

# Chapter 4 : Income from Salaries (Section 15 to 17)

Advance Direct Tax and Service Tax  
[Sub code : 441]

# Learning Objectives

- Employer-Employee Relationship
- Place of Employment
- What is Taxable under Head Salaries (Section 15)
- Allowances
- Leave Salary, Gratuity, Pension, Bonus, Advance Salary, Arrears of Salary
- Perquisites and its valuation
- House Rent Allowance
- Deductions from Salaries (Section 16)
- Profits in lieu of Salary

# Introduction

- Income under the head 'Salaries' comprise remuneration in any form (including perquisites) due for services in the nature of employment under an express or implied contract of employment or service. Thus the contractual relationship should be as between an employer and employee.
- Income from "salaries" is chargeable to tax on due basis.

# Employer-Employee Relationship

- To fall under the ambit of salaries, the **relationship** between the payer and payee **has to be that of Employer-employee**.
- An Employee **should not be an agent** of the Employer
- For ascertaining whether a person is an employee or an agent, a rough and ready test is whether under the terms of his employment the employer exercises a supervisory control in respect of the work entrusted to that person.
- An employee acts under the direct control and supervision of his employer. An agent on the other hand, in the exercise of his work, is not subject to the direct control or supervision of the principal
- Generally an **agent is paid commission** upon effecting the result which he has been instructed by his principal to achieve, an **employee is paid wages or salary**.

# Place of Employment

- Salary accrues at the place where service is rendered. Thus leave salary paid abroad to a person employed in India when he proceeds on leave to a foreign country is treated as income arising in India
- Similarly, when a person employed in India settles in a foreign country after retirement and receives his pension abroad the pension so paid to him will be taken as income accruing in India and will be liable to tax even though he may be a non-resident. This is because the pension is paid on account of service rendered in India

# Income Taxable under the Head – “Salaries”

- Any salary due from an employer or former employer to an assessee in the previous year, whether actually paid or not,
- Any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it becomes due to him.
- Any arrears of salary paid or allowed to him in a previous year by or on behalf of an employer or former employer, if not charged to income tax and for any earlier previous years

# SALARY [SECTION 17]

- Salary includes –
  - ✓ Wages;
  - ✓ any annuity or pension,
  - ✓ any gratuity;
  - ✓ any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
  - ✓ any advance of salary;
  - ✓ any payment received by an employee in respect of any period of leave not availed of by him;
  - ✓ employer's contribution to recognized provident fund is excess of 12% of salary of an employee

# ALLOWANCES

- An Allowance is defined as a fixed amount of money given periodically in addition to Salary for the purpose of meeting some specific requirements connected with the service rendered by the employee or by way of compensation for some unusual conditions of employments.
- These allowances are generally taxable and are to be included in gross salary unless a specific exemption has been provided.

# Fully Taxable Allowances

- Dearness Allowance or Special Allowance
- Fixed Medical Allowance
- Tiffin Allowance
- Servant Allowance
- Non-Participating Allowance
- Hill Allowance
- City Compensatory Allowance
- Field Allowance
- Service / Professional Allowance
- Overtime Allowance
- Warden / Proctor Allowance
- Any other allowance not specifically exempted otherwise

# Allowance Not fully Taxable

- ❖ House Rent Allowance
- ❖ Special Allowance for performance of official duty
- ❖ Conveyance Allowance
- ❖ Leave Travel Allowance
- ❖ Entertainment Allowance
- ❖ The detailed listing of the prescribed allowances which are exempt and the limits of exemption under section 10(14) Rule 2bb (Some examples are – Education Allowance, Hostel Allowance, Border Area Allowance, Tribal area allowance, Island duty allowance etc.)

# Leave Salary @ Retirement

- *Leave salary in the case of central/state Government employees*, amount of leave salary received is **fully exempt** from tax
- *Leave salary to other employees*- leave salary is exempt from tax to the extent of the **least of the following**—
  - Cash equivalent of the leave salary in respect of the period of earned leave standing to the credit of employees at the time of retirement (earned leave entitlements cannot exceed 30 days for every year of actual service rendered for the employer from whose service he has retired); OR
  - 10 months' "average salary"; OR
  - the amount specified by the Govt., i.e., Rs. 3,00,000/- OR
  - the amount of leave encashment actually received at the time of retirement

# Gratuity @ Death or Retirement

- Any death-cum-retirement gratuity received under the revised Pension Rules of the Central Government is exempt
- *Employees covered by the payment of Gratuity Act, 1972 – Least of the following amount of gratuity is exempt from tax –*
  - ✓ 15 day's salary (7 days in the case of employees of seasonal establishments) based on salary last drawn for every completed year of service or part thereof in excess of six months
  - ✓ Rs. 10,00,000/- (from 24<sup>th</sup> May 2010)
  - ✓ Gratuity actually received

# Contd...

- *In any other case –*

*Least of the following amount of gratuity is exempt from tax –*

- ✓ to the extent it does not exceed one-half month's salary for each year of completed service [calculated on the basis of the average salary for the ten months immediately preceding the month]
- ✓ Subject to maximum of Rs. 10,00,000/- (from 24<sup>th</sup> May 2010)
- ✓ Gratuity Actually Received

# RETRENCHMENT COMPENSATION

- *The Retrenchment Compensation shall mean –*
    - ✓ compensation received by a workman at the time of the closing down of the undertaking in which he is employed
    - ✓ Compensation received by a workman, at the time of the transfer of the ownership or management of the undertaking in which he is employed to a new employer
  - *The amount exempt under this clause shall not exceed –*
    - an amount calculated in accordance with the provisions of clause (b) of section 25F of the Industrial Disputes Act, 1947
    - such amount, not being less than Rs.50,000/- and not exceeding Rs.5,00,000/-
- whichever is lower.

# Compensation Received at the Time of Voluntary Retirement

- Any amount received or receivable by an employee at the time of his voluntary retirement or termination of his service, in accordance with any scheme or schemes of voluntary retirement or in the case of a public sector company a scheme of voluntary separation, to the extent such amount does not exceed Rs.5,00,000/-.
- In case of a Public sector company, an authority established under a central state or provincial Act, or local authority where the compensation is received in accordance with scheme of voluntary retirement which is framed in accordance with prescribed guidelines, no approval is required from any authority for enabling the Employees to claim relief u/s 10(10C).

# Contd...

- However, in case of other companies, the scheme needs to satisfy the prescribed conditions. Here the Scheme has to meet the following criteria:
  - ✓ It applies to an employee who has completed ten years of service or completed 40 years of age.
  - ✓ It applies to all employees, including workers and executives excepting directors of the company/co-operative society
  - ✓ The scheme of voluntary retirement/separation has been drawn to result in overall reduction in the existing strength of the employees
  - ✓ The vacancy caused by voluntary retirement/separation is not to be filled up
  - ✓ The amount receivable on account of voluntary retirement/separation of the employees, does not exceed the amount equivalent to three months' salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation.

# PENSION

- Pension received by a person from the employer after his retirement is taxed as salary.
- The Pension can be either uncommuted or commuted.
- **Commuted Pensions** received the **government employees** are **wholly exempt** under section 10(10A).
- *For other employees, following amount is exempt —*
  - if employee has received gratuity then commuted value of 1/3rd of the pension which he is entitled to receive and
  - in any other case, commuted value of 1/2 of the pension which he is entitled to receive

# PERQUISITES

- The phrase perquisite signifies some additional benefit in additions to the amount that may be legally due by way of contract for services rendered
- Perquisites may be provided in cash or in kind
- Perquisites are included in the salary only if they are received by an employee from his employer
- Perquisites received from a person other than employer are taxable under the head "Profit and Gain of business or profession" or "Income from other sources" as the case may be

## “Perquisite” includes –

- The value of rent-free accommodation provided to the assessee by his employer;
- the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;
- the value of any benefit or amenity granted or provided free of cost or at concessional rate;
- any sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the assessee;

# Contd...

- any sum payable by the employer, whether directly or through a fund, to effect an assurance on the life of the assessee or to effect a contract for an annuity;
- 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;
- The amount of any contribution to an approved superannuation fund by the employer in respect of the assessee, to the extent it exceeds one lakh rupees;
- The value of any other fringe benefit or amenity as may be prescribed.

# What is NOT Perquisite

- The use of any vehicle provided by a company or an employer for journey by the assessee official purpose;
- The value of any medical treatment provided to an employee or any member of his family in any hospital maintained by the employer and also for medical treatment abroad in specified cases only when specified conditions satisfied;
- Any premium paid by an employer for an employee or his family, to effect an health insurance under any scheme approved by the Central Government;
- Any sum paid by the employer in respect of any expenditure actually incurred by the employee on medical treatment of the Employee or his family up to Rs.15,000/ - in the previous year;
- Expenses on telephones including a mobile phone actually incurred on behalf of the employee by the employer

# Interest-free or Concessional loans to employees

- Loan exceeding Rs.20,000/- received from your employer (either interest-free or at a concessional rate) is taxable Perk.  
Exception: Loan given for medical treatment of specified diseases
- The value shall be determined as the sum equal to the interest computed at the **rate charged per annum by the State Bank of India**, as on the 1st day of the relevant previous year in respect of loans for the same purpose advanced by it on the maximum outstanding monthly balance as reduced by the interest, if any, actually paid by him or any such member of his household.
- Petty Cash Loans up to Rs. 20,000/- is not considered as perquisite.

# Perk value of Free Food & Domestic Help

- Free food and non-alcoholic beverages provided by such employer during working hours at office or business premises or through paid vouchers which are not transferable and usable only at eating joints, to the extent the value thereof either case **does not exceed fifty rupees per meal** or to tea or snacks provided during working hours.
- The value of benefit to the employee or any member of his household resulting from the provision by the employer or services of a sweeper, a gardener, a watchman or a personal attendant, shall be the **actual cost to the employer**.

# Valuation of Rent-free Accommodation

Circumstances	Where Accommodation is unfurnished	Where Accommodation is furnished
Where the accommodation is provided by the Central Government or any State Government	License fee determined by the Central Government or any State Government in respect of accommodation	License Fee + 10% of cost of furniture (including appliances and air conditioners)
Accommodation provided by any other employer (Either owned by employer or taken on lease)	(i) 15% of salary in cities having population exceeding 25 lakhs as per 2001 census; (ii) 10% of salary in cities having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2001 census (iii) 7.5% of salary in other areas <b>OR</b> Actual amount of lease rental paid or payable by the employer or 15% of salary, whichever is lower	Value of unfurnished accommodation + 10% of cost of furniture (including appliances and air conditioners)
Accommodation is provided by the employer in a <b>HOTEL</b> (except where the employee is provided such accommodation for a period not Exceeding in aggregate fifteen days on his transfer from one place to another)	Not applicable	24% of salary OR the actual charges paid or payable to such hotel, which is Lower

# Use of Movable Asset

- The value of benefit to the employee resulting from the use by the employee or any member of his household of any movable asset (other than assets already specified in this rule and other than laptops and computers) belonging to the employer or hired by him shall be determined at 10% per annum of the actual cost of such asset or the amount of rent or charge paid or payable by the employer, as the case may be, as reduced by the amount, if any, paid or recovered from the employee for such use.

# Transfer of Movable Asset

- Valuation will be as under –

Mode of Valuation	Electronics items /Computers	Motor Car	Any other Asset
Step 1 : Find out the cost of the asset to Employer	Actual Cost to Employer	Actual Cost to Employer	Actual Cost to Employer
Step 2 : Less : Nominal wear & tear for completed years during which asset is used for business purpose	50% of each completed year by reducing balance method	20% of each completed year by reducing balance method	10% of each completed year by reducing balance method
Step 3 : Less : Amount recovered from Employee	Amount actually recovered	Amount actually recovered	Amount actually recovered
Taxable Value of Perquisite (Step 1 – Step 2 – Step 3)	Balance Amount	Balance Amount	Balance Amount

# CAR Perquisite

Circumstances	Where cubic capacity of engine does not exceed 1.6 liters	Where cubic capacity of engine exceeds 1.6 liters
Where Motor Car Owned or Hired by Employer and – (a) is used wholly and exclusively in the performance of his official duties; (b) Is used exclusively for personal or private purpose by employee	No Value  Actual Amount of expenses for running & maintenance + Depreciation	No Value  Actual Amount of expenses for running & maintenance + Depreciation
(c) is used partly in performance of official duties and partly for personal purpose and – ➤ The expenses on running & maintenance are met or reimbursement by Employer  ➤ The expenses on running & maintenance for private or personal use are fully met by Employee	Rs. 1,800 p.m. ( <i>plus</i> Rs. 900 p.m., if chauffeur is also provided to run the motor car)  Rs. 600 p.m. ( <i>plus</i> Rs. 900 p.m., if chauffeur is also provided to run the motor car)	Rs. 2,400 p.m. ( <i>plus</i> Rs. 900 p.m., if chauffeur is also provided to run the motor car)  Rs. 900 p.m. ( <i>plus</i> Rs. 900 p.m., if chauffeur is also provided to run the motor car)

# Contd...

Circumstances	Where cubic capacity of engine does not exceed 1.6 liters	Where cubic capacity of engine exceeds 1.6 liters
<p>Where the employee owns a motor car but the actual running and maintenance charges (including remuneration of the chauffeur, if any) are met or reimbursed to him by the employer and—</p> <p>(i) such reimbursement is for the use of the vehicle wholly and exclusively for official purposes;</p> <p>(ii) such reimbursement is for the use of the vehicle partly for official purposes and partly for personal or private purposes of the employee or any member of his household</p>	<p>No Value</p> <p>The Actual amount of expenditure incurred by the Employer <b>LESS</b> Rs.1,800 p.m. (<i>plus</i> Rs. 900 p.m., if chauffeur is also provided to run the motor car)</p>	<p>No Value</p> <p>The Actual amount of expenditure incurred by the Employer <b>LESS</b> Rs.2,400 p.m. (<i>plus</i> Rs. 900 p.m. if chauffeur is also provided to run the motor car)</p>

# Free or Concessional Education Facility

- The value of free or concessional educational facilities shall be determined as the sum equal to the amount of expenditure incurred by the employer in that behalf or where the educational institution is itself maintained and owned by the employer **OR**
- where free educational facilities for such member of employees' household are allowed, the value of the perquisite to the employee shall be determined with reference to the cost of such education in a similar institution in or near the locality
- **Provided** that where the educational institution itself is maintained and owned by the employer and free educational facilities are provided to the children of the employee, nothing contained in this sub-rule shall apply if the cost of such education or the value of such benefit per child does not exceed **one thousand rupees per month.**

# Security or Sweat equity shares

- 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.

Explanations –

- ✓ “specified security” means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956)
- ✓ “sweat equity shares” means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash
- ✓ 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 as reduced by the amount actually paid

# House Rant Allowance

- Any special allowance specifically granted to an assessee by his employer to meet expenditure actually incurred on payment of rent in respect of residential accommodation occupied by the assessee, to such extent as may be prescribed having regard to the area or place in which such accommodation is situate and other relevant considerations.
- It is very much clear that HRA is not available where –
  - the residential accommodation occupied by the assessee is owned by him; or
  - the assessee has not actually incurred expenditure on payment of rent (by whatever name called) in respect of the residential accommodation occupied by him

# Contd...

- Quantum of Deduction will be Least of following –

Mumbai / Kolkata / Delhi / Chennai	Other Cities
<input type="checkbox"/> Allowance Actually Received	<input type="checkbox"/> Allowance Actually Received
<input type="checkbox"/> Rent Paid in excess of 10 % of Salary	<input type="checkbox"/> Rent Paid in excess of 10 % of Salary
<input type="checkbox"/> 50 % of Salary	<input type="checkbox"/> 40 % of Salary

# DEDUCTIONS FROM SALARIES [Section 16]

- **Entertainment Allowance :**

In case of Government Employee –

- ✓ Rs.5,000
- ✓ 20% of salary
- ✓ Amount of Entertainment Allowance granted  
Least of the above three is given as deduction from salary income.

In case of Other Employee:

- **No deduction** is available for Entertainment Allowance

- **Professional Tax**

A deduction of any sum paid by the assessee on account of a tax on employment not exceeding Rs.2,500.

# Profits in lieu of Salary

- The "profits in lieu of salary" includes –
  - the amount of any compensation due to or received by an assessee from his employer in connection with the termination of his employment or the modification of the terms and conditions relating thereto
  - any payment due to or received by an assessee from an employer or a former employer or from a provident or other fund
  - any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy
  - any amount due to or received - before his joining any employment with that person; or after cessation of his employment with that person
  - Special Bonus on retirement