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 head salaries
- 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 far tax purposes.

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 purposes not only includes the cash received. It also includes the value of facilities 'and benefits provided to the employee: The incomes taxable under the head salaries include .

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 an employer though not due or before it becomes due to him

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., remuneration received by workers. Salaries and wages both are to be taken under the head salaries.

ii) Relationehip of employee and employer: Any payment will fall under the head 'salaries' only when there exists a relationship of employer and employee 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 employthent 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 organisation, the employer pays him certain sum like gratuity etc. Any such

3) any arrear of salary paid or allowed to him in previous year by or on behalf of an employer or a former employer, if not charged to tax for any earlier previous year.

Definition

For the purpose of Sections 15 and 16 of the Income Tax Act the term 'salary' includes:

i) Wages

ii) any annuity or pension

iii) any gratuity

iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages.

v) any advance of salary

vi) any payment received by an employee in respect of any period of leave not availed by him i.e., encashment of leave salary.

vii) the annual accretion to the recognized provident fund of an employee to the extent provided in the rules. This may take two forms. Firs) employer's contribution to Provident Fund. Second interest credited on the accumulated balance of recognized provident fund standing to the credit of the employee. As per rules employer's contribution to the PF in excess of 10% of the salary of the employee and the interest credited to the PF accumulations in excess of 12% will be considered as salary. It is significant to note that Section 7 deems both the above items as income of the relevant previous year in which the credit has been made.

viii) Amount of the transferred balance of recognized provident fund to the extent to which it is taxable.

It may be noted that the term 'salary' has been defined in the widest sense to include monetary and non-monetary items. Certain items like employer's contribution in excess of 10% to PF and interest accrued on PF balance in excess of 12% are treated as salaries and are deemed to be the incomes of the previous year in which the relevant credits are made. This definition of 'salary' is for the purposes of Sections 15 and 16. Secion 15 deals with the chargeability of a receipt under the head 'salaries'. Section 16 on the other hand allows certain deductions from salaries like standard deduction, entertainment allowance and profession tax.

payment though received after the employee leaves the organisation is taxable under the head salaries as it is received for services 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.

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 Ist March. So salary for a previous year 1989-90 will be salary of the month for March 1989 to the salary for the month of February 1990.

b) for employees of bank and non-government organisations the salary is due on last date of same month i.e., salary for February is due on 28th February so salary income for previous year 1989-90 will be the salary for the month of April 1989 to March 1990.

5.2.2 Definition of Salary for Different Purposes

The definition of 'salary' differs for different purposes. The purposes for which the definition of salary would differ include

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 rent.

iv) Calculating qualifying amount of PF contributions.

v) Calculating the entertainment allowance.

vi) Calculating standard deduction under Section 16 (1)

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

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

ix) Determination of salary of Rs. 24,000 regarding taxability of perquisites under Section 17(2) iii (c) (specified employees),

x) Compensation under Section 10 (10B) Chart 5.1 will help you to know the meaning of 'salary' for different purposes at a glance.

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. For example suppose an HMT Watch is presented to an employee by a company for completing 25 years of meritorious service, the value of such a watch cannot be taxed as salary in the hands of the employee. Such presents do not occur at regular intervals. They, come, probably, once in the service career. The immediate nexus of the present is the meritorious service of the employee rather than the contract of employment.

However, it should be noted that whether an item of receipt constitutes personal gifts or testimonial in appreciation of meritorious services depends upon the facts of the particular case. Normally speaking, if there is a general scheme of award applicable to all employees after they complete a particular span of service, such gifts are

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 of Rs.24,000 regarding taxability of perquisites under Sec. 17(2)(iii)(c)	Gas, Electric energy or Water	Compensation u/s 10(10B)
Basic Salary or wages. Advance Salary. Arrears of Salary. Annuity or Pension. Gratuity. Fees, Commission, Bonus. Allowances including Dearness Allowana. Profits in lieu of salary perquisites Excess contribution to R.P.F. by employer over 10% of salary. Excess interest received from R.P.F. over 12% rate of interest will be taxable. Taxable portion of transferred balance to R.P.F.	1. Basic Salary (excluding advance or arrears of salary received) 2. Taxable Allowance. 3. Bonus. 4. Electricity, gas and water bills paid or reimbursed by the employer. provided they are otherwise taxable. 5. Commission. (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 allowance, and value of perquisites.)	1. Basic Salary. 2. Dearness Allowance if the terms of employment so provide. i.e., it is taken into account for retirement benefits, or Dearness Pay. (Excluding all other allowances, bonus or perquisites and all extras). 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 column.	Basic Salary exclusive of any allowance, benefit or other perquisite.	Basic Salary, Fees, Commission, Perquisite, Advance Salary, Arrear of salary, Profit in lieu of salary, Excess contribution by employer to R.P.F. over 10% of salary, Interest credited to R.P.F. in excess of 12% rate, taxable portion of transferred balance to R.P.F. (excluding exempted receipts.)	Same as for House Rent Allowance or Recognised Provident Fund.	Basic Salary, Dearness Allowance, All oiher allowances. 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.	Basic Salary exclusive of all extras, but including dearness pay or dearness allowance given under the terms of employment and commission at fixed percentage of turnover achieved by the employee and given under terms of employment.	Salary allowances, value of rent-free or concessional accommodation, light, water or any other amenity and travel concession; but does not include Bonus, Gratuity employer's contribution to any fund for retirement benefits.

treated as personal in nature and exempt from tax. However when there is no such general scheme, and the management awards employees chosen at their own sweet will and pleasure, such payments will constitute salary in the hands of the recipients.

5.3 MAIN ITEMS INCLUDED IN SALARY

Let us have analyse the components of salary income one by one.

5.3.1 Salary or Wages

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

Salary, bonus, commission or remuneration paid to a partner by the firm is merely an appropriation of firm's profits. Just because it is called 'salary' by the firm, it cannot become salary in the hands of the partner. It is taxable in the hahds of the partner under the head 'Profits and gains of business or professions' and not under the head 'Salaries'.

Salary in lieu of resignation notice is chargeable on the basis of its receipt. ***V.D. Talwar*** v ***CIT (1963) 49 ITR 122 (SC).***

5.3.2 Encashment of Earned Leave on Retirement

An employee can encash his earned leave while in service and also at the time of retirement. Amount received on encashment of earned leave while in service is fully taxable without any exemption. However, where, due to the addition of such leave salary to his normal salary income the employee pays tax at a higher slab rate he will be entitled to relief under Section 89(1).

On retirement

Encashment of unutilised earned leave at the time of retirement is exempted from tax under Section 10 (10 AA) subject to the following provisions:

(i) Government employees

In case of Central/State government employees, any amount received as cash equivalent of leave salary in respect of the period of earned leave to his credit at the time of retirement/superannuation is fully exempt.

The retirement may be on superannuation i.e., retirement on reaching a specified age or otherwise like termination, voluntary retirement etc. Even if the employee voluntarily resigns from service the exemption will apply ***CIT V.R.J. Shahney (1966) 159 ITR 160 (Mad).***

(ii) **Other employees**

In the case of other employees, leave salary is exempt from tax to the extent of the least of the following:

(a) The amount of leave encashment actually received.

(b) Leave salary for which the employee is entitled on the basis of earned leave standing to his credit. This entitlement, to earned leave however cannot exceed 30 days for every year of actual service,

'Salary' for the entitled leave period is to be calculated on the basic of average salary drawn by the employee during the period of ten months, immediately preceding the month in which the employee retired. 'Salary' for this purpose means basic salary and includes dearness allowance if the terms of employment so provide. I1 also includes commission based on fixed percentage of turnover achieved by an employee as per terms of contract of employment—*Gestetner Duplicators* (P) *Ltd.* v *CIT* ***(1979) 177 ITR 1 (SC).***

(c) Salary for 8 months of earned leave period. For this purpose 'salary' has the same meaning as explained in (b) above.

(d) Notified monetary ceiling

The CBDT by notification No. S.O. 553 (E) dated 8th June, 1988 has notified the upper monetary limit in respect sf exemption of leave salary. In respect of those retiring on or after 1-1-1988, the limit applicable is Rs. 79,920/- employees retiring between July 1, 1987 to December 31, 1987 the limit is Rs. 77,760/-.

It has been clarified that where an employee gets exemption in respect of encashment of earned leave while retiring from the service of one employer and again gets encashment of earned leave from another employer on his retirement from service, the monetary ceiling limit mentioned above will be reduced by the amount of exemptiqn availed of by the employee when retiring from the services of his earlier employer. In other words, the total exemption in respect of leave encashed on retirement from all employers cannot exceed the specified monetary limit.

Where leave salary is paid to the legal heirs of the deceased employee in respect of privilege leave standing to the credit of such employee at the time of his death the same is not taxable as salary. This is because of the fact that there exists no employer-employee relationship in regard to this payment.
(circular letter No. F.35/1) 65-IT (B), dated November 5, 1965.

Cash equivalent of leave salary received by the family of a Government servant who died in harness, is not taxable in the hands of the recipient. (Circular No. 309 dated July 3, 1981.) Illustration 1 will help you to understand the provisions regarding encashment of earned leave during retirement,

Illustration 1
Mr. X is the general manager of Plus Steel Ltd. He draws a salary of Rs. 5000/- per month. He retires on 31st December 1989, after completing 26 years and 11 months of service. He is entitled to one month earned leave for every year of completed service. He has availed of 20 months earned leave while in service. He has encashed the unutilised earned leave while in service. He has encashed the unutilised earned leave standing to his credit on the basis of last drawn salary. He got an increment of Rs. 500/- on 1-7-89. Compute the gross salary of Mr. X for the assessment year 1990-91.

Solution

Mr. X.

Computation of gross salary for assessment year 1990-91.

Salary for 9 months
(1-4-89-31-12-89)
3 X Rs. 4500 + 6 X 5000 = 43,500.00

Encashment of earned leave
Total earned leave to which X is entitled 27 monfhs
Less earned leave availed 20 months
Balance of credit 7 months
Cash received on the basis of Rs. 5000/- per month. 35,000.00
Less exemption under Section 10 (IOAA) :

(a) Actual amount received. Rs 35,000/-
(b) Leave salary for the unutilised entitled period on the basis of average salary drawn during 10 months immediately preceding retirement.

$$\frac{7 \times (5 \times 4500 + 5 \times 5000)}{10}$$

$4 \times$ Rs. 4750/- = Rs. 33,250/-

(c) Salary for 8 months of earned leave period

exempted under the **Act.**
8 X **Rs.** 4750/- = **Rs.** 38,000/-

(d)	Rs. 79,920/-		
	The least is exempt	Rs. 33,250/-	1,750/-
	Excess amount is taxed	(35,000 – 33,250)	
	Gross Salary		45,250

Note : Section 10 (AA), provides for the basis of average salary drawn during 10 months immediately preceding retirement. It should be read as average salary for 10 months immediately preceding ***the months in which retirement took place.*** This is a logical reading since the same basis is applicable for calculating exemption in respect of gratuity.

5.3.3 Bonus

This is taxable in the year of receipt. If the employee receives arrears of earlier years' 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 the terms of employment. Pension received both by government and non-government employees is taxable under the head 'Salaries'. Sometimes the employer wants to take lump sum payment in lieu of pension on monthly basis. Such lump sum is known as commuted value of pension the provisions of such commutation are as follows:

Commutation of pension—Section 10 (10 A)
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. However Section 10 (10 A) provides for certain exemptions.

(a) Any commuted pension received by a government employee is fully exempt. Also the entire commuted value of pension received by a government servant who voluntarily resigns and joins the services of a public sector corporation is exempt—circular No. 286 dated 17th November, 1980.

(b) Non-government employees
   (i) in a case where the employee receives gratuity, the commuted value of one-third of the whole pension which he is normally entitled to receive and
   (ii) in any other case, the commuted value of one-half of such pension is 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 (i). Arrears of pension are taxable on due basis whether received or not—T.A. *Ramasubramaniam v* CIT ***(1975) 100 ITR 408 (Mad).***

Look at Illustration 2 for clear understanding of pensions received by different categories of employees.

Illustration 2

Determine the taxable amount of pension for the assessment year 1990-91 in the following cases.

i) A receives Rs. 1200/- per month as pension from :
   (a) the Central government
   (b) a public sector corporation and
   (c) a private sector company during previous year 1989-90.

ii) A retires from government service on 30th April 1989. He gets pension of Rs. 1,2001- per month upto December, 1989 with effect from January 1, 1990 he gets one-third of his pension commuted for Rs. 22,0001-.

iii) A retires from Tata Steel Company Ltd., in June 39, 1989. He gets pension of Rs. 2,0001- per month upto 31-1-1990.. With effect from 1-2-1990 he gets 75%

of his **pension** commuted for Rs. 70,0001- at the time of retirement he got Rs. **1,00,000/-** as gratuity from the company.

Solution

i) Rs. **14,400/-** will be taxable as salary in A's hands for 1990-91 assessment year subject to permissible deductions. It does not matter whether he is a government servant, a servant of public sector, or a private sector company. However, since his total income will be below the taxable limit of Rs. **18,000/-** no liability arises for payment of tax.

(ii) Non-commuted pension from May **89-December** 89 Rs. **1200/-** X 8	**Rs. 9,600/-**
Since A is a goveinment servant the entire commuted value of Rs. **22,000/-** is exempt from tax.	
Uncommuted pension from 1-1-90 **to** 31-3-90 **Rs. 1200/-** X **2/3** X 3	**Rs. 2,400/-**
Total taxable uncommuted pension.	**Rs. 12,000/-**
(iii) Uncommuted pension from 1-7-89 to 31-1-90 Rs. **2000/-** X 7	**= Rs. 14,000/-**
Commuted value of 75% of pension Rs. **70,000/-** Since A has received gratuity **1/3rd** of the commuted value of the whole pension is exempt **from tax i.e. Rs. 70,000 X 4/3 X 1/3 = Rs. 31,111/-**	
Taxable portidn of commuted pension	**Rs. 38,889/-**
Uncommuted pension from 1-2-90 to 31-3-90 **Rs. 2,000/- X 1/4 X** 2	= Rs. **1,000/-**
Taxable pension (subject to standard deduction)	**53,889/-**

5.3.5 Annuity

Annuity means "an yearly allowance, or income, the grant of an annual sum for a **term of year,** for life or in **perpetuity."**

(a) Annuity payable by the present employer is taxable as salary.

(b) **Annuity** received from a past employer is covered by **Section 17(3) (ii)** under 'any other payment'and hence constitutes **profits** in lieu of salary and is chargeable to tax as salary.

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

5.3.6 Gratuity

Gratuity means "a gift or present, often in return for favours or services." Gratuity is paid over and above the normal salary. 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 tax treatment of gratuity is as follows:

Gratuity paid is taxable as salary. However, Section 10 (10) provides for certain exemptions. Such exempted portion of gratuity is not to be treated as income.

(a) Any death-cum-retirement gratuity received by all categories of central government employees, State government employees or employees of a local authority is fully exempt from income tax.

(b) Any **gratuity** received by an employee (whose **salary** does not exceed Rs. **2500/- p.m.)** under the Payment of **Gratuity Act,** 1972 is exempt to the extent specified in that Act.

The following limits are specified by the above Act. The least of these limits is exempt from income tax.

(a) Actual amount of gratuity received

(b) Rs. 50,000

(c) Amount of gratuity to which the employee is entitled.

The entitlement is 15 days salary (7 days for seasonal establishment employees) for every years of completed service. Service for more than six months will be counted as one year. Amount of 15 days salary is to be calculated by dividing the last drawn monthly salary by 26. This is because of a specific decision of the Supreme Court referred to later. In the case of piece-rated employees amount of 15 days wages is to be calculated on the average of total wages (excluding overtime) received for a period of 3 months immediately preceding the termination of the employee.

Salary here includes dearness allowance but does not include any bonus, house rent allowance, overtime wages and any other allowance.

Illustration 3 will help you in computing the taxable amount of gratuity for employees who earn a salary of less than Rs. 2,500/

Illustration 3

B, an employee of TR Co. Ltd. receives Rs. 50,0001- as gratuity as par the provisions of Payment of Gratuity Act 1972. He retires in March 1990 after putting in 26 years and 9 months service. At the time of retirement his monthly salary was Rs. 1700/- Calculate the taxable gratuity in his hands.

Solution

Completed year of service 27 years

15 days salary i.e. $\frac{1700 \times 15}{26}$ = Rs. 980/-

As per the decision of the Supreme Court in Digvijay Woollen Mills Ltd. v Mahendra Pratap Rai Buch (1980) 4 Taxman 15 (SC) to find out the average day's salary we have to divide the monthly salary by 26.

Limits:

(i)	Gratuity received	Rs. 50,000/-
(ii)	15 days of wages for each completed year of service Rs. 980 X 27	Rs. 26,460/-
(iii)	Rs. 50,000	

The exempted portion of gratuity is Rs. 26,460 and the balance of Rs. 23,540/- (50,000–26,460) will be taxable in the hands of B as salary.

Any other employee:

In case of any other employee other than the two categories mentioned above, the gratuity received by him on his retirement or on his becoming incapacitated prior to retirement or on termination of employment or any gratuity received by his widow, children or dependents on his death is exempt to the extent of least of the following limits:

(i) Actual gratuity received.

(ii) Rs. 1,00,000/-

(iii) **Entitled gratuity:** This is equal to 1/2 month salary for every year of completed service. Average monthly salary is to be calculated on the basis of 10 months' salary immediately preceding the month in which the employee retires.

For calculating completed years of service any fractional portion (even if it amounts to 11 months and 29 days) is to be ignored. This is different from the basis adopted under the Payment of Gratuity Act.

'Salary' for this purpose includes dearness allowance if the terms of employment so provide. It also includes commission if it is payable under the terms of employment at a fixed percentage of turnover achieved by the employee. If however the employee paid commission as a percentage of general turnover of the company which is not related to the turnover achieved by the employee such commission is not to be included in salary.

Any gratuity received in excess of the exempted limit is taxable as salary. However, since the employee will be paying tax on higher slab rates during the year of receipt of gratuity, he will be entitled to claim relief under Section 89(1).

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. 1,00,000/-

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.

Look at Illustration 4 for understanding the calculation of taxable gratuity for employees having salary of more than Rs. 2,500/- p.m.

Illustration 4

A has been working with two companies, X Ltd., and Y Ltd. The following particulars are given to you.

X Ltd.

Date of retirement	June 1, 1989
Service	30 years, 11 months
Gratuity received	Rs. 1,00,000/-
Basic pay from 1.4.1989	Rs. 4,000/- p.m.
Yearly increment	Rs. 400/-
Increment month	April, 1989
D.A. (considered for retirement benefits)	Rs. 1000/- p.m.
Commission payable to him on sales achieved by him.	2%
Turnover achieved by him in 1988	Rs. 2,40,000/-
Turnover achieved by him in 1989 (up to 31.5.1989)	Rs. 1,20,000/-

Y Ltd.

Date of retirement	March, 1990
Service	27 years, 10 months
Gratuity received	Rs. 75,0001-
Average salary drawn in 10 months immediately preceding March 90	Rs. 3,600/-

Compute the taxable gratuity in the hands of A for the Assessment year 1990-91.

Solution

X Ltd.

Previous year 1989-90—Assessment year 1990-91.

		Rs.
	Gratuity Received	1,00,000/-
	Least of the following is exempted	
(a)	Actual gratuity received	1,00,000/-
(b)	Average salary	
	Basic pay for 10 months immediately preceding the month of retirement	
	$2 \times 4000 + 8 \times 3{,}600$	36,800/-
	D.A. 10×1000/-	10,000/-
	Commission	
	Turnover for 10 months preceding the month of retirement	
	Rs. 1,20,000 + 1,00,000 $\frac{(2{,}40{,}000 \times 5)}{12}$	

= Rs. 2,20,000/- 2% commission	4,400/-
Salary for 10 months	51,200/-
Salary for one month	5,120/-
No. of completed years of service × 1/2 Average Salary	76,800/-
(c) Rs. 1,00,000 Exempted amount	76,800/-
Taxable gratuity is (1,00,000—76,800) i.e.	23,200/-

Y. Ltd.

Previous year 1989-90—Assessment year 1990-91 Limits.

		Rs.
(a)	Actual gratuity received	75,000/-
(b)	Completed years of service × 1/2 × Average salary for 10 months immediately preceding the month of retirement 27X1/2X3500 = Rs. 47,250/-	
(c)	Rs. 1,00,000/- — Rs.76,800 being the amount of gratuity exempt already. Rs. 23,200/-	Rs. 23,200/-
	Taxable gratuity	Rs. 51,800/-
	Total taxable gratuity for assessment year 1990-91 is Rs. 23,280 + Rs. 51,800/-	Rs. 75,000/-

5.3.7 Advance Salary

It is common practice for employees to receive salary in advance under conditions of emergency. According to Section 15 tax is chargeable on all salaries (a) which are due whether actually paid or not and also those (b) which arc 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 instalments along with interest or free of interest as the case may be. This loan is not to be treated as salary.

For example Mr. X is an employee in T.V.S. Ltd. In March, 1990 he obtained from his company Rs. 10,000/- as a loan to puchase a scooter. He also withdrew from his employer in March, 1990 Rs. 5,000/- being his salary for April, 1990 since the amount of loan was insufficient for the purchase of the scooter.

In computing the income of Mr. X for the assessment year 1990-91 the loan of Ks. 10,0001- is not to be included, However, the salary for April 90 withdrawn by him in March '90 should be included in X's income for the previous year ending 31.3.1990. In other words for the assessment year 1990-91 salary income for 13 months will become taxable in the hands of X.

However once advance salary is taxed in a particular previous year, it will not be taxed again in the succeeding previous year. This is made clear by the explanation to section 15 which specifically provides that where any salary paid in advance is included in the total income of any person for any previous year it shall not be included again in the total income of the person when the salary becomes due.

Relief

It is to be noted that when advance salary is taxed in the year of receipt, more than 12 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 such case of hardship 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 Section 89.

5.3.8 Allowances

Allowance means cash received apart from the salary. All types of allowances like dearness allowance, city compensatory allowance, children's education allowance etc., by whatever name called are taxable as salaries even though they have not been specifically included in the definition.

Now-a-days there is a growing practice by several companies to give such allowances as conveyance allowance, education allowance etc., as voucher payments. In other word the vouchers are so worded that the payments constitute reimbursements towards expenditure actually incurred. The quantum of allowance for each employee over a period of say one year remains constant. Such payments clearly constitute 'salary' in the hands of the recipient.

The allowances may be fully taxable, partially taxable or fully exempted. Chart 5.2 gives the list of these three types of allowances.

Chart 5.2

Allowances

Fully taxable	Partially exempted	Fully exempted
1) Dearness Allowance or Dearness Pay 2) Medical Allowance 3) Tiffin Allowance 4) Servant Allowance 5) Non-Practising Allowance. 6) Hill Allowance 7) Warden Allowance 8) Deputation Allowance 9) Overtime Allowance	1) House Rent Allowance 2) Entertainment Allowance 3) Special Allowances exempt U/S 10(14) (ii) a) Children Education Allowance b) Hostel Allowance c) Composite Hill Compensatory Allowance d) Tribal Area Allowance e) Allowance for meeting personal expenditure to an employee of a transport organisation while on duty during the running of such transport. f) Border Area, Remote Area. Difficult Area or Disturbed Area Allowance.	1) Travelling Allowance 2) Foreign Allowance 3) Allowances to High Court Judges 4) Allowance from UNO 5) Special Allowances notified U/S 10(14)(i) a) Travelling Allowance. b) Daily Allowance c) Conveyance Allowance. for performance of official duty

Let us now discuss Partially Exempted Allowances one by one. Fully taxable and fully exempted allowances do not require further elaboration.

A) Mouse Rent Allowance: Section **10(13A):** Generally employees are paid house rent allowance by their employers to meet the expenditure incurred by them towards house rent. Under Section 10(13A) read with Rule 2A such house rent allowance is exempt from tax subject to the following limits.

(a) The actual amount of HRA received in respect of the period during which the house was occupied by the employee during the previous year (relevant period) or

(b) Excess of rent paid by the employee over 10% of salary due to him in respect of the relevant period.

'Salary' for this purpose includes dearness allowance if the terms of employment so provide but excludes all other allowances and perquisites. In includes commission if it is payable under the terms of employment at a fixed percentage of turnover achieved by the employee, or

(c) (i) 50% of salary due to the employee in respect of the relevant period, where such accommodation is situated at Bombay, Calcutta, Delhi and Madras and

(ii) 40% of salary due to the employee in respect of relevant period, where such accommodation is situated at any other place.

The least of the above three is exempt.

Any excess of HRA received over the exempted amount will be taxed as salary. The exemption in respect of HRA will not be available if the (a) residential accommodation occupied by the assessee is owned by him or (b) the assessee has not actually incurred expenditure on payment of rent in respect of the residential accommodation occupied by him.

Illustration 5 will help you to understand the provisions regarding HRA.

Illustration 5

A is an employee of United Breweries Ltd., in Bangalore. He draws a basic pay of Rs. 5000/- p.m. and D.A. of Rs. 500/- p.m. which is considered for computation of retirement benefits. He earns 5% commission on sales achieved by him. The turnover achieved by him during financial year ended 1989-90 is Rs. 2,00,000/- He is paid HRA of Rs. 2000/- p.m. He pays a rent of Rs. 1,500/- p.m. Calculate his taxable salary for assessment year 1990-91.

Solution

			Rs.
Basic pay Rs. 5,000/- X 12			60,000/-
D.A. Rs. 500 X 12			6,000/-
Commission Rs. 2,00,000 X 5/100			10,000/-
HRA received		24,000/-	
Less HRA Exempt u/s 10(13A)			
(i) Actual	Rs. 24,000/-		
(c) Excess of rent paid over 10% of salary. Rs. 18,000/- − 10% of (Rs. 60,000 + Rs: 6000 + Rs. 10,000) = Rs. 18,000 − Rs. 7,600 = Rs. 10,400/-			
(iii) 40% of salary is Rs. 30,400/-			
The least is exempt	Rs. 10,400/-		
Taxable HRA (24,000 − 10,400)			13,600/-
Gross Salary			89,600/-
Less standard deduction @ 33'3% Rs. 12,000/-			12,000/-
Taxable salary			77,600

B) Entertainment Allowance

Entertainment allowance is part and parcel of salary income and it is chargeable to tax. However it is a practical fact that employees to whom such allowance is granted spend a considerable portion thereof on entertaining customers to improve the business prospects of their employer. Realising this situation, the Act has allowed a statutory deduction in respect of cnteitainment allowance. You will find a detailed discussion of the same in Unit 6 dealing with statutory deductions from salaries.

C) Special Allowances specifically exempted u/s 10(14) (ii) notification No. SO 259(5) dated 27-3-1990 has notified the following allowances in this regard with effect from 1990-91 assessment year.

(a) Composite Hill compensatory allowance or High Altitude allowance or uncongenial climate allowance or show bound area allowance or Avalanche allowance.

The prescribed limits are Rs. 600/-, Rs. 1200/- or Rs. 150/- per month depending upon the regions.

(c) Border area allowance or remote area allowance or difficult area allowance or disturbed area allowance.

The prescribed limits are Rs. 650/-, Rs. 525/-, Rs. 375/-, Rs. 300/- or Rs. 100/- per month depending on regions.

(c) Tribal **allowance**
This exemption is available @ Rs. 100/- 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.

(d) 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 is exempt up to a specified limit. The specified limit is 70% of such allowance or Rs. 1000/- p.m., whichever is less.

(e) Children educational allowance—Rs. 50/- per month per child up to a maximum of two children.

(f) Hostel Allowance : Any allowance granted to an employee to meet the hostel expenditure on his child Rs. 150/- p.m. per child up to a maximum of two children.

5.3.9 '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 supplants 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. Profits in lieu of salary, as we know are treated as salary by definition. Hence such compensation is taxable as salary.

Some times the terms and conditions of employment may be modified to provide that in future the employer 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 **unrecognised** fund :

Any payment received by an assessee from an unrecognized providend fund or other fund (not being an approved superannuation fund) to the extent it consists of employer's contribution and interest thereon is taxable as profits in lieu of salary.

Interest on the employee's contribution to an unrecognized provident fund is chargeable to tax as "income from other sources". Employee's contribution however is taxed year to year.

(iii) Any other payments

Any other payments made by an employer or a former employer is included in profits in lieu of salary. Where an employer gives to his employee any sum by way of personal gift and not an appreciation of his services, it is not taxable.

Specific exemptions

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

(i) Exempted gratuity—(Section 10 (10)

(ii) Exempted value of commuted pension—Section 10 (10A)

(iii) Exempted amount of retrenchment compensation—Section 10 (10B).

(iv) Compensation received by public sector employee on voluntary retirement—Section 10 (10C)

(v) Payment from statutory provident fund—Section 10 (11).

(vi) Exempted amount of accumulated balance (under Rule 8 of Part A of IV Schedule) from recognized provident fund—Section 10 (12).

(vii) Payment from Approved Superannuation fund—Section 10 (13)

Check Your Progress A

1) What are the.rules regarding due date of salary for non-government employees?

....

....

....

2) A is a non-government employee getting a salary of Rs. 2,400. He retires and receives Rs. 45,000 as gratuity. The amount 'of gratuity to which A is entitled is Rs. 36,000. What is his taxable gratuity?

....

....

....

3) X retires on 30th April 1989. He gets Rs. 2,000 per-month pension up to September 1989. With effect from October 1, 1989 he gets 1/2 of his pension .commuted for Rs. 36,000. Calculate the amount of taxable pension for assessment year 1990-91 if he is a government employee.

....

....

....

4) Mr. Mohan who is residing in Delhi gets Rs. 2,500 p.m. as House Rent Allowance. He actually pays Rs. 2,000 p.m. as rent, His salary for the purposes of HRA is Rs. 6,000 p.m. What is the taxable portion of HRA?

....

....

....

5) Which of the following is True and which is False

i) Under Section 10 (10AA) leave salary for a period up to a maximum of eight 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. 50,000.

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

v) Interest on employees contribution to unrecognised provident fund is chargeable under the head salaries.

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 services rendered. The meaning of salary for tax purposes 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, 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 it has many meanings. 'Salary' includes different items for different purposes. 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 instalment 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: An yearly allowance, income, the grant of a sum for a term of year, for life or in perpetuity.

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. This is 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. This they can accumulate: Generally all organisations allow their employees to enc :h 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 . 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 payments from unrecognized provident fund and all other payments made by an employer or former employer as profits in lieu of salary. These are taxable as salary income.

Salary: For income tax 'purposes this term is much wider than what is commonly understood. It includes not only payments in cash but also monetary value of facilities made available in kind.

5.6 ANSWERS TO CHECK YOUR PROGRESS

A 2 Rs. 9,000 3 Rs. 16,000 4 Rs. 13,200
5 i) True ii) True iii) False iv) False v) False

5.7 TERMINAL QUESTIONS/EXERCISES

Questions

1) What is the meaning of term salary as per Sections 15 and 16 of Income Tax Act 19611 ,
2) What are the provisions of Income Tax Act regarding commutation of pension?
3) What do you mean by 'profits in lieu of salary'?

Exercises

1) Y is employed in Supercem Ltd. In March, 1990 he ,obtained from his company Rs. 12,000 as a loan to purchase a scooter. He also withdrew in the same month Rs. 6,000 being his salary for April, 1990 since the amount of loan was insufficient for the purchase of the scooter. Y drew a consolidated salary of Rs. 5,000 from April 1989 to September 1989 and Rs. 6,000 from October 1989 onwards. Compute Y's gross salary income for 1990-91 assessment year.

   (Answer : Rs. 72,000)

2) A received the following payments from his employer during the previous year ended 31st March, 1990.

Salary	Rs. 50,000
Advance salary for April, 1990	Rs. 4,500
Loan for purchase of scooter	Rs. 15,000
One HMT watch for completing 25 years of service, valued at	Rs 1,000

   Compute his grass salary for the previous year

   (Answer : Rs. 54,500)

3) From the following particulars calculate C's gross salary income for the previous year ending 31st March, 1990.

Basic pay	Rs. 4,000 p.m.
D.A.	Rs. 400 p.m.
Earned leave encashed during the year	Rs. 5,000
Earned leave encashed on retirement on 31st March 1990	Rs. 20,000
Completed years of service	20 years
Earned leave to C's credit at the time of his retirement	5 months

   (Answer : Rs. 57,800)

4) From the following particulars calculate B's gross salary for 1990-91 assessment year.

Basic pay	Rs. 3,000 p.m.
D.A.	Rs. 300 p.m.
Bonus received for 1988-1990 at Rs. 3,000 per year	Rs. 9,000
Earned leave encashed before retirement on 31st March 1990	Rs. 10,000
Earned leave encashed on retirement	Rs. 7,000

   (Answer : Rs. 58,600)

5) A retires from Tata Steel Company Ltd., on June 30, 1989. He gets pension of Rs. 3,000 per month up to 31.1.1990. With effect from 1.2.1990 he gets 75% of his pension commuted for Rs. 90,000. At the time of retirement he got Rs. 1,00,000 as gratuity from the company. Compute the taxable pension in the hands of A for the previous year 1989-90.

   (Answer : Rs. 72,500)

6) From the following particulars given by D calculate the exempted amount of gratuity.

Date of retirement	June, 1989
Service	30 years, 11 months
Gratuity received	Rs. 1,00,000
Basic pay from 1.4.1989	Rs. 5,000 p.m.
Yearly increment	Rs. 500
Increment month	May, 1989
D.A. (considered for retirement benefits)	Rs. 1,000 p.m.

Commission payable on sales achieved by him	2%
Turnover achieved by him in 1988	Rs. 2,40,000
Turnover achieved by him in 1989 (up to 31st May 1989)	Ks. 1,20,000

(Answer : Rs. 97,350)

7) A is an employee of Ispat Ltd. in Madras. He draws a basic pay of Rs. 4,000 p.m. and D.A. of Rs. 400 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 financial year ended 1989-90 is Rs. 2,00,000. He is paid HRA of Rs. 1,500 p.m. He pays rent of Rs. 1,500 p.m.

   Calculate his gross salary for 1990-91 assessment year..

   (Answer : Rs. 64,680)

8) From the following particulars furnished by F calculate the gross salary for 1990-91 assessment year.

Basic pay from April, 1989	Rs. 6,000 p.m.
Annual increment due from October each year	Rs. 500
D.A. (not considered for computing retirement benefits)	10% basic pay
Date of retirement	31.3.1990
Completed years of service	20 years
Gratuity received	Rs. 1,00,000
HRA received	Rs. 2,000 p.m.
House rent paid	Rs. 2,000 p.m.
Commission on turnover achieved	Rs. 6,000
Uncashed earned leave at credit on the date of retirement	15 months
Amount received on encashment of the above leave	Rs. 90,000

   (Answer : Rs. 1,65,100)

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