UNIT 5 SALARIES-I

Structure

5.0 OBJECTIVES

After studying this Unit, you should be able to:

- define the term salary;
- list the items included under the heads salaries; and
- explain the provisions of Income Tax Act, 1961 in relation to the above items.

5.1 INTRODUCTION

A person has to pay tax on the income earned by him in the previous year on the basis of his residential status. "Income from Salary' is one of the main heads of income. In this unit, you will learn the definition of the term 'salary' and the items included in the salary income. You will also learn the calculation of the items to be included in salary for tax purpose.

5.2 MEANING OF SALARY

Any remuneration paid by an employer to an employee for the services rendered by him is called salary. Salary for income tax purpose not only includes the cash received but also includes the value of facilities and benefits provided to the employee.

The income taxable under the head salaries includes:

1) Any salary due from an employer, or former employer in the previous year, whether paid or not.
2) Any salary paid or allowed to an employee in the previous year by or on behalf of any employer though not due or before it becomes due to him.
3) Any arrear of salary paid or allowed to him in previous year by or on behalf of employer or a former employer, if not charged to tax for any earlier previous year.
4) Any wages paid from current or former employer in previous year.
5) Any pension received by employer in previous year.

Gross Salaries	=	Cash receipts e.g. cash salary or wages. Bonus commission Allowance etc.	+	Perquisites e.g., Monetary value of House, Car, Servant, Gas, Electricity, Water, Education etc.	+	Profits in Lieu Salary

Definition

According to Section 17 (1) of the Income Tax Act, the term 'salary' includes:

a) Basic salary or Wages;
b) Bonus;
c) Commission, fee and interim relief;
d) Over time payments;
e) Annuity;
f) Advance salary and arrears of salary;
g) Annual accretion in employee's recognized provident fund;
h) Taxable part of transferred balance;
i) Contribution made by central government in previous year under notified pension scheme in employees account referred to in section 80CCD;
j) Encashment of earned leave;
k) Gratuity;
l) Pension;
m) Compensation on retrenchment;
n) Amount received on voluntary retirement.

5.2.1 Some Important Points Regarding Salary

There are some points related to salary, which are to be kept in mind. The understanding of these points is very important and it will help you in computing the taxable salary of an individual. They are as follows.

i) Salaries and Wages: The income tax act makes no distinction between the salaries i.e., remuneration received by executive and wages i.e., remunerates received by workers. Salaries and wages both are to be taken under the head salaries.

ii) **Relationship of employee and employer:** Any payment will fall under the head 'salaries' only when there exists a relationship between employer and employee and between the payer and the payee. A person may hold an office and still may not be an employee, for example, a director of a company.

iii) **Salaries and Professional Income**: A profession involves the making of successive employment. If such employment is incidental to the exercise of profession, the remuneration received thereby will be taxed under Section 28. For example, if a Chartered Accountant is appointed to audit the accounts for a particular year, the income from such a contract is professional income and if he is employed to look into the accounts of the company regularly, the income so received will be salaried income.

iv) **Payment made after cessation of employment**: When the employee leaves the organization, the employer pays him certain sum like gratuity etc. Any such payment though received after the employee leaves the organization is taxable under the head salaries as it is received for service rendered in past.

v) **Tax-free salary:** Sometimes, the employer deducts the tax at source and pays net salary to the employee. In such cases, the individual has to show the aggregate salary i.e. net salary plus tax paid in his gross total income.

vi) **Deductions by employer**: There are certain compulsory deductions from salary like contribution to provident fund or charges for providing accommodation which are deducted by the employer and the net salary is given to the employee. Even though the amount has been deducted, it is included in the salary income. The reason is that it is only the application of income.

vii) **Dearness Pay:** It is a part of basic salary and is assumed to be given under the terms of employment, but for the valuation of rent free house, house rent allowance, gratuity (other than gratuity under the Payment of Gratuity Act), leave salary, recognized provident fund, and perquisite of gas, electricity, water, it shall be treated as part of basic salary only when it enters into the computation of superannuating or retirement benefits of the assessee concerned.

viii) **Due date of salary**: The rules are as follows:

a) For government and semi-government employee, the salary is due on first date of next month i.e., salary for February is due on 1st March. For this purpose, previous year salary will be from 1st March to 28th February of next year.

b) For bank employees and non-government organizations, the salary is due on last date of same month i.e., salary for February is due on 28th February. For this purpose, previous year salary will be from 1st April to 31st March of next year.

ix) **Dearness allowance**: If it is paid under the terms of employment – Dearness allowance is deemed to be under the terms of employment in the following two cases:

   a) When it is included in 'salary' for the purpose of computation of annual contribution in the recognized provided fund;

   b) When it is included in 'salary' for the purpose of computation of retirement benefits payable to an employee.

x) **Voluntary payments**: Every payment, in cash or in kind, made by an employer to his employee in consideration of his service under a contract of service or voluntarily is taxed under the head 'salaries'. Thus, salary, perquisite or allowance may come as a gift to an employee, yet it would be taxable. Any payment made by employer to his employee will not be excluded from his salary income merely because the employer made it voluntarily.

xi) **Salary foregoing or surrendering**: Section 15 of the Income Tax Act, 1961, charges salary on due basis. Tax liability is created at the time the salary becomes due. If an employee foregoes or surrenders his salary, he cannot escape from his taxliability.

xii) **Deduction from salary**: Deductions made by the employee out of the salary due to an employee are regarded as application of income. These deductions may be compulsory or optional or under a contract or voluntarily. In every case, deductions from salary are regarded as applications ofincome.

xiii) **Place of accrual of salary**: According to Section 9 of the Act, salary is deemed to accrue at the place where the service for which it is paid, is rendered. Salary accrued in India is deemed to accrue or arise in India though it has been paid outside India.

5.2.2 Definition of Salary for Different Purposes

The definition of 'salary' differs for different purpose. The purpose for which the definition of salary would differ is as follows:

i) Computation of taxable income under the head salaries.

ii) Calculating the exempted amount of House rent allowance under Section 10(13A).

iii) Calculating the value of rent-free accommodation or accommodation provided at a concessional rate.

iv) Calculating qualifying amount of provident fund contributions.

v) Calculating the entertainment allowance.

vi) Calculating exempted gratuity, exempted portion of encashment of earned leave etc.

vii) Calculating perquisite value of gas, electricity or water.

viii) Determination of salary of Rs. 50,000 regarding taxability of perquisites under Section 17(2) (iii)(c) (specified employees).

ix) Compensation on retrenchment under Section 10(10B)

Chart 5.1 will help you to know the meaning of 'salary' for different purpose at a glance.

Chart 5.1: Different Meanings of 'Salary' for Different Purposes

For computation of taxable income under the head salaries	*Rent-free House or Concession in rent*	*House Rent Allowance*	*Qualifying Amount of Contribution to R.P.F.*	*Entertainment Allowance*	*Standard Deduction u/s 16(1)*	*Gratuity*	*Determination of salary or Rs. 50,000 regarding taxability of per quisites under Sec. 17(2) (iii)(c)*	*Compensation u/s 10(10B)*	*Voluntary retirement Sec 10(10C)*
1. Basic Salary or wages. 2. Advance Salary. 3. Arrear of Salary. 4. Annuity or Pension. 5. Gratuity. 6. Fees, Commission Bonus. 7. Allowances including Dearness. Allowances 8. Profits in lieu of Salary 9. Perquisites 10. Excess Contributionto R.P.F. by employer over 12% of salary 11. Excess interest received fromR.P.F. over 9.5% rate of interest will be taxable. 12. Taxable portion of transferred balanceto R.P.F.	1. Basic Salary (excluding advance or arrears of salary received) 2. Taxable Allowance. 3. Bonus. 4. Commission 5. Any other payment in cash (Excluding dearness allowance not entering into retirement benefits of the employee, employer's contribution to R.P.F., Allowances exempt from tax, deductible amount of entertainment allowances, and value of Perquisites.)	1. BasicSalary. 2. Dearness Allowance if the terms of employment to provide, i.e., it is taken into account for retirement benefits, or dearness Pay. (Excluding all other allowances, bonus or perquisites and allextras). 3. Commission based on fixed percentage of turnover achieved by the employee and given under terms of employment.	Same as for House Rent Allowance as per proceeding column.	Basic Salary exclusive of any allowance, benefit or other perquisite.	Total of taxable salary i.e., Gross taxable salary	Basic salary plus DA as per under the terms of employment, commission based on fixed percentage of turnover.If the employee is covered by the Gratuity Act., D.A shallalways be included in salary.	1. Basic Salary, 2. Dearness allowance, 3. All other allowances, 4. Bonus, Commission, etc. and all monetary payments included in gross salary after allowing deduction u/s 16. For this purpose, salary will not include perquisites as they are not received in cash.	1. Salary, 2. allowances, 3. value of rent-free or concessional accommodation, 4. Light, water orany other amenity and travel concession; but does not include Bonus, Gratuity, and employer's contribution to any fund for retirement benefits.	1. Basic salary last drawn + D.A. (if under the terms of employment) + Commission on sales (basic on fixed% of sales)

Testimonials and personal gifts

Testimonials and personal gifts which are given purely out of personal affection and regard, although received by an employee from his employer would not be chargeable to tax as salary income. But, during the previous year, the value of such gift, voucher or token is upto Rs. 5,000 in the aggregate the value of perquisite shall be taken as NIL. But, if the aggregate value of gifts per annum is above Rs. 5,000, the excess amount of gift will be a taxable perquisite.

5.3 MAIN ITEMS INCLUDED IN SALARY

5.3.1 Salary or Wages

Let us analysis the components of salary income one by one.

In the eyes of law and as per the principle, there is no difference between salary and wages receivable by a laborer and the salary receivable by the corporates, are taxable under head 'Salaries'. From income tax point of view there is no difference between the two terms. Both salary and wages are taxed under the head salaries.

The study of computing process of taxable salary may be studied in the following headings:

a) Computation of gross salary
b) Deductions out of gross salary
c) Computation of taxable salary

Gross Salary

(I) Salary
[Salary due, or salary received or arrears of salary]
Salary includes:
i) Wages
ii) Annuity or pension
iii) Gratuity
iv) Fees, commission, perquisites or profits in lieu of or in addition to salary
v) Advance salary
vi) Encashment of leaves
vii) Annual accreation to recognised provided fund
viii) Transferred balance
ix) Voluntary payments
x) Contribution by the Central Government or any other employer to employees pension scheme U/S 80CCD during the previous year.

(II) Allowances
i) Fully taxable
ii) Partly taxable
iii) Fully exempt

(III) Perquisite
i) General perquisites
ii) Specific perquisites
iii) Tax free perquisites

IV) Profits in Lieu of salary
i) Compensation for the loss of or the variation in the terms of service
ii) Any payment by the employer to his employee in appreciation of his services
iii) Amount received from provident or other fund

Fig. 5.1: Gross Salaries

Salary or Wages

The terms 'salary' may be taken to denote payments made to a white collar worker or higher category of employees like assistants, officers etc. while 'wages' may denotepayments made to blue collar worker or casual labourers etc. The distinction is not material for Income tax purpose as both the payments are chargeable under the head 'salaries'.

Under Section 17(1) of Income Tax Act, the term 'salary' includes the following receipts:

a) Basic salary or Wages;

b) Bonus;

c) Commission, fee and interim relief;

d) Over time payments;

e) Annuity;

f) Advance salary and arrears of salary;

g) Annual accretion in employee's recognized provident fund;

h) Taxable part of transferred balance;

i) Contribution made by central government in previous year under notified pension scheme in employees account referred to in section 80CCD;

j) Encashment of earned leave;

k) Gratuity;

l) Pension;

m) Compensation on retrenchment;

n) Amount received on voluntary retirement.

Illustration 1

Shri Shanker Dayal has been getting a salary @ 3,600 per month since 1st April 2020. He has been allowed an increment of Rs. 200 on 1st August, 2020. Compute his basic salary.

Solution:

Computation of basic salary of Shri Shanker Dayal for the Assessment Year 2021-22

	Rs
April 2020 to July 2020 (Rs.3,600×4)	14,400
August 2020 to March 2021 (Rs.3,800×8)	30,400
Basic Salary	**44,800**

5.3.2 Encashment of Earned Leave on Retirement

An employee may be allowed to avail different types of leave e.g. medical leave, casual leave and earned leave. Some employers give cash for these leaves. Encashment of earned leave is also known as 'leave salary'. It is an incentive to an employee not to enjoy leave standing to his credit. If he does not avail of the leave which he is entitled to avail, he is paid equivalent cash salary for the leave not availed by him. This payment is termed as 'encashment of earned leave'. If the earned leaves are encashed during service, whole amount of cash received shall be taxable to all types of employees, whether government or non-government employees. The employee can demand for relief under Section 89(1).

Encashment of leave at the time of retirement/death: When an employee takes retirement from the service or resigns from service, he is given some amount for his earned leave. It is called encashment of earned leave or leave salary. It is also called discounting of leaves. Some part of this money received by the employee is taxable and remaining part shall be exempted. The provisions of Income Tax Act regarding exemption of encashment of earned leave are given below:

1) **Government Employee:** The whole amount of sum received by the employee of Central and State Government as encashment of earned leave at the time of his retirement (whether on superannuation or otherwise) or on resignation is fully exempt from tax. This exemption is also available on voluntary retirement but does not include termination of service. Thus, this exemption is not available on termination of service. Encashment received by the family members of government employees is also exempt from tax.

   'Leave salary' paid to the legal heirs of deceased employee in respect of privilege leave standing to his credit at the time of his death is not taxable as salary. It is fully exempt.

2) **Non-Government Employee (including employees of Local Authority, Statutory Corporation and Public Sector Enterprises):** Least amount of following four items shall be tax free. Remaining amount shall be included in salary.

   a) Actual amount of encashment of earned leave received or;

   b) Salary of maximum 10 months calculated on the basis of average salary of 10 months preceding immediately from the retirement.

   c) Calculated amount of encashment of leave for the approved period not taken during the services. (Maximum period of 30 days for each completed year is approved for encashment of earned leave),or

   d) The amount specified by the government, i.e. Rs. 3,00,000

Note:

i) Meaning of salary= (Basic Salary + Dearness Pay + Dearness Allowance (if under terms of employment)+ Commission at fixed rate on turnover by employee).

ii) While calculating the earned leave, the total number of years of service completed will be taken only but the incomplete number of months or days will be ignored.

Illustration 2

Mr. X is the general manager of Plus Ltd. He draws a salary of Rs. 5,500/- per month. He retires on 31st December 2020, after completing 26 years and 11 months of service. He is entitled to one month earned leave for every year of completed service. Rs. 1,00,000 received for encashment of earned leave on retirement. He has availed of 20 months earned leave while in service. He has encashed the unutilized earned leave standing to his credit on the basis of last drawn salary. Compute the taxable amount of leave encashment of Mr. X for the assessment year 2021-22.

Solution:

Computation of Taxable Amount of Encashment of earned leave of Mr X for Assessment Year 2021-22

a)	Leave (one month's leave for each completed year of service)		26 months
b)	Leave availed		20 months
c)	Leave due (26 months – 20 months)		6 months
d)	Exempted amount would be least of the following:		Rs.
	1)	Actual amount of encashment received	1,00,000
	2)	10 months average salary (Rs. 5,500 × 10)	55,000
	3)	Cash equivalent to 6 months @ average salary (5,500 × 6)	33,000
	4)	Maximum exemption limit	3,00,000

Taxable amount of Earned Leave = Actual amount received – least of the (1) (2) (3) (4) above i.e. amount of Rs. 1, 00,000 – 33,000 = Rs. 67,000

Hence, Rs 67,000 is taxable amount of Earned Leave.

Gross Salary = Basic salary + Taxable part of leave encashment

= [Rs. 5,500x9 (April, 2020-Dec, 2020)] + Rs. 67,000

= Rs. 49,500 + Rs. 67,000 = Rs. 1, 16,500

Illustration 3

Shri Omkar Narain was employed in a company. He took voluntary retirement on 1st December, 2020 after completing 25 years of service. On 1st January, 2020 his salary was Rs. 8,000 p.m. after adding the annual increment. In this company, two months leave accrued every year. Compute the amount exempt regarding encashment of earned leave from the following particulars.

	A	B	C
Total leave availed during service	10 months	Nil	30 months
Actually received amount	Rs. 2,40,000	Rs. 3,00,000	Rs. 1,20,000

Solution:

Average salary Rs. 8,000 p.m

Approved period of earned leave 25 months

(On the basis of 30 days per year).

The least of the following amount will be exempt.

		A	B	C
i)	Salary for10 months on the basis of average salary	Rs. 80,000	Rs, 80,000	Rs. 80,000
ii)	Salary for the period Remaining after deduction leave availed from the approved period	15×8,000	25×8,000	Nil
		1,20,000	2,00,000	Nil
iii)	Maximum limit	3,00,000	3,00,000	3,00,000
iv)	Actual amount received	**A**	**B**	**C**
		Rs. 2,40,000	Rs. 3,00,000	Rs. 1,20,000
	The exempt amount will be	80,000	80,000	Nil

Illustration 4

Determine the exempt amount of the encashment of earned leave from the following particulars.Employees retiring from a limited company on 31st Dec., 2020

Monthly salary at the time of retirement	**A** Rs. 25,000	**B** Rs. 25,000	**C** Rs. 25,000
Duration of service	30 years	30 years	30 years
Leave availed during service	-	20 months	32 months
Leave entitlement is at the rate Of 1.5 month for each year			
Leave at the credit	45 months	25 months	13 months
Leave salary paid to employee	Rs. 6,75,000	Rs. 3,75,000	Rs. 1,95,000

Solution:		**A**	**B**	**C**
i)	Actual amount received	Rs. 6,75,000	Rs. 3,75,000	Rs. 1,95,000
ii)	10 months' salary			
	10 × 25,000	Rs. 2,50,000	Rs. 2,50,000	Rs. 2,50,000
iii)	Encashment of leave	(30 years- 0 months)	(30 years- 20 months)	(30 years- 32 months)
	in credit on the basis of	30×25,000	10×25,000	Nil
	one month for each year of service	7,50,000	2,50,000	Nil
iv)	Maximum amount	3,00,000	3,00,000	3,00,000
	Least of the above four amount will be tax free exemptamount	2,50,000	2,50,000	Nil

Illustration 5

R, an employee of ADB ltd. Retired from the company on 30/11/2020.At the time of his retirement, he receives Rs 2, 88,000 as leave salary from his employer. The following information is provided by the employee:

Salary at the time of retirement (p.m.)	Rs 18,000
Period of service	20 years and 8 months
Leave encashment	Rs 2,88,000
Leave availed while in service	14 months
Balance unavailed leave at the time of retirement	16 months
Average salary for the months of Feb, 2020 to Nov, 2020	Rs 17,600
Leave entitled	1 ½ month for every completed year of service

Compute the amount of taxable leave encashment of R for Assessment Year 2021-22

Solution:

The minimum of the following four amounts will be exempt:

	Rs
1) Leave encashment actually received	2,88,000
2) 10 months average salary i.e. Rs 17,600 ×10	1,76,000
3) Leave encashment for 6 months @ Rs 17,600 p.m.	1,05,600
4) Amount specified by the government	3,00,000

Hence, Rs 1,05,600 would be exempt and the balance of Rs 1,82,400 would form part of gross salary.

Note:

Although R is entitled to 1 ½ months leave for every completed year of service, for the purpose of calculating limit for clause 3 above, the calculations will be done on the basis of maximum 30 days, leave for every completed year of service. Therefore, the maximum leave allowable for purpose of clause 3 i.e. 30 days × 20 = 600 days i.e. 20 months.

Leave already availed by employee is 14 months. Therefore, the unavailed leave calculated on basis of 30 days leave for every completed year of service is 6 months (20-14)

5.3.3 Bonus, Fees, Commission, Profit in Lieu of Salary

An employee may get bonus, Fees, Commission, profit in lieu of salary, interim relief etc. from his employer. Bonus may be monthly, annually or may depend on a certain percentage on sale or any other measurement. This is taxable in the year of receipt. If the employee receives arrears of earlier year's bonus, bonus in a subsequent year, he is entitled to claim relief under section 89(1).

5.3.4 Pension

A person is entitled for pension every month after retirement as per terms of employment. Pension received both by government and non-government employee is taxable under the head 'Salaries'. It is chargeable to tax on accrual basis, whether it is received voluntarily or under a contract. It is periodical or lump sum payment received by an employee from his employer after his retirement from service. It is taxable as salary. But if the employee was receiving tax free salary, the pension payable to his widow would also be tax free, but treated as family pension in income from other sources. A similar rule is applicable to the pension paid by a foreign government to its employees serving in India. But the pension earned and received in the hands of an ordinary resident is taxable. Salary and pension received from UNO is not

Chargeable to tax in India. A new pension scheme has been introduced in the case of an employee joining central government service on or after January 1, 2004. This scheme is mandatory to every employee. The law relating to pension is briefly stated below.

i) **Periodical Pension** (Uncommuted Pension): Such as monthly, yearly or otherwise paid pension, is chargeable to tax as salary in the hands of all employees i.e. Government as well as non-Government employee.

ii) **Commuted Pension:** Sometimes, the employee wants to take lump sum payment in lieu of pension on monthly basis. Such lump sum is known as commuted pension. The provisions of such commutation are as follows.

$$\text{Total pension} = \frac{\text{Commuted value ofpension}}{\text{Commuted part of pension}}$$

iii) **Commutation of pension** Section 10 (10A): Where an employee gets a lump sum as a consideration for commutation of his pension, the sum received constitutes salary in his hands and is taxable according to the followingprovisions:

a) **Commuted pension received by Government employees**

Any commuted pension received by a Government employee shall be fully exempt, also the entire commuted value of pension received by a government servant, who voluntary resigns and join the services of a public sector corporation is exempt.

b) **Commuted pension received by Non-government employees** Commuted pension in this case is exempt from tax, to the extent stated below:

i) Where the employee is in receipt of gratuity, the commuted value of $1/3^{rd}$ of the total pension shall be exempt.

ii) In any other case, the commuted value of ½ of total pension shall be exempt.

Any excess over such exempted amount is taxable as salary, where on account of taxation of commuted pension, the pensioner pays tax on a higher slab rate; he is entitled to relief under section 89(1). Arrears of pension are taxable on due basis, whether received or not.

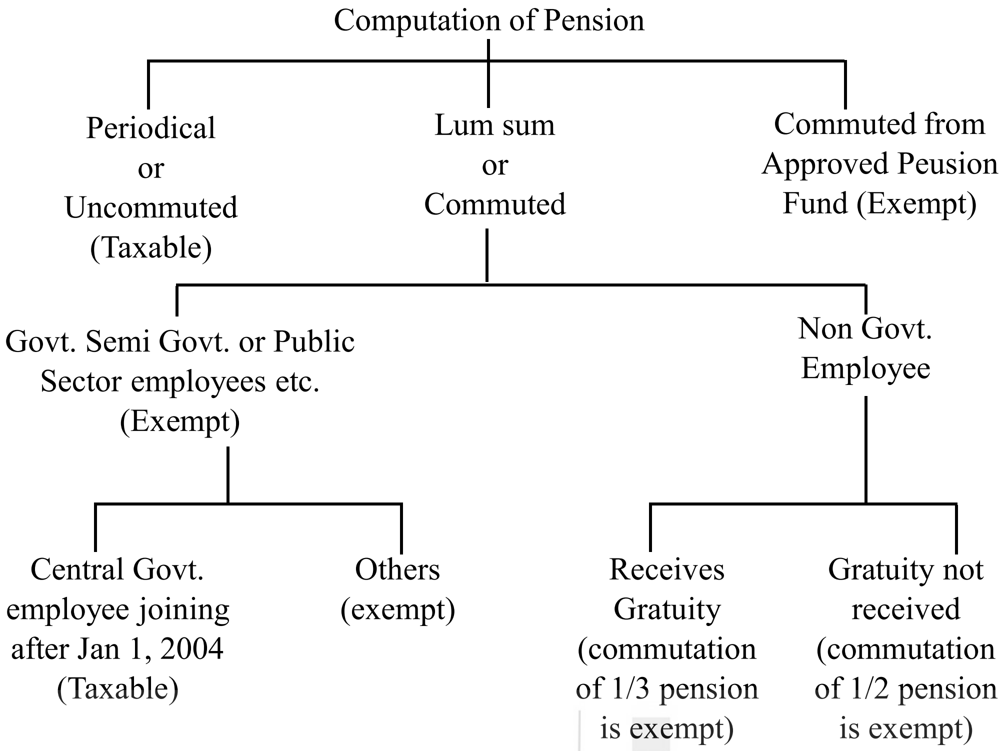

Fig. 5.2: Computation of types of pension

Illustration 6

Mr. Madhur is getting a pension Rs. 4,000 per month from a company. During the previous year he got two-third pension commuted and received Rs. 1,86,000. Compute the exempted amount, if (a) he also received gratuity (b) he did not received gratuity, for the assessment year 2021-22.

Solution:

Mr. Madhur is a non-Govt. employee, Tax Free commuted pension in his case is as below:

a) He received gratuity.	Rs.
Commuted value of 2/3 pension	1,86,000
Commuted value of full pension = 1,86,000 × $\frac{3}{2}$	2,79,000
Commuted value of $\frac{1}{3}$ pension = 2, 79,000 × $\frac{1}{3}$	93,000
Hence, Exempt amount will be Rs. 93,000 and balance amount Rs. 1, 86,000 – 93,000) = Rs. 93,000 is taxable.	
b) When Mr. Madhur does not receive gratuity commuted value of 2/3 pension = Rs. 86,000	
Commuted value of full pension = 1, 86,000 × $\frac{3}{2}$	2, 79,000
Commuted value of $\frac{1}{2}$ pension = 2, 79,000 × $\frac{1}{2}$	1, 39,500
Hence exempt amount will be Rs. 1, 39,500 and balance amount (1, 86,000 – 1, 39,500) = Rs. 46,500 is taxable.	

Illustration 7

Determine taxable pension for the assessment year 2021-22 in the following circumstance:-

i) Mr. Shantanu retired from ABC Ltd. on June 30, 2020. He got a pension @ Rs. 1,500 p.m. up to November 30, 2020. He got Rs. 1,50,000 on December 1, 2020 as commuted value of his 60% pension. What would have been the position if he also received a gratuity at the time of retirement.

ii) Mr. Harshit retired from the Central Government services on July 1, 2021. He received pension @ Rs. 2000 p.m. up to February, 2021. He got a lump sum of Rs. 1, 00,000 on March 1, 2021 as commuted value of ¼ pension.

iii) Received by an individual during the previous year Rs. 50,000 as commutation of pension from LIC pension fund set up under an approved pension scheme.

iv) Mr. Satish received Rs. 1,800 p.m. as pension from Honda Ltd., a public limited company in private sector, during the previous year.

Solution:

i) Mr. Shantanu is a non-government employee. Uncommuted pension received by him is chargeable to tax. Commuted pension receivable by him is partly tax-free and partly chargeable to tax. Pension will calculate in two parts.

a) Uncommuted pension chargeable to tax is computed Rs. 7,500 as under: Pension @ Rs. 1,500 p.m. from July 1,2020 to November 30, 2020 i.e. for 5 months	
Pension @ 600 p.m. [Rs. 1,500-60% of 1,500 (Commuted)] from December 1, 2020 to March 31, 2021 i.e. for 4 months	Rs.
[1500-900] 600 × 4	2,400
Total Uncommuted pension chargeable to tax	9,900
b) Commuted pension chargeable to tax is computed as under:	
Commuted value of 60% of the pension	1,50,000
Commuted value of full pension $\left[1,50,000 \times \frac{100}{60}\right]$	2,50,000
i) When Mr. Shantanu does not receive gratuity ½ of the commuted value of full pension is exempt from tax $\left[\frac{2,50,000}{2}\right]$	1,25,000
Amount chargeable to tax (1,50,000 – 1,25,000)	25,000
ii) When Mr. Shantanu receives gratuity 1/3 of the full commuted pension is exempt $\left[\frac{2,50,000}{3}\right]$	83,333
Amount chargeable to tax (1,50,000– 83,333)	66,667

Thus, when Mr. Shantanu gets gratuity also then, taxable amount will be Rs. 76,567 (Rs.66, 667 commuted + Rs. 9,900Uncommuted).

When Mr. Shantanu does not received gratuity, then taxable amount will be Rs. 34,900 (Rs. 25,000 commuted + Rs. 9,900 Uncommuted)

ii) Mr. Harshit is an employee of the central government. Commuted pension received by a government employee is wholly exempt under section 10(10-A). Thus, commuted pension of Rs. 1,00,000 is wholly exempt.

Uncommuted pension will be taxable as under:	Rs.
Pension for 8 months @Rs.2,000	16,000
(1, July 2020 to February, 2021)	
Pension for March 2020 after deducting	
The commuted pension i.e. Rs. 2,000 – ¼th of it	1,500
Taxable amount of pension	17,500

iii) Commutation of pension received from LIC pension fund is exempt from tax. Hence, Rs. 50,000 isexempt.

iv) Mr. Satish is a non-government employee and periodical pension i.e. Rs. 1,800 × 12 – Rs. 21,600 is taxable.

5.3.5 Annuity

A certain sum paid for a certain period by the employer to his employee in consideration of service rendered by him is called annuity. It is explained by points given below:

a) Annuity payable by the present employer is taxable assalary.

b) Annuity received from a past employer is also chargeable totax.

c) Annuity from any other person such as from LIC etc, under an insurance policy is taxable as 'income from other sources'.

5.3.6 Gratuity [Section 10(10)]

Gratuity is a gratuitous payment made by the employer to his employee. It is a gift or present, in return for favor of services rendered, at the time of retirement or death. It is paid in recognition of long and meritorious services, rendered by the employee. The payment of gratuity act, 1972 has legally recognized the concept. Even where the act is not applicable, invariably all employers provide for payment of gratuity to their employees through the terms of employment. The amount of gratuity is paid to the employee, if he survives at the time of retirement, or to his wife or children, if he dies before retirement.

The provisions regarding gratuity are stated below:

a) In the case of government employees [Sec10(10)(i)]

Any death – cum – retirement gratuity received by central, state, local government employees is fully exempt from income tax.

b) **In the case of employees covered by the Payment of Gratuity Act, 1972 [Sec 10(10)(ii)]**

Any gratuity received by an employee covered by the Payment of Gratuity Act, 1972 is exempt from tax to the extent as stated below:

i) 15 days salary (7 days in case of employees of a seasonal concern) for each years' service (service for a period of more than 6 months is regarded as one year's service) based on salary last drawn i.e., 15 days salary x length of service, or.

ii) 20,00,000 as maximum amount; or

iii) Actual amount of gratuity received, whichever is less

Taxable gratuity = Actual gratuity received – Exempted gratuity

(Meaning of salary for purpose of computation of gratuity = Last drawn salary + D.A. last drawn by the employee but excluding all other payments)

Note:

1) Any bonus, commission, H.R.A., overtime wages or any other allowances is not included.

2) Salary of 15 days is calculated as below.

$$\text{15 day's salary} = \frac{\text{Salary drawn in last month}}{26} \times 15$$

3) Salary of 15 days in case of piece rated employee is calculated as below:

$$\text{15 days salary} = \frac{\text{Monthly average wages (Including overtime wages) received during last 3 months}}{26} \times 15$$

4) For the purpose of this act, one month is regarded as 26 days.

5) 6 months or more than 6 months shall be considered as one year.

Table 5.2: Gratuity Rules in Brief:

Government (Central, State or Local) Employees of all categories U/S 10 (10) (i)	**Employees covered by the payment of Gratuity Act, 1972 U/S 10(10)(ii)**	**Employees i.e. covered U/S 10(10)(iii) , but, not covered under Payment of Gratuity act, 1972**
Gratuity received is totally exempt	Least of the following amount is exempt: i) 15 days or 7 days salary on the basis of salary last drawn for services of 6 months or more in each year; or ii) Rs. 20,00,000; or iii) Actual Gratuity received **Note:** a) Salary = Salary (including D.A) last drawn by the employee excluding all other payments b) 15 day's salary = $\frac{\text{Salary of last month drawn} \times 15}{26}$	Least of the following amount is exempt: i) ½ months average salary for each completed year of service; or ii) Rs. 20,00,000; or(iii) Actual Gratuity received **Note:** a) Salary = Basic salary +D.A. (if it is under the terms of employment)+Commission on sale (if it is fixed percentage on sales effected by employee). The salary will be average salary, computed on the basis of average salary of 10 months immediately preceding the months of retirement. b) Completed year = Period of full year of service. Any fraction of the year is ignored.

Illustration 8

Mr. Shakil is an employee of Axis Ltd. He receives Rs.5, 00,000 as gratuity as per the provisions of payment of gratuity act, 1972. He retired on 31st March, 2021 after doing service for 27 years and 9 months. At the time of retirement his monthly salary was Rs. 17,000. Calculate the taxable gratuity in the hands of Mr Shakil for Assessment year 2021-22.

Solution:

i) 15 days salary for each completed year of service.	Rs.
Completed year is 28 because fraction of month is more than 6 months.	
$17{,}000 \times \frac{15}{26}$	
9,808 × 28	2, 74,624
ii) Maximum amount	20,00,000
iii) Actual amount received	5,00,000

The minimum amount of above three amount is 2, 74,624 which is exempted and remaining part (5, 00,000 – 2, 74,624) = Rs, 2, 25,376 is taxable as gratuity.

Illustration 9

Mr. Ashutosh was retired from an Indian company after serving 34 years 4 months on 31st December, 2020. The company paid him Rs. 8, 00,000 as gratuity under the payment of Gratuity act, 1972. His monthly salary and D.A. at the time of retirement was Rs. 58,000 and Rs. 5,800 respectively. Compute the exempted gratuity U/S 10(10)(ii) of income tax act.

Solution:

i) 15 days salary for each completed year of service.	Rs.
Salary = 58,000 + 5,800 = $63{,}800 \times \frac{15}{26}$	
= 36,808 x 34	12, 51,472
ii) Maximum amount	20,00,000
iii) Actual amount received	8, 00,000.

Minimum amount of above three is Rs. 8, 00,000 so total amount which is receiving that is exempt from tax.

iii) **In the case of any other employees [Sec 10(10) (iii)] :** The employees who are not covered under the Payment of Gratuity Act, 1972, received gratuity by him or by his widow or by his children on his retirement, death, termination of service, resignation or on his becoming incapacitated prior to his retirement, is exempt from tax to the extent as stated below:

a) ½ month's average salary for each year of completed service; or

b) maximum amount i.e. Rs.20,00,000; or

c) Actual gratuity received.

Note:

1) Meaning of salary for computation of gratuity: Basic salary + Dearness Allowance. + Dearness Pay (if under the terms of employment) + commission (if it is payable at a fixed percentage of turnover.)

2) Average monthly salary is to be calculated on the basis of 10 months' salary immediately preceding the month in which the employee retires.

3) For calculating completed years of service any fractional portion (even if it amounts to 11 months and 29 days) is to be ignored.

4) Any gratuity received in excess of the exempted limit is taxable as salary. However, any gratuity received in excess of the exempted limit is taxable as salary.

5) Where gratuity is received by an employee from more than one employer, either in the same year or in different years. The total amount of gratuity exempt cannot exceed Rs.20,00,000.

Since gratuity is taxed as salary, existence of relationship of employer and employee is vital. For example, the gratuity paid by LIC to its agents does not qualify for any exemption.

Illustration 10

After serving for 33 years and 9 months in Reliance Petro chemicals Ltd. Mr A, who is covered by payment of gratuity act, retires from service on 30th April, 2020. The Company pays him a gratuity of Rs 85,000.His monthly basic salary at the time of retirement was Rs 4,500.

You are required to determine the amount of exempted gratuity under section 10(10) of the income tax act.

Solution:

Mr A is covered under payment of gratuity act, 1972; his total period of service is 33 years and 9 months, hence, 34 years of service will be taken. For computing salary of 15 days, salary of last month will be taken and 15/26 of this salary will be done.

15 days salary = 4,500 × 15/26 = Rs 2,596

The amount of exempted gratuity will be least of the following:	Rs.
a) Actual amount	85,000
b) Rs 2,596 × 34	88,264
c) Maximum	20, 00,000

Exempted gratuity will be Rs 85,000

Illustration 11

Mr Vishesh, who is not covered by the payment of gratuity act, 1972, receives a gratuity of Rs 5, 76,000, when he retires on 23rd June, 2020 after a service of 34 years 9 months and 23 days. His last drawn emoluments are as follows:

Basic salary Rs 30,000, Dearness allowance Rs 7,200 p.m. (Fixed)

Annual increment in basic salary Rs 1,200 p.m. falls due on 1st Jan, every year

What amount of gratuity is exempt from tax in the assessment year 2021-22?

Solution:

Average basic salary for 10 months immediately preceding the month in which he retires Rs 30,000, which has been calculated as under:

	Rs.
Salary for 5 months @ Rs 28,800 p.m. (August 2019 to December 2019)	1, 44,000
Salary for 5 months @ Rs 30,000 p.m. (January 2020 to May 2020)	1,50,000
Total salary for 10 months	2, 94,000
Average salary of last 10 months (Rs. 2, 94,000/10)	29,400
Half month's average salary (Rs 29,400/ 2)	14,700

The amount of gratuity exempt u/s 10(10) will be least of the following:

1)	Actual amount of gratuity received	5,76,000
2)	Half month's salary for each year of completed service Rs 14,700 × 34	4, 99,800
3)	Maximum Limit Exempted amount of gratuity 4,99,800 Taxable Gratuity = Rs 5, 76,000 –Rs 4, 99,800 =Rs 76,200	20,00,000

5.3.7 Compensation on Retrenchment

An employee may be retrenched from service under Industrial Disputes Act, 1947.Two points are important in this connection:

i) Retrenchment on winding-up of business;

ii) Transfer of employee from one service to another

If an employee gets some amount of compensation from his employer due to retrenchment, it is included in gross salary. But whole amount of compensation is not taxable. Some part of it is tax-free. Least of the following amounts shall be exempt and remaining taxable amount will be included in the gross salary:

a) Actual amount of compensation received;

b) Salary for service period calculated on the basis of 15 days salary for each completed calendar year (6 months or more shall be treated one year);

c) Amount declared by Central Government Rs. 5, 00,000.

d) 26 days shall be taken for one month

e) Computation of 15 days salary shall be computed as below:

Meaning of average salary

Meaning of salary = Basic salary + Dearness Allowance (Whether it is under terms of conditions or not) + Dearness Pay

$$\text{Average salary of three months (Including dearness allowance)} \times \frac{15}{26}$$

Note:

1) A workman means that workman who is covered under Industrial dispute Act. It does not include manager, administer, whose salary is more than Rs 10,000 pm and who render their services for managerial affairs, personnel employed in army, police services and navy services.

2) The workman can demand for relief u/s 89(1), if amount of compensation on retrenchment exceeds above mentioned exempted limit.

5.3.8 Voluntary Retirement [Section 10(10C)]

If any employee of Public Sector Company or any other company or any authority established under any act or any corporation or cooperative society or university or Indian institute of technology established under any central or provincial act or any management institute notified by central government, takes retirement from his service voluntary, whole amount received or receivable in this connection shall be exempt upto a maximum limit of Rs. 5, 00,000.An exemption of maximum Rs. 5, 00,000 shall be allowed. The advantage of such exemption upto Rs 5, 00,000 shall also be given to employees of such concerns which are very famous for all over India or state and these concerns are notified by central government. If any assessee gets sum under such scheme in installments, he will also be entitled to avail this exemption upto a total limit of Rs. 5, 00,000.

Least of the following will be exempt from tax:

i) Actual compensation amount received

ii) Salary of 3 months service period of full year service length

iii) Remaining month of service * salary at the time of retirement

iv) Maximum amount Rs 5, 00,000

Note: [Meaning of Salary- Basic salary + Dearness Pay +Dearness allowance (if it is under terms of employment) + Commission at fixed percentage on sale (if any)]

5.3.9 Advance Salary

Advance salary means the salary received by an employee before it is earned by him it is included in the taxable income of the recipient. But, it is not so included when it becomes due.Tax is chargeable on all salaries

a) Which are due whether actually paid or not and also those

b) Which are paid whether due or not to the employee during the financial year.

In view of this specific provision even advance salary received i.e salary received for services yet to be rendered would also be taxable in the year of receipt although such salary is not yet due to the employee. Thus, salary is taxable at the earliest point of time i.e on the date of accrual or on becoming due or on receipt of salaries.

Advance against salaries

This is loan availed by an employee which will be repaid by him to his employer in installments along with interest or free of interest as the case may be. This loan is not to be treated as salary.

Relief: It is to be noted that when advance salary is taxed in the year of receipt, more than12 months' salary may be taxed in one previous year. This will increase the income limit and higher slab rates may be applied in calculating tax payable, in this type of case, the employee can apply to the assessing officer in the prescribed form for relief which will be granted to him by virtue of the provisions of Sec. 89.

5.3.10 Allowances

All monetary payments made by an employer to his employees, other than salary, are termed as allowance. It is fixed, predetermined and given regularly in addition to salary in connection with the services rendered by the employee. It may be given in form of reimbursement of some expenditure incurred by the employee or may be given irrespective of actual expenditure. From the income tax view point, all the allowances may be classified in three parts, i.e.fully taxable, partially exempted and fully exempted,which are shown in Table 5.2 below:

Table 5.3: Allowances

Fully taxable	Partially exempted	Fully exempted
1) Dearness Allowance or Dearness Pay 2) Medical Allowance 3) Tiffin Allowance 4) Servant Allowance 5) Non-Practicing Allowance 6) Warden Allowance 7) Deputation Allowance 8) Overtime Allowance 9) City Compensatory Allowance 10) Other Allowances: i) Shift allowance ii) Marriage allowance iii) Project allowance	1) House Rent Allowance 2) Entertainment Allowance 3) Travel Allowance 4) Special Allowance exempt u/s 10(14)(ii) a) Children Education Allowance b) Hostel Allowance c) Composite hill Allowance d) Tribal Area Allowance e) Allowance for meeting personal expenditure to an employee of transport organization while on duty during the running of such transport f) Border Area Remote Area, Difficult Area or Disturbed Area Allowance	1) Conveyance Allowance 2) Foreign Allowance 3) Allowances to High Court Judges 4) Allowance from UNO 5) Special Allowance notified U/S 10(14)(i) a) Tour allowance b) Daily Allowance c) Conveyance Allowance for performance of official duty d) Helper allowance e) Academic allowance f) Uniform allowance

5.3.10.1 Fully Taxable Allowances

Fully taxable allowances which are shown in the table received by an employee from his employer are included fully in his salary income in order to ascertain his tax – liability.

5.3.10.2 Partially Exempted Allowances

The allowances which are partially exempted and remaining part is taxable treated under this category. The taxable portion is ascertained as below.

(A) House Rent Allowance [Sec 10 (13A)]

Generally, employees receive house rent allowance from their employers to meet the expenditure incurred by them towards house rent. It is exempt from tax subject to the following limits:

Least of the following is exempt from tax:

i) Actual house rent Allowance received by the employee in respect of the relevant period; or

ii) Rent paid by the employee in excess of 10% of salary due to him in respect of the relevant period; or

iii) 50% of salary due to him in respect of the relevant period if the accommodation is situated at Mumbai, Kolkata, Delhi or Chennai; or

iv) An amount equal to 40% of the salary due to him in respect of the relevant period if the accommodation is situated at any other place.

The least amount is exempt from tax and the remaining amount shall be taxable and is included in the gross salary.

Quantum of exemption: Minimum of following three limits:

	Mumbai/Kolkata/Delhi/Chennai	Other cities
1.	Allowance actually received	Allowance actually received
2.	Rent paid in excess of 10% of salary	Rent paid in excess of 10% of salary
3.	50% of salary	40% of salary

Note:

i) Meaning of salary = Basic salary + Dearness allowance (if it is under the termsof employment) + commission at fixed rate on sale.

Illustration 12

Mr. Varun resides in Chennai. He is paid Rs. 3, 80,000 as basic salary. He also gets Rs.1, 20,000 as House rent allowance. The rent paid by him is Rs. 95,000; calculate exempt and taxable house rent allowance.

Solution:

Least of the following is exempt:	Rs.
i) Actual house rent allowance received	1, 20,000.
ii) Excess of rent paid over 10% of salary (95,000 – 38,000)	57,000
iii) ½ of salary $\frac{3,\,80,000}{2}$	1, 90,000

As Rs. 57,000 is the least amount, Thus, exempt house rent allowance is Rs. 57,000 thus, taxable house rent allowance = Rs. 1,20,000 – 57,000 = Rs. 63,000.

Illustration 13

Mr. Rakesh received the following emoluments from a private company during the previous year: (i) Salary @ Rs. 8,000 p.m., (ii) Dearness allowance @ 20% of salary (1/2 of it is under the terms of employment) (iii) Bonus Rs. 20,000 (iv) Commission on sale @ 5% (sales Rs. 2, 50,000) (v) House rent allowance @ Rs. 2,000 p.m. Compute the taxable House rent allowance when he:

a) Resides in a rented house @ Rs. 2,200 p.m. in Agra.

b) Resides in a rented house @ Rs. 3,000 p.m. in Delhi.

c) Resides in a house owned by his mother without paying any rent. Fair rental value of the house is Rs. 4,000 p.m.

Solution:

Salary + D.A. (under the terms of employment) + commission on sale = Rs. 96,000 (Rs. 8,000 × 12)+D.A. 9,600 (10% of D.A. under the terms of employment) +12,500 $\left(\text{Rs. } 2,50{,}000 \times \frac{5}{100}\right)$ = Rs.1, 18,100.

a) When he resides in Agra at Rs. 2,200 p.m. Least of the following will be exempted.	Rs.
i) Actual allowance received Rs. 2000 × 12	24,000
ii) (Rent paid – 10% of salary) or Rs. 26,400 – 11,810	14,590
iii) 40% of salary	47,240
Hence, Rs. 14,590 is exempt	
Taxable H.R.A. = Rs. 24,000 – Rs. 14,590	9,410

b) When he resides in Delhi at Rs. 3,000 p.m. least of the following will be exempted.	Rs.
i) Actual amount received Rs. 2,000 × 12	24,000
ii) (Rent paid – 10% of salary) Rs. 36,000 – Rs. 11,810	24,190
iii) 50% of salary	59,050
Rs. 24,000, Actual H.R.A. received is fully exempt.	

c) Taxable H.R.A.will be Rs.24,000. He will not get exemption of any amount of H.R.A. as he is not paying any rent for his residential accommodation.

B) Entertainment Allowance

It is paid by an employer to his employee to compensate his entertainment expenses. The total amount is firstly included in his salary income and at last if employee fulfills certain conditions, it is allowed as deduction. This has been explained under the head "Deductions from Salaries" in unit 6.

C) Transport Allowance

Transport allowance is taxable for normal personfrom A.Y. 2019-20 but for blind or deaf or dumb or orthopedically handicapped with disability of lower extremities, it will be exempt up to Rs. 3,200 p.m.

D) Special Allowances specifically exempted u/s 10 (14) (ii) notification No. SO 259(5) dated 27-3-1990 have notified the following allowances:

i) **Special Compensatory Hilly area allowance or High Altitude allowance or uncongenial climate allowance or show bound area allowance or Avalanche allowance** is exempt from tax up to maximum of Rs. 300 p.m. If employee is working at height 1,000 meter or above the sealevel.

The prescribed limit depends upon the height of the regions, Rs. 7,000 for Siachen area of Jammu & Kashmir or Rs. 800 p.m. for other hill areas (located at height of more than 9,000 feet).

ii) **Border area allowance or remote area allowance or difficult area allowance or disturbed area allowance** is exempt at the following rates:

a) Andaman, nicobar and narcondum islands some specified places of north, some specified places of himachal Pradesh, and areas beyond 25 km from Lungali district of Mizoram - **Rs. 1,300 p.m.**

b) Continental shelf of India and exclusive economic zone of India- **Rs. 1,100 p.m.**

c) Arunchal Pradesh, Jammu and Kashmir, district Lungali of Mizoram, Nagaland, Tripura, South Andaman, some areas of Himachal Pradesh- **Rs. 1,050 p.m.**

d) Uttar Pradesh, Haryana, Rajasthan, Punjab, Aizawal district of Mizoram, some areas of Jammu and Kashmir, Tripura, Manipur, himachal Pradesh- **Rs. 750 p.m.**

e) Jog falls in district shimoga of Karnataka - **Rs. 300 p.m.**

f) Some areas of Himachal Pradesh, throughout Assam and Meghalaya- **Rs. 200 p.m.**

iii) **Tribal allowance**

This exemption is available @ Rs. 200 per month in nine States (i) Madhya Pradesh (ii) Tamil Nadu (iii) Uttar Pradesh (iv) Karnataka (v) Tripura (vi) Assam (vii) West Bengal (viii) Bihar and (ix) Orissa.

iv) **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 in India, is exempt up to a specified limit. The specified limit is 70% of such allowance or Rs. 10,000 p.m. (whichever is less)

v) **Children educational allowance:** It is exempt @Rs. 100 per month per child up to a maximum of two children.

vi) **Hostel allowance:**Any allowance granted to an employee to meet the hostel expenditure on his child @ Rs. 300 p.m. per child up to a maximum of two children.

viii) Compensatory field area allowance: Exempt to the extent of Rs. 2,600 permonth (Specified areas of Jammu and Kashmir, Uttar Pradesh, Himachal Pradesh, Manipur, Nagaland, specified areas of Arunachal Pradesh).

viii) Counter insurgency allowance: Exempt to the extent of Rs. 3,900 per month. This allowance is granted to members of armed forces operating in areas away from their permanent location for a period of more than 30 days.

ix) Underground allowance: Such allowance is granted to an employee who is working in uncongenial climate in underground coal mines shall be exempt to the extent of Rs. 800 per month.

x) High altitude allowance: Given to the members of armed forces for altitude of 9000 feet to 15000 feet Rs. 1,060 per month and altitude above 15000 feet Rs. 1,600 per month.

xi) Special compensatory highly active field area allowance: Such allowance is given to the members of armed forces and is Exempt upto the extent of Rs. 4,200 per month.

xii) Island (duty) allowance: Given to the member of the armed forces in Andaman & Nicobar and Lakshadweep Group of Islands and is exempt upto the extent Rs. 3,250 per month.

xiii) Compensatory modified field area allowance: Exempt upto the extent of Rs. 1,000 per month (Specified area of Punjab, Rajasthan, Haryana, Himachal Pradesh, Arunachal Pradesh, Assam, Mizoram, Tripura, Sikkim, West Bengal Uttar Pradesh, Specified Areas of Jammu and Kashmir)

5.3.11 'Profits' in Lieu of Salary

As stated above-the term salary includes any profit in lieu of salary, the above term according to Section 17(3) includes:

i) Compensation received by an employee on termination of his employment or on modification of his terms of employment. Compensation is basically a capital receipt since it is the very source of income i.e., the salary. Capital receipts are not taxable unless by definition they are treated as income. In the present case, the termination compensation is specifically treated as profit in lieu of salary.Such compensation is taxable as salary.

Sometimes, the terms and conditions of employment may be modified in future; the employee will get lower salaries in lieu of which they will be paid immediately a lump sum consideration. Such payment is taxable as salary.

ii) Payments from unrecognized fund

Any payment received by an assessee from an unrecognized provident fund or any fund (not being an approved superannuating fund) tothe extent it consists of employer's contribution and interest thereon is taxable as profits in lieu of salary.

Specific exemptions

The following payments, however, do not constitute profits in lieu of salary.

i) Exempted Gratuity-[Section10(10)]

ii) Exempted value of Commuted Pension-Section 10(10A)

iii) Exempted amount of Retrenchment Compensation-Section 10(10B)

iv) Payment from Statutory Provident Fund-Section 10(11).

v) Exempted amount from Recognized Provident Fund-Section 10(12).

vi) Payment from Approved Superannuation Fund-Section10(13).

vii) House Rent Allowance.

Check Your Progress A

1) Define the term 'Salary' as per Section 17(1) of Income Tax Act.

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2) A is a non – government employee getting a salary of Rs. 6,000. He retires and receives Rs. 4, 00,000 as gratuity after serving 25 years 8 months. The employee is covered by the Payment of Gratuity Act. Calculate exempted amount of gratuity.

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3) Mr. Rathore retires from Private Service on 30th April, 2020 and his pension has been fixed at Rs. 6,000 p.m. He gets ½ of his pension commuted and gets Rs. 3, 00,000. He also received Rs. 1, 50,000 as gratuity. He gets his pension commuted during January, 2021. Pension becomes payable on the 1st day of each month, calculate taxable pension.

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4) Mr. Kaushik retired from service on 31st December, 2020. His pension was fixed at Rs. 6, 000 p.m. He commutes half of his pension and received Rs. 2, 70,000. Find out taxable amount of commuted pension if:

   i) He is government employee.

   ii) He is a private employee who get gratuity

   iii) He is a private employee who did not get any gratuity.

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5) Which of the following statements are True or False:

   i) Under Section [10(10AA)], leave salary for a period up to maximum of ten months is exempt from tax.

   ii) Family pension received by the wife of a deceased employee is taxable under the head 'Income from other sources'.

   iii) The maximum notified exemption in respect of gratuity received by private sector employees is Rs.20,00,000.

   iv) For calculating the exemption in respect of house rent allowance, all allowances are to be included in salary.

   v) Interest on employee's contribution to unrecognized provident fund is chargeable under the head salaries.

   vi) The maximum amount for deduction as entertainment allowance to government employee is Rs.5,000.

   vii) Foreign allowance is exempted from tax.

   viii) House Rent Allowance is exempted for Government Employees.

   ix) Salary includes wages and pension.

   x) The maximum exempted limit for Gratuity is Rs 20,00,000.

5.4 LET US SUM UP

Income from salary is one of the main heads of income. Salary means any remuneration paid by the employer to the employee for service rendered. The meaning of salary for tax purpose is very wide. It not only includes the cash received but also the monetary value of facilities and benefits attached with the office of employment. It includes salary or wages, bonus, pension, annuity, gratuity, leave encashment, advance, fees or commission, contribution to provident fund, profit in lieu of salary.

In order to calculate the taxable salary of an individual, the taxable amount of all the above items is to be calculated and added together. The term salary is not only wide but has many meaning. 'Salary' includes different items for different purpose, for example, while calculating the encashment of earned leave 'salary' means basic salary, dearness allowance if terms of employment so provide and commission, if based on fixed percentage of turnover. For calculating gratuity and HRA, 'salary' includes basic salary, DA, if terms of employment so provide, dearness pay and commission, if based on fixed percentage of turnover.

5.5 KEY WORDS

Advance against salary: This is loan availed by employee repayable in installment and is not taxable.

Advance Salary: This is salary received for services yet to be rendered, and is taxable on receipt basis.

Allowance: Monetary benefits attached to an office or employment like conveyance allowance, HRA, etc for meeting particular requirements connected with the services rendered by the employee or compensation for unusual conditions of service.

Annuity: A certain sum paid for a certain period by the employer to his employee in consideration of service rendered by him.

Arrears of Salary: This means salary due but not yet received.

Commutation of Pension: A retired employee who is in receipt of pension can choose to forego a part of his pension in future, in lieu of which, he can get a lump sum. Thisis known as commutation. Exemption is available in respect of such commutation subject to limits.

Encashment of Earned Leave: Usually, employees get 30 days of earned leave in a year which can be accumulated. Generally, all organization allows their employees to encash their earned leave, if the accumulation exceeds a prescribed limit. Leave encashed during service period is taxable while leave encashed on retirement is exempt subject to certain limits.

Gratuity: This is a lump sum payment paid to an employee, usually at the time of retirement in recognition of long and meritorious service. Exemption is available subject to certain limits.

Pension: This is a monthly payment received by a retired employee from his former employer. This is taxable as salary income.

Profits in Lieu of Salary: The Income Tax Act treats certain items like compensation received by an employee on termination of his employment, certain payment from unrecognized provident fund and all other payment made by an employer or former employer as profits in lieu of salary. These are taxable as salary income.

5.6 ANSWERS TO CHECK YOUR PROGRESS

Check Your Proegess A

2) Rs. 90,000;
3) Rs. 1, 54,000;
4) (a) fully exempt (b) Rs. 90,000 (c) Rs. Nil
5) i) True, ii) True, iii) True, iv) False, v) False, vi) True, vii) True, viii) False, ix) True x) True

5.7 TERMINAL QUESTIONS/EXERCISES

1) What are the provisions of Income Tax Act regarding commutation of pension?
2) What are the provisions for calculating House rent allowance?
3) What do you mean by profit in lieu of salary?

4) Mr. Ajay is an officer in U.P. Govt. in the pay scale of Rs. 10,000 – 500 – 16,000 since 1st June, 2020. Calculate basic salary for the A.Y. 2021-22.

[Answer: 10,000 x 2 + 10,500 x 10 =1,25,000]

5) Mr. Abhishek is getting a pension of Rs. 8,000 per month from a company. During the previous year he got his three-fourth pension commuted and received Rs. 7, 20,000. Compute the exempted amount assuming if he also received gratuity.

[Answer: Rs. 3, 20,000]

6) Mr. Sanjeev is working in a concern. His basic pay is Rs. 6,000 p.m. and dearness pay @ 10% of basic pay. Commission based on fixed percentage of turnover Rs. 25,000 for the whole year. House rent allowance is Rs. 1,200 p.m. and actual rent paid by him Rs. 1,000 p.m. House is situated in Lucknow. Compute taxable House rent allowance.

[Answer: Rs. 12,100]

7) From the following particulars, compute Mr. Jagdish's taxable amount of earned leave.

	Rs.
Basic Pay	8,000 p.m.
D.A. (Under the terms of employments)	800 p.m.
Earned Leave encashed on retirement on 31st March, 2020	2, 00,000
Completed year of service	20 years
Leave in credit	5 months

[Answer :(2, 00,000 – 44,000) = Rs. 1,56,000]

8) From the following particulars, calculate gross taxable salary of Mr. Ashish for the A.Y. 2021-22.

Basic Pay	10,000
D.A. (Under the terms of employment)	5,000
Bonus	25,000
Taxable part of Gratuity received	3, 00,000
Completed year of service	35 years
Leave consumed during service	28 months
Actual amount of leave encashment	1, 50,000

[Answer: Gross salary Rs.3, 85,000]

9) From the following particulars of Dr. Ghanshyam Das, calculate the exempted amount of gratuity. He is not covered by the Payment of Gratuity Act.

Date of retirement	30 June,2020
Gratuity received	Rs.5, 00,000
Service	30 years 11months

Basic Pay	Rs, 10,000 p.m
D.A. (Considered for retirement benefit)	Rs. 3,000 p.m.
Commission on sales	2%
Sales achieved by him	3,80,000

[Answer: Exempted amount = Rs.2,04,495]

10) Mr. Nagraj, who is not covered under Payment of Gratuity Act, retires on 25 December, 2020 from ABC Ltd. and service of 36 years 9 months and he received gratuity amount Rs 5,00,000. His salary is Rs. 6,000 per month up to June 30, 2020 and 7,000 per month from July 2020. He also gets D.A. of Rs. 1,000 per month (70% of which is considered for service benefit). Find the taxable amount of Gratuity for the A.Y. 2021-22.

[Answer: Rs. 3,70,400]

11) Mr. Azad is an employee of Vijaya Steal Company in Delhi. He draws a basic pay of Rs. 12,000 p.m. and D.A. 8,000 p.m. which is considered for computation of retirement benefits. He earns 3% commission on sales achieved by him. The turnover achieved by him during F.Y. ended 2020-21 is Rs. 8,00,000. He is getting H.R.A. of Rs. 8,000 p.m. He pays rent of Rs. 8,000 p.m. calculate his gross salary for A.Y. 2021-22.

[Answer: (1,44,000+96,000+24,000) = 2,64,000+Taxable H.R.A. 26,400= 2,90,400]

12) Sri Amar is an employee in a company of Chennai. Following are the particulars. Rs.

a)	Basic Salary	7,000 p.m.
b)	D.A. (under the terms ofemployment)	1,000 p.m.
c)	H.R.A.	1,200 p.m.
d)	Rent actually paid	1,500p.m.

e) He retired on 1st January, 2020 after completing 25 years of service. The company paid him Rs. 4,50,000 as gratuity. He is not covered under the payment of gratuity act. The company paid him Rs. 5,000 p.m. as pension.

f) Salary and pension become due on the last day of each month. Compute gross salary of Sri Amar.

[Answer: Taxable H.R.A. = (Rs 10,800 – Rs 6,300) = Rs 4,500

Taxable Gratuity = (Rs 4,50,000 – Rs 1,00,000) = Rs 3,50,000

Gross Salary (63,000+9,000+15,000+4,500+3,50,000) = Rs. 4,41,500]

> **Note:** These questions will help you to understand the unit better. Try to write answer for them. But do not submit your answers to the University. These are for your practice.