the employer and its running and maintenance expenses met or reimbursed by employer**

– **Car is fully used in the performance of official duties of the employee**

– Perk value is NIL

– **Car is fully used for private, personal or family purpose of the employee.** The value of perk is.

Actual expenses incurred by the employer on running and maintenance of car	XXX
Salary of Chauffeur	XXX

Normal wear and tear of car (10% of actual cost)	XXX
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Total	XXX
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Less: Any Mount Charged by employer from employee	XXX
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Taxable Perk	XXX
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– **Car is used partly for private and partly for personal or family purpose.**

i. If the expenses on maintenance and running are met or reimbursed by the employer

1. When the CC of engine does not exceed 1.6 litres Rs.1800 p.m.

2. When the CC of engine exceeds 1.6 litters Rs. 2400 p.m
- ii. If the expenses on maintenance and running are met or reimbursed by the employee

1. When the CC of engine does not exceed 1.6 litres Rs.600 p.m.

2. When the CC of engine exceeds 1.6 litters Rs. 900 p.m.

- iii. Facility of Chauffeur: In case of Chauffeur or driver is also provided by employer to run the motor car Rs. 900 p.m. shall be added in the above mentioned in the above mentioned amounts mentioned in point (i) and (ii) above

Value of Perk = Amount specified for use of car + Rs. 900 p.m. for driver's salary.

- ii. **Motor car is owned by the employee and its running and maintenance expenses met or reimbursed by employer**

- **Car is fully used in the performance of official duties of the employee**
- No value to be taxed but a proper log book must be maintained
- **Care is fully used for private, personal or family purpose of the employee.** The value of perk is.

Actual expenses incurred by the employer on running and XXX maintenance of car

Less:

1. Rs. 1800 p.m. for small car and Rs. 2400 p.m. big car plus
2. Rs. 900 p.m. for driver or a higher sum for official purposes subject to certain conditions

XXX

Taxable Perk

XXX

- **Car is used partly for private and partly for personal or family purpose.**

Value of perquisites to be taxed shall be the amount spend and reimbursed by the employer (on running and maintenance of the car including driver's salary) for the private or family use of the car. However, in case any amount is recovered from the employee, the same shall be reduced.

- iii. **Where employee owns any other automotive conveyance but the actual running and maintenance expenses met or reimbursed by employer**

- **Employee’s conveyance is being used only for official purpose** - No value to be taxed but a proper log book must be maintained
- **Employee’s conveyance used partly for official purpose and partly for personal or family purpose of the employee.** The taxable value of perk shall be the actual amount of expenditure incurred by the employer as reduced by the amount of Rs. 900 p.m. or a higher sum for official purposes subject to certain conditions

Conditions for claiming higher amount as deduction in respect of official purposes (allocable to points B and C above)

- The employer has maintained complete record/details of journey undertaken for official purpose covering date of journey, destination, mileage and the amount of expenditure incurred thereon; and
- The employer gives the certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.

Employee or any member of his household uses more than one car belong to employer

Valuation of one car (at the choice of the employee) shall be @ Rs.1800 p.m. or Rs. 2400 p.m. as the case may be and the valuation of any other car or cars shall be made as if he had been provided with such a car or cars exclusively for his private or personal use.\

Car at concessional rate:

First of all calculate the value as if car has been provided totally free of cost

XXX

Less: Any amount charged from the employee for the use of car

XXX

Value of Perl to be taxed

XXX

2. Free Servants

- i. In case servants are employed by employee but there salary is paid by employer full salary is taxable for all the employees.
- ii. In case of service of sweeper, gardener and watchman are provided by employer full salary of these employees is taxable and it shall be reduced by any amount paid by employee. In case gardener is provided for rent free house owned by employer its salary added in FRV and is not taxable separately.
- iii. In case employer provides any other servant his full salary is taxable for specified employees only.

3. **Free gas, light, water:** In case connection is on the name of employer and bill is also paid by the employer, actual cost of such benefits is taxable. It shall be reduced by any amount paid by the employee.

4. **Free Education:** If employee provides free education to the members of household of employee reasonable amount which employee would have spent on similar type of education in same or nearby locality is taxable.

5. **Free transport:** If conveyance is hired or ticket is purchased by employer, actual expenses are taxable. It shall be reduced by any amount paid by the employee.

6. Medical facility

19. Profits in Lieu of Salary Sec 17(3): It includes

1. Any compensation received from present or employer during relevant previous year on termination of service or on modification of terms of service.
2. Any payment received from present or past employer except given u/s 10(10), 10(10A), 10(10AA), 10(10B), 10(11), 10(13), 10(13A), and any payment out of provided fund to the extent it is taxable
3. Any amount due to or received whether in lump sum or otherwise by any assessee from any person:
 - i. Before his joining any employment with that person or
 - ii. After cessation of his employment with that person.

All above payments are fully taxable unless exempted u/s 10

20. Receipts which are includible under the Head Salaries under section 17(1) or 17(3) but exempted u/s 10

- **Leave Travel Concession u/s 10(5):** Exempted upto rules effective from 1.10.1997
- **Passage money u/s 10(6):** Deleted from Assessment Year 2004-05
- **Any foreign allowance or perks u/s 10(7):** If given by Govt. to its employees posted abroad are fully exempted
- **Gratuity u/s 10(10):** A Govt. employee or semi-government employee where Govt. rules are applicable – Fully exempted.

1. For employees covered under Payment of Gratuity Act (Persons on non-managerial posts in factories) – Exempt upto to least of followings:

- i. Notified limit Rs.10 lakhs (less any amount exempted earlier)
- ii. 15 days average wages for every one completed year of service (period exceeding 6 months = 1 year). $\frac{1}{2}$ month's salary = (average monthly salary or wages \times (15/25))
- iii. Actual amount received

2. **For other Employees:** Exempted upto least of the following provided service is more than 5 years or employee has not left services of his own:

- i. Notified limit of Rs. 10 Lakhs (less any amount exempted earlier)
- ii. $\frac{1}{2}$ month's average salary for every one year of completed service (months to be ignored). Average salary = Salary (same as for provided fund) for 10 months preceding the month of retirement divided by 10.
- iii. Actual amount received.

– **Commutation of Pension u/s 10(10A):** In case commuted value of pension is received.

1. If Govt. employees – fully exempted
2. If other employee who receives gratuity also – Lump sum amount is exempted upto commuted value of $\frac{1}{3}^{\text{rd}}$ of pension
3. If other employees does not get gratuity – Lump sum amount is exempted upto commuted value of $\frac{1}{2}$ of pension.

– **Leave Encashment u/s 10 (10AA)**

1. If received by the Govt. employee at the time of retirement - Fully exempted
2. If received during the services – Fully taxable for all the employees
3. If received by the private employee at the time of retirement exempted upto:
 - i. Notified limit Rs. 3 lakhs
 - ii. Average salary \times 10 months
 - iii. Actual amount received
 - iv. Average salary \times No. of months leave due. Leave due is to be calculated taking one month leave or actual entitlement whichever is less. Average salary = Salary (Same as for Provident Fund) for 10 months including the month of retirement divided by 10.

– **Retrenchment Compensation:** Received by workers covered under Industrial Disputes Act (section 10(10B)) only for those workers who fulfil the conditions given under Factories Act (as payment of Gratuity Act) least of the following is exempted:

1. Notified limit of Rs. 5 lakhs
2. Actual amount received
3. Amount payable under Industrial Disputes Act.

– **Any compensation received by an employee of public sector undertakings, universities, public sector companies:**

1. If given to employees of public sector undertakings under a scheme approved by the CIT is fully exempted
2. For other employees it shall be exempted up to least of the following:
 - i. Rs. 5 lakhs

- ii. 3 month salary for every one year of service.
 - iii. Actual amount received or
 - iv. $\text{Salary} \times \text{no. of month's service}$ is due before actual retirement. Salary has same meaning as for PF and salary for last month is to be taken
- **Any tax on perks paid by the employer** – Fully exempted u/s 10(10CC)
 - **Any payment received out of SPF** – Fully exempted u/s 10(11)
 - **Any payment received out of RPF** – Fully exempted u/s 10(12) if service exceeds 5 years.
 - **Any payment received out of an approved superannuation fund** – Fully exempted u/s 10(13)

21. Deductions out of Gross Salary (Sec. 16)

- **Entertainment Allowance u/s 16(ii)**: Discussed earlier
- **Tax on Employment u/s 16(iii)**: In case any amount of professional tax is paid by the employee or by his employer on his behalf – Fully allowed as deduction.