

# **Department of Commerce (CA)**

## **CORE PAPER-XII-DIRECT TAX**

**SEMESTER: V  
B.COM(CA)**

**SUB CODE:18BCA53C**

### **UNIT 2: HEADS OF INCOME-SALARIES**

#### **REFERENCE BOOK:**

- INCOME TAX LAW AND PRACTICE- GAUR AND NARANG
- DIRECT TAXES-B.B.LAL
- INCOME TAX LAW AND PRACTICE-DINKAR PAGARE
- INCOME TAX LAW AND PRACTICE -MALHOTRA

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# Meaning

Salary includes [section 17(1)] :-

- ii. Wages
- iii. Any annuity on pension
- iv. Any gratuity
- v. Any fees, commission, bonus, perquisite on profits in lieu of or in addition to any salary on wages
- vi. Any advance of salary
- vii. Any earned leave
- viii. Employers contribution (taxable) towards recognized provident fund.

## BASIS OF CHARGE

Income is taxable under head "Salaries", only if there exists *Employer - Employee Relationship* between the payer and the payee. The following **incomes** shall be chargeable to income-tax under the head "Salaries":-

2. Salary Due
3. Advance Salary [u/s 17(1)(v)]
4. Arrears of Salary

Note:

- (i) Salary is chargeable on due basis or receipt basis, whichever is earlier.
- (ii) Advance salary and Arrears of salary are chargeable to tax on receipt basis only.

# Allowances

Allowance is generally defined as a fixed quantity of money or other substance given regularly in addition to salary for the purpose of meeting some particular requirement connected with the services rendered by the employee or as compensation for unusual conditions of that service.

- Dearness Allowance - It is Always **Taxable**.
- City Compensatory Allowance - It is Always **Taxable**.

## Contd...

### 1. House Rent Allowance

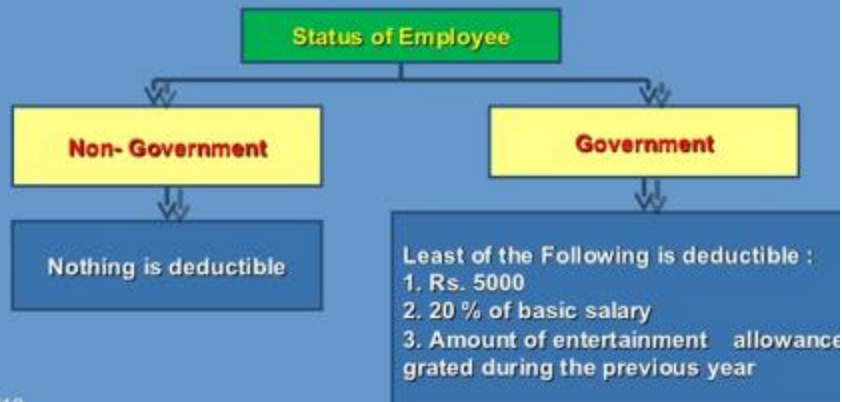
Exemption In Respect Of House Rent allowance is regulated by rule 2A. The least of the three given below is Exempt from Tax.

1	An Amount Equal to 50 % of Salary. Where Residential House is situated at Bombay, Calcutta, Delhi or Madras and An Amount Equal to 40 % of Salary where Residential House is situated at any Other Place.
2	House Rent Allowance Received by The Employee in Respect of The Period during which Rental Accommodation is Occupied by the Employee during the Previous Year.
3	The Excess of Rent Paid over 10 % of Salary.

## Contd...

- **Entertainment allowance [sec.169(ii)]-**

Entertainment allowance is first included in salary in come under the head "salaries" and thereafter a deduction is given on the basis enumerated below:



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## Contd...

Exemption is available on the aforesaid basis in the case of following allowances :-

NAME OF ALLOWANCE	NATURE OF ALLOWANCE
Travelling Allowance/ Transfer Allowance	Any allowance granted to meet the cost of travel on tour or on transfer (including sum paid in connection with transfer, packing and transportation of personal effects on such transfer).
Conveyance Allowance	Conveyance allowance granted to meet the expenditure on conveyance in performance of duties of an office (expenditure for covering the journey between office and residence is not to be included).
Daily Allowance	Any allowance whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from this normal place of duty.

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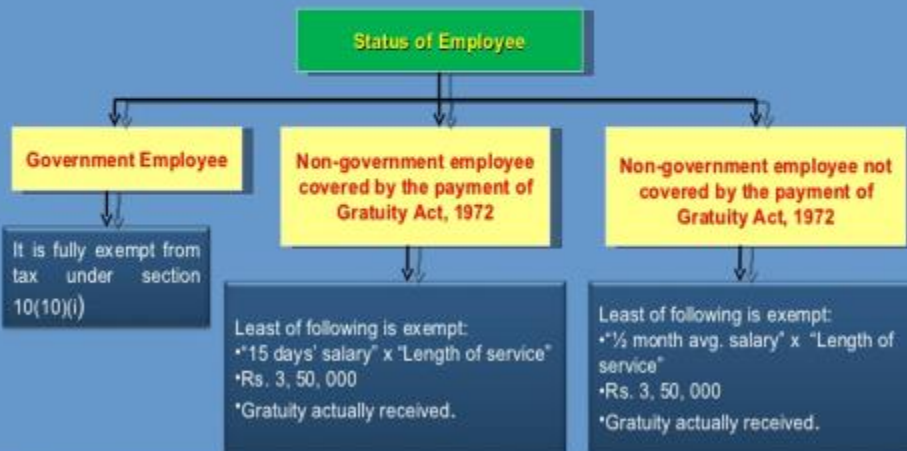
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Name of allowance	Exemption as specified in rule 2BB
Special Compensatory (Hill Areas) Allowance	Amount exempt from tax varies from Rs. 300 per month to Rs. 7,000 per month
Border area allowance	The amount of exemption varies from Rs. 200 Per month to Rs. 1,300 per month
Tribal areas/ scheduled areas allowance	Rs. 200 Per Month
Allowance for transport employees	The amount of exemption is- b.70 per cent of such allowance; or c.Rs. 6,000 per month, whichever is lower.
Children education allowance	The amount exempt is limited to Rs. 100 per month per child up to a maximum of two children.
Hostel expenditure allowance	It is exempt from tax to the extent of Rs. 300 per month per child up to a maximum of two children.
Compensatory field area allowance	Exemption is limited to Rs. 2,600 per month in some cases.

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- **Gratuity [Sec.10(10)]** – Gratuity is a retirement benefit. It is generally payable at the time of cessation of employment and on the basis of duration of service. Tax treatment of gratuity is given below:



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### **Computation of salary income**

Salary income = Gross salary – Deductions U/s 16

Gross salary = Basic salary U/s 17(1) + Allowances U/s 17(3)(b) + Perquisites U/s 17(2) + Profit in lieu of salary U/s 17(3)

**Less**

Deductions u/s 16 = Entertainment allowance u/s 16(ii) + Employment tax u/s 16(iii)  
= **Income from the head salary**

### **Provident fund.**

Provident fund scheme is a scheme intended to give substantial benefits to an employee at the time of his retirement. Under this, a specified sum is deducted from his salary as contribution and employer also contributes certain sum to this scheme. The contribution of the employer and employee are invested in approved securities. Interest earned from this is also credited to this provident fund account. Thus the balance of the provident fund account consists of the following:

- i) Employee's contribution
- ii) Employer's contribution
- iii) Interest on employee's contribution
- iv) Interest on employer's contribution

The accumulated balance is paid to the employee at the time of retirement or resignation. In the case of death of the employee, the same is paid to the legal heirs.

There are four types of provident funds:

- i) Statutory Provident Fund (SPF) :** The SPF is governed by Provident Fund Act, 1925. It applies to employees of government, semi-government, local bodies etc
- ii) Recognised Provident Fund (RPF) :** RPF means a provident fund recognized by the Commissioner of income tax for the purpose of tax. It is governed by the Provident fund act 1952.
- iii) Unrecognised Provident Fund (URPF) :** it is a provident fund not recognized by the Commissioner of income tax
- iv) Public Provident Fund (PPF) :** PPF is operated under the Public Provident Fund Act 1968. It is open to general public. Salaried employees may also contribute to PPF in addition to the fund operated by the employer.

**Problem: 1**

Resident of Rampur Sri Vimal gets 72,000 as salary, 6,000 as dearness pay, 6,000 as dearness allowance and 10,000 per annum as fixed commission during the previous year. During previous year he received 30,000 as house rent allowance though he paid 36,000 as rent. Compute house rent allowance exempt from tax.

**Solution: 1****Computation of Exempted Amount of H. R. A.**

Salary 72,000 + D.P. 6,000 = 78,000

Amount exempt least of the following:

- i. H. R. A. received 30,000
- ii. Rent paid - 10% of salary ( 36,000 - 7,800) 28,200
- iii. 40% of salary 31,200

**H. R. A. exempt 28,200**

**Other allowances and their exemption limits:-**

S.I No	Allowance	Extend of exemption.
1	Any special compensatory allowance/hill compensatory allowance/high altitude allowance	800 per month or 7,000 per month or 300 per month depending upon the locations
2	Any Special Compensatory Allowance in the Nature of Border Area Allowance, Remote Locality Allowance or Difficult Area Allowance / Disturbed Area Allowance	1,300 per month or Rs1,100 per month or Rs1,050 per month or 750 per month or 200 per month depending upon the specified locations
3	Tribal area allowance	200 per month
4	Any allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place, provided that such employee is not in receipt of daily allowance	70 per cent of such allowance up-to a maximum of 10,000 per month
5	Children education allowance	100 per month per child up to a maximum of two children

6	Children hostel allowance	300 per month per child up to a maximum of two children
7	Compensatory field area allowance	2,600 per month
8	Compensatory modified field area allowance	1,000 per month
9	Any special allowance in the nature of counter insurgency allowance granted to the member of armed forces operating in areas away from their permanent locations for a period of more than 30 days.	3,900 per month
10	Transport allowance granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty	1600 per month
11	Transport allowance granted to an employee, who is ` blind or orthopedically handicapped with disability of lower extremities, to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty	3200 p.m.
12	Underground allowance	800 p.m.

### **Tax Treatment of the Provident Fund:- ALLOWANCES**

An allowance is defined as a fixed amount of money given periodically in addition to the 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 employment. It is taxable on due/accrued basis whether it is paid in addition to the salary. These allowances are generally taxable and are to be included in the gross salary unless a specific exemption has been provided in respect of them.

#### **Fully Exempted Allowances.**

- (1) Foreign allowance given by Government to its employees posted abroad is fully exempted
- (2) House rent allowance given to Judges of High Court and Supreme Court is fully exempted.
- (3) Sumptuary Allowances given to Judges of High Court and Supreme Court is fully exempted.
- (4) Allowances from U.N.O.



(5) Allowances to Teacher/Professor from SAARC member states

(6) Allowances to member of Union Public Service Commission.

Particulars	SPF	RPF	URPF	PPF
Employees contribution	Eligible for deduction U/S 80C	Eligible for deduction U/S 80C	Not eligible for deduction U/S 80C	Eligible for deduction U/S 80C
Employer's contribution	Fully exempt	amount in excess of 12% of salary is taxable	Not taxable yearly	N.A( there is only one contribution)
Interest credited	Fully exempt	Amount in excess of 9.5% p.a is taxable	Not taxable yearly	Fully exempt
Lump sum amount received at retirement	Fully exempt	Fully exempt(at least five year service)	a)employer's contribution and interest taxable under the head salary b)interest of employee contribution taxable under the head 'other sources' c)employees contribution is exempted	Fully exempt

### Problem: 2

Sri Vinay is a government employee. He draws a monthly salary of 20,000 besides a dearness allowance @ 5,000 p. m. He gets 500 p. m. as entertainment allowance. He spent during the previous year, 2,000 out of entertainment allowance. Find out the amount of deduction regarding entertainment allowance.

### Solution: 2

#### Computation of Deduction Regarding Entertainment Allowance

The amount of deduction allowable will be the least of the following:

- i. 1/5 of basic salary 48,000
- ii. 5,000 5,000
- iii. Amount received 6,000

**Exempted Amount 5,000.**

### PERQUISITES

The term "perquisites" includes all benefits and amenities provided by the employer to the employee in addition to salary and wages either in cash or in kind which are convertible into money. These benefits or amenities may be provided either voluntarily or under service contract. For income-tax purposes, the perquisites are of three types:

- (A) Tax-free perquisites
- (B) Taxable perquisites
- (C) Perquisites taxable under specified cases.

**(A) Tax-free perquisites (in all cases)**

The value of the following perquisites is not to be included in the salary income of an employee :

**i. Medical Facilities:**

- (a) The value of any Medical facility provided to an employee or his family member in any hospitals, clinics, etc. maintained by the employer.
- (b) Reimbursement of expenditure actually incurred by the employee on medical treatment for self or for his family members in any hospitals, dispensaries etc. maintained by the Government or local authority or in a hospital approved by the chief commissioner.
- (c) Group medical insurance obtained by the employer for his employees (including family members of the employees) or all medical insurance payments made directly or reimbursement of insurance premium to such employees who take such insurance.
- (d) Reimbursement of medical expenses actually incurred by the employee up-to a maximum of 15,000 in the aggregate in a year, in a private hospital for his and his family.
- (e) Any expenditure incurred or paid by the employer on the medical treatment of the employee or any family member of the employee outside India, the travel and stay abroad of such employee or any family member of such employee or any travel or stay abroad.

**Valuation of Perquisites.**

The valuation of various perquisites is done as follows:-

**1) Valuation of Residential Accommodation.**

S.I No	Circumstance	Unfurnished (A)	Furnished (B)
1	Accommodation is provided by union or state government.	License fee determined by the government as reduced by the rent paid by the employee	Add 10% of the cost of furnishing to the value determined under (A)
2	a)Where accommodation is provided by the employer and owned by the employer. or	i) 15% of salary in cities having population of 25 lakh or more ii)10 % of salary in cities having population in between 10 to 25 lakhs. iii) 7.5% of salary in cities	Add 10% of the cost of furnishing to the value determined under (A)

	b) where accommodation is taken on lease or rental by the employer	having population less than 10 lakh. or Actual amount of lease rental paid or payable by the employer or 15% of salary whichever is lower as reduced by the rent paid by the employee.	
3	Accommodation is provided by the employer in hotel	Not applicable	24% of the salary or actual amount paid in hotel whichever is lower.

Here “salary” includes the pay, allowances, bonus or commission payable monthly or otherwise or any monetary payment, by whatever name called.

### Problem:3

Mr. Nishanth is employed in a town (population 13 lakh). His particulars of income for the A. Y.:

Basic salary 8,000 p.m. DA 2,000 p. m. (40% enters into retirement benefits),  
 Bonus 8,000 p. a., Commission 4,500 p.a., EA 500 p.m. Fair rental value of rent-free house provided by the employer 40,000 p.a., Value of furniture provided 20,000. Compute income from salary.

### Solution: 3

Computation of income from salary

Salary 96,000

D. A. 24,000

Bonus 8,000

Commission 4,500

Entertainment Allowance 6,000

Value of furnished house 14,410

1,52,910.

Less: Deduction Nil

**Income from salary 1,52,910.**

**Note:** Computation of value of rent- free house:

Salary 96,000 + 40% D.A.9,600 + 8,000 + 4,500 + 6,000 = 1,24,100

10% of salary 12,410

Add: 10% cost of furniture 2,000

**Value of rent - free house = 14,410**

## 2).Valuation of Motor Car.

Owner	Expenses met by	Purpose	Value of car
1(a) Employer	Employer	Only official	Not a perquisite
1(b) Employer	Employer	Only Private	Total of: i. Actual expenditure on car ii. Remuneration to chauffeur. iii. 10% of the above cost of car Less: amount charged by the employee
1(c)(i) Employer	employer	Partly official and partly personal	Cubic capacity of engine upto 1.6 ltr: 1,800 p.m + 900 p.m (chauffeur) Cubic capacity of engine above 1.6 ltr: 2,400 p.m + 900 p.m (chauffeur)
1(c)(ii) Employer	employee	Partly official and partly personal	Cubic capacity of engine upto 1.6 ltr: 600 p.m + 900 p.m (chauffeur) Cubic capacity of engine above 1.6 ltr: 900 p.m + 900 p.m (chauffeur)
2(i) Employee	Employer	Only official use	Not a perquisite
2(ii) Employee	Employer	Partly personal and partly official	Actual expenditure incurred Less: Value of Car cubic capacity upto 1.6 litres or Value of Car cubic capacity above 1.6 litres

Sri.Chowdhry is Purchase Officer in a Company in Kota. He furnished the following particulars regarding his income for previous year 2014-15:

- i. Net basic salary 1,49,000 which is after deducting 7,400 for income tax, 20,000 as contribution to recognized provident fund and rent for bungalow 3,600.
- ii. Bonus 60,000
- iii. Travelling Allowance for Tour 25,000.
- iv. Reimbursement of medical bills 7,500.
- v. He lives in a bungalow belonging to the company in a town (population 15 lakh), its fair rent is 6,000 per month. The company has provided on this bungalow the facility of a gardener and a cook each of whom is being paid a salary of 250 per month and 900 p. m. respectively. The company paid in respect of this bungalow 6,000 for electric bill and 1,200 for water bill.
- vi. He has been provided with a large car for official and personal use. The maintenance and running expenses of the car including car driver are borne by the company.

vii. The following amounts were deposited in his provident fund account:

- (1) Own contribution 20,000
- (2) Company's contribution 20,000 and
- (3) Interest 9.5% p. a. 23,000

viii. Deposit in P. P. F. 16,000

Compute his taxable income from salary for the A.Y. 2016 – 17

**Solution: 4**

**Computation of taxable salary**

(For the Assessment Year)

1. Salary	1,49,000	
Income – tax deducted	7,400	
Contribution to P.F.	20,000	
Rent deducted	3,600	1,80,000
2. Bonus 60,000		
3. Employer's contribution to R. P. F. in excess of 12% salary		Nil
4. Perquisites:		
Gardener		3,000
Cook		10,800
Concession in rent		20,400
Electric bill paid by the employer		6,000
Water bill paid by the employer		1,200
Car – ( 2,400 + 900) × 12		39,600
<b>Gross salary</b>		<b>3,21,000</b>

**Notes:** 1. Concession in rent has been determined as under:

$$\text{Salary} = 1,80,000 + 60,000 = 2,40,000$$

$$10\% \text{ of } 2,40,000 \text{ } 24,000$$

$$\text{Less: Rent paid } 3,600$$

$$\text{Concession in rent } 20,400$$

2. Reimbursement of medical bills is exempt upto 15,000.

3. Travelling allowance for tour is exempt u/s 10(14) (i)

**Problem: 5**

Mr. A has retired from a private company on 30<sup>th</sup> November, 2014. He was working since 1<sup>st</sup> March, 1988. He received 2,00,000 as gratuity. His salary grade was 5,000-110-8,000-200-15,000, since 1<sup>st</sup> March, 2003. He was also getting D. A. @ 25% Basic Salary. Calculate his exempted gratuity

- (A) if he comes under Gratuity Act,  
(B) if he doesn't come under Gratuity Act.

**Solution: 5**

Computation of Exempted Gratuity

**A. Under Gratuity Act**

$$\text{Salary } 6,100 + 1,525 = 7,625 \times 15 \div 26 = 4,399$$

Least of the following is exempt

- i.  $4,399 \times 27 \text{ yrs} = 1,18,773$
- ii. 10,00,000
- iii. Amount Received 2,00,000

**Exempted Gratuity 1,18,773**

**B. Not covered under Gratuity Act**

Salary 1 month 6,000

Salary 9 months 54,900

60,900

Average salary 6,090

Half month salary 3,045

Least of the following is exempt:

- i.  $3,045 \times 26 \text{ yrs} = 79,170$
- ii. 10,00,000
- iii. Amount received 2,00,000

**Exempted Gratuity 79,170**

