■ *Meaning of "hand-made"* - The articles or things should be manufactured or produced by means of human skill, craftsmanship and labour. In common parlance, all handicraft items will be eligible.

■ *Meaning of 'artistic value'* - The word 'artistic' generally denotes something which is a 'work of art', and the dictionary meaning of the word 'art' is the "expression or application of creative skill and imagination, especially through a visual medium such as painting or sculpture" (Concise Oxford English Dictionary). The word 'value' in the present context will cover not only monetary worth but also material worth. Thus, the term 'artistic value', when read in conjunction with the word 'hand-made' will signify that the articles or things must be having decorative utility as distinct from commonplace utility (like routine furniture items) and must, in common parlance, be a 'showpiece'.

■ *Wood must be used as prime raw material* - Wood must form the predominant content in the article or thing. It is, however, not necessary that the article or thing must contain wood alone.

42.1-2 *IT SHOULD BE A NEW UNDERTAKING* - The undertaking is not formed by splitting up, or the reconstruction, of a business already in existence.

■ *What is splitting up of business* - The expression "splitting up of the business already in existence" indicates a case where the integrity of a business earlier in existence is broken up and different sections of the activities previously conducted are carried on independently—*CIT* v. *Hindustan General Industries Ltd.* [1982] 137 ITR 851 (Delhi).

■ *"Reconstruction"* - The concept of "reconstruction" will not be attracted in cases where (*i*) a concern which is already running one industrial unit set up another industrial unit manufacturing identical goods, or (*ii*) a concern set up ancillary unit for manufacture of goods for captive consumption. For detailed discussion please refer to para 254.1-1a.

■ *Exception* - The aforesaid condition of "new undertaking" is not applicable where the business is re-established, reconstructed or revived by the same assessee, by satisfying the conditions given in section 33B [*see* para 254.1-1a[1]].

42.1-3 *IT SHOULD NOT BE FORMED BY TRANSFER OF MACHINERY OR PLANT PREVIOUSLY USED FOR ANY PURPOSE* - It is not formed by a transfer to a new business of machinery and plant previously used for any purpose. This rule is, however, not applicable in a few cases [for detailed discussions *see* paras 254.1-1b, 254.1-1b[1] and 254.1-1b[2]].

42.1-4 *90 PER CENT SALE SHOULD BE IN OVERSEAS MARKET* - 90 per cent or more of the sale of the undertaking during the previous year should be by way of export of eligible articles or things. The 90 per cent minimum requirement must be satisfied with reference to the total sales (export as well as non-export) of the undertaking and not with reference to the export sales alone. The requirement applies to the 'undertaking' and not to the 'assessee'. However, export shall not include any transaction by way of sale or otherwise, in a shop, emporium or any other establishment situated in India, not involving clearance at any customs station as defined in the Customs Act, 1962. For detailed discussion, *see* para 249.3-1a.

42.1-5 *EMPLOYMENT OF 20 OR MORE WORKERS* - It should employ 20 or more workers during the previous year in the process of manufacture or production.

42.1-6 *THERE MUST BE REPATRIATION OF SALE PROCEEDS INTO INDIA* - *See* paras 39.1-4, 39.1-4a and 39.1-4b.

42.1-7 *AUDIT* - Deduction under section 10BA is not available unless the assessee furnishes auditor's report in Form No. 56H along with the return of income.†

42.1-8 *DEDUCTION UNDER SECTION 10A/10B IS NOT TAKEN* - Where in computing the total income of the undertaking for any assessment year a deduction is claimed under section 10A or 10B, the undertaking shall not be eligible for claiming any deduction under section 10BA.

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†It is not possible to attach any certificate, statement or audit report with new income-tax return forms. The assessee should himself retain the audit report in Form No. 56H. It may be furnished in original whenever the Assessing Officer wants to examine it in assessment proceedings or otherwise.

42.2 ***Amount of deduction*** - If the aforesaid conditions are satisfied then deduction is available on the basis of amount computed as follows :

Profit of the business of the undertaking × export turnover in respect of eligible articles or things ÷ total turnover of the business carried on by the undertaking.

The following points should be noted :

1. Export turnover for this purpose means the consideration in respect of export by the undertaking of eligible articles or things received in, or brought into, India by the assessee in convertible foreign exchange within the time-limit or within the extended time-limit as stated above. It does not include freight, telecommunication charges or insurance attributable to the delivery of the articles or things outside India.

2. The aforesaid method of *pro rata* determination must be followed even in those cases where the assessee has export business of eligible articles or things along with other lines of business and separate books of account are maintained for determining profits of export business.

3. The aforesaid profit is deductible for six assessment years, *i.e.*, assessment years 2004-05 to 2009-10.

4. Where a deduction is allowed under section 10BA in computing the total income of the assessee, no deduction shall be allowed under any other section in respect of its export profits.

5. *See* para 39.5 for power of the Income-tax Department to recompute profit.

6. Deduction under section 10BA is not controlled by section 80AB as deduction under section 10BA is not a deduction under Chapter VI-A—***Enercon Wind Farms (Krishna) Ltd.*** v. ***CIT***[2008] 21 SOT 29 (Mum.).

42-P1 *The profit and loss account of X Ltd. for the year ending March 31, 2009 is as follows :*

	Rs.		Rs.
Cost of goods sold	*35,00,000*	*Sales turnover*	*80,00,000*
Other expenses	*50,000*	*Interest on bank deposit*	*5,00,000*
Net profit	*49,50,000*		
	85,00,000		*85,00,000*

The company is engaged in the business of export of hand-made artistic articles made of wood.

The following situations are considered—

1. The company employs less than 20 workers.

2. The company employs 20 or more workers but it uses imported raw material.

3. The company employs 20 or more workers. It does not use imported raw material. Out of the sales turnover of Rs. 80,00,000, domestic turnover is Rs. 8,00,001.

4. The company employs 20 or more workers. It does not use imported raw material. Out of the sales turnover of Rs. 80,00,000, sale in overseas market is Rs. 75,00,000 and sale in domestic market is Rs. 5,00,000. Out of the export of Rs. 75,00,000, amount remitted to India in convertible foreign exchange till September 30, 2009 is Rs. 66,50,000. It does not include freight, insurance, telecommunication charges, etc.

SOLUTION : *Situation 1* - As the company employs less than 20 workers, nothing is deductible under section 10BA.

Situation 2 - As the company uses imported raw material, nothing is deductible under section 10BA.

Situation 3 - As the export outside India is less than 90 per cent of the turnover, nothing is deductible under section 10BA.

Situation 4 - As 90 per cent or more of its sales (Rs. 75,00,000/Rs. 80,00,000 = 93.75%) are by way of export outside India, deduction under section 10BA is available on the following lines —

	Rs.
Export turnover (a)	66,50,000
Total turnover (b)	80,00,000
Profit of the business (Rs. 49,50,000 — Rs. 5,00,000, being interest) (c)	44,50,000
Amount deductible under section 10BA [(c) × (a) ÷ (b)]	36,99,062.50

Income exempt under section 13A

43. The following categories of income derived by a political party are not included in computing its total income :

a. any income which is chargeable under the heads "Income from house property", "Capital gains" and "Income from other sources" ; and

b. any income by way of voluntary contributions.

Exemption under section 13A is not available unless the political party satisfies the following conditions :

a. the political party keeps and maintains such books of account and other documents as would enable the Assessing Officer to properly deduce its income therefrom ;

b. the political party keeps and maintains a record of each voluntary contribution in excess of Rs. 20,000 and of the names and addresses of persons who have made such contributions ;

c. the accounts of the political party are audited by a chartered accountant or other qualified accountants; and

d. the treasurer of a political party (or any authorised person) shall in each financial year prepare a report in respect of contribution received by the political party in excess of Rs. 20,000 from any person/company in that year and submit it (before due date of submission of return of income) to the Election Commission.

The term "political party" for this purpose means an association or body of individuals citizens of India registered or deemed to be registered with the Election Commission of India as a political party.

CHAPTER FOUR

Salaries

Essential norms of salary income

46. In order to understand the meaning of expression "salary", one has to keep in mind the following norms :

46.1 ***Relationship between payer and payee*** - Income under the head "Salaries" covers all remuneration due/paid to a person in respect of services rendered by him under an express or implied contract of employment. Charge under this head of income presumes the relationship of an employer and an employee between the payer and payee in contrast to that of a principal and an agent. The distinction between the two types of relationship is vital because income earned by an employee from his employer is chargeable under the head "Salaries", whereas income earned by an agent is chargeable either under the head "Profits and gains of business or profession" or under the head "Income from other sources"—*Cowan* v. *Seymour* [1920] 1 KB 500 (CA).

In this respect, the following broad propositions should be kept in view :

46.1-1 *EMPLOYER AND EMPLOYEE VIS-A-VIS PRINCIPAL AND AGENT* - An employee works under the direct control and supervision of his employer. He not only receives instructions from his employer but is subject to right of the employer to control the manner in which he should carry out the instructions. On the other hand, an agent is generally free to carry out his principal's instructions according to his own discretion.

46.1-2 *INCOME FROM HOLDING OF AN OFFICE - WHETHER FROM EMPLOYMENT* - The emoluments to be taxable under the head "Salaries" must be received by virtue of an office amounting to employment. Mere holding of an office is not, however, sufficient to bring the tax incidence under the head "Salaries".

46.1-3 *EMPLOYER AND CONTRACTOR - THEIR RELATIONSHIP* - It may be true in a broad sense to say that one who is employed is an employee and it would certainly sound funny to refer to a bank president as an employee of his bank. While, however, it is strictly correct to say that everyone who is an employee is employed by another, it is not equally true to say that everyone who is employed by another is his employee. For instance, a solicitor who is engaged by a client to do certain work for him is employed by him for that purpose, as his doctor who gives his professional skill to a patient, but no one would think of referring to either of these professional men as an employee of his client or his patient—*Carter* v. *Great West Lumber Co.* [1919] 3WWR 901.

- *Sub-contractor* - A sub-contractor is not the employee of the contractor employing him— *Rapson* v. *Cubitt* [1842] 9 M & W 710. An employee of sub-contractor is *prima facie* not the employee of the main contractor—*Johnson* v. *Lindsay & Co.* [1891] AC 371 (HL). However, an employee of one employer may become the employee of another if services are lent.

46.1-4 *PAYMENT RECEIVED IN CAPACITY OTHER THAN EMPLOYEE* - Payment received by an individual from a person other than his employer cannot be termed as salary and consequently, such payment is not chargeable to tax under the head "Salaries". Such payment may be chargeable under the head "Profits and gains of business or profession". For instance, commission received by a director from a company is salary if director is an employee of the company. If, however, the director is not an employee of the company, commission cannot be termed as salary and consequently, it will be taxable either under the head "Profits and gains of business or profession" or "Income from other sources". Similarly, emoluments received by a college lecturer from his college is salary, irrespective

of the fact whether it is received in cash or kind, or whether it is received for academic work or non-academic (*viz.*, wardenship allowance). When, however, the same lecturer is paid for setting question paper by a university, the remuneration is not salary, as it is not received from the employer, and is taxable under the head "Income from other sources". The moot point is that what is not received from employer cannot be termed as salary. A Member of Parliament or a State Legislature is not treated as an employee of the Government. Salary and allowances received by him are, therefore, not chargeable to tax under the head "Salaries" but are chargeable to tax under the head "Income from other sources"— Circular Letter : F. No. 40/29/67-IT (A-I), dated May 22, 1967.

46.2 *Salary and wages - Conceptually not different* - Conceptually, there is no difference between salary and wages. Both are compensation for work done or services rendered, though ordinarily salary is paid in connection with services of non-manual type of work, while wages are paid in connection with manual services—*Gestetner Duplicators (P.) Ltd.* v. *CIT* [1979] 117 ITR 1 (SC).

46.3 *Salary from more than one source* - If an individual receives salary from more than one employer during the same previous year (maybe due to change of employment or due to employment with more than one employer simultaneously), salary from each source is taxable under the head "Salaries". For instance, if a clerk works with two employers on part-time basis, salary from both the employers will be chargeable to tax under the head "Salaries".

46.4 *Salary from former employer, present employer or prospective employer* - Remuneration received (or due) during the previous year is chargeable to tax under the head "Salaries" irrespective of whether it is received from a former, present or prospective employer.

46.5 *Salary income must be real and not fictitious* - Amount taxable under the head "Salaries" is real salary and not fictitious salary. There should be an intention to pay and receive salary. Where, for example, there was, merely in order to comply with the requirement of the Board of Education Rules, an agreement between the assessee (a school teacher) and the governing body of the school granting a certain salary to the assessee and simultaneously there was another agreement by which an identical sum was to be returned by the assessee to the governing body as donation, it was *held* that there was in reality no agreement to pay and receive salary—*Reade* v. *Brearley* [1933] 17 TC 687. Likewise, if there is no intention to render any service and agreement is made to make payment on paper in order to claim the same as business deduction, the amount received by the so-called employee is not chargeable as salary.

46.6 *Foregoing of salary* - Section 15 [*see* para 47 *infra*] taxes salary on "due" basis, even if it is not received. If, therefore, an employee foregoes his salary, it does not mean that salary so foregone is not taxable. Once salary has accrued to an employee, its subsequent waiver does not make it exempt from tax liability. Such voluntary waiver or foregoing by an employee of salary due to him is merely an application of income and is nonetheless chargeable to tax.

46.7 *Surrender of salary* - If an employee opts to surrender his salary to the Central Government under section 2 of the Voluntary Surrender of Salaries (Exemption from Taxation) Act, 1961, the salary so surrendered would be excluded while computing his taxable income. Thus, tax is not payable in respect of salary surrendered, which can be basic salary as well as different allowances. Benefit of tax exemption in respect of salary surrendered is available to all employees whether they are employed in private sector or public sector.

46.8 *Salary paid tax-free* - If salary is paid tax-free by the employer, the employee has to include in his taxable income not only the salary received but also the amount of tax paid by the employer. It does not make any difference whether tax is paid under terms of contract by the employer or voluntarily. Under section 17(*2*)(*iv*) such payment is statutorily deemed as "perquisite" [*see* para 51.1 *infra*].

46.9 *Voluntary payments* - Salary, perquisite or allowance may come as a gift to an employee and yet it would be taxable. The Act does not make any distinction between gratuitous payment and contractual payment [*see*, however, para 49.16].

46.10 ***Salary under section 17(1)*** - Under section 17(*1*), salary is defined to include the following :

a. wages ;

b. any annuity or pension ;

c. any gratuity ;

d. any fees, commission, perquisite or profits in lieu of or in addition to any salary or wages ;

e. any advance of salary ;

f. any payment received in respect of any period of leave not availed by him ;

g. the portion of the annual accretion in any previous year to the balance at the credit of an employee participating in Recognised Provident Fund to the extent it is taxable ;

h. transferred balance in a Recognised Provident Fund to the extent it is taxable; and

i. the contribution made by the Central Government in the previous year, to the account of an employee under a pension scheme referred to in section 80CCD (applicable from the assessment year 2004-05).

Basis of charge [Sec. 15]

47. The basis of charge is explained in the following paras—

47.1 ***Basis of charge as per section 15*** - As per section 15, salary consists of :

a. any salary due from an employer (or a former employer) to an assessee in the previous year, whether actually paid or not ;

b. any salary paid or allowed to him in the previous year by or on behalf of an employer (or a former employer), though not due or before it became due ; and

c. any arrears of salary *paid* or allowed to him in the previous year by or on behalf of an employer (or a former employer), if not charged to income-tax for any earlier previous year.

The same is explained in the table given below—

Nature of salary	*Is it taxable as income of the previous year 2008-09*
Salary which becomes due during the previous year 2008-09 (whether paid during the same year or not)	Yes
Salary which is received during the previous year 2008-09 (whether it becomes due in a subsequent year)	Yes
Arrears of salary paid during the previous year 2008-09 although it pertains to one of the earlier years and the same were not taxed earlier on due basis	Yes
Arrears of salary paid during the previous year 2008-09 although it pertains to one of the earlier years but the same were taxed earlier on due basis	No

47.2 ***Salary is taxable on "due" or "receipt" basis whichever is earlier*** - Basis of charge in respect of salary income is fixed by section 15. Salary is chargeable to tax either on "due" basis or on "receipt" basis, whichever matures earlier.

For the removal of doubt, it has been clarified that where any salary, paid in advance, is assessed in the year of payment, it cannot be subsequently charged to tax in the year in which it becomes due (*Expln. 1* to sec. 15). Similarly, if salary paid in arrears has been assessed in the past on "due" basis, it cannot be taxed again when it is paid [*Expln. 2* to sec. 5]. If, however, salary paid in arrears has not been assessed on "due" basis, it is liable to be assessed in the year in which it is paid.

For instance, if salary of 2009-10 is received in advance in 2008-09, it is included in the total income of the previous year 2008-09 on "receipt" basis (as tax incidence matures earlier on "receipt" basis, "due" basis is not relevant in this case; therefore, salary will not be included in total income of the previous year 2009-10). On the other hand, salary, which has become due in 2007-08 and received in 2008-09, is included, in total income of the previous year 2007-08 on "due" basis (as incidence of tax matures earlier on "due" basis, "receipt" basis is inapplicable; salary, will, therefore, not be included in total income of the previous year 2008-09). Tax is, thus, attracted at the earliest possible point of time.

47.3 ***Method of accounting adopted by employee not relevant*** - Method of accounting cannot vary the basis of charge fixed by section 15.

47-P1 *Up till June 30, 2008, X is in the employment of A Ltd. on the fixed salary of Rs. 25,000 per month which becomes "due" on the first day of the next month. On July 1, 2008, X joins B Ltd. (salary being Rs.30,000 per month which becomes "due" on the last day of each month). Salary is actually paid on the seventh day of the next month in both cases. Find out the amount of salary chargeable to tax for the assessment year 2009-10.*

SOLUTION : *Computation of salary for the previous year 2008-09* —

Different months	"Due" date or "receipt" date, whichever is earlier	Amount Rs.
1. March 2008	April 1, 2008	25,000
2. April 2008	May 1, 2008	25,000
3. May 2008	June 1, 2008	25,000
4. June 2008	July 1, 2008	25,000
5. July 2008	July 31, 2008	30,000
6. August 2008	August 31, 2008	30,000
7. September 2008	September 30, 2008	30,000
8. October 2008	October 31, 2008	30,000
9. November 2008	November 30, 2008	30,000
10. December 2008	December 31, 2008	30,000
11. January 2009	January 31, 2009	30,000
12. February 2009	February 28, 2009	30,000
13. March 2009	March 31, 2009	30,000
Total		3,70,000

Place of accrual of salary income [Sec. 9(1)]

48. Income under the head "Salaries" is deemed to accrue or arise at the place where the service (in respect of which it accrues) is rendered. Under section 9(1)(*ii*), salary in respect of service rendered in India is deemed to accrue or arise in India, even if it is paid outside India or it is paid or payable after the contract of employment in India comes to an end. Pension paid abroad is deemed to accrue in India, if it is paid in respect of services rendered in India. Likewise, leave salary paid abroad in respect of leave earned in India is deemed to accrue or arise in India.

▪ *Exception to the rule* - Section 9(1)(*iii*), however, makes a departure to the aforesaid rule. By virtue of this section, salary paid by the Indian Government to an Indian national is deemed to accrue or arise in India even if service is rendered outside India. Deeming provisions of section 9(1)(*iii*) are applicable only in respect of salary and not in respect of allowances and perquisites paid/allowed by the Government to Indian national working abroad as such allowances and perquisites are exempt under section 10(7) [*see* para 50.5].

The provisions of section 9(1)(*ii*)/(*iii*) are summarized below (it is assumed that salary is paid at the place where service is rendered).

Who is employee		Who is employer	Where service is rendered	It is taxable in India	
				Salary	Allowance/ perquisite
Case 1	Indian citizen (resident or non-resident)	Government of India	Outside India	Yes[1]	No[2]
Case 2	Non-resident (but not covered by Case 1)	Any	Outside India	No	No
Case 3	Resident and ordinarily resident (but other than Case 1)	Any	Anywhere	Yes	Yes

Tax treatment of different forms of salary income

49. Basic salary and dearness pay are charged to tax under section 15. The tax treatment of other receipts is given below :

49.1 ***Advance salary [Sec. 17(1)(v)]*** - Advance salary is taxable on receipt basis, in the assessment year relevant to the previous year in which it is received, irrespective of the incidence of tax in the hands of the employee. The recipient can, however, claim relief in terms of section 89 [*see* para 60.1]. A loan taken from employer is not taxable as advance salary[3].

49.2 ***Arrear salary*** - It is taxable on receipt basis, if the same has not been subjected to tax earlier on due basis. In this case also recipient can claim relief under section 89 [*see* para 60.1].

49.3 ***Leave salary*** - The provisions regarding taxability of leave salary are given below—

49.3-1 ***WHAT IS LEAVE SALARY*** - As per service rules, an employee gets different leaves. An employee has to earn leave in the first instance and only when he has leave to his credit, he can apply for leave. If a leave (standing to his credit) is not taken within a year, as per the service rules it may lapse or it may be encashed or it may be accumulated. The accumulated leaves standing to the credit of an employee may be availed by the employee during his service time or, subject to service rules, such leaves may be encashed at the time of retirement or leaving the job. Encashment of leave by surrendering leave standing to one's credit is known as "leave salary".

49.3-2 ***BROAD TAX TREATMENT*** - Broad tax treatment is given below—

Nature of leave encashment	Status of employee	Whether it is taxable
Leave encashment during continuity of employment	Government/non-Government employee	It is chargeable to tax. However, relief can be taken under section 89
Leave encashment at the time of retirement/leaving job	Government employee	It is fully exempt from tax under section 10(*10AA*)(*i*) [*see* para 49.3-3]
Leave encashment at the time of retirement/leaving job	Non-Government employee	It is fully or partly exempt from tax in some cases under section 10(*10AA*)(*ii*) [*see* para 49.3-4]

49.3-3 ***LEAVE SALARY AT THE TIME OF RETIREMENT TO CENTRAL/STATE GOVERNMENT EMPLOYEES*** - In the case of Central/State Government employee, any amount received as cash equivalent of leave salary in respect of period of earned leave at his credit at the time of retirement/superannuation, is exempt from tax [sec. 10(*10AA*)(*i*)].

49.3-4 ***LEAVE SALARY AT THE TIME OF RETIREMENT TO OTHER EMPLOYEES*** - In the case of a non-Government employee (including an employee of a local authority or public sector undertaking), leave salary is exempt from tax on the basis of least of the following—

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1. Taxable by virtue of section 9(1)(*iii*) - *see* para 32.5.

2. Not taxable by virtue of section 10(7) - *see* para 50.5.

3. *See*, however, para 52.10.

1.	Period of earned leave (in number of months) to the credit of the employee at the time of his retirement or leaving the job [*see* Note 1] × Average monthly salary [*see* Note 2]
2.	10 × Average monthly salary
3.	The amount specified by the Government [*i.e.*, Rs. 3,00,000 applicable from April 1, 1998; for earlier period, *see* para 49.3-4a]
4.	Leave encashment actually received at the time of retirement.

Notes :

1. How to find out leave standing to the credit of an employee at the time of retirement or leaving the job - It will be calculated as follows—

Step (a) - Find out duration of service in number of years (ignore any fraction of year).

Step (b) - Find out rate of earned leave entitlement from the service rules—how many days leave is credited for each year of service (earned leave entitlements cannot exceed 30 days for every year of actual service rendered for the employer from whose service he has retired). For instance, if earned leave is credited at the rate of 40 days leave for each year of service, for *Step (b)* calculation shall be made at the rate of 30 days leave for each year of service. If, however, earned leave is credited at the rate of 25 days leave for each year of service, for *Step (b)* calculation shall be made at the rate of 25 days leave for each year of service.

Step (c) - Find out earned leave actually taken or encashed (in number of days) during the service time.

The computation shall be made as follows—

[*Step (*a*) × Step (*b*) minus Step (*c*)*] ÷ 30

2. How to find out average monthly salary - Salary, for this purpose, means basic salary and includes dearness allowance if terms of employment so provide. It also includes commission based upon fixed percentage of turnover achieved by an employee. "Average salary" for the aforesaid purpose is to be calculated on the basis of average salary drawn during the period of 10 months immediately preceding the retirement [see problem 49.3-P3].

■ *When earned leave salary is received from two employers* - Where the cash equivalent of unutilised earned leave is received by an employee from two or more employers in the same year, the maximum amount exempt from tax under section 10(*10AA*)(*ii*) will not exceed the amount specified by the Government. In cases where an employee who has received any cash equivalent of unutilised earned leave in any earlier year from his former employer or employers received cash equivalent of unutilised earned leave from his present employer in a later year, the ceiling limit specified above will be reduced by the amount of cash equivalent of unutilised earned leave which has been exempted under section 10(*10AA*)(*ii*) in any earlier year or years.

Exemption already claimed by an assessee under section 10(*10AA*)(*i*) will not be considered—***Chander Kumar Shukla* v. *CIT*** [2007] 15 SOT 229 (Delhi).

49.3-4a AMOUNT SPECIFIED BY THE GOVERNMENT - The maximum amount not chargeable to tax under section 10(*10AA*)(*ii*), as specified by the Government, is as follows :

Date of retirement (whether on superannuation or otherwise)	*Amount Rs.*
❑ Between January 1, 1988 and March 31, 1995	79,920
❑ Between April 1, 1995 and June 30, 1995	1,30,320
❑ Between July 1, 1995 and July 1, 1997	1,35,360
❑ Between July 2, 1997 and April 1, 1998	2,40,000
❑ After April 1, 1998	3,00,000

49.3-2P1 *X retires on March 16, 2009 from a private sector company. According to the service rules, he is entitled for 24 days leave for each year of completed service. The following information is available from the records of the employer-company —*

Duration of service	*32 years*
Gross leave entitlement (32 yrs. × 24)	*768 days*
Less : Leave actually availed while in service	*108 days*

Balance	*660 days*
Less : Leave encashment taken during 1997-98	*390 days*
Balance	*270 days*
Less : Leave encashment given on May 10, 2008 [@ Rs. 5,000 per month]	*60 days*
Leave standing to the credit of X at the time of retirement	*210 days*

Salary and dearness allowance paid to X prior to retirement are as follows —

	Basic salary per month Rs.	Dearness allowance per month [62 per cent is part of salary for determining retirement benefits] Rs.
January 1, 2008 to October 31, 2008	*4,000*	*1,000*
November 1, 2008 to March 16, 2009	*5,000*	*1,250*

Accordingly, he has been paid Rs. 43,750 (i.e., Rs. 6,250 × 210/30) at the time of retirement on March 16, 2009. Find out the amount of leave salary chargeable to tax for the assessment year 2009-10 taking into consideration the following points raised by X —

1. "Average salary" for the purpose of section 10(10AA) should be calculated on the basis of salary drawn during 10 months immediately preceding the retirement.

2. The word "month" has not been defined in the Act. As per section 3(35) of the General Clauses Act, 1897, "month" shall mean a month reckoned according to the British calendar. Consequently, in this case (according to X) average salary should be calculated on the basis of salary drawn during 10 months ending on February 28, 2009 (i.e., from May 1, 2008 to February 28, 2009).

SOLUTION : The opinion of X, given in the problem, is not legally tenable because of the following reasons —

1. The General Clauses Act defines the word "month" as a month "reckoned" according to the British calendar.

2. The word "reckoned" according to the *Shorter Oxford English Dictionary* means "to count, to make calculation; to ascertain by counting". For instance, the period commencing on April 24, 2008 and ending on May 23, 2008 is one month according to the British calendar—*see Poornasree Agencies* v. *Universal Enterprises* [1995] 83 Comp. Cas. 66 (Ker.). The definition of "month" as given in the General Clauses Act does not state that the word "month" always means a period commencing on the first day of the month and ending on the last day of the month.

3. Accordingly, if a person retires on March 16, 2009, "average salary" shall be determined on the basis of salary drawn during ten months ending on the date of retirement (i.e., May 17, 2008 to March 16, 2009).

Computation of exemption

	Basic salary Rs.	62% of dearness allowance Rs.
Salary from May 17, 2008 to October 31, 2008 (5 months and 14 days)	21,867	3,389
Salary from November 1, 2008 to March 16, 2009 (4 months and 16 days)	22,667	3,513
Total of ten months (Rs. 51,436)	44,534	6,902
Average monthly salary (Rs. 51,436/10)		5,143.60
a. Cash equivalent of leave to the credit of X on the date of retirement (i.e., Rs. 5,143.60 × 210/30)		36,005.20
b. 10 months' salary (i.e., Rs. 5,143.60 × 10)		51,436
c. Amount notified by the Government		3,00,000
d. Amount received		43,750

Rs. 36,005.20 is the amount exempt from tax under section 10(10AA) and the amount taxable for the assessment year 2009-10 is Rs. 7,744.80. Besides, Rs. 10,000, being the leave encashment taken on May 10, 2008, is taxable

for the assessment year 2009-10. Therefore, the amount taxable for the assessment year 2009-10 is Rs. 17,744.80 which is subject to relief under section 89.

49.3-5 ***OTHER POINTS*** - The following other points should also be kept in view :

- *Relief under section 89* - Relief under section 89 [*see* para 60] would be admissible in respect of encashment of leave salary by an employee when in service—Circular No. 431, dated September 12, 1985 or leave salary paid at the time of retirement or otherwise.
- *Leave salary to legal heirs not taxable* - Salary paid to the legal heirs of a deceased employee in respect of privilege leave standing to the credit of such employee at the time of his/her death is not taxable as salary—Circular Letter No. F. 35/1/65-IT(B), dated November 5, 1965. Sum 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.
- *Retirement or otherwise* - Exemption under section 10(*10AA*) is available in respect of cash equivalent of earned leave at the employee's credit only at the time of retirement, whether such retirement is on superannuation or otherwise. The word "otherwise" covers the case of retirement which takes place not at the time of superannuation but any other time. According to the Madras High Court in *CIT* v. *R.J. Shahney* [1986] 159 ITR 160, Allahabad High Court in ***CIT*** v. ***Vijay Pal Singh*** [2005] 144 Taxman 504 and the Bombay High Court in *CIT* v. *D.P. Malhotra* [1998] 229 ITR 394 voluntary retirement from service is one such case which comes within the four corners of the words "otherwise than superannuation".

The words "or otherwise" should not be construed *ejusdem generis*, but rather as extending the scope of the statute to include the case of retirement which does not take place at the superannuation but some other time. Barring the case of "termination" of service, any other case of leaving service (whether under the Voluntary Retirement Scheme of the employer or by way of resignation by the employee) is covered by section 10(*10AA*).

49.4 ***Salary in lieu of notice period*** - It is taxable under section 15 on receipt basis—*V.D. Talwar* v. *CIT* [1963] 49 ITR 122 (SC).

49.5 ***Salary to a partner*** - Salary paid to a partner by a firm is an appropriation of profits. It is, therefore, not chargeable under the head "Salaries" but is taxable under the head "Profits and gains of business or profession". Likewise, interest, bonus, commission or remuneration, by whatever name called, due to (or received by) a partner of a firm from such firm is not taxable under section 15 [*Expln. 2* to sec. 15].

49.6 ***Fees and commission*** - Fees and commission are taxable as salary irrespective of the fact that they are paid in addition to or in lieu of salary. Even where salary and commission are paid to employees under two separate agreements, commission would be taxable as salary when work done under the agreement is performed by the employee for the benefit of his employer—*CIT* v. *T. Abdul Wahid & Co.* [2000] 243 ITR 467 (Mad.).

If, however, fees or commission is paid to a person (other than an employee), it is not taxable as salary income. For instance, commission paid to a director (not being an employee) for his giving guarantee for repayment of loan, etc., is taxable under the head "Income from other sources".

49.7 ***Bonus*** - It is taxable in the year of receipt if it has not been taxed earlier on due basis. While contractual bonus is regarded as salary, gratuitous bonus is taxable as perquisite. If bonus is received in arrears, the assessee can claim relief in terms of section 89 [*see* para 60.1].

49.8 ***Gratuity [Sec. 10(10)]***[1] - According to the *Shorter Oxford English Dictionary*, the expression "gratuity" means "a gift or present, often in return for favours or services". In literary sense, it denotes a gratuitous payment made by an employer to his employee for services rendered to him. In the

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1. Section 10(*10*) and 10(*10AA*) do not make a discrimination between Central and State Government employees on one hand and employees of statutory corporations and private sector, on other, and are, thus, not violative of article 14—*K. Gopalakrishnan* v. *Secretary, CBDT* [1994] 73 Taxman 220/206 ITR 183 (Mad.).

present age, however, it is no more a gratuitous payment. It is paid for long and meritorious services rendered by an employee. With the enactment of the Payment of Gratuity Act, 1972, gratuity payment has become legally compulsory in most of the cases. Where the Payment of Gratuity Act, 1972 is inapplicable, an employee can claim gratuity under the terms of contract of employment. Tax treatment of gratuity is given below :

Status of employee	*Whether gratuity is taxable*
Government employee	It is fully exempt from tax under section 10(*10*)(*i*)
Non-Government employee covered by the Payment of Gratuity Act, 1970	It is fully or partly exempt from tax under section 10(*10*)(*ii*) [*see* para 49.8-2]
Non-Government employee not covered by the Payment of Gratuity Act, 1970	It is fully or partly exempt from tax under section 10(*10*)(*iii*) [*see* para 49.8-3]

49.8-1 *IN THE CASE OF GOVERNMENT EMPLOYEES** - Any death-*cum*-retirement gratuity received under :

a. the Revised Pension Rules of the Central Government ; or

b. the Central Civil Services (Pension) Rules, 1972 ; or

c. any similar scheme applicable to (*i*) the members of civil services of the Union, or (*ii*) holders of posts connected with defence or of civil posts under the Union, or (*iii*) the members of all India services, or (*iv*) the members of civil services of a State, or (*v*) holders of civil posts under a State, or (*vi*) the employees of a local authority,

is wholly exempt from tax under section 10(*10*)(*i*). Similarly, retirement gratuity received under the Pension Code or Regulations applicable to the members of defence services is wholly exempt from tax.

49.8-1P1 *X, an employee of the Central Government, receives Rs. 92,000 as gratuity at the time of his retirement on December 31, 2008 under the New Pension Code. Is gratuity fully exempt from tax ? Does it make any difference if he joins a company in the private sector on January 11, 2009 ?*

SOLUTION : Gratuity received by X will be fully exempt from tax under section 10(10)(*i*). This exemption will be available even if he joins a private sector company after retirement from the Government service.

49.8-2 *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 on the following basis—

1.	15 days' salary (7 days' salary in the case of employees of a seasonal establishment) based on salary last drawn for each year of service (*i.e.*, 15 days' salary × length of service)
2.	Rs. 3,50,000.
3.	Gratuity actually received.

■ *What is exempt from tax* - The least of the above three is exempt from tax. Gratuity in excess of the aforesaid limits is taxable in the hands of the assessee. However, the assessee can claim relief under section 89.

* Employees of statutory corporations are not covered by this category.

†The Payment of Gratuity Act, 1972 is applicable to the following—

a. every factory, mine, oilfield, plantation, port and railway company ;

b. every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a State, in which ten or more persons are employed, or were employed, on any day of the preceding twelve months ;

c. such other establishments or class of establishments, in which ten or more employees are employed, or were employed, on any day of the preceding twelve months, as the Central Government may, by notification, specify in this behalf.

A shop or establishment to which the Payment of Gratuity Act has become applicable shall continue to be governed by the Act notwithstanding that the number of persons employed therein at any time after it has become so applicable falls below ten.

49.8-2a OTHER POINTS - The following points merit consideration in this context :

- *What is chargeable to tax* - Gratuity in excess of the aforesaid limits is taxable in the hands of the assessee. However, the assessee can claim relief under section 89 [*see* para 60.2].
- *How to find out length of service* - If the period of service is 6 months or less than 6 months, it shall be ignored for this purpose. Conversely, if the period of the service is more than 6 months, it shall be taken as one full year. Consider the following cases—

	The difference between date of retirement and date of joining	*Length of service for the purpose of section 10(10)(ii)*
Case 1	26 years, 5 months and 29 days	26 years
Case 2	26 years and 6 months	26 years
Case 3	26 years, 6 months and 1 day	27 years
Case 4	26 years, 11 months and 29 days	27 years

- *Meaning of "Salary"* - "Salary" for the purpose of the aforesaid limits means salary last drawn by the employee and includes dearness allowance but does not include any bonus, commission, house rent allowance, overtime wages and any other allowance.
- *Salary of 15 days* - Salary of 15 days is calculated by dividing salary last drawn by 26, *i.e.*, maximum number of working days, in a month. For instance, if monthly salary at the time of retirement is Rs. 800, 15 days' salary would come to Rs. 461.54 (*i.e.*, Rs. 800 × 15 ÷ 26).
- *Case of piece-rated employee* - In case of a piece-rated employee, 15 days' salary would be computed on the basis of average of total wages (excluding wages paid for overtime) received for a period of three months immediately preceding the termination of his employment.

For instance, X is a piece-rated employee. He retires on June 20, 2008. During the period March 21, 2008 to June 20, 2008, he has been paid total wages of Rs. 32,780, which includes overtime payment of Rs. 8,200. 15 days' salary shall be determined as follows—

	Rs.
Wages of 3 months ending on the date of retirement	32,780
Less: Payment for overtime	8,200
Balance	24,580
One month's salary (1/3 of Rs. 24,580)	8,193
15 days salary (15/26 of Rs. 8,193)	4,727

49.8-2P1 *X, an employee of A Ltd., receives Rs. 62,000 as gratuity (he is covered under the Payment of Gratuity Act, 1972). He retires on January 31, 2009 after service of 29 years and 8 months. At the time of retirement monthly salary of X was Rs. 3,100. Is the entire amount of gratuity exempt from tax?*

SOLUTION : In this case 30 years will be taken as completed years of service. 15 days' salary is Rs. 1,788.46 [i.e., Rs. 3,100 (being the salary last drawn) × 15÷26 (being working days in a month)].

Out of Rs. 62,000 received as gratuity, the least of the following will be exempt from tax :

a. Rs. 53,653.85 (being 15 days' salary for each completed year of service, *i.e.*, Rs. 1,788.46 × 30) ;
b. Rs. 3,50,000 ;
c. Rs. 62,000 (being gratuity actually received).

Rs. 53,653.85, being the least of the three sums, is exempt from tax *vide* section 10(10)(*ii*). The balance of Rs. 8,346.15 (*i.e.*, Rs. 62,000 — Rs. 53,653.85) is taxable in the assessment year 2009-10. X can, however, claim relief in terms of section 89 [see para 60.2].

49.8-3 ***IN THE CASE OF ANY OTHER EMPLOYEE*** - Any other gratuity [not covered by paras 49.8-1 and 49.8-2 above], received by an employee on retirement, death, termination, resignation or on his becoming incapacitated prior to the retirement, is exempt from tax on the following basis—

1.	Rs. 3,50,000[1].
2.	Half month's average salary for each completed year of service[2].
3.	Gratuity actually received.

■ *What is exempt from tax* - The least of the above three is exempt from tax. Gratuity in excess of the aforesaid limits is taxable in the hands of the assessee. However, the assessee can claim relief under section 89.

49.8-3a OTHER POINTS - The following points merit consideration in this context—

■ *Computation of service period* - For calculating length of service any fraction of the year shall be ignored. Consider the following cases—

	The difference between date of retirement and date of joining	*Length of service for the purpose of section 10(10)(ii)*
Case 1	26 years, 5 months and 29 days	26 years
Case 2	26 years and 6 months	26 years
Case 3	26 years, 6 months and 1 day	26 years
Case 4	26 years, 11 months and 29 days	26 years

■ *How to calculate average monthly salary* - Average monthly salary is calculated on the basis of average salary of 10 months immediately preceding the month in which an employee is retired. For instance, if the date of retirement is November 10, 2008, salary will be calculated on the basis of average salary for 10 months' period ending October 31, 2008. Salary, for this purpose, means basic salary. It includes dearness allowance/pay, if the terms of employment so provide (or if dearness allowance/pay is taken into account for computing retirement benefits). If commission is payable at a fixed percentage of turnover achieved by an employee, such commission would partake of the character of "salary"—*Gestetner Duplicators (P.) Ltd.* v. *CIT* [1979] 1 Taxman 1/117 ITR 1 (SC).

For instance, an employee retires on March 10, 2009. Salary drawn by him during May 1, 2008 and February 28, 2009, is as follows :

May 1, 2008 to December 31, 2008	Rs. 26,000 per month
January 1, 2009 to February 28, 2009	Rs. 26,500 per month

Besides, he receives Rs. 400 per month as dearness allowance (forming part of salary for the computation of retirement benefit), 20 per cent of basic pay as dearness pay (not part of salary for the computation of retirement benefits). He is also entitled to 6 per cent commission on sales achieved by him (during May 1, 2008 and February 28, 2009, turnover achieved by the employee is Rs. 25,77,860).

Average monthly salary in this case would be computed as under :

	Rs.
Total basic salary drawn during 10 months immediately preceding the month in which the employee is retired (*i.e.*, from May 1, 2008 to February 28, 2009) : (8 × Rs. 26,000 + 2 × Rs. 26,500)	2,61,000
Average basic salary (*i.e.*, Rs. 2,61,000 ÷ 10)(*a*)	26,100
Dearness allowance of one month (*b*)	400
Dearness pay (ignored as not part of salary)	—

1. Rs. 30,000 in respect of gratuity becoming payable before January 31, 1982; Rs. 36,000 in respect of gratuity becoming payable from January 31, 1982 to March 30, 1985, Rs. 50,000 in respect of gratuity becoming payable after March 30, 1985 but before January 1, 1986, Rs. 1,00,000 in respect of gratuity becoming payable on or after January 1, 1986 but before April 1, 1995, Rs. 2,50,000 in respect of gratuity becoming payable on or after April 1, 1995 but before September 24, 1997 and Rs. 3,50,000 in respect of gratuity becoming payable on or after September 24, 1997.

2. The words "each year of completed service" used in section 10(*10*) are not confined to completed years of service under one employer and have to be interpreted to mean an employee's total service under two different employers including employer other than one from whose service he has retired, for the purposes of calculation of period of years of his completed service, provided he was not paid gratuity by former employer—*CIT* v. *P.M. Mehra* [1993] 201 ITR 930 (Bom.).

	Rs.
Commission of 10 months (*i.e.*, 6 per cent of Rs. 25,77,860)	1,54,672
Monthly commission (*i.e.*, Rs. 1,54,672 ÷ 10)(*c*)	15,467
Average monthly salary [*i.e.*, (*a*) + (*b*) + (*c*)]	41,967

Note : For this purpose, commission is included only if it is based upon a fixed percentage of turnover achieved by the employee.

■ *Gratuity received from more than one employer* - Where gratuities are received by an employee from more than one employer in the same previous year, the aggregate maximum amount of gratuity exempt from tax under section 10(*10*)(*iii*) cannot exceed Rs. 3,50,000[1].

■ *Gratuity received in earlier years* - If an employee, who has received gratuity in any earlier year from his former employer(s), receives gratuity from another employer in a later year, the aforesaid limit of Rs. 3,50,000[1] will be reduced by the amount(s) of gratuity exempted from tax under section 10(*10*)(*iii*) in any earlier year(s).

■ *Gratuity received while in service* - Any gratuity paid to an employee while he continues to remain in service (whether or not after he has put in minimum specified period of service) is not exempt from tax. Tax exemption will be available only if gratuity is paid on (*i*) retirement ; (*ii*) becoming incapacitated prior to such retirement ; (*iii*) termination of employment ; (*iv*) resignation ; or (*v*) death. Gratuity received under other circumstances would not be exempt from tax, though the assessee can claim relief under section 89 [*see* para 60.2].

■ *Basis of gratuity calculation* - Gratuity received by an assessee from his employer or former employer is qualified for exemption even if it has been calculated on the basis other than the basis of half month's salary for each completed year of service. The exemption is, however, not available, if the relationship of employer-employee does not exist between the payer and recipient. For instance, gratuity payable by the Life Insurance Corporation of India to its insurance agents is not qualified for exemption as agents are not employees of the Corporation.

■ *Gratuity received by family members after the death of the employee* - If gratuity is paid after the death of an employee (say X is the employee), then the case may fall in one of the following situations given below—

	Normal date of retirement of X	*When gratuity becomes due*	*Date of payment of gratuity*	*Date of death of X*
Situation 1	June 30, 2008	June 30, 2008	July 11, 2008	July 20, 2014
Situation 2	June 30, 2008	June 30, 2008	July 11, 2008	July 6, 2008
Situation 3	June 30, 2014	July 6, 2008	July 11, 2008	July 6, 2008

In *Situation 1*, the gratuity becomes due (and paid) during the lifetime of X, it is taxable in the hands of X. He can claim exemption under section 10(*10*).

In *Situation 2*, gratuity becomes due on June 30, 2008 at the time of retirement. It is taxable in the hands of X even if it is received by legal heirs on July 11, 2008 after his death. After claiming exemption under section 10(*10*)(*ii*)/(*iii*), the balance shall be included in the salary income of X. Income-tax return shall be submitted by Mrs. X (or her children) as legal heirs of X.

In *Situation 3*, X dies on July 6, 2008 while in service. Gratuity is sanctioned after his death on July 6, 2008. It cannot be taxed in the hands of deceased employee X as it becomes due and is paid after his death. This amount is not taxable in the hands of legal heirs also as it does not partake the character of income in their hands but is only a part of the estate devolving upon them.

49.8-3P1 *X is the Marketing Manager of A Ltd. He retires on November 30, 2008 after service of 22 years and 10 months. At the time of retirement he has been paid Rs. 2,80,000 as gratuity, although A Ltd. is not covered by the Payment of Gratuity Act, 1972. Find out the salary chargeable to tax (ignore standard deduction) for the assessment year 2009-10.*

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1. *See* Footnote *1* on page *114*.

The following additional information is available —

1. Salary and allowances

Basic salary at the retirement	*Rs. 8,000 per month*
Month from which increment is allowed	*July*
Amount of last increment	*Rs. 1,000*
Dearness allowance (fixed since 2004 and only 15 per cent is considered for retirement benefit)	*Rs. 2,000 per month*
Commission (fixed on per month basis since 2004)	*Rs. 500*

2. Besides, he gets 0.5 per cent commission on turnover achieved by him. Turnover for different months is as follows —

	Rs.
January 2008	*70,000*
February 2008	*80,000*
March 2008	*85,000*
April 2008 to June 2008	*2,70,000*
July 2008 to October 2008	*3,70,000*
November 2008	*95,000*

3. As per service rules, salary, allowances and commission become due on first day of the next of each month and paid on the same day.

4. X retires on November 30, 2008 and hands over the charge on the same day at 5.30 PM to the Deputy Marketing Manager.

5. For the purpose of section 10(10)(iii) average monthly salary is calculated on the basis of average salary for the ten months immediately preceding the month in which an employee is retired. Although X is not in service after 5.30 PM on November 30, 2008, he claims that while calculating "average monthly salary" for the purpose of section 10(10)(iii), salary from February to November 2008 shall be considered as he retires effectively from December 1, 2008.

SOLUTION : *Computation of average monthly for purpose of section 10(10)(iii)* - X retires on November 30, 2008 and he hands over the charge on the same day at 5.30 PM. On November 30, 2008 after 5.30 PM, he cannot sign any document as the Marketing Manager of A Ltd. Therefore, it is incorrect to state that he retires *with effect* from December 1, 2008. The effective date of retirement is November 30, 2008 (5.30 PM). Consequently, average monthly salary shall be computed on the basis of salary of X during the period of 10 months immediately prior to the month of retirement (*i.e.*, January 2008 to October 2008) on the following lines—

	Rs.
Basic salary from January to June 2008 (Rs. 7,000 × 6)	42,000
Basic salary from July to October 2008 (Rs. 8,000 × 4)	32,000
15% of dearness allowance of January - October 2008	3,000
Fixed commission	*Nil*
0.5% commission on turnover achieved during January and October 2008 [0.5% of Rs. 8,75,000]	4,375
Total	81,375
Average	8,137.50

Computation of exemption under section 10(10)(iii)

Out of Rs. 2,80,000, the least of the following is exempt—

a. Rs. 3,50,000 ;

b. Rs. 89,512.50 (being 0.5 × Rs. 8,137.50 × 22) ; or

c. Rs. 2,80,000.

Amount chargeable to tax is Rs. 1,90,487.50.

Computation of salary

	Basic salary Rs.	Dearness allowance Rs.	Fixed commission Rs.	Commission @ 0.5% of turnover Rs.
Salary of March 2008 (which becomes due on April 1, 2008 and paid on the same day)	7,000	2,000	500	425
Salary from April 2008 to June 2008 (due date and date of payment : May 1, 2008, June 1, 2008 and July 1, 2008)	21,000	6,000	1,500	1,350
Salary from July to November 2008 (due and payment dates : August 1, 2008, September 1, 2008, October 1, 2008, November 1, 2008 and December 1, 2008) [Rs. 8,000 × 5]	40,000	10,000	2,500	2,325
Total (Rs. 94,600)	68,000	18,000	4,500	4,100

Taxable amount	Rs.
Basic salary, dearness allowance and commission	94,600
Gratuity [relief is available under section 89]	1,90,488
Salary income	2,85,088

49.8-3P2 *X functioned as the managing director of a company under an agreement, which was to be operative from January 1, 2004 for a term of five years. The agreement, inter alia, provided for payment of gratuity to the managing director as per the terms of the agreement at the time of termination of appointment. During the accounting year relevant to the assessment year 2009-10 after the expiry of the said agreement on January 1, 2009, X is paid Rs. 15,000 gratuity in accordance with the terms of the agreement. Thereafter, X is appointed as managing director under a fresh agreement which also contains a clause as to payment of gratuity. X claims that under section 10(10), a part of the gratuity received is exempt from tax. The Assessing Officer is of the opinion that the assessee's services have not been terminated, with the result that no gratuity falls due and, consequently, section 10(10) is not applicable. Discuss whether X is entitled for exemption.*

SOLUTION : When an employee retires and earns gratuity and the same employer offers such employee a job under a fresh agreement and the new agreement provides for the payment of gratuity, that would in no way, militate against the concept of gratuity if such gratuity is paid on the first retirement. Retirement, in the case of a managing director, will be a matter of contract and the agreement may provide for payment of gratuity on the expiration of the term of appointment. Therefore, whatever happens to the managing director thereafter, whether the managing director is appointed for a fresh term under a fresh agreement or not, the earlier agreement works itself out and, consequently, when the managing director retires, he or she would be entitled to whatever gratuity is contemplated as payable under the agreement. The fact that such a person is employed again under a fresh contract without any break would make no difference, for it will not alter the character of the earlier payment made pursuant to the agreement. Therefore, in the instant case, section 10(*10*) is attracted and X is entitled to the admissible deduction—*CIT* v. *Savitaben N. Amin* [1985] 20 Taxman 278 (Guj.).

49.9 *Pension* - The tax treatment of pension in different cases is given below—

	Different situations	*Tax treatment*
Case 1	Pension is received from UNO by the employee or his family members	It is not chargeable to tax
Case 2	Family pension received by the family members of armed forces (after the death of the employee)	It is exempt under section 10(*19*) in some cases—*see* para 38.35A.
Case 3	Family pension received by family members in other cases (after the death of the employee)	It is taxable in the hands of recipients under section 56 under the head "Income from other sources". Standard deduction is available under section 57 which is 1/3 of such pension or Rs. 15,000, whichever is lower.
Case 4	Pension received by an employee (during his lifetime) who has joined the Central Government on or after January 1, 2004	*See* para 49.9-2
Case 5	Pension received by an employee (during his lifetime) in any other case [sec. 17(1)(*ii*)]	*See* para 49.9-1

49.9-1 *PENSION [SEC. 17(1)(ii)]* - Pension covered under *Case 5* above is chargeable to tax as follows—

Pension	Status of employee	Is it chargeable to tax
Uncommuted pension	Government/non-Government employee	It is chargeable to tax
Commuted pension	Government employee	It is fully exempt from tax under section 10(*10A*)(*i*)
Commuted pension	Non-Government employee	It is fully or partly exempt from tax under section 10(*10A*)(*ii*) [*see* para 49.9-1b]

49.9-1a UNCOMMUTED PENSION - It is periodical payment of pension. For instance, X gets monthly pension of Rs. 2,000. It is taxable as salary under section 15 in the hands of a Government employee as well as non-Government employee.

49.9-1b COMMUTED PENSION - It is lump sum payment in lieu of periodical payment.

For instance, after his retirement, X gets Rs. 2,000 per month as monthly pension. As per service rules, he gets 25 per cent of his pension commuted for Rs. 60,000 (after commutation he will get the remaining 75 per cent, *i.e.*, Rs. 1,500 by way of monthly pension). In this case Rs. 60,000 is commuted pension which X has received in lieu of 25 per cent of his monthly pension. Commuted pension is taxable as under—

Status of employee	Gratuity received/not received	Exemption in respect of commuted pension under section 10(10A)
Government employee (*i.e.*, an employee of Central Government, State Government, local authority and statutory corporation)	Gratuity may (may not) be received.	Entire commuted pension is exempt from tax* is exempt under section 10(*10A*)(*i*)
Non-Government employee	Gratuity is received.	One-third of the pension which he is normally entitled to receive is exempt from tax under section 10(*10A*)(*ii*).
Non-Government employee	Gratuity is not received.	One-half of the pension which he is normally entitled to receive is exempt from tax under section 10(*10A*)(*ii*).

In accordance with the aforesaid rules, pension is chargeable to tax on "accrual" basis whether it is received voluntarily or under a contract. Arrears of pension are also assessable on "due" basis whether paid or not—*T.A. Ramasubramaniam* v. *CIT* [1975] 100 ITR 408 (Mad.). In respect of the pension which is not exempt from tax, the assessee can, however, claim relief under section 89 [*see* para 60.4].

49.9-2 *NOTIFIED PENSION SCHEME IN CASE OF AN EMPLOYEE JOINING CENTRAL GOVERNMENT OR ANY OTHER EMPLOYER ON OR AFTER JANUARY 1, 2004* - These provisions are given below —

1. Contribution by the Central Government or any other employer to the notified pension scheme is first included under the head "Salaries" in hands of the employee.

2. Such contribution is deductible (to the extent of 10 per cent of the salary of the employee) under section 80CCD.

3. Employee's contribution to the notified pension scheme (to the extent of 10 per cent of the salary of the employee) is also deductible under section 80CCD.

4. When pension is received out of the aforesaid amount, it will be chargeable to tax in the hands of the recipient.

5. The aggregate amount of deduction under sections 80C, 80CCC and 80CCD cannot exceed Rs. 1,00,000.

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*Judges of the Supreme Court and High Courts will be entitled to the exemption of the commuted pension under section 10(*10A*)(*i*) of the Act - Circular No. 623, dated January 6, 1992.

6. "Salary" for the purpose of *points 2* and *3* (*supra*) includes basic salary and dearness allowance (if the terms of employment so provide) but excludes all other allowances and perquisites.

7. No deduction will be allowed under section 80C in respect of amounts on which deduction has been claimed under section 80CCD.

49.9-P1 *Determine the taxable amount of pension for the assessment year 2009-10 in the following cases :*

1. X retires from the Central Government services on May 31, 2008. He gets pension of Rs. 900 per month up to January 31, 2009 (i.e., Rs. 900 × 8). With effect from February 1, 2009, he gets one-third of his pension commuted for Rs. 62,000.

2. X retires from B Ltd. on July 31, 2008. He gets pension of Rs. 1,000 per month up to December 31, 2008. With effect from January 1, 2009 he gets 60 per cent of pension commuted for Rs. 1,70,000. Does it make any difference if he also receives gratuity of Rs. 3,000 at the time of retirement ?

3. X retires from P Ltd. on March 31, 2008. P Ltd. pays Rs. 2,600 per month as pension but does not pay any gratuity. On the request of X, P Ltd. pays Rs. 80,000 in lieu of commutation of 25 per cent of pension on January 31, 2009.

4. What will be the amount of taxable pension if X, under the circumstances mentioned at (3), receives Rs. 3,400 gratuity at the time of retirement ?

5. X joins the Central Government service on January 1, 2008 (salary being Rs. 50,000 per month). The Government contributes Rs. 5,000 per month to the pension fund account of X. X makes a matching contribution. X pays Rs. 24,000 annually as life insurance premium (sum assured : Rs. 80,000).

SOLUTION :

1. While uncommuted pension is chargeable to tax, commuted pension is exempt from tax in the case of Government employees. Therefore, commuted pension of Rs. 62,000 is exempt from tax. The amount of uncommuted pension will be calculated as under :

	Rs.
Uncommuted pension up to January 31, 2009 (*i.e.*, Rs. 900 × 8)	7,200
Uncommuted pension from February 1, 2009 to March 31, 2009 (*i.e.*, 2/3 × 900 × 2)	1,200
Total uncommuted pension	8,400

2. In the case of a non-Government employee while uncommuted pension is fully chargeable to tax, commuted pension is partly chargeable to and partly exempt from tax. Amount of taxable pension will be commuted as under :

UNCOMMUTED PENSION

	Rs.
Uncommuted pension from July 31, 2008 to December 31, 2008 (*i.e.*, Rs. 1,000 × 5)	5,000
Uncommuted pension from January 1, 2009 to March 31, 2009 (*i.e.*, Rs. 1,000 × .4 × 3)	1,200
Total uncommuted pension chargeable to tax as salary	6,200
COMMUTED PENSION	
Commuted value of 60% (*i.e.*, 60% of usual pension)	1,70,000
Commuted value of full pension (*i.e.*, 100/60 × Rs. 1,70,000)	2,83,333
If X does not receive gratuity	
Amount exempt (½ of commuted value of full pension, *i.e.*, ½ × Rs. 2,83,333)	1,41,667
Commuted pension chargeable to tax as salary (*i.e.*, Rs. 1,70,000—Rs. 1,41,667)	28,333
If X receives gratuity	
Amount exempt (one-third of commuted value of full pension, *i.e.*, 1/3 × Rs. 2,83,333)	94,444
Commuted pension chargeable to tax as salary (*i.e.*, Rs. 1,70,000—Rs. 94,444)	75,556

3. Amount of pension taxable as salary will be computed as under :

Uncommuted pension	
Uncommuted pension from April 1, 2008 to January 31, 2009 (*i.e.*, Rs. 2,600 × 10)	26,000
Uncommuted pension from February 1, 2009 to March 31, 2009 (*i.e.*, Rs. 2,600 × 2 × .75)	3,900
Total uncommuted pension chargeable to tax	29,900

	Rs.
Commuted pension	
Commuted value of 25% of usual pension	80,000
Commuted value of full pension (*i.e.*, Rs. 80,000 × 100 ÷ 25)	3,20,000
Maximum amount exempt from tax (*i.e.*, 1/2 of Rs. 3,20,000, as X does not receive gratuity)	1,60,000

As amount received in commutation of pension is less than maximum amount exempt from tax, nothing is chargeable to tax.

4. While the taxable amount of uncommuted pension will be the same as commuted under (3) *supra*, the taxable amount of commuted pension will be determined as under :

	Rs.
Commuted value of 25% of usual pension	80,000
Commuted value of full pension (*i.e.*, Rs. 80,000 × 100 ÷ 25)	3,20,000
Maximum amount exempt from tax (*i.e.*, 1/3 of Rs. 3,20,000 as X receives gratuity)	1,06,667

As amount received in commutation of pension is less than maximum amount exempt from tax, nothing is chargeable to tax.

Note : X can claim relief under section 89 in respect of commuted pension chargeable to tax.

5. Income of X for the assessment year 2009-10 will be as follows :		Rs.
Basic salary (Rs. 50,000 × 12)		6,00,000
Contribution to the pension fund by the Central Government (Rs. 5,000 × 12)		60,000
Gross salary		6,60,000
Less : Standard deduction		—
Gross total income		6,60,000
Less : Deductions	Rs.	
Under section 80C (maximum 20% of sum assured)	16,000	
Under section 80CCD (*i.e.*, Rs. 60,000 + Rs. 60,000)	1,20,000	
Total	1,36,000	
Aggregate deduction under sections 80C, 80CCC and 80CCD cannot exceed Rs. 1,00,000		1,00,000
Net income		5,60,000

49.9-P2 *X had joined the service of the Union Government in 1984. In 1996, he was deputed to a public sector corporation. During 2008, he opts to be absorbed in service of the public sector corporation and retires voluntarily from the service of the Government. He is entitled either to draw pension or commute the same. He exercises the latter option and accordingly receives Rs. 90,000. Whether Rs. 90,000 is exempt from tax under section 10(10A)(i) ?*

SOLUTION : The entire amount is exempt from tax under section 10(10A)(*i*). The issue has been decided by the Division Bench of the Delhi High Court in the case of C.K. *Karunakaran* v. *Union of India* [1980] 4 Taxman 178. The Department has accepted the decision of the Court—Circular No. 286, dated November 17, 1980.

49.10 ***Annuity [Sec. 17(1)(ii)]*** - According to the *Shorter Oxford English Dictionary*, annuity means "an yearly allowance, or income; the grant of an annual sum for a term of year, for life, or in perpetuity". An annuity payable by a present employer is taxable as salary even if it is received voluntarily without any contractual obligation of the employer. An annuity received from an ex-employer is taxed as profit in lieu of salary under section 17(*3*)(*ii*). Annuity received from a person other than employer under an insurance policy or other contract or under the terms of a deed is, however, taxable under section 56 as income from other sources.

49.11 ***Annual accretion to the credit balance in provident fund*** - *See* para 56.2.

49.12 ***Amount transferred from unrecognised provident fund to recognised provident fund [Rule 11(4) of Part A of the Fourth Schedule]*** - Out of the sum standing to the credit of an employee under

recognised provident fund which is accorded recognition for the first time, a part of the sum transferred from unrecognised provident fund to the recognised provident fund is taxable under the head "Salaries". Of all the sums comprised in the transferred balance, the amount which would have been liable to tax if provident fund had been recognised from the date of institution of the fund, shall be deemed to be the income received by the employee in the previous year in which recognition of the fund takes effect. The remaining amount is not chargeable to tax. No other relief or exemption is granted.

49.13 ***Retrenchment compensation [Sec. 10(10B)]*** - Compensation received by a workman under the Industrial Disputes Act, 1947, or under any other Acts or rules, orders or notification issued thereunder or under any standing orders or under any award, contract of service or otherwise, at the time of retrenchment, is exempt from tax to the extent of lower of the following :

a. an amount calculated in accordance with the provisions of section 25F(*b*) of the Industrial Disputes Act, 1947 ; or

b. the amount as specified by the Government (*i.e.*, Rs. 5,00,000) ; or

c. the amount received.

One should keep in view the following —

▪ With effect from the assessment year 1986-87, the aforesaid limits will not apply in cases where the compensation is paid under any scheme approved by the Central Government.

▪ Compensation in excess of the aforesaid limits is taxable as salary which is, however, eligible for relief under section 89 read with rule 21A [*see* para 60].

49.14 ***Profits in lieu of salary [Sec. 17(3)]*** - "Profits in lieu of salary" is defined by section 17(*3*). These payments are made to an employee in lieu of salary even if these payments have no connection with the "profits" of the employer—*Karamchari Union* v. *Union of India* [2000] 109 Taxman 1 (SC). These are the following—

▪ *Compensation for loss of employment or modification of the employment terms* - Compensation for loss of employment or modification of terms of employment is generally treated as a capital receipt. But by virtue of section 17(*3*)(*i*), any compensation due to or received by an assessee from his employer or former employer at or in connection with the termination of his employment or modification of terms of employment is taxable as profit in lieu of salary. It is taxable on "due" or "receipt" basis, whichever comes earlier. The recipient may claim exemption under section 10(*10B*) or 10(*10C*) [*see* paras 49.13 and 49.20].

The following are the salient features—

a. compensation is received by an assessee from his employer or former employer ;

b. it is received at or in connection with termination of his employment or modification of terms and conditions relating thereto.

▪ *Payment from unrecognised provident or superannuation fund* - At any given time, accumulated balance in any provident fund/superannuation fund consists of the following—

a. employer's contribution ;

b. interest on employer's contribution ;

c. employee's contribution ; and

d. interest on employee's contribution.

The first two are taxable as "profits in lieu of salary" subject to the following propositions—

1. The provident fund/superannuation fund is an unapproved fund.

2. These are taxable at the time of payment to the assessee [as the word "payment" is used in section 17(*3*)(*ii*)]. In other words, employer's contribution to unrecognised provident/superannuation fund is not taxable in the year in which contribution is made but is taxable when payment becomes due or payment is actually made to an employee. Similarly, interest on employer's contribution is not taxable in the year in which the amount is credited but in the year in which payment becomes due or the payment is made. It may be noted that interest on employee's contribution is taxable under the head "Income from other sources".

■ *Payment under keyman insurance policy* - Any sum received under keyman insurance policy (including the sum allocated by way of bonus on such policy) is taxable as "profits in lieu of salary".

■ *Payment before joining or after retirement* - From the assessment year 2002-03, profits in lieu of salary will include amount received in lump sum or otherwise, prior to employment or after cessation of employment for the purpose of taxation.

■ *Any other payment* - Any other payment (other than what is exempt under different clauses of section 10) due to or received by an assessee from his employer (or former employer) is treated as "profits in lieu of salary". For instance, medical allowance is taxable as "profits in lieu of salary".

Exemption is, however, available in respect of following which may otherwise be taxable as salary—

a. payment of gratuity exempted under section 10(*10*)[1] ;

b. payment of house rent allowance exempted under section 10(*13A*)[2] ;

c. payment of commuted pension exempted under section 10(*10A*)[3] ;

d. payment of retrenchment compensation exempted under section 10(*10B*)[4] ;

e. payment from an approved superannuation fund under section 10(*13*) ;

f. payment from statutory provident fund and public provident fund ;

g. payment from recognised provident fund to the extent it is exempt under section 10(*12*)[5].

49.14-1 REIMBURSEMENT OF EXPENSES - IS IT "PROFITS IN LIEU OF SALARY" - The grant of allowance to meet the expenses for the duties of office or employment even if falling within the extended meaning of income under section 2(*24*), would not straightway be salary unless they fall within the definition of salary under section 17(*1*) and reimbursement of expenses which does not result in personal profit or gain under section 17(*1*)(*iv*) so as to be called profits in lieu of or in addition to salary, will not be salary so as to be chargeable to tax under section 15. In *Chimanbhai H. Patel* v. *CIT* [1998] 99 Taxman 63, the Gujarat High Court held† that —

a. entire incentive bonus earned by the assessee as Development Officer of LIC is not a part of salary within ambit of section 17(*1*)(*iv*) ;

b. while determining "profits in lieu of salary", profit cannot be worked out unless the expenditure which is necessary and properly incurred for the purpose of earning the income is deducted ; and

c. it cannot be said that only deduction admissible in such a case is standard deduction under section 16(*i*).

49.15 ***Remuneration for extra duties*** - Where an employee agrees to do something outside the duties of his office, thereby enlarging the scope of his office, for which he is given extra payment, that payment is taxable as salary. If, however, the relationship of employer and employee does not exist between the payer and payee, such additional remuneration is not chargeable to tax as income from salary but is assessable as income from business or profession or income from other sources.

49.16 ***Voluntary payment to his employees*** - Voluntary payments made by an employer to his employee is taxable in the hands of the recipient as salary if such payment is made with reference to services rendered by virtue of employment. If such payment accrues to the employee by virtue of his employment, it may be taxable, irrespective of the fact whether or not there is any legal obligation on the employer to make the payment—*Herbert* v. *McQuade* [1902] 2 KB 631 (CA). In case of voluntary payment, one must take into consideration all relevant circumstances under which the payment is made to decide whether or not that payment is taxable as salary—*Dewhurst* v. *Hunter* [1932] 146 LT 510 (HL).

Conversely, if payment made to an employee is in the nature of personal gifts/testimonial, it is not taxable as salary—*Bridges* v. *Hewitt* [1957] 2 AER 281 (CA). However, such payment (exceeding

1. *See* para 49.8.
2. *See* para 50.2.
3. *See* para 49.9.
4. *See* para 49.13.
5. *See* para 56.

†Contrary verdict is given by the Bombay High Court in *CIT* v. *Gopal Krishna Suri* [2000] 113 Taxman 707.

Rs. 50,000) may be taxable under section 56(2)(*vi*) under the head "Income from other sources" [*see* para 199]

49.16-1 PAYMENT MADE GRATUITOUSLY TO WIDOW/LEGAL HEIRS OF EMPLOYEES - A lump sum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in active service, is not taxable— Circular No. 573, dated August 21, 1990. Likewise, if a person or his legal heirs receive *ex gratia* payment from the Central Government, State Government, local authority, public sector undertaking, consequent upon injury to the person/death of a family member, while on duty, the *ex gratia* payment will not be liable to income-tax—Circular No. 776, dated June 8, 1999.

49.17 ***Salary received from a United Nations Organisation*** - Section 2 of the UN (Privileges and Immunities) Act, 1947 (read with section 18 of the Schedule thereto) grants exemption from income-tax to salaries and emoluments paid by the United Nations to its officials. Apart from salary received by employees of the UNO, any pension covered under the UN (Privileges and Immunities) Act and received from United Nations Organisation is also exempt from tax—Circular No. 293, dated February 10, 1981.

49.18 ***Salary to foreign technicians*** - *See* para 54.

49.19 ***Salary to other foreign citizens*** - *See* para 55.

49.20 ***Compensation received at the time of voluntary retirement or separation [Sec. 10(10C)]**** - Compensation received at the time of voluntary retirement or separation is exempt† from tax if the following conditions are satisfied—

1. Compensation is received at the time of voluntary retirement or termination (or in the case of an employee of a public sector company at the time of voluntary separation).

2. Compensation is received by an employee of the following undertakings —

a. an authority established under a Central, State or Provincial Act;

b. local authority;

c. university;

d. an Indian Institute of Technology;

e. the State Government;

f. the Central Government;

g. a notified institute having importance throughout India or any State (*i.e.*, International Crops Research Institute for Semi-Arid Tropics; Action for Food Production, New Delhi, Government Tool Room & Training Centre, Rajajinagar Ind. Estate, Bangalore);

h. notified institute of management (*i.e.*, Indian Institute of Management, Ahmedabad, Bangalore, Calcutta or Lucknow and the Indian Institute of Foreign Trade, New Delhi);

i. public sector company; or

j. any company or a co-operative society.

3. Compensation is received in accordance with the scheme of voluntary retirement/separation which is framed in accordance with prescribed guidelines—*see* para 49.20-1.

4. Maximum amount of exemption is Rs. 5,00,000.

5. Where exemption has been allowed to an employee under section 10(*10C*) for any assessment year, no exemption thereunder shall be allowed to him in relation to any other assessment year.

49.20-1 GUIDELINES - The guidelines for the purposes of section 10(*10C*) have been laid down by rule 2BA. The scheme of voluntary retirement framed by a company or authority should be in accordance with the following requirements, namely—

a. it applies to an employee who has completed 10-years of service or completed 40 years of age (this condition is, however, not applicable in case the amount is received by an employee under voluntary separation scheme framed by a public sector undertaking);

*Section 10(*10C*) is constitutionally valid—*Sashikant Laxman Kale* v. *Union of India* [1990] 52 Taxman 352 (SC).

† Any sum received/receivable on voluntary retirement would be exempt from the assessment year 2005-06 if the aforesaid conditions are satisfied.

b. it applies to all employees (by whatever name called), including workers and executives of the company or authority or of a co-operative society excepting directors of a company or of a co-operative society ;

c. the scheme of voluntary retirement or separation has been drawn to result in overall reduction in the existing strength of the employees ;

d. the vacancy caused by voluntary retirement or separation is not to be filled up, nor the retiring employee is to be employed in another company or concern belonging to the same management ; and

e. the amount receivable on account of voluntary retirement or separation of the employees does not exceed the amount equivalent to three months' salary for each completed year of service or salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation.

The following points should also be kept in view :

- Approval of such scheme of voluntary retirement is not required.
- Taxpayers can frame different schemes of voluntary retirement or separation for different classes of their employees. However, these schemes have to conform to the aforesaid guidelines prescribed in rule 2BA of the Income-tax Rules.
- For meaning of the term "salary", *see* para 50.2-1.
- It is the last salary drawn which is to form the basis for computing the amount of payment.
- One of the requirements in the guidelines prescribed for schemes of voluntary retirement is that the scheme should apply to an employee of a company or authority who has completed ten years of service or forty years of age. Since the employee of a company or concern (presuming that he is less than forty years of age) which has been set up less than ten years ago, cannot satisfy the aforesaid requirement, the amount receivable by him shall not be entitled to income-tax exemption under section 10(*10C*).
- The scheme of voluntary retirement should be drawn to result in overall reduction in the existing strength of the employees of a company or authority. This requirement reflects the criterion of economic viability for framing the schemes of voluntary retirement. The scheme which does not result in overall reduction in the existing strength of the employees of a company or concern will not be in accordance with the guidelines prescribed for the purposes of section 10(*10C*).
- The requirement in the guidelines which reflects the economic criterion is to the effect that the scheme of voluntary retirement has been drawn to result in overall reduction in the existing strength of the employees of the company or concern. Therefore, schemes can be drawn even by profit-making companies or concerns.
- It is not the intention of the Legislature that every VRS framed by the companies must provide that an employee availing benefit of VRS would be paid an amount either equivalent to (*1*) three months' salary for each completed year of service, or (*2*) salary at the time of retirement multiplied by the balance months of service left before the date of his retirement on superannuation. The amount receivable by an employee on account of his voluntary retirement can be either of the aforesaid two amounts (not necessarily lower of the two). However, the amount which will qualify for exemption under section 10(*10C*) will be up to Rs. 5 lakhs only. On construction of rule 2BA of the Rules, it is difficult to hold that other manners/modes of payment of amount in the VRS framed by the companies are forbidden—***Arunkumar T. Makwana*** v. ***ITO*** [2006] 156 Taxman 436 (Guj.).
- Relief under section 89 is admissible in respect of the amount received by the assessee-employee from the employer at the time of voluntary retirement or separation—*CIT* v. *M. Raman* [2000] 245 ITR 856 (Mad.).† Merely because an exemption has been allowed under section 10(*10C*), relief under section 89 cannot be denied—***ITO*** v. ***Dilip Shirodkar*** [2004] 137 Taxman 59 (Panaji), ***CIT*** v. ***G. V. Venugopal*** [2005] 144 Taxman 784 (Mad.), ***CIT*** v. ***Surendra Prabhu*** [2005] 149 Taxman 82 (Kar.), ***ITO*** v. ***Chandra Kant S. Dharma*** [2005] 94 ITD 152 (Indore), ***CIT*** v. ***Rajinder C. Khambkar*** [2007] 13 SOT 630 (Mum.) (SMC), ***Firturam Yadav*** v. ***CIT*** [2007] 15 SOT 75 (Nag.).

†A Special Leave Petition (SLP) in this case has been filed by the Government in Honourable Supreme Court.

Allowance

50. Allowance is generally defined as fixed quantity of money or other substance given regularly in addition to salary for the purpose of meeting some particular requirement connected with the services rendered by the employee or as compensation for unusual conditions of that service—*Mutual Acceptance Co.* v. *FCT* [1944] 69 CLR 389. It is fixed, pre-determined and given irrespective of actual expenditure. Under the Act, it is taxable under section 15 on "due" or "receipt" basis, whichever comes earlier, irrespective of the fact that it is paid in addition to or in lieu of salary. Tax treatment of different allowances is given below :

50.1 ***City compensatory allowance*** - It is always taxable. Even if city compensatory allowance is paid to meet additional expenditure, it is additional salary and, consequently, chargeable to tax—*Karamchari Union* v. *Union of India* [2000] 109 Taxman 1 (SC).

50.2 ***House rent allowance [Sec. 10(13A) and rule 2A]*** - Exemption in respect of house rent allowance is regulated by rule 2A. It is based upon the following—

1.	An amount equal to 50 per cent of salary, where residential house is situated at Bombay, Calcutta, Delhi or Madras and an amount equal to 40 per cent of salary where residential house is situated at any other place.
2.	House rent allowance received by the employee in respect of the period during which rental accommodation is occupied by the employee during the previous year.
3.	The excess of rent paid over 10 per cent of salary.

- *Amount exempt from tax* - The least of the above three is exempt from tax.

50.2-1 MEANING OF SALARY - "Salary" for the aforesaid purposes means basic salary and includes dearness allowance if terms of employment so provide. It also includes commission based on a fixed percentage of turnover achieved by an employee as per terms of contract of employment—*Gestetner Duplicators (P.) Ltd.* v. *CIT* [1979] 1 Taxman 1/117 ITR 1 (SC). But it does not include any other allowance and perquisites.

- *Salary shall be determined on "due" basis* - Basic salary, dearness allowance and commission are determined on "due" basis in respect of the period during which rental accommodation is occupied by the employee in the previous year [*Explanation (ii)* to rule 2A]. It, therefore, follows that salary of a period other than the previous year are not considered, even though such amount is received during the previous year and is taxable on "receipt" basis. Likewise, salary of the period during which rental accommodation is not occupied in the previous year are left out of the aforesaid computation.

50.2-2 NO EXEMPTION WHEN RENT PAID DOES NOT EXCEED 10 PER CENT OF SALARY - Exemption is denied where an employee lives in his own house, or in a house for which he does not pay any rent or pays rent which does not exceed 10 per cent of salary.

50.2-3 MODE OF COMPUTATION OF EXEMPTION - The amount of exemption in respect of house rent allowance received by an employee depends upon the following :

a. "salary" of the employee ;

b. house rent allowance ;

c. rent paid ; and

d. the place where house is taken on rent.

When these four are the same throughout the previous year, the exemption should be calculated on "annual" basis. When, however, there is a change in respect of any of the aforesaid factors, then the exemption shall be worked out on "monthly" basis.

50.2-P1 *X, who resides in Kanpur, receives Rs. 78,000 as basic pay during the previous year 2008-09. He stays in his father's house up to August 31, 2008 for which he does not pay any rent and thereafter in an accommodation taken on monthly rent of Rs. 3,000. The employer, however, pays Rs. 700 per month as house rent allowance throughout the previous year. As the sum of house rent allowance paid is the least of the three sums [viz., (a) Rs. 31,200, i.e., 40 per cent of salary, (b) Rs. 8,400, i.e., house rent allowance, and (c) Rs. 13,200, i.e., excess of rent paid over 10 per cent of salary], he claims that entire house rent allowance is exempt from tax under section 10(13A) read with rule 2A. Is he legally correct?*

SOLUTION : The mode of computation of X is not correct, as salary of the period during which rented accommodation is not occupied by X is not to be taken into account—*Explanation* (*ii*) to rule 2A. A correct application of rule 2A justifies an exemption of Rs. 4,900 calculated on the basis of the least of the following : (*a*) Rs. 2,600 per month (being 40% of monthly salary) ; or (*b*) Rs. 700 per month (being the amount of house rent allowance) ; or (*c*) Rs. 2,350 per month [being the excess of rent paid over 10% of salary, *i.e.*, Rs. 3,000 per month —10% of Rs. 6,500 per month (*i.e.*, Rs. 78,000 ÷ 12)]. As the least of the three sums is Rs. 700 per month, amount exempt from tax is Rs. 4,900 @ Rs. 700 per month for 7 months during which the rented accommodation is occupied by X.

Hence, the amount of house rent allowance chargeable to tax is to be worked out as Rs. 3,500 (*i.e.*, Rs. 8,400 — Rs. 4,900).

50.2-P2 *X is employed by A Ltd. up to November 30, 2008 on the following monthly salary (place of posting : Delhi) —*

	Up to May 31, 2008 Rs.	From June 1, 2008 Rs.
Basic salary	*5,000*	*6,000*
Dearness allowance (60 per cent of dearness allowance is part of salary for computing retirement benefits)	*1,200*	*1,500*
Dearness pay (not part of salary for computing retirement benefit)	*600*	*600*
Commission	*1,000*	*1,000*
House rent allowance	*3,000*	*4,500*

With effect from December 1, 2008, he joins B Ltd. on monthly salary of Rs. 11,000 (place of posting : Amritsar). Besides, he gets dearness allowance @ Rs. 4,000 per month (10 per cent of which is considered for provident fund contribution) and house rent allowance @ Rs. 6,000 per month.

Rent paid per month by X is as follows :

	Delhi Rs.	Amritsar Rs.
From April 1, 2008 to July 31, 2008	*600*	—
August 1, 2008 to December 31, 2008	*3,000*	—
January 2009	—	*1,000*
February 1, 2009 to March 31, 2009	—	*6,100*

Determine the amount of house rent allowance chargeable to tax for the assessment year 2009-10.

SOLUTION: *House rent allowance chargeable to tax*

	April 2008 and May 2008 Rs.	June and July 2008 Rs.	August to November 2008 Rs.	December 2008 Rs.	January 2009 Rs.	February and March 2009 Rs.
Basic salary	5,000	6,000	6,000	11,000	11,000	11,000
Dearness allowance (only the portion which is considered for calculating retirement benefits)	720	900	900	400	400	400
Salary	5,720	6,900	6,900	11,400	11,400	11,400
50% of salary	2,860	3,450	3,450	5,700	—	—
40% of salary	—	—	—	—	4,560	4,560
House rent allowance	3,000	4,500	4,500	6,000	6,000	6,000
Excess of rent paid over 10% of salary	28	*Nil*	2,310	1,860	*Nil*	4,960
Amount exempt from tax	28	*Nil*	2,310	1,860	*Nil*	4,560
Amount chargeable to tax	2,972	4,500	2,190	4,140	6,000	1,440

Amount taxable for the assessment year 2009-10 comes to Rs. 36,724.

50.3 ***Entertainment allowance [Sec. 16(ii)]*** - Entertainment allowance is first included in income under the head "Salaries" and thereafter a deduction is given on the basis enumerated in the following paragraph :

- In the case of a Government employee (*i.e.*, a Central Government or a State Government employee), the least of : (*a*) Rs. 5,000 ; (*b*) 20 per cent of salary ; or (*c*) amount of entertainment allowance granted during the previous year, is deductible.

In order to determine the amount of entertainment allowance, deductible from salary, the following points need consideration :

1. For this purpose "salary" excludes any allowance, benefit or other perquisites.

2. Amount actually expended towards entertainment out of entertainment allowance received is not taken into consideration. Deduction is granted according to the aforesaid rules, even if the amount received as entertainment allowance is not proved to have been spent—*CIT* v. *Kamla Devi* [1971] 81 ITR 773 (Delhi).

- From the assessment year 2002-03, entertainment allowance deduction will not be available to non-Government employees.

50.4 ***Special allowances prescribed as exempt under section 10(14)*** - The provisions of section 10(*14*) are given below :

50.4-1 *WHEN EXEMPTION DEPENDS UPON ACTUAL EXPENDITURE BY THE EMPLOYEE* - The following allowances are exempt under section 10(*14*) to the extent the amount is utilised for the specified purpose for which the allowance is received. In other words, in the cases given below the amount of exemption under section 10(*14*) is —

a. the amount of the allowance ; or

b. the amount utilised for the specific purpose for which allowance is given,

whichever is lower.

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

Name of allowance	*Nature of allowance*
Travelling allowance/transfer allowance	Any allowance (by whatever name called) granted to meet the cost of travel on tour or on transfer (including any sum paid in connection with transfer, packing and transportation of personal effects on such transfer).
Conveyance allowance	Conveyance allowance granted to meet the expenditure on conveyance in performance of duties of an office (it may be noted that an expenditure for covering the journey between office and residence is not treated as expenditure in performance of duties of the office and, consequently, such expenditure is not exempt from tax).
Daily allowance	Any allowance whether granted on tour or for the period of journey in connection with transfer, to meet the ordinary daily charges incurred by an employee on account of absence from his normal place of duty.
Helper allowance	Any allowance (by whatever name called) to meet the expenditure on a helper where such helper is engaged for the performance of official duties.
Research allowance	Any allowance (by whatever name called) granted for encouraging the academic research and other professional pursuits.
Uniform allowance	Any allowance (by whatever name called) to meet the expenditure on the purchase or maintenance of uniform for wear during the performance of duties of an office.

Note: As stated earlier, the amount of exemption in the above cases is amount of allowance or the expenditure incurred for the specific purpose for which allowance is given, whichever is lower. However, it is not open to the Assessing Officer to call for the details of expenses actually incurred by the assessee unless the allowances are disproportionately high compared to the salary received by the assessee or unreasonable with reference to the nature of the duties performed by the assessee—***Madanlal Mohanlal Narang*** v. ***CIT*** [2007] 11 SOT 76 (Mum.).

Provisions illustrated - During the previous year 2008-09, the following allowances are given to X by the employer company—

Nature of allowance	Amount of allowance Rs.	Amount actually spent for the purpose given in column 1 Rs.	Amount chargeable to tax Rs.
Travelling allowance for official purposes	36,000	32,000	4,000
Transfer allowance given at the time of transfer of X from Delhi to Ajmer	40,000	41,000	*Nil*
Conveyance allowance for official purposes	50,000	42,000	8,000
Helper allowance for engaging helper for official purposes	68,000	64,000	4,000
Research allowance	1,00,000	90,000	10,000
Uniform allowance for official purposes	18,000	17,000	1,000

50.4-2 *WHEN EXEMPTION DOES NOT DEPEND UPON EXPENDITURE* - In the cases given below, the amount of exemption does not depend upon expenditure incurred by the employee. Regardless of the amount of expenditure, the allowances given below are exempt to the extent of —

a. the amount of allowance ; or

b. the amount specified in rule 2BB,

whichever is lower.

On the above basis, exemption is available in the case of the following allowances. It may be noted that in these cases, the amount of actual expenditure is not taken into consideration—

Name of allowance	*Nature of allowance*	*Exemption as specified in rule 2BB*
Special Compensatory (Hill Areas) Allowance	It includes any special compensatory allowance in the nature of special compensatory (hilly areas) allowance or high altitude allowance or uncongenial climate allowance or snow bound area allowance or avalanche allowance.	Amount exempt from tax varies from Rs. 300 per month to Rs. 7,000 per month
Border area allowance	It includes any special compensatory allowance in the nature of border area allowance or remote locality allowance or difficult area allowance or disturbed area allowance.	The amount of exemption varies from Rs. 200 per month to Rs. 1,300 per month
Tribal areas/ scheduled areas allowance	Tribal areas allowance is given in (*a*) Madhya Pradesh; (*b*) Tamil Nadu; (*c*) Uttar Pradesh; (*d*) Karnataka; (*e*) Tripura; (*f*) Assam; (*g*) West Bengal; (*h*) Bihar; (*i*) Orissa.	Rs. 200 per month
Allowance for transport employees	It is an allowance granted to an employee working in any transport system to meet his personal expenditure during his duty performed in the course of running of such transport from one place to another place provided that such employee is not in receipt of daily allowance.	The amount of exemption is— *a.* 70 per cent of such allowance; or *b.* Rs. 6,000 per month, whichever is lower.

Name of allowance	Nature of allowance	Exemption as specified in rule 2BB
Children education allowance	This allowance is given for children's education.	The amount exempt is limited to Rs. 100 per month per child up to a maximum of two children.
Hostel expenditure allowance	This allowance is granted to an employee to meet the hostel expenditure on his child.	It is exempt from tax to the extent of Rs. 300 per month per child up to a maximum of two children.
Compensatory field area allowance	If this exemption is taken, the same employee cannot claim any exemption in respect of border area allowance mentioned above.	Exemption is limited to Rs. 2,600 per month in some cases.
Compensatory modified area allowance	If this exemption is taken, the same employee cannot claim any exemption in respect of border area allowance mentioned above.	Exemption is limited to Rs. 1,000 per month in some cases.
Counter insurgency allowance	It includes any special allowance in the nature of counter-insurgency allowance granted to the members of armed forces operating in areas away from their permanent locations. If this exemption is taken, the same employee cannot claim any exemption in respect of border area allowance mentioned above.	Exemption is limited to Rs. 3,900 per month in some cases.
Transport allowance	Transport allowance is granted to an employee to meet his expenditure for the purpose of commuting between the place of his residence and the place of his duty.	It is exempt up to Rs. 800 per month (Rs. 1,600 per month in the case of an employee who is blind or orthopaedically handi-capped).
Underground allowance	Underground allowance is granted to an employee who is working in uncongenial, unnatural climate in underground mines.	Exemption is limited to Rs. 800 per month.
High altitude allowance	It is granted to the members of armed forces operating in high altitude areas.	It is exempt from tax up to Rs. 1,060 per month (for altitude of 9,000 to 15,000 feet) or Rs. 1,600 per month (for altitude above 15,000 feet).
Highly active field area allowance	This special allowance is granted to the members of armed forces in the nature of special compensatory highly active field area allowance.	It is exempt from tax up to Rs. 4,200 per month.
Island duty allowance	This special allowance is granted to the members of armed forces in the nature of Island (duty) allowance in Andaman and Nicobar and Lakshadweep group of Island.	It is exempt up to Rs. 3,250 per month.

Provisions illustrated - The following illustrations are given to have better understanding:

1. During the previous year 2008-09, the following allowances are given to X by the employer-company—

Nature of allowance	Amount of allowance Rs.	Amount spent Rs.	Amount of exemption Rs.	Amount chargeable to tax Rs.
Tribal area allowance for X's posting in Assam for two months	1,000	Not relevant	200 p.m.	600

Nature of allowance	Amount of allowance Rs.	Amount spent Rs.	Amount of exemption Rs.	Amount chargeable to tax Rs.
Child education allowance for X's elder son	1,800	Not relevant	100 p.m.	600
Child education allowance for X's younger son	900	Not relevant	—	900
Child education allowance for X's daughter	1,080	Not relevant	100 p.m.	*Nil*
Hostel expenditure allowance for X's elder son	6,600	Not relevant	300 p.m.	3,000
Transport allowance for commuting between office and residence	12,000	Not relevant	800 p.m.	2,400

2. The following allowances are given by a transport company to its drivers to meet personal expenditure in the course of running trucks from one place to another place (none of these drivers is in receipt of daily allowance)—

Name of drivers	Amount of allowance Rs.	Amount spent Rs.	Amount not chargeable to tax Rs.	Amount chargeable to tax Rs.
X	72,000	Not relevant	70% of 72,000	21,600
Y	1,20,000	Not relevant	6,000 per month	48,000
Z*	30,000	Not relevant	6,000 per month	18,000
A**	46,200	Not relevant	70% of 46,200	13,860

*Z is in employment only for 2 months during the previous year 2008-09.

**A is in employment only for 7 months during the previous year 2008-09.

50.5 ***Allowance to Government employees outside India [Sec. 10(7)]*** - Any allowance paid or allowed outside India by the Government to an Indian citizen, for rendering services outside India, is wholly exempt from tax.

50.6 ***Tiffin allowance*** - It is taxable.

50.7 ***Fixed medical allowance*** - It is taxable†.

50.8 ***Servant allowance*** - It is taxable.

50.9 ***Allowance to High Court Judges [Sec. 22D(b) of the High Court Judges (Conditions of Service) Act, 1954]*** - Any allowance paid to a Judge of a High Court under section 22A(*2*) of the High Court Judges (Conditions of Service) Act, 1954, is not taxable with effect from the assessment year 1975-76.

50.10 ***Allowance received from United Nations Organisation*** - Allowance paid by the UNO to its employees is not taxable by virtue of section 2 of the UN (Privileges and Immunities) Act, 1974.

50.11 ***Allowance to foreign technician*** - *See* para 54.

50.12 ***Allowance to other foreign citizens*** - *See* para 55.

50.13 ***Compensatory allowance under article 222(2) of the Constitution*** - Compensatory allowance received by a Judge under article 222(*2*) of the Constitution is not taxable, since it is neither salary nor perquisite—*Bishambar Dayal* v. *CIT* [1976] 103 ITR 813 (MP).

50.14 ***Sumptuary allowance*** - Sumptuary allowance given to High Court Judges under section 22C of the High Court Judges (Conditions of Service) Act, 1954 and to Supreme Court Judges under section 23B of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax from the assessment year 1987-88.

†However, provision of medical facility is not chargeable to tax in certain cases [*see* para 52.13].

Perquisites [Sec. 17(2)]

51. The term "perquisite" is defined in *Webster's New International Dictionary* as "a gain or profit incidentally made from employment in addition to regular salary or wages, especially one of a kind expected or promised". Similarly in *Murray's English Dictionary*, it is defined as "any casual emolument or benefit attached to an office or position in addition to salary or wages". *The Chambers Twentieth Century Dictionary* defines "perquisite" as "property acquired otherwise than by inheritance : a casual profit : anything left over that a servant or other has by custom a right to keep : a tip expected upon some occasion : emoluments : something regarded as falling to one by right". Thus, the phrase "perquisite" signifies some benefit in addition to the amount that may be legally due by way of contract for services rendered.

The following propositions should also be kept in view :

- *Personal benefit* - "Perquisite" denotes something that benefits a man by going *into his own* pocket; it does not, however, cover a mere reimbursement of necessary expenses incurred by him—*Owen* v. *Pook* [1969] 74 ITR 147 (HL).
- *Cash or kind* - It may be provided in cash or in kind.
- *Should be provided by employer* - Perquisites are included in salary income only if they are received by an employee from his employer (maybe former, present or prospective)—*David Mitchell* v. *CIT* [1956] 30 ITR 701 (Cal.). Perquisites, received from a person other than employer, are taxable under the head "Profits and gains of business or profession" or "Income from other sources".
- *Enforceable right* - A benefit or advantage would be taxable as perquisite only if it has a legal origin—*see CIT* v. *L.W. Russel* [1964] 53 ITR 91 (SC). As an unauthorised advantage taken by an employee without his employer's authority would create a legal obligation to restore such advantage, it would not amount to "perquisite" taxable under the Act—*CIT* v. *C. Kulandaivelu Konar* [1975] 100 ITR 629 (Mad.), *CIT* v. *C. Narayanan Nair* [1989] 180 ITR 303 (Ker.). On the other hand, if the benefit has been conferred unilaterally without the aid of an agreement between the parties, the employee can be taxed on the perquisite. It is not necessary that the benefit should have been received under an enforceable right—*CIT* v. *S.S.M. Lingappan* [1981] 7 Taxman 71 (Mad.).
- *Personal accident policy* - Premium paid by employer towards personal accident policy of employee is not taxable as perquisite—*CIT* v. *Lala Shri Dhar* [1972] 84 ITR 192 (Delhi).
- *Pensionary deferred annuity benefits* - Payments made by an employer to provide pensionary/ deferred annuity benefits to his employees are taxable as perquisites only when a vested interest accrues to the employee—*CIT* v. *L.W. Russel* [1964] 53 ITR 91 (SC).
- *Contingent rights* - One cannot be said to allow a perquisite to an employee if the employee has no right to the same. It cannot apply to contingent payment to which the employee has no right till the contingency occurs—***CIT*** v. ***Pramod Bhasin*** [2006] 8 SOT 72 (Delhi).
- *Personal advantage during employment* - Perquisites are taxable under the head "Salaries" only if they are : (*a*) allowed by an employer to his employee, (*b*) allowed during the continuance of employment, (*c*) directly dependent upon service, (*d*) resulting in the nature of personal advantage to the employee, and (*e*) derived by virtue of employer's authority. It is not necessary that a recurring and regular receipt alone is a perquisite. Even a casual and non-recurring receipt can be perquisite if the aforesaid conditions are satisfied.

51.1 ***"Perquisite" as defined by the Act*** - A combined reading of sections 15 and 17 suggests that salary would include, among other things, perquisites. Section 17(*2*) gives an inclusive definition of perquisite, as including :

a. the value of rent-free accommodation *provided* to the assessee by his employer [sec. 17(*2*)(*i*)] ;

b. the value of any concession in the matter of rent respecting any accommodation *provided* to the assessee by his employer [sec. 17(*2*)(*ii*)] ;

c. the value of any benefit or amenity *granted or provided* free of cost or at concessional rate in any of the following cases :

i. by a company to an employee who is a director thereof ;

ii. by a company to an employee, being a person who has substantial interest in the company ;

iii. by any employer (including a company) to an employee to whom provisions of (*i*) and (*ii*) above do not apply and whose income under the head "Salaries" exclusive of the value of all benefits or amenities not provided for by way of monetary benefits, exceeds Rs. 50,000 [sec. 17(*2*)(*iii*)];

d. any sum *paid* by the employer in respect of any obligation which but for such payment would have been payable by the assessee [sec. 17(*2*)(*iv*)] ;

e. any sum *payable* by the employer, whether directly or through a fund other than a recognised provident fund or approved superannuation fund or a deposit-linked insurance fund, to effect an assurance on the life of the assessee or to effect a contract for an annuity [sec. 17(*2*)(*v*)] ; and

f. the value of any other fringe benefit or amenity as may be prescribed [sec. 17(*2*)(*vi*)].

51.2 ***Perquisites - When taxable in the hands of an employee*** - The following perquisites are taxable in the hands of an employee —

Category A: *Perquisites taxable in the hands of all employees (irrespective of the fact whether or not employer is liable to pay fringe benefit tax)* —

Different perquisites given under section 17(2) read with rule 3	*Exception*	*Para No.*
(1)	*(2)*	*(3)*
A1. Furnished/unfurnished house without rent or at concessional rent	*See* Note 1	52.1, 52.2, 52.3
A2. Service of a sweeper, gardener, watchman or personal attendant	Not taxable if the employee is a non-specified employee [*see* para 51.2-1]	52.6
A3. Supply of gas, electricity or water for household purposes	Not taxable if the employee is a non-specified employee [*see* para 51.2-1]	52.4
A4. Education facility to employee's family members	Not taxable if the employee is a non-specified employee [*see* para 51.2-1]	52.5
A5. Leave travel concession (not being the case of twice in a block of four years)	Not taxable if the employee is a non-specified employee [*see* para 51.2-1]	52.7
A6. Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee		52.8
A7. Amount payable by an employer directly or indirectly to effect an assurance on the life of employee or to effect a contract of an annuity	Contribution to recognized provident fund/ approved superannuation fund	52.9
A8. Interest-free/concessional loan	Loan not exceeding Rs. 20,000, loan for medical treatment subject to certain conditions	52.10
A9. Providing use of movable asset	Providing use of computer/laptop in any case (and car if employer is subject to fringe benefit tax)	52.11
A10. Transfer of movable asset		52.12
A11. Medical facility (expenditure being more than Rs. 15,000)	Medical facility in employer's hospital/Government hospital, expenditure in respect of specified treatment, health insurance premium, medical facilities outside India if a few conditions are satisfied. Moreover, it is not taxable if the employee is a non-specified employee [*see* para 52.2-1]	52.13
A12. Any other benefit or amenity, service, right or privilege (not being telephone/mobile facility and not being any perquisite which is covered in *Category A* and *Category B*	It does not cover those perquisites which are taxable in the hands of employer under fringe benefit tax	52.21

Category B: *Perquisite taxable in the hands of an employee when employer is not liable to pay fringe benefit tax* [i.e., *when employer is a sole proprietor, Hindu undivided family, the Central*

Government, any State Government, a political party, any person whose income is exempt under section 10(23C), a charitable institute (subject to registration under section 12AA), RBI or SEBI]

Different perquisites given under section 17(2) read with rule 3	*Exception*	*Para No.*
(1)	*(2)*	*(3)*
B1. Car or any other automotive conveyance	Not taxable if the employee is a non-specified employee [*see* para 51.2-1]	52.14
B2. Transport facility by a transport undertaking (not being provided by railways or by an airline)	Not taxable if the employee is a non-specified employee [*see* para 51.2-1]	52.15
B3. Travelling, touring accommodation		52.17
B4. Free food and beverages	If provided in office during office hours and the expenditure is Rs. 50 per meal or less	52.16
B5. Gift or gift voucher	Rs. 5,000 (if gift is in kind)	52.18
B6. Club		52.20
B7. Credit card		52.19

Note 1 - Residential accommodation - The perquisite in respect of residential accommodation is not taxable if it is provided in a remote area. Further it is not taxable if it is provided to a High Court Judge, Supreme Court Judge, Union Minister, Leader of Opposition in Parliament and an Official in Parliament. In the case of transfer, if residential accommodation is provided in a hotel, it is not chargeable to tax for 15 days in aggregate during the previous year.

Note 2 - When employer is not subject to fringe benefit tax - The perquisite given in *Category B* (*i.e.*, car, transport facility, travelling/touring, food and beverages, gift, club or credit card) is taxable in the hands of an employee only if the employer is not liable to pay fringe benefit tax. In other words, *Category B* perquisites are not taxable if the employer is subject to fringe benefit tax. Fringe benefit tax is not applicable if the employer is an individual (*i.e.*, sole proprietor), Hindu undivided family, Government, a political party, a person whose income is exempt under section 10(23C), a charitable institute (which is subject to registration under section 12AA), RBI or SEBI. To put it differently, it can be concluded that if the employer is liable to pay fringe benefit tax, only perquisites given under *Category A* are chargeable to tax in the hands of employees. Conversely, if the employer is not liable to fringe benefit tax, perquisites given under *Category A* as well as *Category B* are chargeable to tax in the hands of employees.

51.2-1 ***SPECIFIED/NON-SPECIFIED EMPLOYEES*** - An employee is either a specified employee or a non-specified employee.

- *Classification - "Specified employee" and "Non-specified employee"* - Perquisites given under *A2, A3, A4, A5, A11, B1* and *B2* are taxable only when an employee is a specified employee. In other words, perquisites given under *A2, A3, A4, A5, A11, B1* and *B2* are not taxable in the hands of a non-specified employee.
- *Classification - Does not have much practical utility* - The classification between specified and non-specified employee is of limited application in the practical sense. This is because an employee is referred to as a non-specified employee only when he is drawing annual salary of Rs. 50,000 or less in a financial year. Since the exemption slab for all individuals is at least Rs. 1,50,000 (for the assessment year 2009-10), one can infer that largely all employees (who pay income-tax) are specified employees. The statement that perquisites given under *A2, A3, A4, A5, A11, B1* and *B2* are not taxable in the case of a non-specified employee, does not have much practical utility, as all employees paying tax are specified employees. However, the meaning of specified/non-specified employee is given in the following paras for theoretical purposes—
- *Non-specified employee* - Any employee, other than a specified employee, is a "non-specified employee".
- *Who is a specified employee* - The following employees are known as specified employees—

1. A director-employee - An employee who is a director in the employer-company at any time during the previous year, is a specified employee of the company in which he is a director.

2. An employee who has substantial interest in the employer-company - An employee who has a substantial interest in the employer-company at any time during the previous year is a specified employee of the company in which he has substantial interest. A person has substantial interest in the employer-company, if he is a beneficial owner of equity shares carrying 20 per cent or more voting power in the employer-company.

3. An employee drawing in excess of Rs. 50,000 - An employee (not covered by the above two categories), whose income chargeable under the head "Salaries" (exclusive of the value of all benefits or amenities not provided by way of monetary payments) exceeds Rs. 50,000, is a specified employee. For computing the sum of Rs. 50,000, the following are excluded or deducted :

a. all non-monetary benefits ;

b. monetary benefits which are not taxable under section 10 [for instance, house rent allowance to the extent exempt under section 10(13A) is excluded]; and

c. deduction on account of entertainment allowance and deduction on account of professional tax.

Where salary is received from more than one employer, the aggregate salary from these employers will have to be taken into account for the purpose of determining the aforesaid monetary ceiling.

Valuation of perquisites

52. Perquisites are valued on the basis of their value to the employee and not on the basis of the cost to the employer for providing such perquisites—*Wilkins* v. *Rogerson* [1963] 49 ITR 395 (CA). However, the value of perquisite is included in salary income only if it is actually provided to the employee. The value of perquisite (which is not enjoyed by the employee) cannot be included in the total income, though the contract of service provides for that perquisite. Taxable perquisites are valued in accordance with Income-tax rules and executive instructions.

- Perquisites provided by the employer (directly or indirectly) to an employee or any member of his household (by reason of his employment) shall be chargeable to tax in the hands of the employee. "Member of household" shall include—

a. spouse (whether dependent or not);

b. children and their spouses (whether dependent or not);

c. parents (whether dependent or not); and

d. servants and dependants.

52.1 ***Valuation of rent-free unfurnished accommodation [Rule 3(1)]***† - An employer may own residential accommodation and provide it free of rent to his employees. Even if he does not own a residential accommodation, he may take the same on lease for providing it to his employees. "Accommodation" includes a house, flat, farm house (or part thereof), or accommodation in a hotel, motel, service apartment, guest house, carvan, mobile home, ship or other floating structure.

Provision of rent-free accommodation is a perquisite, which is taxable in the hands of all employees (specified as well as non-specified).

For the purpose of valuation of the perquisite in respect of unfurnished accommodation, all employees are divided in two categories :

- Central and State Government employees [*see* para 52.1-1].
- Private sector employees [*see* para 52.1-2].

52.1-1 CENTRAL AND STATE GOVERNMENT EMPLOYEES - This category includes Central Government employees and State Government employees. Besides, this category includes those Central Government employees and State Government employees who are on deputation to a public sector undertaking but the accommodation is providing by the Central Government or State Government.

Employees of a local authority or a foreign Government are not covered by this category (these employees are treated as non-Government employees for this purpose).

†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

■ *Rule of valuation* - The value of perquisite in respect of accommodation provided to such employees will be equal to the licence fee which would have been determined by the Central Government or State Government in accordance with the rules framed by the Government for allotment of houses to its officers.

■ *Exception* - It may be mentioned that rent-free official residence provided to a Judge of a High Court under section 22A(1) of the High Court Judges (Conditions of Service) Act, 1954, or to a Judge of the Supreme Court under section 23(1) of the Supreme Court Judges (Conditions of Service) Act, 1958 is exempt from tax. A similar exemption is extended to an officer of Parliament, a Union Minister and a Leader of Opposition in Parliament.

52.1-1P1 *X is a Joint Secretary in the Ministry of Industry. During the previous year ending March 31, 2009, he has been allotted a rent-free unfurnished flat at New Delhi. Though the licence fee of the flat as per Government's rule is Rs. 3,600 per annum, its fair market rent is not less than Rs. 18,000 per annum. Determine the value of the perquisite in respect of rent-free unfurnished flat for the assessment year 2009-10 on the assumption that salary of X is (a) Rs. 48,000 per annum, and (b) Rs. 76,000 per annum.*

SOLUTION : As X is a Government employee, the valuation of perquisite in respect of rent-free flat would be Rs. 3,600, being the licence of the flat as per Government's rule. Market rental value of the flat as well as the salary of the employee are irrelevant for this purpose.

52.1-2 ***PRIVATE SECTOR EMPLOYEES*** - Under this category are covered those employees who do not fall in the first category covered by para 52.1-1. In this category, the value of the perquisite in respect of rent-free accommodation depends, on salary of the employee.

52.1-2a SALARY - HOW TO CALCULATE - For the purpose of valuation of perquisite in respect of rent-free accommodation, salary includes :

a. basic salary ;

b. dearness allowance/pay, if terms of employment so provide ;

c. bonus ;

d. commission ;

e. fees ;

f. all other taxable allowances (excluding the portion not taxable) ; and

g. any monetary payment which is chargeable to tax (by whatever name called).

For this purpose, salary does not include the following :

i. dearness allowance/pay if it is not taken into account while calculating retirement benefits, like provident fund, gratuity, etc., or if it does not form part of salary according to terms of employment ;

ii. employer's contribution to provident fund account of an employee ;

iii. all allowances which are exempt from tax ; and

iv. value of perquisites [under section 17(*2*)].

■ One should note the following points—

1. Salary to be calculated on "accrual" basis - While computing salary for the purpose of valuation of perquisite in respect of rent-free accommodation, basic salary, bonus, commission, fees, allowances, etc., are included on "accrual" basis. For instance, advance salary of a period other than the previous year is not included, even if the same is received in the previous year. Similarly, salary due in the previous year is included, even if it is received after the end of the previous year. In other words, salary accrued for the period during which rent-free accommodation is occupied by the employee will be considered, whether it is received during the previous year or not.

2. Salary from two or more employers - Salary from all employers in respect of the period during which an accommodation is provided will be taken into consideration.

3. Monetary payments v. *Perquisites* - A combined reading (*g*) and (*iv*) (*supra*) suggests that monetary payments which are in the nature of perquisites under section 17(*2*) shall not be included.

Conversely, monetary payments which are not in the nature of perquisites under section 17(*2*) shall be included. Consider the following monetary payments—

■ Payment of gas, electricity, water and income-tax bills [being perquisites under section 17(*2*)(*iii*)/(*iv*)] is not into consideration.

■ Leave encashment of salary pertaining to the current year (not being a perquisite) is taken into consideration.

52.1-2b BASIS OF VALUATION - The basis of valuation is given below—

Population of city as per 2001 census where accommodation is provided	*Where the accommodation is owned by the employer*	*Where the accommodation is taken on lease or rent by the employer*
Exceeding 25 lakh	15 per cent of salary in respect of the period during which the accommodation is occupied by the employee	Amount of lease rent paid or payable or 15 per cent of salary, whichever is lower
Exceeding 10 lakh but not exceeding 25 lakh	10 per cent of salary in respect of period during which the accommodation is occupied by the employee	Same as above
Any other	7.5 per cent of salary in respect of period during which the accommodation is occupied by the employee	Same as above

Notes :

1. The above rules are not applicable to any accommodation located in a 'remote area' (*i.e.*, an area located at least 40 kilometers‡ away from a town having a population not exceeding 20,000) provided to an employee working at a mining site or an onshore oil exploration site, or a project execution site or dam site or power generation site or an accommodation provided in an offshore site of similar nature. A project site for this purpose means site of project up to the stage of its commissioning—Circular No. 15/2001, dated December 12, 2001. Moreover, the perquisite in respect accommodation of temporary nature (and having plinth area of 800 sq. ft. or less) which is located at least 8 km. away from the local limits of a municipality or cantonment board provided to an employee working at a mining site or an onshore oil exploration site, or a project execution site or a dam site or power generation site or an offshore site, is not chargeable to tax.

2. Where on account of the transfer of an employee from one place to another, he is provided with accommodation at the new place of posting while retaining the accommodation at the other place, the value of perquisite shall be determined with reference to only one such accommodation which has the lower value for a period not exceeding 90 days and thereafter the value of perquisite shall be charged for both such accommodations.

52.1-2P1 *X is in employment with ABC (P.) Ltd. and is posted at Madras branch of the company. During the previous year 2008-09, he receives Rs. 92,000 as basic salary, Rs. 9,000 as entertainment allowance, Rs. 9,000 as bonus and commission, Rs. 8,000 as city compensatory allowance and Rs. 6,000 as arrears of bonus and commission of the financial year 2006-07. The employer also pays electricity supply bills of Rs. 4,000 on behalf of X. In addition the employer has provided a rent-free unfurnished flat (lease rent paid by the employer is Rs. 69,000) and free use of a motor car for private purposes (expenditure of the employer : Rs. 7,000). Determine the taxable value of the perquisite in respect of rent-free house for the assessment year 2009-10, on the assumption that lease rent of the house for the year 2008-09 is paid by the employer only in the financial year 2009-10.*

SOLUTION : Salary for the purpose of computation of taxable value of the rent-free flat would be calculated as under :

	Rs.
Basic salary	92,000
Bonus and commission	9,000
City compensatory allowance	8,000
Arrears of bonus and commission (not considered)	—

‡However, off-shore sites of similar nature do not have to meet any requirement of distance.

	Rs.
Electricity supply bills (not considered)	—
Perquisite in respect of motor car (not chargeable to tax in hands of X)	—
Entertainment allowance	9,000
Salary for the purpose of computation of perquisite in respect of rent-free flat	1,18,000

Valuation of the perquisite - Rs. 17,700 (being 15% of salary or lease rent, whichever is lower) is the taxable value of the perquisite for the assessment year 2009-10.

52.1-2P2 *X receives the following emoluments during the previous year ending March 31, 2009: basic salary : Rs. 92,000, dearness allowance : Rs. 8,000 (48 per cent forms part of salary for computing retirement benefits), income-tax paid on behalf of X : Rs. 7,000 and education allowance : Rs. 4,800 (total allowance paid for 3 children). During the previous year 2008-09, he is paid Rs. 20,000 by way of a special allowance.*

X is a retired Government employee. Pension received from the Government is Rs. 3,070 per month.

He has been provided a rent-free unfurnished house by the employer from September 1, 2008. Find out the taxable value of the perquisite for the assessment year 2009-10 under the following situations—

a. *the house is owned by the employer and it situated in Kelapur (population : 9.50 lakh);*
b. *the house is owned by the employer and it is situated in Ajmer (population : 30 lakh);*
c. *the house is taken on lease by the employer (lease rent being Rs. 1,000 per month);*
d. *the house is taken on lease by the employer (lease rent being : Rs. 20,000 per month).*

SOLUTION : The taxable value of the perquisite depends upon salary of the employee and lease rent. Salary of the employee from September 1, 2008 to March 31, 2009 is as follows—

	Rs.
Basic salary	92,000
Dearness allowance (48% of Rs. 8,000)	3,840
Income-tax (not considered)	—
Education allowance [Rs. 4,800 – Rs. 2,400 being exemption under section 10(14)]	2,400
Special allowance	20,000
Pension from Government (Rs. 3,070 × 12)	36,840
Salary of 12 months	1,55,080
Salary of 7 months from September 1, 2008 to March 31, 2009	90,463

Computation of taxable value of the perquisite

	Situations			
	(a) Rs.	(b) Rs.	(c) Rs.	(d) Rs.
15% of salary [7.5% of salary in situation (a)]	6,785	13,569	13,569	13,569
Lease rent from September 1, 2008 to March 31, 2009	NA	NA	7,000	1,40,000
Taxable value of the perquisite	6,785	13,569	7,000	13,569

52.1-2P3 *X, posted at Madras, receives the following emoluments from his employer during the previous year 2008-09 :*

Basic salary : Rs. 80,000, salary in lieu of leave for the current year : Rs. 8,000, bonus : Rs. 9,600, reimbursement of medical expenses : Rs. 6,000, entertainment allowance (date of joining April 4, 1970) : Rs. 8,000, car provided by the employer : Rs. 7,000, electricity expenses borne by the employer : Rs. 5,000, income-tax paid by the employer: Rs. 4,000 and special allowance : Rs. 8,400. The employer provides a rent-free house (owned by the employer) whose particulars are : fair rent Rs. 86,400, salary of gardener : Rs. 4,800, expenses on maintenance of garden: Rs. 12,000, expenses on maintenance of swimming pool in the house : Rs. 9,200, house repairs : Rs. 11,000, salary of sweeper : Rs. 3,200 and salary of watchman : Rs. 6,800.

Determine the value of the perquisite in respect of rent-free house, if (a) X is an officer of the Government of Tamil Nadu whose services have been lent to LIC, and accommodation to him has been allotted by the State Government and Rs. 9,000 (all inclusive) is the licence fee of the accommodation occupied by X as per the State Government's rules; and (b) X is an employee of PQR (P.) Ltd.

SOLUTION : Salary for the purpose of computing the value of rent-free accommodation is Rs. 1,14,000 (consisting of basic salary, salary in lieu of leave, bonus, entertainment allowance, and special allowance).

If X is an officer of the Government of Tamil Nadu and his services have been lent to LIC - Rs. 9,000 (being licence fee of the house as per the Government's rule) is the taxable value of the perquisite.

If X is an employee of PQR (P.) Ltd. - A Rs. 17,100 (being 15% of salary) is taxable value of the perquisite.

52.1-2P4 *X is employed by A Ltd. in Delhi. His salary and allowances are as follows—Basic salary Rs. 35,000 per month (increased to Rs. 38,000 per month from October 1, 2008), dearness pay : 40 per cent of basic salary (60 per cent of which is considered for computing provident fund), commission : Rs. 10,000 per month (increased to Rs. 14,000 per month from December 1, 2008). Bonus : 25 per cent of basic salary (payable annually in the month of November). X is transferred to Bombay on September 1, 2008. He has been provided a rent-free unfurnished house (owned by the company) at Delhi which he has occupied up to December 31, 2008. The employer-company has provided a leased accommodation at Bombay with effect from September 1, 2008 (lease rent being Rs. 9,000 per month up to October 31, 2008, Rs. 18,000 per month from November 1, 2008). Find out the taxable value of the perquisite in respect of the rent-free accommodation for the assessment year 2009-10.*

SOLUTION : Taxable value of the perquisite shall be determined as follows :

(Rs. in '000)

Different months of the previous year	Basic salary	Dearness pay [40% of 60% of (1)]	Commission	Bonus [25% of (1)]	Salary for the purpose of valuation of house [(1)+(2)+(3)+(4)]	Value of Delhi house [15% of (5)]	Lease rent of Bombay house	Value of Bombay house [(7) or 15% of (5) whichever is less]	Taxable value
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
April 2008	35	8.4	10	8.75	62.15	9.32	—	—	9.32
May 2008	35	8.4	10	8.75	62.15	9.32	—	—	9.32
June 2008	35	8.4	10	8.75	62.15	9.32	—	—	9.32
July 2008	35	8.4	10	8.75	62.15	9.32	—	—	9.32
August 2008	35	8.4	10	8.75	62.15	9.32	—	—	9.32
September 2008	35	8.4	10	8.75	62.15	9.32	9	9	9 *
October 2008	38	9.12	10	9.5	66.62	9.99	9	9	9 *
November 2008	38	9.12	10	9.5	66.62	9.99	18	9.99	9.99 *
December 2008	38	9.12	14	9.5	70.62	10.59	18	10.59	10.59 + 10.59 *
January 2009	38	9.12	14	9.5	70.62	—	18	10.59	10.59
February 2009	38	9.12	14	9.5	70.62	—	18	10.59	10.59
March 2009	38	9.12	14	9.5	70.62	—	18	10.59	10.59
Total									127.54

52.2 *Valuation of rent-free furnished accommodation* - The perquisite in respect of rent-free furnished accommodation may be provided in the following two different ways—

Case 1	A furnished accommodation (not being a hotel accommodation given below) [*see* para 52.2-1]
Case 2	Accommodation provided in a hotel (it includes accommodation in a hotel or a licensed accommodation in the nature of motel, service apartment or guest house) [*see* para 52.2-2]

52.2-1 *A FURNISHED ACCOMMODATION (NOT BEING IN A HOTEL)* - Value of the perquisite shall be calculated as follows -

Step 1	Find out value of the perquisite on the assumption that the accommodation is unfurnished [*see* para 52.1]
Step 2	To the value so arrived at, *add* value of furniture. Value of furniture for this purpose is as follows: *a.* 10 per cent per annum of the original cost of furniture, if furniture is owned by the employer; *b.* actual hire charges payable (whether paid or payable), if furniture is hired by the employer.

*Up to August 31, 2008, X has been posted at Delhi. From September 1, 2008, X is transferred to Bombay. For 4 months he has been provided house both at Bombay and Delhi. Out of 4 months, for 3 months (September, October and November) one of the two houses whose taxable value is lower will be taxable. However, for the month of December, perquisite will be taxable at both the places.

- *Meaning of furniture* - "Furniture" here includes radio sets, television sets, refrigerators, air-conditioners and other household appliances.

52.2-2 *A FURNISHED ACCOMMODATION IN A HOTEL*† - Besides accommodation in a hotel, it includes licensed accommodation in the nature of motel, service apartment or guest house. The value of the perquisite is determined on the basis of lower of the following two—

1.	24 per cent of salary paid or payable for the period during which such accommodation is provided in the previous year.
2.	Actual charges paid or payable by the employer to such hotel.

When hotel bill includes charges for other facilities - Services provided as an integral part of the accommodation, need not be valued separately as perquisite. Any other service over and above that for which the employer makes payment or reimburses the employee (like hotel bill includes charges for lunch and dinner) shall be taxable in the hands of employer under fringe benefit tax.

- *Exception* - If an accommodation is provided in a hotel and the following two conditions are satisfied, nothing is chargeable to tax—

Condition 1	The hotel accommodation is provided for a total period not exceeding in aggregate 15 days in a previous year.
Condition 2	Such accommodation is provided on an employee's transfer from one place to another place.

Note - If in the aforesaid case, the hotel accommodation is provided for more than 15 days, then the perquisite is not taxable for the first 15 days. After that it is chargeable to tax.

52.2-P1 *X, received during the previous year ending March 31, 2009 emoluments consisting of basic pay : Rs. 96,000 ; project allowance : Rs. 14,000 and reimbursement of medical expenditure : Rs. 4,000. His employer has also provided a rent-free furnished flat in Bombay. Lease rent of the unfurnished flat is Rs. 72,000 per annum. Some of the household appliances provided to X with effect from August 1, 2008 are owned by the employer (cost price of which is Rs. 96,000, date of purchase is April 1, 1970 and written down value, as on April 1, 2008 is Rs. 9,000). Employer pays Rs. 12,000 annually as hire charges for one air-conditioner installed in rent-free flat. Compute the value of the perquisite if : (1) X is a Secretary in the Ministry of Industry and Rs. 5,000 is the licence fee of unfurnished flat as per Central Government's Rules ; and (2) X is the Managing Director of PQR (P.) Ltd. Does it make any difference if X has been provided a hotel accommodation throughout the year (tariff being Rs. 2,00,000 per annum).*

SOLUTION : *Valuation of unfurnished flat* :

1. *If X is a Secretary to the Central Government* - Rs. 5,000 is the taxable value of the unfurnished flat.

2. *If X is the Managing Director of PQR (P.) Ltd.* - Salary for the purpose of calculating taxable value of the perquisite works out to be Rs. 1,10,000 (*i.e.*, Rs. 96,000 + Rs. 14,000). As lease rent of unfurnished flat (*i.e.*, Rs. 72,000) exceeds 15% of salary, Rs. 16,500 (15% of salary) is the taxable value of the perquisite.

Valuation of furniture :	Rs.
10% per annum of cost of furniture (*i.e.*, 10% of Rs. 96,000 × 8 ÷ 12)	6,400
Add : Rent of air-conditioner	12,000
Valuation of furniture	18,400

Valuation of furnished flat :	Value of flat			Value of hotel accommodation
	Unfurnished flat Rs.	Furniture Rs.	Furnished flat Rs.	Rs.
If X is a Secretary to the Central Government	5,000	18,400	23,400	26,400
If X is a Managing Director of PQR (P.) Ltd.	16,500	18,400	34,900	26,400

†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

52.3 ***Valuation of accommodation provided at concessional rent [Sec. 17(2)(ii)]†*** - If an accommodation is provided to an employee at concessional rent, the valuation should be made as follows (these rules are applicable whether the accommodation is furnished or unfurnished or it is provided in a hotel)—

Step 1	Find out the value of the perquisite on the assumption that no rent is charged by the employer [for this purpose the rules given in para 52.1, 52.2-1 or 52.2-2 are applicable].
Step 2	From the value so arrived at, deduct the rent charged by the employer from the employee.

The balancing amount (if it is positive) is the taxable value of the perquisite in respect of concession in rent.

■ Interest foregone by an employee (to whom a rent-free house is provided by the employer) on interest free advances given to the employer shall be treated as rent paid— *see CIT* v. *Ashraf-Ur-Rehman Azimullah* [1994] 209 ITR 341 (Bom.).

52.3-P1 *Continuing Problem 52.2-P1, suppose the employer, instead of providing flat free of rent, charges Rs. 24,000 per annum as rent of furnished flat. Find out the taxable value of the perquisite in respect of the accommodation provided at concessional rent.*

SOLUTION : Value of perquisite will be computed as under :

Flat	Valuation of rent-free furnished flat as per 52.2-P1 (1) Rs.	Rent charged by employer (2) Rs.	Valuation of flat provided at concessional rate (1) minus (2) Rs.
- If X is a Secretary to the Central Government	23,400	24,000	Nil
- If X is a Managing Director of PQR (P.) Ltd.	34,900	24,000	10,900
Hotel accommodation	26,400	24,000	2,400

52.4 ***Valuation of perquisite in respect of gas, electric energy or water supply provided free of cost†*** - It is taxable on the following basis :

Mode of valuation	*Gas, electricity or water is purchased by the employer from an outside agency*	*Gas, electricity or water is supplied by the employer out of own sources*
Step 1 - Find out cost to the employer	Amount paid or payable by the employer to the outside agency	Manufacturing cost per unit incurred by the employer
Step 2 - *Less*: Amount recovered from the employee	Recovery from the employee	Recovery from the employee
Taxable value of the perquisite (*Step 1* — *Step 2*)	Balancing amount (if it is positive)	Balancing amount (if it is positive)

52.5 ***Valuation of perquisite in respect of free education†*** - The basis of valuation of such a perquisite is explained below :

52.5-1 ***TRAINING OF EMPLOYEES*** - Amount spent for providing free education facilities to, and training of the employee, is not taxable.

52.5-2 ***FIXED EDUCATION ALLOWANCE*** - Fixed education allowance given in cash by the employer to the employee to meet the cost of education of the family members of the employee is exempt from tax to the extent of Rs. 100 per month per child (up to a maximum of two children). Moreover, any allowance granted to an employee to meet hostel expenditure of his child is exempt from tax to the extent of Rs. 300 per month per child for a maximum of two children.

†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

52.5-3 ***PAYMENT OF SCHOOL FEES OF EMPLOYEES' CHILDREN*** - School fees of the family members of the employees, paid by the employer directly to the school, is taxable as a perquisite in all cases.

52.5-4 ***REIMBURSEMENT OF SCHOOL FEES OF EMPLOYEES' CHILDREN*** - Reimbursement of expenditure, incurred for the education of the family members of the employee, is taxable as a perquisite in all cases. Any such reimbursement of tuition fees to a Central Government employee or private or public sector employee is, therefore, taxable— Circular Letter No. 35/7/65-IT(B), dated February 12, 1965.

52.5-5 ***EDUCATION FACILITY IN EMPLOYER'S INSTITUTE*** - The table given below highlights the provisions—

Different situation	*Amount chargeable to tax*
Where the educational institution is owned and maintained by the employer and educational facility is provided or where such educational facility is provided in any institute by reason of employee's employment with the employer—	
a. Where educational facility is provided to employee's children [Note 1]—	
❑ Where cost of education or value of such benefit does not exceed Rs. 1,000 per month per child (no restriction on number of children) [proviso to rule 3(5)]	*Nil*
❑ Where such amount exceed Rs. 1,000 per month per child	Cost of such education in a similar institution in or near the locality (-) Rs. 1,000 per month per child (-) amount paid or recovered from the employee
b. Where educational facility is provided to member of his household (other than children)	Cost of such education in a similar institution in or near the locality (-) amount paid or recovered from the employee

Notes—

1. Grand children and other member of household are included in (*b*) *supra.*

2. The following judicial rulings are important—

- Proviso to rule 3(5) stands attracted only where the educational institution is itself maintained and owned by the employer and free educational facilities are provided to the children of the employee—*Birla Vidya Niketan* v. *ITO* [2008] 166 Taxman 492 (Delhi).
- A literal reading of the rule 3(5) indicates that if the cost of education per child exceeds Rs. 1,000 per month, the entire cost will be the value of the perquisite. However, keeping in view the departmental instructions in respect of free meal and gift *vide* Circular No. 15/2001, dated December 12, 2001, where the similar language is used, only the sum in excess of Rs. 1,000 per month per child alone should be treated as perquisite.

  The same view is taken by the Delhi Tribunal in the case of *ITO* v. *Bal Bharti Public School* [2007] 17 SOT 151. In an earlier decision in the case of *ITO* v. *Director, Delhi Public School* [2007] 18 SOT 453 (Delhi), the Delhi Tribunal has taken a contrary view (*i.e.*, nothing is taxable only if cost of education in a similar institute after excluding amount recovered from the employee is equal to or less than Rs. 1,000 per month. In case, it exceeds Rs. 1,000 per month, the entire amount is chargeable to tax). It is respectfully submitted that the decision of *Delhi Public School* (*supra*) requires reconsideration.

52.5-6 ***TRUST FOR THE BENEFIT OF EMPLOYEE'S CHILDREN*** - If contribution is made under an educational trust, created for the named children of employees, the same is not taxable—*Barclays Bank Ltd.* v. *Naylor* [1980] 39 TC 256. In *CIT* v. *M.N.Nadkarni* [1985] Tax. 79(3)-256 (Bom.), it was *held* that there was no right created in favour of any employee against the company for any scholarship being paid to his children. The scholarship was paid entirely gratuitously by the company and in its sole discretion. Payment of the scholarship amount was never received by the employee but by the children concerned or deposited in the special account referred to in the scheme. In these

circumstances, it could not be said that the scholarship amounted to a perquisite received by the assessee as, contemplated under section 17(2)(*iii*)(*c*).

52.5-P1 *Find out the taxable value of the perquisite for the assessment year 2009-10 in the following cases—*

1. X is an employee in the Accounts Department of A Ltd. On November, 27, 2008, he attends a seminar on "Perquisite Valuation". Seminar fees of Rs. 2,500 is paid by A Ltd.

2. Y's son is a student of ninth class of DPS, Noida. Rs. 17,800 being tuition fees of Y's son is paid/reimbursed by B Ltd. where Y is employed. There is no arrangement between B Ltd. and DPS, Noida.

3. Star Public School, Ajmer, is owned and maintained by C Ltd., a manufacturing company. Books of account of the school and C. Ltd. are maintained separately. Z is an employee of C Ltd. The following family members of Z are students in Star Public School—

	Cost of education in a similar institution	*Amount charged from Z*
A, daughter of Z	*Rs. 5,500 per month*	*Rs. 800 per month*
B, dependent brother of Z	*Rs. 6,000 per month*	*Rs. 1,600 per month*

4. Suppose in (3) (supra) Star Public School is not owned/maintained by C Ltd. As per arrangement of C Ltd. with the school, family members of employees of C Ltd. can have educational facility in the school. 100 seats are reserved for this purpose for which the company annually pays Rs. 40 lakh to the school (no separate billing by the school to the employees of C Ltd.). Family members of Z are students of the school. Cost of education in a similar institute and amount charged from Z by C Ltd. are given in the table in (3) (supra).

SOLUTION :

1. Expenditure on training/education of an employee is not chargeable to tax. X is, therefore, not chargeable to tax.
2. Rs. 17,800, being tuition fees paid/reimbursed by B Ltd., is taxable in the hands of Y.
3. School is maintained by the employer. Amount taxable in the hands of Z will be as follows—

	Rs.
A (daughter of Z) [12 × (Rs. 5,500 – Rs. 1,000 – Rs. 800)]	44,400
B (brother of Z) [12 × (Rs. 6,000 – Rs. 1,600)]	52,800

4. The taxable amount will be the same as given in (3) (*supra*).

52.6 ***Valuation of perquisite in respect of free domestic servants*†** - The value of benefit to the employee (or any member of his household) resulting from the provision by the employer of services of a sweeper, a gardener, a watchman or a personal attendant, shall be the actual cost to the employer. The actual cost in such a case shall be the total amount of salary paid or payable by the employer (or any other person on his behalf) for such services as reduced by any amount paid by the employee for such services.

The following points should be noted—

1. If an employer provides a rent-free house (owned by employer) to his employee, expenses (inclusive of salary of a gardener) incurred by the employer on maintenance of garden and ground attached to the house, is not taxable separately — *See* **Annex 1** to this Chapter.

2. Domestic servant allowance given to an employee is always chargeable to tax. It is taxable even if the allowance is used for engaging a domestic servant.

52.7 ***Valuation of leave travel concession in India [Sec. 10(5)]*†** - Leave travel assistance extended by an employer to an employee for going anywhere in India along with his family is exempt on the basis of provisions given in the table below. "Family" for this purpose includes spouse and children of the employee. It also includes parents, brothers and sisters of the employee, who are wholly or mainly dependent upon the employee—

†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

Different situations	*Amount of exemption (exemption is available only in respect of fare for going anywhere in India along with family twice in a block of four years)*
■ Where journey is performed by air	Amount of economy class air fare of the National Carrier by the shortest route or the amount spent, whichever is less.
■ Where journey is performed by rail	Amount of air-conditioned first class rail fare by the shortest or amount spent, whichever is less.
■ Where the places of origin of journey and destination are connected by rail and journey is performed by any other mode of transport	Amount of air-conditioned first class rail fare by the shortest route or the amount spent, whichever is less.
■ Where the places of origin of journey and destination (or part thereof) are not connected by rail :	
❑ Where a recognised public transport exists	First class or deluxe class fare by the shortest route or the amount spent, whichever is less.
❑ Where no recognised public transport system exists	Air-conditioned first class rail fare by the shortest route (as if the journey had been performed by rail) or the amount actually spent, whichever is less.

52.7-2 *OTHER POINTS* - One should also keep in view the following points —

■ *Only 2 journeys in a block of 4 years is exempt* - Exemption on the aforesaid basis is available in respect of 2 journeys performed in a block of four calendar years commencing from 1986. The different blocks are :

a. 1998-2001 (*i.e.*, January 1, 1998 to December 31, 2001);

b. 2002-2005 (*i.e.*, January 1, 2002 to December 31, 2005);

c. 2006-2009 (*i.e.*, January 1, 2006 to December 31, 2009).

d. 2010-2013 (*i.e.*, January 1, 2010 to December 31, 2013).

■ *"Carry-over" concession* - If an assessee has not availed travel concession or assistance during any of the specified four-year block periods on one of the two permitted occasions (or on both occasions), exemption can be claimed in the first calendar year of the next block (but in respect of only one journey). This is known as "carry over concession". In such case, the exemption so availed will not be counted for the purposes of claiming the future exemptions allowable in respect of 2 journeys in the subsequent block.

> ***Provisions illustrated*** - For the block 2006-2009, X can claim exemption in respect of leave travel concession under section 10(5) on two occasions. X has availed the exemption only on one occasion (or he has not availed the exemption at all) during 2006-2009, then he can take the benefit of "carry over" concession. The benefit of carry over is available only in respect of one journey provided he avails leave travel concession exemption under section 10(5) in the first calendar year of the next block (*i.e.*, during the calendar year 2010). In addition, he can avail exemption on two more occasions during 2010-2013.

■ *Exemption is based upon actual expenditure* - The quantum of exemption is limited to the actual expenses incurred on the journey. In other words, without performing any journey and incurring expenses thereon, no exemption can be claimed.

■ *Exemption is available in respect of fare* - The exemption is strictly limited to expenses on air fare or rail fare or bus fare only. No other expenditure, like scooter/taxi charges at both ends, porterage expenses during the journey and lodging/boarding expenses are qualified for exemption.

■ *Exemption is available in respect of shortest route* - Where the journey is performed by a circuitous route, the exemption is limited to what is admissible by the shortest route. Likewise, where the journey is performed in a circular form touching different places, the exemption will be limited to what is admissible for the journey from the place of origin to the farthest point reached, by the shortest route.

■ *Exemption available only in respect of two children born on or after October 1, 1998* - The exemption stated in column two above shall not be available to more than 2 surviving children of an individual born after October 1, 1998. However, this restriction does not apply in respect of children born before October 1, 1998 and also in respect of multiple births after one child. In other words, in respect of journeys performed before October 1, 1998, exemption will be admissible in respect of all the surviving children of the individual. But in respect of journeys performed on or after October 1, 1998 —

a. the exemption will be admissible to all surviving children born before October 1, 1998 ; and

b. in addition, the exemption will be admissible to only two surviving children born on or after October 1, 1998. In reckoning this limit of two children, children born out of multiple birth after the first child will be treated as "one child" only.

■ *Fixed allowance is not subject to exemption* - Fixed sum paid to employees by way of leave travel allowance on the basis of self-declaration made by employees would not be exempt under section 10(5)—*Dr. Reddy Laboratories Ltd.* v. *ITO* [1996] 58 ITD 104 (Hyd.).

52.7-3 *VALUATION OF LEAVE TRAVEL CONCESSION TO A FOREIGN CITIZEN [SEC. 10(6)(I)]* - Travel concession given to foreign citizens during the previous year relevant for the assessment year 2003-04 (or subsequent year) is chargeable to tax.

52.8 *Employee's obligation met by employer [Sec. 17(2)(iv)]*† - Amount paid by an employer in respect of any obligation which otherwise would have been payable by the employee is taxable in all cases.

Provisions illustrated - The following illustrations are given to have better understanding—

1. X is general manager in A Ltd. He engages a domestic servant on monthly salary of Rs.2,000. The entire salary (*i.e.*, Rs. 24,000) is paid by A Ltd. to the domestic servant (or salary is paid by X and A Ltd. reimburses the entire amount).

In this case, the perquisite (*i.e.*, Rs. 24,000) is taxable in the hands of X under section 17(2)(*iv*) in all cases, as the obligation of X to pay salary to the domestic servant is met by his employer.

2. Y takes a loan of Rs. 1 lakh from a bank. The loan is later on paid by his employer on behalf of Y.

Since it is an obligation of Y which is met by his employer, it is a perquisite taxable in the hands of Y.

52.9 *Amount payable by employer to effect an assurance on the life of employee [Sec. 17(2)(v)]*† - Amount payable by an employer, directly or indirectly, to effect an assurance on the life of the assessee or to effect a contract for an annuity, is taxable in the hands of all employees.

This rule is, however, not applicable if the employer makes contribution/payment towards the following—

a. recognised provident fund (up to 12 per cent of salary of the employee);

b. approved superannuation fund;

c. group insurance schemes;

d. employees' state insurance schemes; and

e. fidelity guarantee scheme.

52.10 *Valuation of perquisite in respect of interest-free loan or loan at concessional rate of interest*† - If a loan is given by an employer to the employee (or any member of his household), it is a perquisite chargeable to tax. It is taxable on the following basis—

Step 1	Find out the "maximum outstanding monthly balance" (*i.e.*, the aggregate outstanding balance for each loan as on the last day of each month).
Step 2	Find out rate of interest charged by the State Bank of India (SBI) as on the first day of the relevant previous year in respect of loan for the same purpose advanced by it [*see* para 52.10-1].
Step 3	Calculate interest for each month of the previous year on the outstanding amount mentioned in *Step 1* at the rate of interest given in *Step 2*.

†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

Step 4	From the total interest calculated for the entire previous year under *Step 3*, deduct interest actually recovered, if any, from the employee during the previous year.
Step 5	The balancing amount [*i.e. Step 3* minus *Step 4*] is taxable value of the perquisite.

52.10-1 *SBI LENDING RATES* - SBI lending rates are as follows -

		As on April 1, 2008$ for the assessment year 2009-10
Housing loan	Up to 5 years	10%[1], 10.25%[2]
	Above 5 years but up to 10 years	10.25%[1], 10.50%[2]
	Above 10 years but up to 15 years	10.25%[1], 10.50%[2]
	Above 15 years but up to 25 years	10.50%[1], 10.75%[2]
Car loan, for new car	Up to 3 years (Rs. 7.5 lakh and above)	11.5%
	Up to 3 years (below Rs. 7.5 lakh)	11.75%
	Above 3 years but up to 5 years	11.75%
	Above 5 years but up to 7 years	12%
Two wheeler loan		15.50%
Education loan	Loan amount up to Rs. 4 lakh	12.25%
	Loan amount above Rs. 4 lakh	13.25%
Personal loan		15.50%

52.10-2 *WHEN PERQUISITE IS NOT CHARGEABLE TO TAX* - In the following cases the perquisite is not chargeable to tax—

Exemption 1	If a loan is made available for medical treatment in respect of diseases specified in rule 3A (the exemption is, however, not applicable to so much of the loan as has been reimbursed to the employee under any medical insurance scheme).
Exemption 2	Where the amount of original loan (or loans) does not exceed in the aggregate Rs. 20,000.

Example 1 - X takes a loan of Rs. 2,00,000 from his employer on May 1, 2008 for medical treatment of Mrs. X (medical treatment is specified in rule 3A). Hospital bill is Rs. 2,00,000. The perquisite is not chargeable to tax. Suppose in this case insurance claim of Rs. 50,000 is received on October 15, 2008 which is retained by X. In such a situation, interest on Rs. 50,000 will be chargeable in hands of X with effect from October 15, 2008.*

Example 2 - X takes a loan of Rs. 15,000 from his employer on May 28, 2008 (no other loan is taken so far). As the amount of loan does not exceed Rs. 20,000, nothing is chargeable to tax. Suppose in this case another loan of Rs. 5,500 is taken from the employer on July 17, 2008. Now the aggregate amount of loan exceeds Rs. 20,000. Consequently, interest on Rs. 20,500 (*i.e.* Rs. 15,000 + Rs. 5,500) will be chargeable to tax with effect from July 17, 2008.*

Example 3 - X takes a loan of Rs. 1,70,000 from his employer on October 1, 1999. It is repayable by way of quarterly instalments. On April 1, 2008 the outstanding amount is Rs. 20,000. The perquisite is not exempt from tax, as the amount of original loan is more than Rs. 20,000.

52.10-3 *OTHER POINTS* - The following points should be noted—

1. Interest will be calculated according to the method given above. No other method (*e.g.*, cost of capital/fund to employer) shall be taken into consideration.

$As downloaded from http://www.sbi.co.in on April 1, 2008.

1. Up to Rs. 20 lakh.

2. Above Rs. 20 lakh.

*The basis of calculation shall be the "maximum outstanding balance" on the last day of each month.

2. If a closely-held company gives a loan to an employee who holds at least 10 per cent voting power, such loan is deemed as dividend under section 2(*22*)(*e*), if a few conditions are satisfied. Even in such a case, the perquisite value of interest-free loan is chargeable to tax—***CIT*** v. ***T.P.S.H. Selva Saroja*** [2003] 131 Taxman 1 (Mad.).

52.10-P1 *Determine the taxable value of the perquisite in the following cases—*

1. X is employed by A Ltd. On June 1, 2008, the company gives an interest-free housing loan of Rs. 14,00,000. Loan is repayable within 5 years.

2. Y is employed by B Ltd. On April 1, 2008, he takes a personal loan of Rs. 25,000 from B Ltd. B Ltd. recovers interest @ 7 per cent per annum from Y.

3. C Ltd. gives the following interest-free loan to Z, an employee of the company – Rs. 15,000 for child's education and Rs. 5,000 for purchasing a refrigerator.

4. A purchases a Honda City 1.6 Lxi on March 1, 2008 from a loan of Rs. 8,00,000 taken at concessional rate of 7 per cent per annum from his employer XYZ Ltd. As per the agreed terms of repayment, A is supposed to repay in monthly instalments of Rs. 25,000 starting from January 1, 2009. Compute the taxable value of perquisite in respect of concessional loan for the previous year 2008-09.

5. B takes an interest-free loan of Rs. 7,00,000 from his employer PQR Ltd., on June 16, 2008 for medical treatment of his wife who is suffering from a disease specified in rule 3A. Mrs. B is also covered under a mediclaim insurance cover. Insurance company reimburses her of the hospitalization charges of Rs. 2,50,000 on January 1, 2009. According to terms of repayment of loan, A has to pay Rs. 12,000 per month on the seventh day of each month starting November 2008. Ascertain the taxable value of perquisite in respect of interest-free loan for the previous year 2008-09. The amount paid by the insurance company is retained by B.

X,Y,Z, A and B are specified employees.

SOLUTION : For the assessment year 2009-10, the taxable value of the perquisite will be as under —

1. The lending rate of SBI on April 1, 2008 for a similar loan is 10.00% per annum. Rs. 1,16,667 (being interest @ 10.00% on Rs. 14,00,000 from June 1, 2008 to March 31, 2009) is taxable in the hands of X.

2. The lending rate of SBI on April, 1, 2008 for a similar loan is 15.50% per annum. Rs. 2,125 [being interest @ 8.50% (*i.e.*, 15.50% – 7%) on Rs. 25,000 for one year] is taxable in the hands of Y.

3. Nothing is taxable in the hands of Z as the amount of loan does not exceed Rs. 20,000.

4. The lending rate of SBI for a similar loan is 11.75%. Maximum monthly outstanding amount for the various months in the previous year 2008-09 is as follows:

Month	*Maximum monthly outstanding amount on last day of the month* *Rs.*	*Interest* *Rs.*
April 30, 2008	8,00,000	3,166.67 (*i.e.*, Rs. 8,00,000 × 4.75% × 1/12)
May 31, 2008	8,00,000	3,166.67
June 30, 2008	8,00,000	3,166.67
July 31, 2008	8,00,000	3,166.67
August 31, 2008	8,00,000	3,166.67
September 30, 2008	8,00,000	3,166.67
October 31, 2008	8,00,000	3,166.67
November 30, 2008	8,00,000	3,166.67
December 31, 2008	8,00,000	3,166.67
January 31, 2009	7,75,000	3,067.71 (*i.e.*, Rs. 7,75,000 × 4.75% × 1/12)
February 28, 2009	7,50,000	2,968.75 (*i.e.*, Rs. 7,50,000 × 4.75% × 1/12)
March 31, 2009	7,25,000	2,869.79 (*i.e.*, Rs. 7,25,000 × 4.75% × 1/12)
	Total	37,406

Taxable value of concessional loan is Rs. 37,406 for the previous year 2008-09.

5. The perquisite in respect of interest-free loan provided for medical treatment in respect of a disease specified in rule 3A is not taxable. However, it will not include that amount as has been reimbursed to the employee under any

medical insurance scheme. Therefore, out of loan of Rs. 7,00,000 granted to B, Rs. 2,50,000 reimbursed by insurance company on January 1, 2009 will be taken into account for computing taxable value of perquisite. The SBI lending rate for a similar loan is 15.50% on April 1, 2008.

Month	*Maximum monthly outstanding amount on the last day of the month* Rs.	*Interest* Rs.
January 31, 2009	2,38,000	3,074.17 (*i.e.*, Rs. 2,38,000 × 15.50% × 1/12)
February 28, 2009	2,26,000	2,919.17 (*i.e.*, Rs. 2,26,000 × 15.50% × 1/12)
March 31, 2009	2,14,000	2,764.17 (*i.e.*, Rs. 2,14,000 × 15.50% × 1/12)
	Total	8,757.51

Taxable value of interest-free loan is Rs. 8,757.51 for the previous year 2008-09.

52.11 ***Perquisite in respect of use of movable assets***† - The provisions in brief are given below :

Mode of valuation	*Perquisite in respect of use of movable assets*		
	Computer/ laptops or car	*Any other assets*	
		Owned by employer	*Taken on hire by employer*
Step 1 - Find out cost to the employer	*Nil*	10% per annum of actual cost	Amount of rent paid or payable
Step 2 - *Less*: Amount recovered from the employee	*Nil*	Recovery from the employee	Recovery from the employee
Taxable value of the perquisite (*Step 1* — *Step 2*)	*Nil*	Balancing amount (if it is positive)	Balancing amount (if it is positive).

52.12 ***Valuation of the perquisite in respect of movable assets sold by an employer to its employees at a nominal price***† - The value of benefit to the employee arising from the transfer (directly or indirectly) of any movable asset belonging to the employer to the employee (or any member of his household) shall be determined as follows—

Mode of valuation	*Perquisite in respect of sale of movable assets to employees*		
	Electronic items/computers	*Motor car*	*Any other asset*
Step 1 - Find out cost of the asset to the employer	Actual cost to the employer	Actual cost to the employer	Actual cost to the employer
Step 2 - *Less*: Normal wear and tear for completed years during which the asset was used by the employer for his business purposes	50% for each completed year by reducing balance method	20% for each completed year by reducing balance method	10% for each completed year of actual cost
Step 3 - *Less*: Amount recovered from the employee	Consideration recovered from the employee	Consideration recovered from the employee	Consideration recovered from the employee
Taxable value of the perquisite (*Step 1* — *Step 2* — *Step 3*)	Balancing amount (if it is positive)	Balancing amount (if it is positive)	Balancing amount (if it is positive)

Note - Electronic gadgets in this case means data storage and handling devices like computer, digital diaries and printers. They do not include household appliance (*i.e.*, white goods) like washing machines, microwave ovens, mixers, hot plates, ovens etc.

52.12-P1 *Find out the taxable value of the perquisite in the following cases for the assessment year 2009-10—*

1. X is given a laptop by the employer-company for using it for office and private purpose (ownership is not transferred). Cost of the laptop to the employer is Rs. 96,000.

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†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

2. On October 15, 2008, the company gives its music system to Y for domestic use. Ownership is not transferred. Cost of music system (in 2001) to the employer is Rs. 15,000.

3. The employer sells the following assets to the employees on January 1, 2009—

Name of employee *Asset sold*	Z Car	A Computer	B Fridge
Cost of the asset to employer	*Rs. 6,96,000*	*Rs. 1,17,000*	*Rs. 40,000*
Date of purchase (put to use on the same day)	*May 15, 2006*	*May 15, 2006*	*May 15, 2006*
Sale price	*Rs. 2,10,000*	*Rs. 24,270*	*Rs. 1,000*

Before sale on January 1, 2009, these assets were used for business purpose by the employer.

SOLUTION :

1. X is provided use of laptop by the employer. The perquisite is not chargeable to tax.

2. Y is provided a music system by the employer. The taxable value of the perquisite is determined @ 10% per annum of cost. Accordingly Rs. 690 (being Rs. 15,000 × 10/100 × 168 days ÷ 365 days) is chargeable to tax.

3. The taxable value of the perquisite in the hands of Z, A and B shall be determined as follows –

	Car Rs.	Computer Rs.	Fridge Rs.
Cost of the asset on May 15, 2006	6,96,000	1,17,000	40,000
Less : Normal wear and tear for the first year ending May 14, 2007 (20% of Rs. 6,96,000, 50% of Rs. 1,17,000, 10% of Rs. 40,000)	1,39,200	58,500	4,000
Balance on May 15, 2007	5,56,800	58,500	36,000
Less : Normal wear and tear for the second year ending May 14, 2008 (20% of Rs. 5,56,800, 50% of Rs. 58,500, 10% of Rs. 40,000)	1,11,360	29,250	4,000
Balance on May 15, 2008	4,45,440	29,250	32,000
Less : Sale consideration	2,10,000	24,270	1,000
Taxable value of the perquisite	2,35,440	4,980	31,000

Note - In the case of car and computer/electronic items, normal wear and tear is calculated @ 20% and 50% per annum respectively on the basis of written down value. In the case of any other asset, normal wear and tear is calculated at the rate of 10% per annum of cost of the asset to the employer. Normal wear and tear for a part of the year is not taken into consideration.

52.13 ***Valuation of medical facilities***† - Before discussing the broad provisions, one should note down the following points—

1. Fixed medical allowance is always chargeable to tax.

2. For the purpose of valuation of the perquisite in respect of medical facilities, "family" means—

a. the spouse and children of the individual; and

b. the parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the individual.

52.13-1 ***MEDICAL FACILITIES IN INDIA*** - The provisions are given below—

Hospital (including clinic, dispensary or nursing home)	*Nature of medical facility made available to employees and their family members*	*Expenditure*	*Is it chargeable to tax*
■ Maintained by the employer	Any	Incurred by the employer	Not chargeable to tax (no monetary ceiling)
■ Maintained by— - Central/State Government - local authority	Any	Incurred or reimbursed by employer	Not chargeable to tax (no monetary ceiling)

†This is *Category A* perquisite. It is taxable whether (or not) the employer is liable to pay fringe benefit tax.

Hospital (including clinic, dispensary or nursing home)	*Nature of medical facility made available to employees and their family members*	*Expenditure*	*Is it chargeable to tax*
- any other person but approved by the Government for the treatment of its employees			
■ Approved by the Chief Commissioner having regard to the prescribed guidelines	For treatment of prescribed diseases given in rule 3A(2)	Incurred or reimbursed by the employer	Not chargeable to tax (no monetary ceiling) [*see* Note]
■ Health insurance policy (*i.e.*, group medical insurance premium for employees or medical insurance premium for employees and family members)	—	Medical insurance premium paid or reimbursed by the employer	Not chargeable to tax (no monetary ceiling)
■ Maintained by any other person (for example a private clinic)	Any	Incurred or reimbursed by employer	Not chargeable to tax upto Rs. 15,000 in aggregate per assessment year

Note - The employee should attach with return of income‡ a certificate from hospital, which specifies nature of disease as well as amount of expenditure.

52.13-2 *MEDICAL FACILITIES OUTSIDE INDIA* - Any expenditure incurred by the employer (or reimbursement of expenditure incurred by the employee) on medical treatment of the employee or any member of the family of such employee outside India subject to the conditions given below —

Perquisite not chargeable to tax	*Condition to be satisfied*
■ Medical treatment of employee or any member of family of such employee outside India	Expenditure shall be excluded from perquisite only to the extent permitted by the Reserve Bank of India.
■ Cost on travel of the employee/any member of his family/one attendant who accompanies the patient in connection with treatment outside India	Expenditure shall be excluded from perquisite only in the case of an employee whose gross total income, as computed before including therein the expenditure on travelling, does not exceed Rs. 2,00,000.
■ Cost of stay abroad of the employee or any member of the family for medical treatment and cost of stay of one attendant who accompanies the patient in connection with such treatment	Expenditure shall be excluded from the perquisite only to the extent permitted by the Reserve Bank of India.

52.14 ***Valuation of perquisite in respect of motor car*†** - The table below gives the basis of valuation of perquisite in respect of motor car and other modes of conveyance provided to the employees.

Different situations	*Value of the perquisite*
(1)	*(2)*
I. WHERE CAR IS OWNED BY THE EMPLOYEE	
A. When car expenses are met by the employee	Not a perquisite, hence not taxable himself
B. When maintenance and running expenses are met or reimbursed by the employer	
a. if the car is used wholly for official purposes	No value provided a few condition are satisfied [*see* para 52.14-1]
b. if the car is used wholly for private purposes*	*Step 1* - Find out actual expenditure incurred by the employer

†This is *Category B* perquisite and taxable only if the employer is an individual (*i.e.*, sole proprietor), Hindu undivided family, Government, a political party, a person whose income is exempt under section 10(*23C*), a charitable institute (which is subject to registration under section 12AA), RBI, SEBI or employer is any other person not liable to pay fringe benefit tax.

‡It is not possible to attach any certificate with new income-tax return forms. The assessee should himself retain the certificate. It may be furnished in original whenever the Assessing Officer wants to examine it in assessment proceedings or otherwise.

	Step 2 - Less: Amount recovered from the employee Balancing amount (if it is positive) is taxable value of the perquisite
c. if the car is partly used for official purposes and partly for private purposes*	*Step 1* - Find out actual expenditure incurred by the employer *Step 2 - Less*: Amount used for official purposes (*i.e.*, a sum calculated at the rate of Rs. 1,200 per month where the cubic capacity of the engine does not exceed 1.6 litres‡ or Rs.1,600 per month if such capacity exceeds 1.6 litres‡; and Rs. 600 per month if chauffeur is provided or a higher sum for official purposes as per records of the employer as stated in para 52.14-1 and as certified by the employer) *Step 3 - Less*: Amount recovered from employee Balancing amount (if it is positive) is taxable value of the perquisite
II. WHEN CAR IS OWNED OR HIRED BY EMPLOYER A. When maintenance and running expenses are met or reimbursed by employer	
a. if the car is wholly used for official purposes	No value provided a few condition are satisfied [*see* para 52.14-1]
b. if the car is wholly used for private purposes of the employee or any member of his household	*Step 1* - Find out actual expenditure incurred by the employer [*i.e.*, expenditure on running and maintenance including remuneration of the chauffeur *plus* normal wear and tear of the car (at the rate of 10 per cent per annum of actual cost to the employer) or hire charges if car is taken on hire] *Step 2 - Less*: Amount recovered from employee Balancing amount (if it is positive) is taxable value of the perquisite
c. if the car is used partly for official and partly for private purposes of the employee or any member of his household	A sum calculated at the rate of Rs. 1,200 per month where the cubic capacity of the engine does not exceed 1.6 litres‡ or Rs.1,600 per month if such capacity exceeds 1.6 litres‡; and Rs. 600 per month if chauffeur is provided *Nothing is deductible in respect of any amount recovered from the employee*
B. When maintenance and running expenses are met by employee	
a. if the car is used wholly for official purposes	Not a perquisite, hence not taxable
b. if the car is used wholly for private purposes	*Step 1* - Find out expenditure incurred by the employer (*i.e.*, hire charges if car is taken on rent or normal wear and tear at the rate of 10 per cent of the actual cost of the car if car is owned by the employer *plus* salary of chauffeur, if any, paid or payable by employer) *Step 2 - Less*: Amount recovered from employee Balancing amount (if it is positive) is taxable value of the perquisite
c. if the car is used partly for official and partly for private purposes and maintenance in	A sum calculated at the rate of Rs. 400 per month where the cubic capacity of the engine does not

‡1600cc.

(1)	*(2)*
respect of private use is borne by the employee	exceed 1.6 litres† or Rs. 600 per month if such capacity exceeds 1.6 litres†; and Rs. 600 per month if chauffeur is provided *Nothing is deductible in respect of any amount recovered from the employee*
III. WHEN EMPLOYEE OWNS ANY AUTOMOTIVE CONVEYANCE (OTHER THAN CAR) AND RUNNING AND MAINTENANCE CHARGES ARE MET OR REIMBURSED BY EMPLOYER	
A. If it is used wholly for official purposes	No value provided a few conditions are satisfied [*see* para 52.14-1]
B. If it is used partly for official and partly for private purposes	*Step 1* - Find out actual expenditure incurred by the employer *Step 2 - Less*: Amount used for official purposes (*i.e.*, a sum calculated at the rate of Rs. 600 per month or a higher sum for official purposes as per records of the employer as stated in para 52.14-1 and as certified by the employer) *Step 3 - Less*: Amount recovered from employee Balancing amount (if it is positive) is taxable value of the perquisite

52.14-1 *CONDITIONS TO BE SATISFIED IF CAR IS USED FOR OFFICIAL PURPOSES* - Where the employer or the employee claim that the motor-car is used wholly and exclusively in the performance of official duty, the following conditions should be satisfied—

Condition 1	The employer has maintained complete details of journey undertaken for official purpose which may include date of journey, destination, mileage, and the amount of expenditure incurred thereon.
Condition 2	The employer gives a certificate to the effect that the expenditure was incurred wholly and exclusively for the performance of official duties.

■ The above conditions should also be satisfied if a car is owned by the employee, expenses are incurred or reimbursed by the employer and the employee claims that the expenses for official purposes is more than Rs. 1,200 per month (or Rs. 1,600 per month if cc rating of car exceeds 1,600cc).

52.14-2 *OTHER POINTS* - One should also keep in view the following points —

■ *'Month' - Meaning of* - The word "month" in the table denotes completed month according to the English calendar and a part of the month is left out of consideration.

■ *When two (or more car) are allowed* - The perquisite will be valued as follows —

1. Two or more cars are owned or hired by the employer.

2. The employee (or any member of his household) are allowed the use of such motor-cars (or all or any of such motor-cars) (otherwise than wholly and exclusively in the performance of his duties).

3. In respect of one of such cars (as selected by the employee), the value of perquisite shall be the amount calculated in accordance with II(A)(*c*) of the Table (*supra*) as if the employee had been provided one motor-car for use partly in the performance of his duties and partly for his private or personal purposes.

4. In respect of other remaining car or cars, the value of the perquisite shall be the amount calculated in accordance with item II(A)(*b*) of the Table (*supra*) as if he had been provided with such car or cars exclusively for his private or personal purposes.

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†1600cc.

■ *Car at concessional rate* - If motor car is provided at a concessional rate, the valuation is made according to the basis stated above as if the employee has been provided a free motor car and the amount so computed is reduced by the amount charged by the employer for use of motor car. However, nothing is deductible in situation II(A)(*c*) and II(B)(*c*) in respect of amount recovered from employee.

■ *Car facility between office and residence* - The use of motor car by an employee for the purposes of going from his residence to the place where the duties of employment are to be performed or from such place back to his residence, is not chargeable to tax.

■ *Conveyance facility to judges* - Conveyance facility provided to High Court Judges under section 22B of the High Court Judges (Conditions of Service) Act, 1954 and to Supreme Court Judges under section 23A of the Supreme Court Judges (Conditions of Service) Act, 1958 is not chargeable to tax.

■ *When the perquisite is taxable only in the hands of specified employees* - In asterisk (*) marked situations, perquisite in respect of motor car is taxable both in respect of specified and non-specified employees under section 17(*2*)(*iv*). In the remaining situations, however, perquisite becomes taxable only in the hands of specified employees under section 17(*2*)(*iii*).

52.15 ***Valuation of perquisite in respect of free transport*†** - The provisions in brief are given below:

Mode of valuation	*Employees of railways/airlines*	*Employees of any other transport undertaking*
Step 1 - Find out cost to the employer	*Nil*	Value at which such benefit is offered by the employer to the public
Step 2 - *Less*: Amount recovered from the employee	*Nil*	Recovery from the employee
Taxable value of the perquisite (*Step 1—Step 2*)	*Nil*	Balancing amount (if it is positive)

52.16 ***Valuation of perquisite in respect of lunch/refreshment,† etc.*** - If any lunch allowance, dinner allowance or refreshment allowance is given to an employee, it is always chargeable to tax. The value of free meals provided by the employer is taxable as follows—

Mode of valuation	*Food and non-alcoholic beverages is provided in working hours in remote area or in an offshore installation*	*Lunch/refreshment is provided in working hours at any other place*	
		Tea or snacks in working hours	*Food and non-alcoholic beverages in office premises or through non-transferable paid vouchers usable only at eating joints*
Step 1 - Find out cost to the employer	*Nil*	*Nil*	Cost to the employer in excess of Rs. 50 per meal
Step 2 - *Less*: Amount recovered from the employee	*Nil*	*Nil*	Recovery from the employee
Taxable value of the perquisite (*Step 1 - Step 2*)	*Nil*	*Nil*	Balancing amount (if it is positive)

■ The following points should be noted —

1. Tea or similar non-alcoholic beverages and snacks (in the form of light refreshments) during working hours are not charged to tax as perquisite.

2. Expenditure on provision of free meals in excess of Rs. 50 per meal should be treated as perquisite—Circular No. 15/2001, dated December 12, 2001.

3. Working hours include extended office hours (like working on holidays, over-time).

†This is *Category B* perquisite and taxable only if the employer is an individual (*i.e.*, sole proprietor), Hindu undivided family, Government, a political party, a person whose income is exempt under section 10(*23C*), a charitable institute (which is subject to registration under section 12AA), RBI, SEBI or any other person not liable for fringe benefit tax.

52.17 ***Valuation of perquisite in respect of travelling, touring, accommodation*†** - The basis of valuation is as follows—

Mode of valuation	*Perquisite in respect of travelling, touring, accommodation and any other expenses paid by employer for any holiday availed by employee (or any member of household) other than leave travel concession referred to in para 52.7*	
	Where such facility is available uniformly to all employees	*Where such facility is not available uniformly to all employees*
Step 1 - Find out cost to the employer	Expenditure incurred by the employer	Value at which such facilities are offered by other agencies to the public
Step 2 - *Less*: Amount recovered from the employee	Recovery from the employee	Recovery from the employee
Taxable value of the perquisite (*Step 1* - *Step 2*)	Balancing amount (if it is positive)	Balancing amount (if it is positive).

Notes:

1. Where the employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure so incurred shall also be a fringe benefit or amenity.

2. Where any official tour is extended as a vacation, the value of such fringe benefit will be limited to the expenses incurred in relation to such extended period of stay or vacation.

52.18 ***Valuation of perquisite in respect of gift, voucher or token*†** - The value of any gift [or voucher, or token in lieu of which such gift may be received by the employee (or by the member of his household)] on ceremonial occasions or otherwise shall be determined as the sum equal to the amount of such gift. Where, however, the value of such gift, voucher or token, as the case may be, is below Rs. 5,000 in the aggregate during the previous year, the value of perquisite shall be taken as *nil*.

The following points should be noted—

1. Gifts made in cash or convertible into money (like gift cheques) are not exempt.

2. Gifts up to Rs. 5,000 in aggregate per annum would be exempt, beyond which it would be taxable—Circular No. 15/2001, dated December 12, 2001.

52.19 ***Valuation of perquisite in respect of credit card*†** - The perquisite in respect of credit card is taxable as follows—

Step 1	Find out expenditure incurred by the employer in respect of credit card used by the employee or any member of his household [*see* para 52.19-1]
Step 2	*Less* : Expenditure on use for official purposes [*see* para 52.19-2]
Step 3	*Less* : Amount, if any, recovered from the employee

Note - The balancing amount (if it is positive) is the taxable value of the perquisite.

52.19-1 ***EXPENDITURE INCURRED BY EMPLOYER*** - It includes the amount of expenses including membership fees and annual fees incurred by the employee or any member of his household, which is charged to a credit card (including any add-on-card), provided by the employer (or otherwise paid or reimbursed by the employer).

52.19-2 ***EXPENDITURE FOR OFFICIAL USE*** - Expenditure on use of credit card for official purposes is deductible. To claim deduction, the following conditions should be satisfied—

†This is *Category B* perquisite and taxable only if the employer is an individual (*i.e.*, sole proprietor), Hindu undivided family, Government, a political party, a person whose income is exempt under section 10(*23C*), a charitable institute (which is subject to registration under section 12AA), RBI, SEBI or any other person not liable for fringe benefit tax.

Condition 1	Complete details in respect of such expenditure is maintained by the employer which may, *inter alia*, include the date of expenditure and the nature of expenditure.
Condition 2	The employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

52.20 ***Valuation of perquisite in respect of club expenditure*†** - The perquisite in respect of club facility is as follows—

Step 1	Find out expenditure incurred by the employer in respect of club facility used by the employee or any member of his household [*see* para 52.20-1]
Step 2	*Less :* Expenditure on use for official purposes [*see* para 52.20-2]
Step 3	*Less :* Amount, if any, recovered from the employee

Note - The balancing amount (if it is positive) is the taxable value of the perquisite.

52.20-1 ***EXPENDITURE INCURRED BY EMPLOYER*** - The following points should be noted—

1. It includes any expenditure on club facility used by the employee or any member of his household which is paid or reimbursed by the employer.

2. It includes amount of annual or periodical fees paid or payable to a club.

3. Health club, sports facilities, etc., provided uniformly to all classes of employees by the employer at employer's premises are exempt. Consequently, expenditure on such facility is not included.

4. The initial one time deposits or fees for corporate or institutional membership, where benefit does not remain with a particular employee after cessation of employment are exempt—Circular No. 15/2001, dated December 12, 2001. Consequently, initial fees/deposits, in such case, is not included.

52.20-2 ***EXPENDITURE FOR OFFICIAL USE*** - Expenditure on use of club facility for official purposes is deductible. To claim deduction, the following conditions should be satisfied—

Condition 1	Complete details in respect of such expenditure is maintained by the employer which may, *inter alia*, include the date of expenditure, the nature of expenditure and its business expediency.
Condition 2	The employer gives a certificate for such expenditure to the effect that the same was incurred wholly and exclusively for the performance of official duties.

55.21 ***Any other benefit, amenity, etc.*** - This is a residual head.

55.21-1 ***WHAT IS INCLUDED IN THIS RESIDUAL HEAD*** - It covers any other benefit or amenity, service, right or privilege provided by any employer. However, it does not cover the following—

- *Perquisite already included in preceding paras* - Any perquisite, which is included in preceding paras [*i.e.*, paras 52.1 to 52.20], is not taxable under this head.
- *Telephone/mobile phone* - The perquisite in respect of telephone/mobile phone is not taxable under this head.
- *Perquisite subject to fringe benefit tax* - Any perquisite or benefit which is subject to fringe benefit tax in the hands of employer, is not taxable under this head. The following are taxable in the hands of employer under fringe benefit tax and, consequently, the following are not taxable in the hands of the employees under the residual head—

1. Free or concessional ticket provided by an airline for private journey of his employees and family members.

2. Employer's contribution to an approved superannuation fund for employees but in excess of Rs. 1 lakh per annum per employee.

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†This is *Category B* perquisite and taxable only if the employer is an individual (*i.e.*, sole proprietor), Hindu undivided family, Government, a political party, a person whose income is exempt under section 10(*23C*), a charitable institute (which is subject to registration under section 12AA), RBI, SEBI or any other person not liable for fringe benefit tax.

3. Allotment of shares to employees under a stock option plan.
4. Entertainment.
5. Provision of hospitality of every kind but does not include (*i*) expenditure on, or payment for, food or beverages provided by the employer to his employees in office or factory; (*ii*) any expenditure on or payment through paid vouchers or electronic meal cards subject to a few conditions.
6. Conference (other than fee for participation by the employees in any conference).
7. Sales promotion including publicity but excluding specified advertisement expenditure.
8. Employees' welfare.
9. Conveyance.
10. Use of hotel, boarding and lodging facilities.
11. Repair, running (including fuel), maintenance of motor cars and depreciation thereon.
12. Repair, running (including fuel), maintenance of aircrafts and depreciation thereon.
13. Use of telephone.
14. Maintenance of any accommodation in the nature of guest house other than accommodation used for training purposes (applicable only up to the assessment year 2008-09).
15. Festival celebrations.
16. Use of health club and similar facilities.
17. Use of other club facilities.
18. Gifts.
19. Scholarships.
20. Tour and travel (including foreign travel)

52.21-2 *VALUE OF THE PERQUISITE WHICH COMES UNDER THE RESIDUAL HEAD* - The value of benefit, amenity, service, right or privilege which come under this residual head, shall be determined on the basis of cost to the employer under an arm's length transaction as reduced by the employee's contribution, if any.

Deduction from salary income [Sec. 16]

53. The income chargeable under the head "Salaries" is computed after making the following deductions :

a. standard deduction [sec. 16(*i*)—*see* para 53.1] ;

b. entertainment allowance [sec. 16(*ii*)—*see* paras 53.2 and 50.3] ; and

c. professional tax [sec. 16(*iii*)—*see* para 53.3].

53.1 ***Standard deduction [Sec. 16(i)]*** - Standard deduction is now not available.

53.2 ***Entertainment allowance [Sec. 16(ii)]*** - As explained earlier, entertainment allowance is first included in salary income and thereafter a deduction is allowed in accordance with the rules mentioned in para 50.3.

53.3 ***Professional tax or tax on employment [Sec. 16(iii)]*** - Professional tax or tax on employment levied by a State under article 276 of the Constitution is allowed as deduction.

The following points should be kept in view :

1. Deduction is available only in the year in which professional tax is paid.

2. If the professional tax is paid by the employer on behalf of an employee, it is first included in the salary of the employee as a "perquisite" (since it is an obligation of the employee discharged by the employer, it is taxable) and then the same amount is allowed as deduction on account of "professional tax" from gross salary.

3. There is no monetary ceiling under the Income-tax Act (under the article 276 of the Constitution, a State Government cannot impose more than Rs. 2,500 per annum as professional tax). Under the Income-tax Act, whatever professional tax is paid during the previous year is deductible. Suppose X, posted in Hyderabad, is required to pay Rs. 2,000 every year as professional tax. On May 31, 2008, he pays Rs. 4,000 on account of professional tax (*i.e.*, Rs. 2,000 for the year 2007-08 and Rs. 2,000 for the year 2008-09). In this case, Rs. 4,000 is deductible for the previous year 2008-09 (it is incorrect to state that in such a case only Rs. 2,500 is deductible).

Tax on salary of non-resident technicians [Sec. 10(5B)]

54. The Finance Act, 1993 had inserted clause (*5B*) in section 10 with effect from the assessment year 1994-95. Exemption under section 10(*5B*) is not available from the assessment year 2003-04.

Salaries of other foreign citizens

55. Tax treatment of salary received by other foreign nationals is as follows :

55.1 ***Salary of diplomatic personnel [Sec. 10(6)(ii)]*** - Remuneration received by foreign citizen as an official (by whatever name called) of an embassy, high commission, legation, commission, consulate or trade representation of a foreign State, or a member of the staff of any of that official will be exempt from tax if corresponding Indian official in that foreign country enjoys a similar exemption.

55.2 ***Salary of foreign employees [Sec. 10(6)(vi)]*** - The remuneration received by a foreign national, as an employee of a foreign enterprise, for services rendered by him during his stay in India, is totally exempt from tax provided : (*a*) the foreign enterprise is not engaged in any business or trade in India ; (*b*) his stay in India does not exceed a period of 90 days in such previous year ; and (*c*) such remuneration is not liable to be deducted from the income of the employer chargeable under the Income-tax Act.

55.3 ***Salary received by a ship's crew [Sec. 10(6)(viii)]*** - Salary received by, or due to, a non-resident foreign national as a member of a ship's crew is exempt from tax provided his total stay in India does not exceed 90 days during the previous year.

55.4 ***Remuneration of a foreign trainee [Sec. 10(6)(xi)]*** - Remuneration received by a foreign national as an employee of a foreign Government, during his stay in India, is exempt from tax, if remuneration is received in connection with training in an undertaking or office owned by —

a. the Government; or

b. any company owned by the Central Government or any State Government; or

c. any company which is subsidiary of a company referred to in (*b*) *supra* ; or

d. any statutory corporation ; or

e. any co-operative society, wholly financed by the Central Government, or any State Government.

55.5 ***Remuneration out of funds of an international organisation [Sec. 10(8A)/(8B)]*** - *See* para 38.17.

Employees' provident fund

56. Provident fund scheme is a retirement benefit scheme. Under this scheme, a stipulated sum is deducted from the salary of the employee as his contribution towards the fund. The employer also generally contributes simultaneously an equal amount out of its pocket to the fund. The contributions of employee and employer are invested in gilt-edged securities. Interest earned thereon is also credited to the provident fund account of employees. Thus, the credit balance in the provident fund account of an employee consists of employee's contribution, interest on employee's

contribution, employer's contribution and interest on employer's contribution. The accumulated sum is paid to the employee at the time of his retirement or resignation. In the case of death of an employee, the accumulated balance is paid to his legal heirs. Since the scheme encourages personal savings at micro level and generates funds for investment at macro level, Government provides deduction under section 80C.

56.1 ***Types of provident funds*** - Employees' provident funds may be of the following types :

- Statutory provident fund.
- Recognised provident fund.
- Unrecognised provident fund.

Besides, an employee can also become member of the public provident fund.

56.1-1 *STATUTORY PROVIDENT FUND* - Statutory provident fund is set up under the provisions of the Provident Funds Act, 1925. This fund is maintained by Government and semi-Government organizations, local authorities, railways, universities and recognised educational institutions.

56.1-2 *RECOGNISED PROVIDENT FUND* - A provident fund scheme to which the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 (hereinafter referred to as PF Act, 1952) applies is recognised provident fund. As per PF Act, 1952 any establishment employing 20 or more persons is covered by the PF Act, 1952 (establishments employing less than 20 persons can also join the provident fund scheme if the employer and employees want to do so). An establishment covered by the PF Act, 1952 has the following two alternatives and may join any of the following two schemes —

Alternative available schemes	*Additional formalities to get approval of the Provident Fund Commissioner*	*Status for income-tax purpose*
1. Scheme of the Government set up under the PF Act, 1952	*No*	Such provident fund is recognised provident fund
2. Own scheme of provident fund	A trust has to be created by the employer and employees to start own provident fund scheme. Funds shall be invested in accordance with the rules given under PF Act, 1952. If the scheme satisfies certain rules given under PF Act, 1952, it will get the approval of the PF Commissioner	If it is recognised by the Commissioner of Income-tax in accordance with the rules contained under Part A of the Fourth Schedule to the Income-tax Act, it becomes recognised provident fund

56.1-3 *UNRECOGNISED PROVIDENT FUND* - As stated in *2 supra* (third column), if a provident fund is not recognised by the Commissioner of Income-tax, it is known as unrecognised provident fund.

56.1-4 *PUBLIC PROVIDENT FUND* - The Central Government has established the public provident fund for the benefit of general public to mobilise personal savings. Any member of the public (whether a salaried employee or a self-employed person) can participate in the fund by opening a provident fund account at any branch of the State Bank of India or its subsidiaries or a few nationalised banks. A salaried employee can simultaneously become a member of employees' provident fund (whether statutory, recognised or unrecognised) and the public provident fund. Any amount (subject to minimum of Rs. 500 and maximum of Rs. 70,000 per annum) may be deposited in this account. The accumulated sum is repayable after 15 years (it may be extended). This provident fund, at present, carries compound interest (tax-free) at the rate of 8 per cent per annum. Interest is credited every year but is payable only at the time of maturity.

56.2 ***Tax treatment*** - The table given below highlights the exemptions and deductions available in respect of contributions to and payments from various provident funds (in the case of salaried employees) :

	Statutory provident fund	*Recognised provident fund*	*Unrecognised provident fund*	*Public provident fund*
1	*2*	*3*	*4*	*5*
Employer's contribution to provident fund	Not treated as "income" of the year in which contribution is made	Not treated as "income" up to 12 per cent* of salary[1]. Excess of employer's contribution over 12 per cent of salary[1] is taxable	Not treated as "income" of the year in which contribution is made	Employer does not contribute
Deduction under section 80C on employee's contribution [*see* para 235]	Available	Available	Not available	Available
Interest credited to provident fund	Not treated as income of the year in which interest is credited	Not treated as "income" if rate of interest does not exceed the notified rate of interest (*i.e.*, 9.5 per cent), excess of interest over the notified rate is, however, taxable[4]	Not treated as income of the year in which interest is credited	Exempt from tax
Lump sum payment at the time of retirement or termination of service	Exempt from tax	Exempt from tax in some cases[2]. When not exempt provident fund will be treated as an unrecognised fund from the beginning[3]	*See* note 5 (*infra*)	Exempt from tax

Notes :

1. "Salary" here means basic salary. It includes dearness allowance and dearness pay, if terms of employment so provide. It also includes commission where commission is determined at a fixed percentage of turnover achieved by an employee, then such commission would partake of a character of salary—*Gestetner Duplicators (P.) Ltd.* v. *CIT* [1979] 1 Taxman 1/117 ITR 1 (SC).

2. The accumulated balance due and becoming payable to an employee participating in a recognised provident fund will be excluded from his total income in the following situations :

- If he has rendered continuous service with his employer for a period of 5 years or more. If accumulated balance includes any amount transferred from his individual account in any other recognised provident fund(s) maintained by his former employer(s), then, in computing the period of 5 years, the period(s) for which the employee rendered continuous service to his former employer(s) is also to be included.
- If the employee is not able to fulfil the conditions of such continuous service due to his service having been terminated by reason of his ill-health or by reason of the contraction or discontinuance of the employer's business or due to some other reason beyond the control of the employee.
- If, on the occasion of his retirement, the employee obtains employment with any other employer, to the extent the accumulated balance due and becoming payable to him is transferred to his individual account in any recognised provident fund maintained by such other employer.

3. If the accumulated balance becomes taxable due to non-fulfilment of the aforesaid conditions, the total income of the employee will be recomputed by the Assessing Officer, as if the fund was not recognised from the beginning.

4. Interest credited to recognised provident fund is exempt from tax if rate of interest does not exceed the notified rate given below :

Date of credit of interest (Both days inclusive)	*Notified rate (per cent)*
Between June 18, 1985 and March 31, 1986	10.5
Between April 1, 1986 and March 31, 2001	12
On or after April 1, 2001	9.5

5. Payment received in respect of employee's own contribution is exempt from tax. Interest on employee's contribution is taxable under the head "Income from other sources"— *CIT* v. *G. Hyatt* [1971] 80 ITR 177 (SC). Balance (*i.e.*, employer's contribution and interest thereon) is taxable under the head "Salaries". However, relief can be claimed under section 89 [*see* para 60].

56.2-P1 *X retires on June 30, 2008. He submits the following information —*

Basic salary (since January 2008) : Rs. 20,000 per month, dearness allowance : Rs. 6,000 per month (1/3 of which is part of salary for retirement benefits), employer's contribution towards provident fund : Rs. 3,000 per month (X makes a matching contribution); interest credited at the rate of 15 per cent on April 30, 2008 : Rs. 7,500 ; pension after retirement : Rs. 10,000 per month ; and payment of provident fund at the time of retirement : Rs. 7,60,000 (out of which employer's contribution : Rs. 3,30,000, interest thereon : Rs. 44,000, X's contributions : Rs. 3,40,000, interest thereon : Rs. 46,000). Salary and pension become due on the last day of each month. X has deposited the entire provident fund payment with a company (rate of interest : 9 per cent per annum).

Find out the income of X for the assessment year 2009-10 on the assumption that the provident fund is (a) statutory provident fund, (b) recognised provident fund, or (c) unrecognised provident fund.

SOLUTION :

	Statutory provident fund Rs.	Recognised provident fund Rs.	Unrecognised provident fund Rs.
Basic salary (Rs. 20,000 × 3)	60,000	60,000	60,000
Dearness allowance	18,000	18,000	18,000
PF contribution by the employer [Rs. 3,000 × 3 — 12% of (Rs. 60,000 + 1/3 of Rs. 18,000)]	-	1,080	-
Interest credited in PF account in excess of 9.5% [Rs. 7,500 × 5.5/15]	-	2,750	-
Pension (Rs. 10,000 × 9)	90,000	90,000	90,000
Payment for provident fund account			
- Employer's contribution	-	-	3,30,000
- Interest thereon	-	-	44,000
Gross salary	1,68,000	1,71,830	5,42,000
Less : Deductions	-	-	-
Income from salary	1,68,000	1,71,830	5,42,000
Income from other sources			
- Interest on X's contribution to provident fund	-	-	46,000
- Interest on company deposits (*i.e.*, 9% per annum on Rs.7,60,000 from July 1, 2008 to March 31, 2009)	51,300	51,300	51,300
Gross total income	2,19,300	2,23,130	6,39,300
Less : Deduction under section 80C	9,000	9,000	*Nil*
Net income	2,10,300	2,14,130	6,39,300

Note : In the case of recognised provident fund, it is assumed that X has retired after rendering service of 5 years.

Approved superannuation fund

57. It means superannuation fund which has been and continues to be approved by the Commissioner in accordance with the rules contained in Part B of the Fourth Schedule. The tax treatment of contribution to and payment from the fund is as under :

- Employer's contribution is exempt from tax.
- Employee's contribution qualifies for deduction under section 80C [*see* para 235].
- Interest on accumulated balance is exempt from tax.
- Section 10(*13*) grants exemption in respect of payment from the fund —

a. to the legal heirs on the death of beneficiary (*e.g.*, payment to widow of the beneficiary) ;

b. to an employee in lieu of or in commutation of an annuity on his retirement at or after the specified age or on his becoming incapacitated prior to such retirement ;

c. by way of refund of contribution on the death of the beneficiary ; or

d. by way of refund of contribution to an employee on his leaving the service otherwise than in the circumstances mentioned in (*b*), to the extent to which such payment does not exceed the contribution made prior to April 1, 1962 (for instance, where the amount received by an employee does not include any contribution made prior to April 1, 1962, the whole amount is taxable).

Approved gratuity fund

58. It means a gratuity fund which has been and continues to be approved by the Commissioner of Income-tax in accordance with the rules contained in Part C of the Fourth Schedule. Tax treatment of contribution to and payment from the fund is as under :

- Employer's contribution is exempt from tax.
- Actual payment received by the employee is exempt from tax within the limits specified in section 10(*10*) [*see* para 49.8].

Deduction under section 80C

59. Under the provisions of section 80C, an assessee is entitled to a deduction in respect of the amount invested or deposited in the life insurance policies, provident funds, superannuation funds, etc. (collectively known as net qualifying amount), from gross total income [*see* para 235].

Relief under section 89

60. If an individual receives any portion of his salary in arrears or in advance or receives profit in lieu of salary, he can claim relief in terms of section 89 read with rule 21A as under :

60.1 ***Computation of relief when salary has been received in arrears or in advance [Rule 21A(2)]*** - The relief on salary received in arrears or in advance (hereinafter to be referred as additional salary) is computed in the manner laid down in rule 21A(2) as under :

1. Calculate the tax payable on the total income, including the additional salary, of the relevant previous year in which the same is received.

2. Calculate the tax payable on the total income, excluding the additional salary, of the relevant previous year in which the additional salary is received.

3. Find out the difference between the tax at (*1*) and (*2*).

4. Compute the tax on the total income after including the additional salary in the previous year to which such salary relates.

5. Compute the tax on the total income after excluding the additional salary in the previous year to which such salary relates.

6. Find out the difference between tax at (*4*) and (*5*).

7. The excess of tax computed at (*3*) over tax computed at (*6*) is the amount of relief admissible under section 89. No relief is, however, admissible if tax computed at (*3*) is less than tax computed at (*6*). In such a case, the assessee-employee need not apply for relief.

If the additional salary relates to more than one previous year, salary would be spread over the previous years to which it pertains in the manner explained above.

60.1-P1 *During the previous year ending March 31, 2009, X, a salaried employee (age : 40 years), received Rs. 5,67,000 as basic salary and Rs. 20,000 as arrears of bonus of the financial year 1992-93. During the previous year 1992-93, X has received Rs. 50,000 as salary. X deposits Rs. 1,500 (during 1992-93) and Rs. 10,000 (during 2008-09) in public provident fund.*

SOLUTION : *The admissible relief under section 89 in respect of bonus paid in the financial year 2008-09 will be computed as under :*

	Taxable income and tax liability on "receipt" basis		Taxable income and tax liability on "accrual" basis	
	2009-10 Rs.	1993-94 Rs.	2009-10 Rs.	1993-94 Rs.
Salary	5,67,000	50,000	5,67,000	50,000
Arrears of salary	20,000	-	-	20,000
Gross salary	5,87,000	50,000	5,67,000	70,000
Less : Standard deduction under section 16(*i*)	*Nil*	12,000	*Nil*	12,000
Gross total income	5,87,000	38,000	5,67,000	58,000
Less : Deduction under section 80C	10,000	*Nil*	10,000	*Nil*
Net income	5,77,000	38,000	5,57,000	58,000
Tax on net income	78,100	2,000	72,100	6,800
Less : Rebate under section 88	*Nil*	300	*Nil*	300
Tax	78,100	1,700	72,100	6,500
Add : Surcharge	*Nil*	-	*Nil*	-
Tax and surcharge	78,100	1,700	72,100	6,500
Add: Education cess	1,562	-	1,442	-
Add : Secondary and higher education cess (1% of income-tax and surcharge)	781	-	721	-
Tax liability	80,443	1,700	74,263	6,500

	Rs.
Tax liability of the two assessment years on receipt basis	82,143
Tax liability of the two assessment years on accrual basis	80,763
Tax relief under section 89 for the assessment year 2009-10 (*i.e.*, Rs. 82,143 — Rs. 80,763)	1,380
Tax payable for the assessment year 2009-10 (*i.e.*, Rs. 80,443 — Rs. 1,380)	79,063

60.2 *Computation of relief in respect of gratuity [Rule 21A(3)]* - Under section 89, a relief can be claimed if gratuity is received in excess of the limits specified in para 49.8. However, no relief is admissible if taxable gratuity is in respect of services rendered for less than five years. Cases in which the relief is admissible may be divided into two categories, namely, (*a*) where the gratuity payable is in respect of past service of 15 years or more, and (*b*) where such period is 5 years or more but less than 15 years. Relief in a case belonging to the first category is worked out as under :

1. Compute the average rate of tax on the total income, including the gratuity in the year of receipt.

2. Find out the tax on gratuity at the average rate of tax computed at (*1*) above.

3. Compute the average rate of tax by adding one-third of the gratuity to the other income of each of the three preceding years.

4. Find out the average of the three average rates computed in the manner specified in (*3*) above and compute the tax on gratuity at the rate.

5. The difference between tax on the gratuity computed at (*2*) and that at (*4*) will be the relief admissible under section 89.

In cases covered under the second category, the relief is computed on the similar lines as above with the only difference that instead of average of the average rates of the preceding three years, the average of the rates of the preceding two years is computed by adding one-half of the gratuity to the other income of each of preceding two years.

60.2-P1 *X (age : 58 years) received from his employer Rs. 4,45,417 as death-cum-retirement gratuity on March 31, 2009, after rendering service of 23 years out of which Rs. 4,36,417 is exempt under section 10(10). In addition, he received during the year Rs. 15,08,000 as salary and Rs. 83,100 as bank interest. For the assessment years 2008-09, 2007-08 and 2006-07 his income was Rs. 4,20,000 (salary: Rs. 3,40,000 plus bank interest: Rs. 80,000),*

Rs. 3,40,000 (salary: Rs. 2,37,000 plus bank interest: Rs. 1,03,000) and Rs. 3,22,850 (i.e., salary Rs. 2,33,000 plus bank interest Rs. 89,850), respectively. He pays Rs. 40,000 per annum as premium on an endowment insurance policy on the life of his wife. For the assessment year 2006-07 X is non-resident.

SOLUTION : *Relief under section 89 will be worked out as under:*

	Assessment years			
	2006-07	2007-08	2008-09	2009-10
	Rs.	Rs.	Rs.	Rs.
Salary income	2,33,000	2,37,000	3,40,000	15,08,000
Add : One-third (i.e., Rs. 9,000 × ⅓) of taxable gratuity (Rs. 9,000) in income of each of the three assessment years 2006-07, 2007-08 and 2008-09; and the entire taxable gratuity in the year 2009-10	3,000	3,000	3,000	9,000
Gross salary	2,36,000	2,40,000	3,43,000	15,17,000
Less : Standard deduction	*Nil*	*Nil*	*Nil*	*Nil*
Taxable salary	2,36,000	2,40,000	3,43,000	15,17,000
Bank interest	89,850	1,03,000	80,000	83,100
Gross total income	3,25,850	3,43,000	4,23,000	16,00,100
Less : Deduction under section 80C	40,000	40,000	40,000	40,000
Less : Deduction under section 80L	*Nil*	*Nil*	*Nil*	*Nil*
Net income (rounded off)	2,85,850	3,03,000	3,83,000	15,60,100
Income-tax payable on the total income	35,755	40,900	63,900	3,73,030
Less : Rebate under section 88	*Nil*	*Nil*	*Nil*	*Nil*
Tax	35,755	40,900	63,900	3,73,030
Add : Surcharge	—	—	—	37,303
Tax and surcharge	35,755	40,900	63,900	4,10,333
Add: Education cess (2% of tax and surcharge)	715	818	1,278	8,207
Add: Secondary and higher education cess	—	—	639	4,104
Tax payable on total income	36,470	41,720	65,820	4,22,640
Average rates of tax	12.76%	13.77%	17.19%	27.09%
Average of the average rates of tax for assessment years 2006-07, 2007-08 and 2008-09	14.57%	14.57%	14.57%	—
Tax on Rs. 9,000 @ 14.57%				1,312
Tax on Rs. 9,000 @ 27.09%				2,438
Refund under section 89				1,126

Tax deductible under section 192 for the assessment year 2009-10 (*i.e.*, Rs. 4,22,643 – Rs. 1,126) : Rs. 4,21,520.

60.3 ***Computation of relief in respect of compensation on termination of employment [Rule 21A(4)]*** - If compensation is received by the assessee from his employer or former employer at or in connection with termination of his employment after rendering continuous service for not less than 3 years and where the unexpired portion of his term of employment is also not less than 3 years, the relief is calculated in the same manner as if the gratuity was paid to the employee in respect of service rendered for a period of 15 years or more [*see* para 60.2].

■ *What is "termination"*- Literally, termination means ending. The consequence is the same, *i.e.*, the employee ceases to be in employment either by way of disciplinary proceeding or by availing the benefit of voluntary retirement scheme.

Termination of employment may be due to various reasons; by way of resignation, dismissal, compulsory retirement, superannuation or even by voluntary retirement—***State Bank of Travancore*** v. ***Central Board of Direct Taxes*** [2006] 151 Taxman 140 (Ker.)—*CIT* v. *M. Raman* [2002] 120 Taxman 338 (Mad.).

60.4 ***Computation of relief in respect of payment in commutation of pension [Rule 21A(5)]*** - A relief can be claimed in respect of payment in commutation of pension received in excess of the limits mentioned in para 49.9. Such relief is computed in the same manner as if the gratuity was paid to the employee in respect of service rendered for a period of 15 years or more [*see* para 60.2].

60.5 ***Computation of relief in respect of other payments [Rule 21A(6)]*** - In respect of payment received by an employee other than those mentioned in paras 60.1 to 60.4 above, the relief under section 89 will be granted by the Central Board of Direct Taxes after examining the circumstances of each individual case.

60.6 ***Other points*** - Basically the relief under section 89 is arithmetical. It involves finding out of two rates of tax. The first is the rate of tax applicable to the total income including the extra amount in the year of receipt. The second is finding out the rate by adding the arrears to the total income of the years to which they relate. For this purpose, the Assessing Officer should ask for a true and authentic statement of the total income of the earlier years to which the arrears pertain. There is, therefore, no warrant for issuing a notice under section 148 or calling for returns of income of earlier years—Circular No. 331, dated March 22, 1982.

Meaning of salary for different computations

61. The term "salary" has been assigned different meanings for the purposes of different computations as under :

Different items	*Salary for the purpose of (a) house rent allowance, (b) gratuity (not being gratuity under the Payment of Gratuity Act, 1972), (c) leave encashment, (d) employer's contribution towards recognized provident fund*	*Salary for the purpose of rent-free house [see Note 1]*	*Salary for the purpose of entertainment allowance*	*Salary for the purpose of computing the ceiling of Rs. 50,000 for the purpose of "specified employees" [see Note 2]*
Basic salary	✓	✓	✓	✓
Dearness allowance/pay (forming part of salary as per the terms of employment or forming part of salary for computing retirement benefits)	✓	✓	X	✓
Dearness allowance/pay (not forming part of salary as per the terms of employment or not forming part of salary for computing retirement benefits)	X	X	X	✓
Advance salary	X	X	X	✓
Arrears of salary	X	X	X	✓
Leave encashment (pertaining to the current year)	X	✓	X	✓
Leave encashment (not pertaining to the current year)	X	X	X	✓
Salary in lieu of notice	X	✓	X	✓
Fees	X	✓	X	✓
Commission (as a % of turnover achieved by the employee)	✓	✓	X	✓
Commission (not as a % of turnover achieved by the employee)	X	✓	X	✓

Different items	*Salary for the purpose of (a) house rent allowance, (b) gratuity (not being gratuity under the Payment of Gratuity Act, 1972), (c) leave encashment, (d) employer's contribution towards recognized provident fund*	*Salary for the purpose of rent-free house [see Note 1]*	*Salary for the purpose of entertainment allowance*	*Salary for the purpose of computing the ceiling of Rs. 50,000 for the purpose of "specified employees" [see Note 2]*
Bonus	X	✓	X	✓
Gratuity (payable in respect of service of the current year)	X	✓	X	✓
Gratuity (payable in respect of service of preceding years)	X	X	X	✓
Uncommuted pension	X	✓	X	✓
Annuity from employer	X	✓	X	✓
Employer's contribution towards provident fund	X	X	X	X
Annual accretion to the credit balance in provident fund	X	X	X	X
Retrenchment compensation	X	X	X	✓
Remuneration for extra work	X	✓	X	✓
Voluntary payments	X	✓	X	✓
Salary from a United Nations Organisation	X	X	X	X
Payment received at the time of voluntary retirement [which is not exempt under section 10(*10C*)]	X	X	X	✓
City compensatory allowance	X	✓	X	✓
House rent allowance [which is not exempt under section 10(*13A*)]	X	✓	X	✓
Entertainment allowance [to the extent it is not deductible under section 16(*ii*)]	X	✓	X	✓
Special allowance [exempt under section 10(*14*)]	X	X	X	X
Special allowance [not exempt under section 10(*14*)]	X	✓	X	✓
Foreign allowance [exempt under section 10(*7*)]	X	X	X	X
Tiffin allowance	X	✓	X	✓
Fixed medical allowance	X	✓	X	✓
Allowance to High Court Judges	X	X	X	X
Allowance from a United Nations Organisation	X	X	X	X
Compensatory allowance under article 222(2) of the Constitution	X	X	X	X
Any other allowance	X	✓	X	✓
Amount reimbursed to the employee which is taxable as perquisite under section 17(*2*) [*e.g.*,	X	X	X	✓

Different items	Salary for the purpose of (a) house rent allowance, (b) gratuity (not being gratuity under the Payment of Gratuity Act, 1972), (c) leave encashment, (d) employer's contribution towards recognized provident fund	Salary for the purpose of rent-free house [see Note 1]	Salary for the purpose of entertainment allowance	Salary for the purpose of computing the ceiling of Rs. 50,000 for the purpose of "specified employees" [see Note 2]
gas bills paid by the employee and reimbursed by employer]				
Amount directly paid by employer on behalf of employee and which is taxable as perquisite under section 17(2) [e.g., gas bills paid by the employer directly to the gas company on behalf of employee]	X	X	X	X
Any other monetary payment which is taxable as profits in lieu of salary [e.g., payment of overtime allowance to employee]	X	✓	X	✓
Any other perquisite chargeable to tax under section 17(2)	X	X	X	X

Notes :

1. For the purpose of valuation of the perquisite in respect of rent-free house, salary of the previous year during which rent-free house is given, should be considered. It should be computed on accrual basis. Moreover, salary from all the employers in respect of the said period shall be taken into consideration.

2. For the purpose of finding out whether or not an employee is a specified employee the following shall be deducted - (*a*) standard deduction*, (*b*) deduction on account of entertainment allowance under section 16(*ii*); (*c*) deduction on account of professional tax. Where the salary is received from more than one employer during the relevant previous year, the aggregate salary from these employers will have to be taken into account for the purpose of determining the aforesaid monetary ceiling of Rs. 50,000.

Hints for tax planning

62. For the purpose of tax planning under the head "Salaries" the following propositions should be borne in mind. However, these propositions would hold good only in the context in which they have been made :

- It should be ensured that, under the terms of employment, dearness allowance and dearness pay form part of basic salary. This will minimise tax incidence on house rent allowance, gratuity and commuted pension. Likewise, incidence of tax on employer's contribution to recognised provident fund will be lesser if dearness allowance forms a part of basic salary.
- The Supreme Court has held in *Gestetner Duplicators (P.) Ltd.* v. *CIT* [1979] 1 Taxman 1/117 ITR 1 that commission, payable as per terms of contract of employment at a fixed percentage of turnover achieved by an employee, falls within the expression "salary" as defined in rule 2(*h*) of Part A of the Fourth Schedule. Consequently, tax incidence on house rent allowance, entertainment allowance, gratuity and commuted pension will be lesser if commission is paid at a fixed percentage of turnover achieved by the employee.
- As uncommuted pension is always taxable, employees should get their pension commuted. Commuted pension is fully exempt from tax in the case of Government employees and partly exempt from tax in the case of non-Government employees who can claim relief under section 89.

*Not available from the assessment year 2006-07.

▪ An employee, being a member of a recognised provident fund, who resigns before completing five years of continuous service, should ensure that he joins a firm which maintains a recognised provident fund for the simple reason that the accumulated balance of the provident fund with the former employer will be exempt from tax, provided the same is transferred to the new employer who also maintains a recognised provident fund.

▪ Since employer's contribution towards recognised provident fund is exempt from tax up to 12 per cent of salary, employer may give extra benefit to their employees by raising their contribution to 12 per cent of salary without increasing any tax liability.

▪ While medical allowance payable in cash is taxable, provision of ordinary medical facilities is not taxable if some conditions are satisfied. Therefore, employees should go in for free medical facilities instead of fixed medical allowance.

▪ Since incidence of tax on retirement benefits like gratuity, commuted pension, accumulated balance of unrecognised provident fund is lower if they are paid in the beginning of the financial year, employer and employees should mutually plan their affairs in such a way that retirement, termination or resignation, as the case may be, takes place in the beginning of a financial year.

▪ An employee should take the benefit of relief available under section 89 [*see* para 60] wherever possible. Relief can be claimed even in the case of a sum received from unrecognised provident fund so far as it is attributable to employer's contribution and interest thereon. Although gratuity received during the employment is not exempt from tax under section 10(*10*), relief under section 89 can be claimed. It should, however, be ensured that the relief is claimed only when it is beneficial.

▪ Pension received in India by a non-resident assessee from abroad is taxable in India. If, however, such pension is first received by or on behalf of the employee in a foreign country and later on remitted to India, it will be exempt from tax.

▪ As the perquisite in respect of leave travel concession is not taxable in the hands of the employees if certain conditions are satisfied, it should be ensured that the travel concession should be claimed to the maximum possible extent without attracting any incidence of tax.

▪ As the perquisites in respect of free residential telephone, providing use of computer/laptop, gift of movable assets (other than computer, electronic items, car) by employer after using for 10 years or more are not taxable, employees can claim these benefits without adding to their tax bill.

▪ Since the term "salary" includes basic salary, bonus, commission, fees and all other taxable allowances for the purpose of valuation of perquisite in respect of rent free house, it would be advantageous if an employee goes in for perquisites rather than for taxable allowances. This will reduce valuation of rent-free house.

Problems on salary income

63-P1 *X is employed as a resident engineer in Steel Fabrications Ltd. on a basic salary of Rs. 81,400 per month.*

1. He is required to stay with his family in a rent-free unfurnished bungalow provided by his employer in the factory compound.

2. Company pays college fees of Rs. 1,800 during the year directly to the college for his son, while his daughter is getting free education in an institution run by the company. She is also given free transport in factory bus to and from the school.

3. A sweeper and a watchman look after his bungalow. They are employees of the company on a salary of Rs. 300 per month each.

4. He is entitled to holiday home facility at company's guest house at Darjeeling and this had been availed by him for 15 days during the year along with his family. He was reimbursed the travelling expenses of Rs. 4,000 and was given free board and transport there.

5. Since he had availed 15 days' leave out of 30 days to which he was entitled, he encashed the balance leave of 15 days and got Rs. 5,700 which he claimed to be exempt.

6. He got an interest-free loan of Rs. 50,000 for construction of a house at his native place under a scheme meant for the benefit of the officers of the company. The company accepts deposits at 7 per cent from public. However, SBI lending rate is 8.5 per cent.

7. Company pays Rs. 1,000 per annum on an accident insurance policy for the benefit of X.

8. Company has reimbursed his club fee of Rs. 500 per annum and club bills aggregating to Rs. 4,000 which included bills for entertaining his guests some of whom were company's customers.

9. He purchased a scooter on August 3, 2008 at Rs. 400 (book value) from the company. The market value of the same is about Rs. 2,000. The scooter was purchased by the company on June 30, 2003 for Rs. 32,000.

10. The company made a car (800cc) available to him for official use and personal use. He reimbursed the company at Rs. 2.15 per kilometre for personal use.

X had no shares in the company and he was not related to any directors. Discuss the tax treatment that may be accorded to each of the above items in the hands of X. (There is no need to compute his tax.)

SOLUTION : Basic salary of Rs. 9,76,800 is taxable. Tax treatment of other items are given below :

1. Value of rent-free unfurnished bungalow is to be determined under rule 3 [see para 52.1]. If, however, he is "required to stay" in the rent-free unfurnished bungalow only for discharge of his official duty as "resident engineer", then the perquisite is not chargeable to tax—*CIT* v. *D.S. Blackwood* [1989] 178 ITR 470 (Cal.).

2. Rs. 1,800 directly paid to the college is taxable under section 17(2)(*iv*). Perquisite in respect of daughter's education (including transport facility) is taxable under section 17(2)(*iii*) and if cost of education does not exceed Rs. 1,000 per month per child it is not chargeable to tax.

3. The benefit of providing free sweeper and watchman is taxable. Rs. 7,200 (being expenditure incurred by the employer) is chargeable to tax.

4. Perquisite in respect of free holiday home is chargeable to tax in the hands of employer under fringe benefit tax. Reimbursement of travelling expenses of Rs. 4,000 is exempt under section 10(5) if certain conditions are satisfied [see para 52.7].

5. Leave salary of Rs. 5,700 is taxable, since it is not encashed at the time of retirement, exemption under section 10(*10AA*) is not available.

6. The value of perquisite in respect of interest-free loan is chargeable to tax under section 17(2)(*vi*). Rs. 4,250 (being 8.5% of Rs. 50,000) is chargeable to tax.

7. X has no vested right in the accident insurance policy, as the benefit depends upon contingency of accident. It is, therefore, not taxable—*CIT* v. *Lala Shri Dhar* [1972] 84 ITR 192 (Delhi).

8. Amount spent by the employer (*i.e.*, Rs. 4,500) to pay club fees and bills is taxable under fringe benefit tax in the hands of employer.

9. Taxable value of the perquisite shall be determined as under—

	Rs.
Cost of scooter	32,000
Less: Normal wear and tear for 5 years [10% of Rs. 32,000 for 5 years]	16,000
Balance	16,000
Less: Amount paid by X	400
Taxable value of the perquisite	15,600

10. Perquisite in respect of free car is chargeable to tax in the hands of employer under fringe benefit tax.

63-P2 *What is "transferred balance" when unrecognised provident fund is recognised ? Discuss the tax treatment with the help of case study given below —*

X (27 years) joined ABC Ltd. in the grade of Rs. 7,000-400-15,000 on September 1, 2004. Besides basic salary, he gets the following emoluments during the previous year 2008-09 :

Bonus : Rs. 6,000, education allowance : Rs. 4,200 (for his daughter), employer's contribution to an approved gratuity fund : Rs. 3,400, travelling allowance : Rs. 6,000 (utilised fully for official purposes) and medical bills reimbursed by the company : Rs. 16,121 (expenditure is incurred in a Government hospital in India).

The employer-company maintains a provident fund which gets recognition, from the Commissioner of Income-tax, with effect from January 1, 2009.

On January 1, 2009, the amount standing at the credit of provident fund is transferred to the recognised provident fund along with interest of Rs. 10,800 (rate of interest is lower than the notified rate of interest).

X makes the following annual payments :

1. Contribution to provident fund : 15 per cent of basic salary from the date of joining (employer also makes a matching contribution).

2. Insurance premium on insurance policy of Rs. 70,000 : Rs. 8,000.

3. Contribution to public provident fund : Rs. 41,290.

Determine the total income and tax liability for the assessment year 2009-10 on the assumption that income of X from other sources is Rs. 1,80,000.

SOLUTION : *What is "transferred balance"* - An organisation maintains unrecognised provident fund. The organisation has obtained recognition to its provident fund with existing balances during the previous year. The amount transferred from the unrecognised provident to recognised provident fund is "transferred balance".

How much of the "transferred balance" is taxable - In order to discuss the tax treatment of "transferred balance", one has to keep in mind the following in respect of recognised provident fund *vis-a-vis* unrecognised provident fund —

	Recognised provident fund	Unrecognised provident fund
Employer's contribution	The amount in excess of 12% of employee's salary is taxable in the year of making contribution	Not taxable in the year of contribution
Credit of interest in provident fund	Amount in excess of 9.5% per annum is taxable in the year in which it is credited	Not taxable in the year in which amount is credited.

Of all the sums comprised in the transferred balance, the amount, which would have been liable to tax if the provident fund had been recognised from the date of the institution of the fund, shall be deemed to be the income received by the employee in the previous year in which recognition of the fund takes effect. The remaining amount is not chargeable to tax. No other relief or exemption is granted.

To put it differently, it will be assumed that unrecognised provident fund was recognised provident fund since the time it was created. If the employer's contribution towards provident fund was in excess of limit specified above (*i.e.*, 12% of salary) and/or the interest credited was in excess of 9.5% per annum, then the excess amount shall be taxable in the year in which the unrecognised provident fund is accorded recognition. Out of the "transferred balance", the aforesaid amount is taxable. If the employer's contribution was not more than 12% of salary and/or interest was not more than 9.5% per month, then nothing is taxable out of the transferred balance.

Tax treatment of the information given in the problem is as follows —

	Basic salary Rs.	Contribution of X Rs.	Contribution of the employer Rs.
From September 1, 2004 to August 31, 2005 (*Rs. 7,000 × 12, **15% of basic salary)	84,000*	12,600**	12,600**
From September 1, 2005 to August 31, 2006 (*Rs. 7,400 × 12, **15% of basic salary)	88,800*	13,320**	13,320**
From September 1, 2006 to August 31, 2007 (*Rs. 7,800 × 12, **15% of basic salary)	93,600*	14,040**	14,040**
From September 1, 2007 to March 31, 2008 (*Rs. 8,200 × 7, **15% of basic salary)	57,400*	8,610**	8,610**
From April 1, 2008 to August 31, 2008 (*Rs. 8,200 × 5, **15% of basic salary)	41,000*	6,150**	6,150**
From September 1, 2008 to December 31, 2008 (*Rs. 8,600 × 4, **15% of basic salary)	34,400*	5,160**	5,160**
From January 1, 2009 to March 31, 2009 (*Rs. 8,600 × 3, **15% of basic salary)	25,800*	3,870**	3,870**

	Basic salary Rs.	Contribution of X Rs.	Contribution of the employer Rs.
Basic pay from April 1, 2008 to March 31, 2009 (*Rs. 41,000 + Rs. 34,400 + Rs. 25,800)	1,01,200*	—	—
Contribution towards provident fund from the date of joining till the date of recognition (*i.e.*, from September 1, 2004 to December 31, 2008)	—	59,880	59,880

Computation of total income of the previous year 2008-09

		Rs.
Basic salary [as computed *supra*]		1,01,200
Bonus		6,000
Education allowance (Rs. 4,200 *less* exempt amount : Rs. 1,200—see para 50.4-1)		3,000
Employer's contribution towards approved gratuity fund (*not taxable)		*Nil**
Travelling allowance	Rs. 6,000	Rs.
Less : Exemption under section 10(*14*)*—see para 50.4	Rs. 6,000	*Nil**
Reimbursement of medical bill		*Nil*
Transferred balance (it consists of employer and employee's contribution towards unrecognised provident fund and interest thereon as it stands on December 31, 2008)		
❑ Employee's contribution (*not taxable)		*Nil**
❑ Employer's contribution [*i.e.*, excess of employer's contribution over 12% 3/15 of Rs. 59,880]		11,976
❑ Interest on employer's contribution (not taxable)		-
Excess of employer's contribution over 12% of salary (*i.e.*, 3% of Rs. 25,800, being salary of period during which provident fund is recognised)		774
Gross salary		1,22,950
Less : Standard deduction		—
Income from salary		1,22,950
Income from other sources		1,80,000
Gross total income		3,02,950
Less : Deduction under section 80C [see Note 1]		53,160
Net income (rounded off)		2,49,790
Tax [see Annex 1] (*a*)		9,979
Add : Surcharge (not applicable if net income does not exceed Rs. 10 lakh)		*Nil*
Tax and surcharge		9,979
Add: Education cess [2% of tax and surcharge]		200
Add : Secondary and higher education cess (1% of Income-tax and surcharge)		100
Tax payable (rounded off)		10,280

Notes:

1. Deduction under section 80C is available with respect to the following qualifying amounts :

	Rs.
Provident fund contribution (*i.e.*, 15% of Rs. 25,800 being the salary of the period during which provident fund is recognised)	3,870
Insurance premium	8,000
Public provident fund contribution	41,290
Gross qualifying amount	53,160

2. X can claim tax relief in terms of section 89 in respect of amount of transferred balance included in salary income [see para 60].

63-P3 *X (66 years) is in the Central Government service till his retirement on May 31, 2005 when he joins A Ltd. in which 40 per cent equity shares are held by the Central Government, Punjab Government and the Reserve Bank of India. During the previous year 2008-09, he gets the following from A Ltd.—*

Basic salary : Rs. 20,000 per month ; dearness allowance : Rs. 2,000 per month (half of which is part of salary for retirement purposes) ; overtime allowance up to May 31, 2008 : Rs. 2,000 per month ; helper allowance for office use : Rs. 1,000 per month (expenditure : Rs. 800 per month); medical bills reimbursement : Rs. 44,000 (out of which Rs. 12,000 is in respect of treatment in a Government's hospital) ; free gas and electricity only for personal use : Rs. 24,000 ; free telephone at residence : Rs. 9,000 ; free lunch in office : Rs. 10,500 (amount paid directly to canteen @ Rs. 35 per day for 300 days) ; interest-free loan for house Rs. 2,00,000 for six years (SBI lending rate as on April 1, 2008 : 10.25%); earned leave encashment : Rs. 16,000 (as per service rules X is entitled for 2 days leave for each month of service and during 2008-09, X has encashed 24 days leave earned during the year) ; mediclaim insurance on life of X : Rs. 5,060 ; mediclaim insurance premium on the life of X's brother who is not dependent upon X : Rs. 4,100 (the amount is reimbursed to X) ; leave travel concession for X and his family : Rs. 46,500 (no journey is undertaken). Up to May 31, 2008, X has been paid house rent allowance of Rs. 4,000 per month (rent paid at Delhi : Rs. 4,000 per month). With effect from June 1, 2008, he has been provided a rent-free furnished house at Saket, New Delhi whose lease rent is Rs. 15,000 per month (rent of furniture provided with effect from September 15, 2008 : Rs. 20,000). Further, A Ltd. bears the following expenses in respect of the house—repairs of house : Rs. 6,000 and rent of air conditioning system : Rs. 9,000 (for the summer of 2008).

Income of X from other sources is Rs. 6,80,267 (which includes Government pension of Rs. 1,20,000).

Find out the taxable income tax and liability of X for the assessment year 2009-10 on the assumption that X annually contributes Rs. 30,000 towards recognised provident fund and Rs. 10,000 in public provident fund.

SOLUTION :

Computation of taxable income		Rs.
Basic salary (Rs. 20,000 × 12)		2,40,000
Dearness allowance (Rs. 2,000 × 12)		24,000
Overtime allowance (Rs. 2,000 × 2)		4,000
Helper allowance [(Rs. 1,000 — Rs. 800) × 12]		2,400
Medical bills reimbursement	44,000	
Less: Reimbursement of Government hospital bills	12,000	
Balance	32,000	
Less: Amount not taxable	15,000	17,000
Free gas and electricity		24,000
Free residential telephone (not taxable)		-
Free lunch (not taxable)		-
Earned leave encashment		16,000
Interest-free loan (10.25% of Rs. 2,00,000)		20,500
Mediclaim insurance on the life of X		-
Mediclaim insurance on the life of X's brother not dependent on X		4,100
Leave travel concession		46,500
House rent allowance [Note 1]		4,200
Rent-free furnished house [Note 2]		77,800
Pension from Government		1,20,000
Gross salary		6,00,500
Less : Standard deduction		—
Income from salary		6,00,500
Income from other sources		5,60,267
Gross total income		11,60,767
Less : Deduction under section 80C [contribution to RRF and PPF]		40,000

	Rs.
Net income	11,20,770
Tax	2,33,731
Add : Surcharge (@10% of tax in case net income exceeds Rs. 10 lakh)	23,373
Tax and surcharge	2,57,104
Add: Education cess [2% of tax and surcharge]	5,142
Add : Secondary and higher education cess (1% of tax and surcharge)	2,571
Tax payable (rounded off)	2,64,820

Notes —

1. *House rent allowance* - Salary for this purpose is Rs. 21,000 (being basic salary : Rs. 20,000 + 50% of dearness allowance) per month. Amount exempt from tax is calculated as follows —

a. Rs. 10,500 per month [being 50% of "salary"] ;

b. Rs. 4,000 per month (being house rent allowance) ; or

c. Rs. 1,900 per month (being the excess of rent paid over 10% of salary, *i.e.*, Rs. 4,000 — Rs. 2,100).

The least of the three sums is Rs. 1,900 per month. Amount taxable is Rs. 4,200 [*i.e.*, (Rs. 4,000 — Rs. 1,900) × 2].

2. *Rent free house* - With effect from June 1, 2008, X has been provided a house by the employer. "Salary" for the period June 1, 2008 to March 31, 2009 for the purpose of valuation of the perquisite is as follows —

	Rs.
Basic salary (Rs. 20,000 × 10)	2,00,000
Dearness allowance (Rs. 1,000 × 10)	10,000
Helper allowance (Rs. 200 × 10)	2,000
Earned leave encashment (20 days leave)	13,333
Pension from Government for 10 months	1,00,000
Salary	3,25,333
Lease rent of 10 months	1,50,000
Value of unfurnished house (15% of salary or lease rent, whichever is less, is the taxable value of the unfurnished house)	48,800
Add : Rent of furniture	20,000
Add : Rent of air-conditioning system	9,000
Value of furnished house	77,800

3. Free telephone at residence is not chargeable to tax.

4. Leave encashment taken while in service is taxable without any exemption. Since in this case, leave earned during the current year is encashed, the same is taken into consideration in order to determine the perquisite value of furnished house.

5. Mediclaim insurance premium paid by employer on the life of X is not taxable. However, the same on the life of X's brother is taxable as the brother is not dependent upon X.

6. Leave travel concession is not exempt, as no journey is undertaken by X.

7. Expenditure incurred in respect of house repairs is not chargeable to tax.

63-P4 *X (51 years) is in the service of A Ltd. since 1980. He dies on January 31, 2009. The following information is available :*

Basic salary : Rs. 40,000 per month; dearness allowance : Rs. 12,000 per month (40 per cent of which is included for the purpose of determining retirement benefit) ; transport allowance : Rs. 6,800 per month (out of which only Rs. 600 is used for the journey between office and residence ; the remaining amount is not spent) ; and entertainment allowance : Rs. 2,000 per month. He contributes 15 per cent of basic salary towards recognised provident fund and A Ltd. also makes a matching contribution. Interest is credited at the rate of 9.5 per cent.

After the death of X, his legal heir (i.e., Mrs. X) gets the following payments from A Ltd. :

1. *Salary for the month of January 2009.*
2. *Family pension : Rs. 20,000 per month.*

3. *Encashment of leave standing to the credit of X on January 31, 2009 : Rs. 2,40,000 (as per service rules X is entitled for 45 days leave for each year of service).*

4. *Provident fund balance : Rs. 3,90,000.*

5. *Gratuity : Rs. 2,60,000 (X is not covered by the Payment of Gratuity Act, 1972, nor is there any agreement with the employer to receive gratuity).*

X is a doctor. He runs a small clinic near his residence which is discontinued after the death of X. His income from the clinic for the period April 1, 2008 to January 31, 2009 is Rs. 79,000.

After the discontinuation of the clinic, Mrs. X recovers some of the outstanding bills issued by X (amount recovered during February 1, 2009 to March 31, 2009 : Rs. 1,76,000). Mrs. X does not have any other income. On March 30, 2009, Mrs. X withdraws Rs. 5,40,000 being the balance in account of X in National Saving Scheme, 1987.

Assuming that salary, allowances and pension become "due" on the last day of the month, find out —

a. who will be chargeable to tax in respect of the aforesaid receipts?

b. net income and tax liability for the assessment year 2009-10.

SOLUTION :

Income and tax computation of X	*Rs.*
Basic salary (Rs. 40,000 × 10)	4,00,000
Dearness allowance (Rs. 12,000 × 10)	1,20,000
Transport allowance (Rs. 6,000 × 10)	60,000
Entertainment allowance (Rs. 2,000 × 10)	20,000
Employer's contribution to recognised provident fund in excess of 12% of salary [i.e., 15% of Rs. 4,00,000 — 12% of (Rs. 4,00,000 + 40% of dearness allowance)]	6,240
Gross salary	6,06,240
Less : Standard deduction	—
Salary income	6,06,240
Professional income	79,000
Gross total income	6,85,240
Less : Deduction under section 80C [contribution to RPF]	60,000
Net income	6,25,240
Tax on Rs. 6,25,240	92,572
Add : Surcharge (not applicable if net income does not exceed Rs. 10 lakh)	*Nil*
Tax and surcharge	92,572
Add: Education cess (2% of tax and surcharge)	1,851
Add : Secondary and higher education cess (1% of tax and surcharge)	926
Tax liability (rounded off)	95,350
Income and tax computation of Mrs. X	
Income from profession	
Recovery of bill from patients after the death of X [Note 2, point (*d*)]	1,76,000
Income from other sources	
Salary of X of January 2009 (it is taxable as income of X)	-
Family pension (*i.e.*, Rs. 20,000 × 2)	40,000
Leave encashment (Note 1)	-
Provident fund (not taxable)	-
Gratuity (Note 2)	-
Withdrawal of balance from NSS 1987 (Note 3)	-
Total	2,16,000

	Rs.
Less : Deduction under section 57 in respect of family pension (*i.e.,* 1/3 of Rs. 40,000 or Rs. 15,000, whichever is lower)	13,333
Net income	2,02,670
Tax on Rs. 2,02,670 [rounded off]	2,340

Notes :

1. Leave encashment paid to legal heirs in respect of earned leave is not taxable—*see* para 49.3-3.

2. Gratuity received by Mrs. X (after the death of X) cannot be construed as income in the hands of X. The same is not "income" in the hands of Mrs. X and other legal heirs. One may argue that the exemption under section 10(*10*)(*iii*) is available even if the recipient of gratuity is widow of the employee. But the exemption provision cannot enlarge the scope of term "income". Merely because an exemption is available one cannot claim that the receipt is chargeable to tax. In this context, it is of interest to refer the following —

a. salary income is taxable either on "due" basis or on "receipt" basis, whichever comes earlier. "Gratuity" does not become due during the lifetime of X, nor is it paid to him before his death. It cannot be included in the income of X. As per section 159, when a person dies, his legal representative shall be liable to pay any sum which the deceased would have been liable if he had not died and all the provisions of the Act apply accordingly. However, the legal representative is not liable for payment of tax on income that had not accrued to the deceased till his death—*Arvind Bhogilal* v. *CIT* [1976] 105 ITR 764 (Bom.);

b. the Central Board of Direct Taxes has clarified that a lump sum payment made gratuitously or by way of compensation or otherwise to the widow or other legal heirs of an employee, who dies while still in the active service, is not taxable—Circular No. 573, dated August 21, 1990;

c. the Central Board of Direct Taxes in its Circular Letter No. F35/1/65 - IT(B), dated November 5, 1965, has clarified that salary paid to legal heirs of deceased employee in respect of earned leave is not taxable in the hands of the legal heirs (on the same analogy gratuity is not "income");

d. under section 176(4), where any profession is discontinued on account of death of the person carrying on the profession, any sum received after the discontinuance shall be deemed to be the income of the recipient (to tax gratuity in the hands of legal heirs, a similar provision has not been made) ;

e. the Central Board of Direct Taxes has further clarified in Circular No. 743, dated May 6, 1996 (in the context of taxability of unutilised deposit under the Capital Gains Deposit Account Scheme in the hands of legal heirs) that this amount is not taxable in the hands of legal heirs also as the unutilised portion of the deposit does not partake the character of income in their hands but is only a part of the estate devolving upon them.

On the basis of aforesaid reasoning, it can be said that gratuity received by Mrs. X is not "income" in her hands.

3. Amount withdrawn from the National Saving Scheme, 1987 is taxable in the hands of the recipient. If, however, the amount is received by legal heirs after the death of the depositor, it is not taxable in the hands of deceased or his legal heirs—Circular No. 532, dated March 17, 1989.

4. Income-tax return of X will be submitted by Mrs. X, as legal heirs of X.

63-P5 *Mrs. X (age 62 years) an employee-director of XYZ Ltd., submits the following information relevant for the assessment year 2009-10 —*

Salary : Rs. 2,56,000 ; entertainment allowance : Rs. 1,06,000 ; bonus : Rs. 1,11,200 ; education allowance : Rs. 2,000 (for her grandchildren), income-tax penalty paid by employer : Rs. 1,500 ; medical expenses reimbursed by employer : Rs. 12,100 ; leave travel concession : Rs. 51,300 (actual expenditure on fare is more than Rs. 51,300); free residential telephone : Rs. 11,000 ; free refreshment during office hours : Rs. 2,000 ; payment of electricity bills by employer Rs. 11,000 ; reimbursement of gas bills : Rs. 11,500 ; professional tax paid by Mrs. X : Rs. 1,650 ; furnished flat at concessional rate—lease rent of the house : Rs. 1,60,800 ; cost of maintenance of grounds (including salary of gardener) : Rs. 2,000, salary of two watchmen : Rs. 11,000, salary of sweeper : Rs. 6,200, rent of air-conditioner : Rs. 2,000, cost of furniture : Rs. 18,000 ; Car (1900cc) owned by the employer—cost of car : Rs. 6,70,000 ; maintenance of the car : Rs. 48,000, salary of driver : Rs. 24,000 (10 per cent of the expenditure is attributable for the journey between office and residence and back) ; arrears of bonus of 2004-05 (not taxed earlier) : Rs. 52,000, payment of delegation fee to FICCI for attending 30th All India Conference of Corporate Managers and Tax Executives : Rs. 3,000 ; employer's contribution towards recognised provident fund : Rs. 47,920, interest credited in PF account @ 14 per cent : Rs. 14,000 (credited on August 10, 2008) ; employer's contribution to superannuation fund : Rs. 7,200 ; employer's contribution to approved gratuity fund on accrual basis :

Rs. 2,700 ; dividend from XYZ Ltd., a foreign company : Rs. 57,880 and agricultural income from Nepal : Rs. 2,29,160. Mrs. X is a retired Government employee. She gets a sum of Rs. 14,700 per month as pension from the Government. During the year Mrs. X makes the following contribution and expenditure : (a) rent of furnished house paid to the employer : Rs. 11,200, (b) payment in respect of use of car : Rs. 6,000, as per service rule Mrs. X has to pay an amount equal to Rs. 2 per km., whenever car is used for personal purposes ; however, nothing is payable in respect of journey from office to residence and back, (c) contribution towards recognised provident fund : Rs. 30,000, (d) contribution towards superannuation fund : Rs. 7,200, (e) insurance premium for a policy on the life of her husband : Rs. 5,200 (sum assured : Rs. 90,000) (f) insurance premium for a policy of Rs. 10,000 on the life of her father : Rs. 4,000, (g) deposit in 10-year account under the Post Office Savings Bank (CTD) Rules including advance deposit of April-May 2009 : Rs. 2,400, and (h) payment of school fees of 2 children : Rs. 19,200 for each child.

Calculate the taxable income and tax liability of Mrs. X for the assessment year 2009-10, if she resides in Bombay, on the assumption that X owns a residential house property at Bombay and Goa.

SOLUTION :

Computation of taxable income	Rs.
Salary	2,56,000
Entertainment allowance	1,06,000
Bonus	1,11,200
Education allowance for grandchildren [taxable - see para 50.4-1]	2,000
IT penalty paid by the employer	1,500
Payment of electricity bills	11,000
Reimbursement of gas bills	11,500
Arrears of bonus	52,000
Furnished house at concessional rent [see Note 1]	90,340
Salary of two watchmen	11,000
Salary of sweeper	6,200
Salary of gardener	2,000
Car (not taxable)	*Nil*
Excess of employer's contribution towards provident fund over 12% of salary	17,200
Interest credited in PF account in excess over 9.5% (*i.e.*, Rs. 14,000 × 4.5 ÷ 14)	4,500
Pension from Government	1,76,400
Gross salary	8,58,840
Less : Deductions under section 16	
Standard deduction	*Nil*
Entertainment allowance	*Nil*
Professional tax	1,650
Income from salary	8,57,190
Dividend from XYZ Ltd.	57,880
Agricultural income from Nepal	2,29,160
Gross total income	11,44,230
Less : Deduction under section 80C	80,800
Net income (rounded off)	10,63,430
Income-tax on net income [see Annex 1] (a)	2,21,029
Add : Surcharge (not applicable as net income does not exceed Rs. 10 lakh)	22,103
Tax and surcharge	2,43,132
Add: Education cess (2% of tax and surcharge)	4,863
Add : Secondary and higher education cess (1% of tax and surcharge)	2,432
Tax payable	2,50,430

Notes :

1. *Valuation of the perquisite in the form of concessional rent* - Salary, for the purpose of valuation of perquisite, is Rs. 6,51,600 (*i.e.*, Rs. 2,56,000 + Rs. 1,06,000 + Rs. 1,11,200 + Rs. 2,000 + Rs. 1,76,400). Lease rent of the unfurnished house is Rs. 1,60,800. The perquisite value of the unfurnished house will be Rs. 97,740 (15% of salary). Value of furniture is Rs. 3,800 (being 10% of cost of furniture of Rs. 18,000+rent Rs. 2,000). Value of concession, therefore, works out to Rs. 90,340 (Rs. 97,740+Rs. 3,800—Rs. 11,200)[1].

2. Reimbursement of medical expenses, free residential telephone, free refreshment, payment of conference fees and leave travel concession reimbursed by the employer are not taxable in the hands of the employee.

3. Employer's contribution towards superannuation fund and approved gratuity fund are not taxable [see paras 57 and 58].

4. Mrs. X is entitled to claim relief under section 89 read with rule 21A in respect of arrears of bonus.

5. Deduction under section 80C is the total of the following qualifying amounts:

	Rs.
PF contribution	30,000
Superannuation fund contribution	7,200
Insurance premium on the life of husband	5,200
Insurance premium on the life of father (*not eligible)	*Nil**
Deposit under the Post Office Savings Bank (CTD) Rules (including advance deposit)	*Nil*
School fees of 2 children	38,400
Total	80,800

63-P6 *The following data is given by X (26 years) an employee of B & Co. (a firm).*

Salary	*9,00,000*
Allowance (taxable)	*1,08,000*
Perquisite in kind (taxable)	*1,80,000*
Perquisite in cash (taxable)	*1,22,000*
Amount of income-tax paid by employer	*1,40,000*
Any other income	*Nil*
Amount deductible under sections 80D and 80G	*46,000*
Deduction under section 80C	*94,000*

Find out the following—

a. *taxable income of X ;*
b. *tax liability of X ;*
c. *tax deductible under section 192 ;*
d. *amount exempt under section 10(10CC) ; and*
e. *amount not deductible under section 40(a)(v).*

SOLUTION :

Computation of income (all figures are in thousand)	*Rs. in thousand*
Salary	9,00
Allowances	1,08
Perquisite (non-monetary benefits)	1,80
Perquisite (monetary benefits)	1,22
Income-tax paid by employer (out of tax of Rs. 1,40 paid by employer, it is assumed that $x + y = 1,40$, y, being tax on 1,80 at the average rate of tax which is not taxable and x is the "excess" amount which is chargeable to tax)	x
Gross salary	13,10 + x
Less: Standard deduction	—
Salary	13,10 + x
Any other income	*Nil*
Gross total income	13,10 + x

	Rs. in thousand
Less : Deduction under section 80C	94
Less: Deductions under sections 80D and 80G	46
Net Income	11,70 + x
Income-tax	256 + 0.3x
Add : Surcharge	25.6 + 0.03x
Tax and surcharge	281.6 + 0.33x
Add : Education cess (2% of tax and surcharge)	5.632 + 0.0066x
Add : Secondary and higher education cess (1% of tax and surcharge)	2.816 + 0.0033x
Tax	290.048 + 0.3399x
Average rate of tax	$\frac{290.048 + 0.3399x}{11,70 + x}$
Tax at the average rate of tax on Rs. 180 which is exempt under section 10(*10CC*) and which is equal to y	$\frac{180(290.048+0.3399x)}{11,70 + x}$

Calculation of x and y

$x + y = 140$

$$y = \frac{180(290.048 + 0.3399x)}{1170 + x}$$

$$x + \frac{180(290.048 + 0.3399x)}{1170+x} = 140$$

Multiplying both sides by 1170 + x, one gets

$1170x+x^2 + (180 \times 290.048) + (180 \times 0.3399x)=(140 \times 1170)+ 140x$

$x^2 + (1170+180 \times 0.3399—140)x + (180 \times 290.048—140 \times 1170)=0$

The above expression is in the form of a quadratic equation: $ax^2+bx+c=0$

Where,

$a = 1$

$b = (1170+180\times0.3399-140) = 1091.182$

$c = (180\times290.048-140\times1170) = (-)\ 1,11,591.36$

$$x = \frac{-b \pm \ b^2 - 4ac\ ^{**}}{2a}$$

x = Rs. 94.144, (–) 1,185.326

x cannot be negative, therefore,

x = Rs. 94,144

y = Rs. 45,856

Results may be verified as follows—

	Rs.
Salary	9,00,000
Allowances	1,08,000
Non-monetary perquisites	1,80,000
Monetary perquisite (other than income-tax)	1,22,000
Income-tax paid by employer [y, being Rs. 45,856 is tax on Rs. 1,80,000 which is exempt under section 10(*10CC*) and the balance being x, *i.e.*, Rs. 94,144 is taxable out of total tax payment of Rs. 1,40,000 by the employer]	94,144
Gross salary	14,04,144
Gross total income	14,04,444

	Rs.
Less: Deduction under section 80C	94,000
Less: Deduction under sections 80D and 80G	46,000
Net income	12,64,140
Tax on net income	2,84,242
Add : Surcharge	28,424
Tax and surcharge	3,12,666
Add: Education cess (2% of tax and surcharge)	6,253
Add : Secondary and higher education cess (1% of tax and surcharge)	3,127
Tax	3,22,046
Average rate of tax (Rs. 3,22,046/Rs. 12,64,140)	25.48%
Tax @ 25.48% on Rs. 1,80,000 (*i.e., y*)	45,856
Income exempt under section 10(*10CC*)	45,856
Amount not deductible under section 40(*a*)(*v*)	45,856

**A well known formula for finding the value of '*x*' in a quadratic equation. For verification one may refer any 10th standard school text book on mathematics.

FREQUENTLY ASKED QUESTIONS (FAQs) ABOUT COMPUTATION OF SALARY INCOME

FAQ 1 - *In this book, the perquisite in respect of gardener is not taken as taxable perquisite, when gardener is provided by the employer along with a house (rent-free accommodation) owned by the employer. Rule 3 provides mode of valuation of different perquisite (including the perquisite in respect of gardener). When mode of valuation of perquisite is provided by rule 3, the gardener perquisite should always be chargeable to tax.*

Answer - "Perquisite" is a benefit to an employee at the cost of the employer. If there is no benefit to the employee at the cost of the employer, it cannot be taken as perquisite. Rule 3 provides mode of valuation of different perquisites including provision of a gardener. However, rule 3 is applicable only if there is a perquisite. To put it differently, if there is no personal benefit to the employee at the cost of the employer, rule 3 is not applicable. Rule 3 operates at the stage when a finding is reached that the employee is in receipt of a perquisite under section 17(*2*). Rule 3 cannot be used to determine whether an employee is really in receipt of any perquisite. This rule applies only for determining the value of the perquisite when the fact of receipt of perquisite is otherwise established. The moot point is, therefore, to decide whether provision of gardener is taken as a perquisite if gardener is provided along with a house (owned by the employer) to the employee.

The Central Board of Direct Taxes has commented upon a similar situation in Circular No. 122, dated October 19, 1973, the relevant extract of which is given below—

> "The Board in consultation with the Ministry of Law has re-examined the question of taxability of the salaries paid to the gardeners of the buildings belonging to the employers and occupied by the employees as a perquisite............ An individual might not be interested in having a gardener at all and he might allow the garden to run to weed. On the other hand, he might be an enthusiastic gardener who might himself have laid out large sums on the garden and have employed more gardeners than one. A gardener is employed by the employers primarily with a view to maintain the garden and he renders services whether or not the building is occupied by any employee. In view thereof, it amounts to the maintenance of the house and the grounds which the employer in any case would have done irrespective of the fact whether the building was occupied or vacant. As such, the amount spent on the salary of a gardener by the employer does not represent a sum paid by the employer in respect of any obligation which, but for such payment, would have been payable by the employee. The payment of salary to a gardener as such cannot be regarded as a perquisite so as to justify that amount being taxed in the hands of the employees. However, the expenses incurred by way of maintenance of a gardener may be taken into account for the purposes of estimating the value of the rent-free residential accommodation provided by the employer under rule 3 of the Income-tax Rules, 1962."

The aforesaid observations of the Board clearly pinpoint that the provision of gardener (when gardener is provided along with a house owned by the employer) cannot be taken as a perquisite, as the employer in any case would have maintained the garden irrespective of the fact whether building was occupied by the employee or lying vacant. Since there is no perquisite, the mode of valuation, as provided by rule 3, does not have any practical utility in such a situation. The Board has further clarified that the expenditure on maintenance of garden will be considered while calculating fair market value of the house for the purpose of estimation of the perquisite value of rent-free house. The above Circular was issued in 1973 and at that time, "salary" of an employee as well as "fair rental value" of the house was considered to arrive at the figure of taxable value of the perquisite in respect of rent-free house. Now days, 15% (in some cases 7.5% or 10%) of "salary" of an employee is taxable value of the perquisite in respect of a house owned by the employer. Fair rental value of the house (which also includes garden maintenance expenditure incurred by the employer) is not taken into consideration. Garden maintenance expenditure (including

salary of gardener) and other expenses on general maintenance of the building, do not affect taxable value of house perquisite.

Salary of gardener paid by the employer is not a "perquisite" when gardener is provided along with a house owned by the employer. Expenditure on maintenance of garden (including salary of gardener) cannot be considered even at the time of valuation of the perquisite in respect of rent-free house.

CHAPTER FIVE

Income from house property

Chargeability [Sec. 22]

86. Income is taxable under the head "Income from house property", if the following three conditions are satisfied :

Condition 1	The property should consist of any buildings or lands appurtenant thereto.
Condition 2	The assessee should be owner of the property.
Condition 3	The property should not be used by the owner for the purpose of any business or profession carried on by him, the profits of which are chargeable to income-tax.

Unless, therefore, all the aforesaid conditions are satisfied, the property income cannot be charged to tax under the head "Income from house property".

In other words, if all the aforesaid conditions are satisfied, property income is taxable under section 22 under the head "Income from house property". It makes no difference if the assessee is a company which has been incorporated with the object of buying and developing landed properties—*S.G. Mercantile Corpn. (P.) Ltd.* v. *CIT* [1972] 83 ITR 700 (SC). It equally makes no difference that the property constitutes stock-in-trade of a business or the business of the assessee is to let out house properties—*O.RM.SP.S.V. Firm* v. *CIT* [1960] 39 ITR 327 (Mad.), *Salisbury House Estate Ltd.* v. *Fry* [1930] AC 432 (HL).

Provisions illustrated - The following illustrations are given to have a better understanding—

1. X owns a building. It is given on rent. Income of the property is taxable under the head "Income from house property", as the above-noted three conditions are satisfied.

2. Y owns a building. It is used by him for carrying on a business or he uses the building as his office/factory/godown. In this case, no income is taxable under the head "Income from house property", as condition (c) is not satisfied.

86.1 *Property consisting of any buildings or land appurtenant thereto* - The term "property" is very wide, though under section 22 it is used for a limited purpose, *i.e.*, the property "consisting of any buildings or lands appurtenant thereto". All other types of properties are, thus, excluded from the scope of section 22. Rental income of a vacant plot (not appurtenant to building) is not chargeable to tax under the head "Income from house property", but is taxable either under the head "Profits and gains of business or profession" or under the head "Income from other sources", as the case may be.

86.1-1 ***"BUILDING" DEFINED*** - *The Random House Dictionary of the English Language* defines building as "a relatively permanent, essentially box-like construction having a roof and used for any of a wide variety of activities, as living, entertaining or manufacturing". *The Webster's New International Dictionary* assigns the following meaning to the word building : "That which is built ; specifically, as now generally used, a fabric, or edifice, framed or constructed, designed to stand more or less permanently, and covering a space of land, for use as a dwelling, store house, factory, shelter for beasts or some other useful purpose ; building in this sense does not include a mere wall, fence, monument, hoarding or similar structure though designed for permanent use where it stands ; not a steam boat, ship or other vessel of navigation."

Apart from the dictionary meaning discussed above, many courts have given judicial interpretation of the word "building", some of which are summarised as under :

1. An incomplete house or a house which is in ruins without a roof and without doors cannot be called a building—*Baladin* v. *Lakhan Singh* AIR 1927 All. 214.

2. There may be a building constructed of wood as well as of brick or stone, and it is not necessary that there should be a roof to cover in order to construct a building— *Waite's Executors* v. *IRC* [1914] 3 KB 196 (CA).

3. The word "building" *prima facie* means every structure that could in any sense be called a building, even if erected for a merely temporary purpose—*Fielding* v. *Rhyl Improvement Commission* [1978] 3 CPD 272.

4. From the definition (of the word building in *Webster's New International Dictionary*) it does not appear that the existence of a roof is always necessary for a structure to be regarded as a building. Residential buildings ordinarily have roofs but there can be a non-residential building for which a roof is not necessary. A large stadium or an open air swimming pool constructed at a considerable expense would be a building as it is a permanent structure and designed for a useful purpose. The question as to what is a "building" must always be a question of degree—a question depending upon facts and circumstances of each case—*Ghanshiam Das* v. *Debi Prasad* AIR 1966 SC 1998.

■ *Concluding remarks* - Thus, the word "building" is wide enough to include residential house (whether let out or self-occupied), building let out for office use or for storage or for use as factory, music halls, dance halls, lecture halls, and other public auditorium used for cinema and stage shows.

86.1-2 *"LAND APPURTENANT THERETO" - MEANING OF* - The appurtenant lands in respect of a residential building may be in the form of approach roads to and from public streets, compounds, courtyards, backyards, playgrounds, kitchen garden, motor garage, stable or a coach home, cattle-shed, etc., attached to and forming part of building. In respect of a non-residential building, the appurtenant lands may be in the form of car-parking spaces, roads, connecting one department with another department, playgrounds for the benefit of employees, etc.

As stated earlier, income from vacant plot is not taxed under the head "Income from house property". Ground rent accrued to the owner of a plot of land is not taxable under section 22—*Chowdhury Sharafat Hussain* v. *CIT* [1956] 29 ITR 759 (Pat.). Moreover, income from building sites, till a building is built, is not taxable under this head of income.

Where the assessee has a well in the compound of her dwelling house from which she supplies water to certain companies on payment basis, the assessee's claim that the well is 'land appurtenant to building' and as such income therefrom is taxable under the head "Income from house property", cannot be accepted—*M. Ramalakshmi Reddi* v. *CIT* [1998] 100 Taxman 509/232 ITR 281 (Mad.).

86.2 ***Assessee should be owner of the property*** - Income is taxable under the head, "Income from house property" only if the assessee is the owner of a house property. Income from subletting is not taxable under section 22, but is taxable under section 56 under the head "Income from other sources". It is immaterial whether the owner is in possession and enjoyment of house property or has been let out to third persons.

86.2-1 *MEANING OF THE WORD "OWNER"* - The word "owner" means a legal owner. For the purpose of section 22, owner may be an individual, firm, company, co-operative society, or association of persons. Annual value of property is assessed to tax under section 22 in the hands of owner even if he is not in receipt of income or even if income is received by some other person. For instance, if a person makes gift of rental income to a friend or a relative, without transferring ownership of the property, annual value of property is taxable in the hands of the donor, even if rental income is received by the donee—*S. Kartar Singh* v. *CIT* [1969] 73 ITR 438 (Delhi). In other words, for the purpose of section 22, the owner must be that person who can exercise the rights of the owner, not on behalf of the owner but in his own right—*R.B. Jodha Mal Kuthiala* v. *CIT* [1971] 82 ITR 570 (SC). To put it differently, "owner" for the purpose of section 22 is a person who is entitled to receive income in his own right and as such where a property is handed over to a purchaser to enjoy fruits of that property by the builder, the purchaser is treated as "owner" of that property even though no registered document has been executed in his favour—*CIT* v. *Podar Cement (P.) Ltd.* [1997] 92 Taxman 541 (SC).

■ *Ownership need not be extended to site* - It is not necessary that ownership should extend to the site on which building stands as well as to the superstructure. For instance, if a person builds a superstructure upon a site held by him under a leasehold agreement, he will be the owner of the superstructure and, accordingly, annual value of the superstructure would be taxable in his hands during the currency of lease—*CIT* v. *Estate of Omprakash Jhunjhunwala* [2002] 124 Taxman 111 (Cal.). The position will remain so even if he were to transfer the superstructure to the lessor free of cost on the expiry of lease term. Income of plot of land, *i.e.*, ground rent, is taxable in the hands of the lessor under the head "Profits and gains of business or profession" if the lessor is engaged in the business of letting plot of lands on lease or under the head "Income from other sources" if the lessor is not so engaged.

■ *Income from subletting* - Income from subletting is not taxable as income from house property†. For instance, X owns a house property. He lets it out to Y (rent being Rs. 10,000 per month). Y sublets it to Z on monthly rent of Rs. 40,000. Rental income of X is taxable under the head "Income from house property". Since Y is not the owner of the house, his income is not taxable as under the head "Income from house property", but is taxable as business income under section 28 or as income from other sources under section 56.

86.2-2 ***"OWNER" IN CERTAIN TYPICAL CASES*** - Under the law of insolvency, property of insolvent vests in the Official Assignee. Therefore, Official Assignee can be treated as "owner" for the purpose of section 22—*Re. Official Assignee for Bengal* [1937] 5 ITR 233 (Cal.). If, however, a Receiver is appointed by the Court, the property of the insolvent does not vest in the Receiver. Receiver cannot, therefore, be charged to tax as owner under section 22. In case of mortgage of property, mortgagor of property (not mortgagee) is alone charged to tax under section 22. Where a property is owned by partnership, it is the firm which is assessable under section 22 ; individual partners cannot, therefore, be assessed under section 26 as co-owners—*Sarvamangala Properties Ltd.* v. *CIT* [1973] 90 ITR 267 (Cal.). The same holds true in case of property owned by an association of persons. If property is held under a trust, the income under section 22 is taxable either in the hands of trustees or in the hands of beneficiaries.

Where under a will, life interest in the deceased's property is given to specific legatees, annual value will be assessable in the hands of the legatee and not in the hands of the executor—*Estate of Ambalal Sarabhai* v. *CIT* [2000] 245 ITR 445 (Guj.).

86.2-3 ***OWNER IN THE PREVIOUS YEAR*** - As tax is levied only on the income of previous year, annual value of property, owned by a person during the previous year, is taxable in the following assessment year, even if the assessee is not owner of the property during the assessment year.

86.2-4 ***DEEMED OWNER*** - Besides the legal owner, section 27 provides that the following persons are to be treated as deemed owner of house property for the purpose of charging tax on annual value under the head "Income from house property" :

86.2-4a TRANSFER TO SPOUSE OR MINOR CHILD - The following conditions should be satisfied:—

Condition 1	The taxpayer is an individual.
Condition 2	He or she transfers a house property.
Condition 3	The property is transferred to his/her spouse (not being a transfer in connection with an arrangement to live apart) or to his/her minor child (not being a married daughter).
Condition 4	The property is transferred without adequate monetary consideration.

If the above conditions are satisfied, then the individual who has transferred the property would be deemed as "owner" of the property.

†For exceptions, *see* para 86.2-4d.

Provisions illustrated - The following illustrations are given to have better understanding—

1. X, an individual, owns a house property. On April 1, 2008, he transfers the property without any consideration to his wife. Rental income is received by Mrs. X after April 1, 2008. However, for the purpose of charging tax on rental income, X will be deemed as "owner" of the property. Consequently, income would be taxable in the hands of X.

2. Y gifts Rs. 10,00,000 to Mrs. Y. Mrs. Y purchases a house property out of the gifted money. In this case, the aforesaid provisions are not applicable, as Y has transferred a sum of money to his wife who has purchased a property out of the gifted amount (he has not transferred a house property). Consequently, Y will not be deemed as "owner" of the property. In such a case, income of the property would be computed in the hands of Mrs. Y (as she is the owner of the property) and the income so calculated will be included in the income of Y under the provisions of section 64(1) [see para 209].

86.2-4b HOLDER OF IMPARTIBLE ESTATE - The holder of impartible estate is deemed as owner of the property.

Provisions illustrated - X is one of the ex-Rulers of a former princely State. He has divided all his properties amongst his three sons. However, he could not transfer a building, which is occupied by a temple and which is given, as per family convention, to his eldest son (all the three brothers along with other family members have the right to enjoy the benefit of the property; property is given to the eldest son as it cannot be divided amongst the three brothers as per the family convention; the eldest son is not the beneficial owner of the property; in other words, he holds the property as a trustee on behalf of his younger brothers). For the purpose of section 22, the eldest son, as holder of "impartible estate", is deemed as "owner" of the property.

86.2-4c PROPERTY HELD BY A MEMBER OF CO-OPERATIVE SOCIETY/COMPANY/AOP - A member of co-operative society, company or other association of persons to whom a building (or a part thereof) is allotted or leased under the house building scheme of the society, company or association, is treated as deemed owner of such property.

Provisions illustrated - A flat is allotted by a co-operative group housing society to its members under the house building scheme of the society. Members are deemed as "owners" of the property for the purpose of section 22 (although under the general law the property is owned by the co-operative society). Once a member of a co-operative society is deemed to be owner of a building under section 27(*iii*), irrespective of fact that legal ownership continues to vest with co-operative society, co-operative society cannot be assessed under section 22 in respect of rental income from building—***Monarch Citadel (P.) Ltd.*** v. ***ITO*** [2006] 10 SOT 293 (Bang.).

86.2-4d A PERSON WHO HAS ACQUIRED A PROPERTY UNDER A POWER OF ATTORNEY TRANSACTION - If a person has acquired a property under a "power of attorney transaction" by satisfying the conditions of section 53A of the Transfer of Property Act, then he is deemed as owner of the property, although he may not be the "registered owner" of the property. Section 53A of the Transfer of Property Act requires the following conditions :

Condition 1	There is an agreement in writing between purchaser and seller.
Condition 2	The purchaser has paid the consideration or he is ready to pay the consideration. If there is no consideration as in the case of gift, then section 53A of the Transfer of Property Act is not applicable. Actual payment of consideration is not important. What is important is the fact that the purchaser is ready to make payment whenever the payment becomes due—***Sushma Rani Bansal*** v. ***CIT*** [2007] 165 Taxman 145 (Delhi)(Mag.).
Condition 3	The purchaser has taken the possession of the property. It is enough if transferee has, by virtue of that transaction, a right to enter upon and exercise acts of possession effectively—***Authority for Advance Rulings*** v. ***Jasbir Singh Sarkaria, In re*** [2007] 164 Taxman 108 (AAR - New Delhi).

If the aforesaid three conditions are satisfied, the purchaser becomes the deemed "owner" of the property for the purpose of income-tax, even if he is not the registered owner of the property.

Provisions illustrated - X enters into a written agreement to purchase a property from Y for Rs. 25,00,000. He has paid the consideration and taken possession of the property. The sale deed is yet to be registered. He becomes deemed "owner" of the property for the purpose of paying tax on rental income, although he is not the registered owner of the property.

86.2-4e A PERSON WHO HAS ACQUIRED A RIGHT IN A BUILDING UNDER SECTION 269UA(f) - If a person acquires a right in a building by virtue of a transaction which is referred to in section 269UA(*f*), then he is

deemed as owner of the property. Broadly speaking, section 269UA(*f*) covers giving a property on lease for a term of not less than 12 years (whether fixed originally or there is a provision for extension of term and the aggregate period is not less than 12 years). The above-noted provision of deemed ownership does not cover any right by way of a lease from month to month or for a period not exceeding one year.

From the provisions of section 27(*iiib*) read with section 269UA(*f*) it is clear that where the period of lease is more than 12 years, lessee is deemed to be the owner of the property for purpose of assessment—***Yagyawati Jayaswal Family Trust*** v. ***ITO*** [2004] 89 ITD 199 (Kol.)(SMC).

Provisions illustrated - The following illustrations are given to have better understanding—

1. X owns a property. It is given on lease for a period of 12 years to Y, lease rent being Rs. 40,000 per month. As the period of lease is not less than 12 years, Y becomes deemed "owner" of the property.

2. A owns a property. It is given on lease for a period of 6 years to B, lease rent being Rs. 20,000 per month. B has a right to get renewal of lease for further period of 6 years after the expiry of lease. In this case, the aggregate period of lease is not less than 12 years. Therefore, B is deemed as "owner" of the property.

3. C owns a property, which is given on lease to D for a period of one month, rent being Rs. 10,000. D has a right to get renewal of the lease subject to the condition that every time it will be renewed only for a period of one month and such renewal is possible with mutual consent till 2050. In this case, the aggregate period of lease is more than 12 years, but D will not become deemed "owner" of the property (the property is given on lease from month to month).

86.3 ***Property should not be occupied by the owner for his own business or profession*** - Annual value of a house property is not chargeable to tax under the head "Income from house property", if the following conditions are satisfied—

Condition 1	The owner of the property utilizes the property for the purposes of carrying on his business or profession [for a few examples, *see* para 86.3-1].
Condition 2	Income of the above business or profession is chargeable to tax.

If the above conditions are satisfied, annual value of the property is not taxable under section 22 under the head "Income from house property". This rule is applicable even if in a particular year income from business or profession is *nil* or there is loss. The reason of this exclusion seems to be that notional rent of property is not allowable as a permissible deduction while computing business income, if a person carries on business or profession in his own house property.

▪ *Property owned by partner and used by firm* - For the purpose of section 22, the business carried on by the firm should be regarded as being carried on by all the partners. Thus, annual letting value of a building belonging to the assessee which is in the occupation of a firm in which the assessee is partner, is not includible in income of the assessee under section 22—*CIT* v. *K.M. Jagannathan* [1989] 180 ITR 191 (Mad.), *CIT* v. *P.T. Mannel* [1989] 47 Taxman 108 (Ker.), *CIT* v. *N. Vaidhyanathan* [1989] 180 ITR 198 (Mad.), *CIT* v. *Rabindranath Bhol* [1995] 211 ITR 799 (Ori.), ***CIT*** v. ***Mustafa Khan*** [2005] 145 Taxman 522 (All.).

Where karta of HUF is partner in firm in representative capacity and property belonging to HUF is occupied by firm for carrying on business, exemption under section 22 will be available to HUF—*CIT* v. *Shri Champalal Jeevraj* [1995] 215 ITR 289 (Mad.).

The contrary view expressed by the Karnataka High Court in *CIT* v. *K.N. Guruswamy* [1984] 146 ITR 34, it is respectfully submitted, requires reconsideration.

▪ *Property used by sister concern* - The occupation of the properties by the employees of the sister concern cannot be construed as an occupation by the employees of the assessee themselves for the purpose of claiming exemption under section 22—***CIT*** v. ***T.V. Sundaram Iyengar & Sons Ltd.*** [2004] 271 ITR 79 (Mad.).

86.3-1 *WHERE LETTING OUT IS SUBSERVIENT AND INCIDENTAL TO THE MAIN BUSINESS* - If an assessee constructs residential quarters and lets them out to his employees and letting out of residential quarters is subservient and incidental to the main business, the residential quarters will be treated

as house property used by the assessee for the purpose of his business and, accordingly, annual value thereof will not be chargeable under section 22—*CIT* v. *Delhi Cloth & General Mills Co. Ltd.* [1966] 59 ITR 152 (Punj.). Rent, if any, charged by the assessee, in such a case, is taxable under the head "Profits and gains of business or profession". If the assessee makes its accommodation available to the Government for locating a branch of nationalised bank, post office, police station, central excise office and railway staff quarters with the aim of *carrying on its business efficiently and smoothly*, rent collected is not chargeable under the head "Income from house property" but is assessable under section 28.

- *Used as residence of employee or directors* - When a house property is occupied as residence by employees or its directors, etc., who are concerned with promotion of business of the assessee-company, whether on payment of rent or otherwise, to enable them to discharge their functions efficiently and letting out of property is subservient and incidental to the main business of the assessee, such an occupation amounts to an occupation and user of property by the assessee itself for the purposes of its business, even though no business is actually run in such premises, and income from such property is not assessable as income from house property— *CIT* v. *Modi Industries Ltd.* [1994] 73 Taxman 691/210 ITR 1 (Delhi) (FB).

- *Question of law* - Whether an assessee is "occupying" any part of building for the purpose of any business/profession carried on by him, the profits of which are assessable to tax, is a question of law—*Upper India Chamber of Commerce* v. *CIT* [1947] 15 ITR 263 (All.).

86.3-2 **DEPRECIATION, REPAIRS AND COLLECTION CHARGES** - It is worthwhile to note that in respect of house property owned by the assessee and used by him for his own business or profession, depreciation is allowable under section 32 (whereas no deduction on account of depreciation allowance is allowed in respect of house property, income from which is chargeable under section 22). Moreover, in such case, actual repair expenses and collection charges (in the case of residential quarters let out to employees or where letting is incidental to main business) are allowed as business deduction under sections 31 and 37 (instead of 30 per cent of net adjusted annual value under section 24 which is applicable only if annual value is taxable under section 22).

Applicability of section 22 in certain typical situations

87. Apart from the points discussed in para 86, the following points are relevant for understanding the implications and scope of section 22 :

87.1 ***House property in a foreign country*** - A resident assessee is taxable under section 22 in respect of annual value of a property situated in a foreign country. A resident but not ordinarily resident or non-resident is, however, chargeable under section 22 in respect of income of a house property situated abroad, if income is received in India during the previous year. If tax incidence is attracted under section 22 in respect of a house property situated abroad, annual value will be computed as if the property is situated in India. The Madras High Court in *CIT* v. *R. Venugopala Reddiar* [1965] 58 ITR 439 observed that while computing taxable income, no distinction should be made between a house property situated in India and a house property situated abroad.

87.2 ***Disputed ownership*** - If title of ownership of a house property is under dispute in a court of law, the decision as to who is the owner rests with the Income-tax Department. The department has *prima facie* the power to decide whether the assessee is the owner and is chargeable to tax under section 22, without waiting for judicial judgment of any suit filed in respect of the property—*Re. Keshardeo Chamaria* [1937] 5 ITR 246 (Cal.). It was observed in *Franklin* v. *IRC* 15 TC 464 that the recipient of income is taxable though there may be a rival claim as to the title of source of income and he may have to give up and account for what he is taxed upon.

87.3 ***Property held as stock-in-trade*** - As a specific head of charge is provided for income from house property, annual value of house property cannot be brought to tax under any other head of income. It will remain so even if—

a. the property is held by the assessee as stock-in-trade of a business; or

b. the assessee is engaged in the business of letting out of property on rent, or if the assessee is a company which is incorporated for the purpose of owning house property.

House-owning, however profitable, is neither trade nor business for the purpose of the Act. Where income is derived from house property by the exercise of property rights, income falls under the head "Income from house property"—*CIT* v. *National Storage (P.) Ltd.* [1963] 48 ITR 577 (Bom.).

87.3-1 *EXCEPTIONS* - The rule that income from ownership of house property is taxable under the head "Income from house property" has the following exceptions :

- *Exception one - Letting is incidental and subservient to the main business* - If the letting is only incidental and subservient to the main business of the assessee, rental income is not taxable under the head "Income from house property" but is chargeable as business income under the head "Profits and gains of business or profession" [*see* also para 86.3-1].
- *Exception two - Hiring of complex* - In some cases, income is received not only for letting out of property but also for incidental services or facilities (*e.g.*, a furnished paying guest accommodation, a well equipped theatre, a safe deposit vault). In such cases, the subject hired out is a complex one. The income cannot be said to be derived from mere ownership of house property but because of facilities and services rendered. Income in such case may be assessed as income from business.

87.4 ***Splitting up of a composite rent*** - Apart from recovering rent of the building, in some cases, the owner gets rent of other assets (like furniture) or he charges for different services provided in the building (for instance, charges for lift, security, air conditioning, etc.). The amount so recovered is known as "composite rent". The tax treatment of the composite rent is as follows —

87.4-1 *WHERE COMPOSITE RENT INCLUDES RENT OF BUILDING AND CHARGES FOR DIFFERENT SERVICES (LIKE LIFT, AIR CONDITIONING)* - If the owner of a house property gets a composite rent for the property as well as for services rendered to the tenants, composite rent is to be split up and the sum which is attributable to the use of property is to be assessed in the form of annual value under section 22. The amount which relates to rendition of the services (such as electricity supply, provision of lifts, supply of water, arrangement for scavenging, watch and ward facilities, etc.) is charged to tax under the head "Profits and gains of business or profession" or under the head "Income from other sources".

Provisions illustrated - The following illustrations are given to have better understanding—

1. X owns a property. It is given on rent to Y. Y annually pays Rs. 1,00,000 as rent of the property and Rs. 20,000 for different services like lift, security, air-conditioning, etc. In this case, Rs. 20,000 is not taxable in the hands of X as income from house property. Rs. 20,000 would be taxed in the hands of X after deducting his actual expenditure for providing different services (lift, security, air-conditioning, etc.) as income from other sources or as business income.

2. A owns a property. It is given on rent to B. B annually pays Rs. 1,50,000 as rent of the building as well as the charges for different services (like lift, security, etc.) provided by A. In this case, one has to split up the annual payment of Rs. 1,50,000 into rent of the building and charges for different services. The amount, which relates to rendition of the services (after deducting actual expenditure) is taxable either as business income or as income from other sources. The sum, which is attributable to the use of the property, is to be assessed in the form of annual value under section 22 under the head "Income from house property". This rule is applicable even if it is difficult to split up the annual payment of Rs. 1,50,000. In other words, in such a case it is not legally correct to assess the entire amount of Rs. 1,50,000 (*less* expenditure) as business income or as income from other sources.

87.4-2 *WHERE COMPOSITE RENT IS RENT OF LETTING OUT OF BUILDING AND LETTING OUT OF OTHER ASSETS (LIKE FURNITURE) AND THE TWO LETTINGS ARE NOT SEPARABLE* - If there is letting of machinery, plant and furniture and also letting of the building and the two lettings form part and parcel of the same transaction or the two lettings are inseparable (in the sense that letting of one is not acceptable to the other party without letting of the other), then such income is taxable either as business income or income from other sources. This rule is applicable even if sum receivable for the two lettings is fixed separately.

Provisions illustrated - The following illustrations are given to have better understanding—

1. X owns an air-conditioned furnished lecture hall. It is let out, annual rent being Rs. 5,00,000 (it includes rent of building and rent of air-conditioner and furniture). In this case, letting of lecture hall is not separable from the letting

of air-conditioner/furniture. This income (after excluding expenditure) is taxable as business income or as income from other sources.

2. X owns an air-conditioned furnished lecture hall. It is let out, annual rent being Rs. 3,00,000 for building and Rs. 2,00,000 as rent of air-conditioner and furniture. In this case, letting of lecture hall is not separable from the letting of air-conditioner/furniture. This income (after excluding expenditure) is taxable as business income or as income from other sources. This rule is applicable even if one can find out rent of building and rent of air-conditioner/furniture separately.

87.4-3 ***WHERE COMPOSITE RENT IS RENT OF LETTING OUT OF BUILDING AND LETTING OUT OF OTHER ASSETS AND THE TWO LETTINGS ARE SEPARABLE*** - If there is letting out of building and letting of other assets and the two lettings are separable (in the sense that letting of one is acceptable to the other party without letting out of the other ; for instance letting out of building along with car), then income from letting out of building is taxable under the head "Income from house property" and income from letting out of other assets is taxable either as business income or income from other sources. This rule is applicable even if the assessee receives composite rent from his tenant for two lettings.

87.5 ***Property owned by co-owners [Sec. 26]*** - If a house property is owned by two or more persons, such persons are known as co-owners. Section 26 covers a case if a property is owned by co-owners. Section 26 is applicable if the following conditions are satisfied —

1. The property must consist of building or building and land appurtenant thereto.

2. It is owned or deemed to be owned by two or more persons.

3. The respective shares of the co-owners are definite and ascertainable.

If these conditions are satisfied, then the share of each co-owner in the income of the property (as computed under the head "Income from house property") shall be included in the total income of each such person. The following points should be noted —

1. In respect of property income, co-owners shall not be assessed as an association of persons.

2. The concessional tax treatment in respect of self-occupied property [*see* para 91.1] is applicable as if each such person is individually entitled to such relief.

87.6 ***Other points*** - One should also keep in view the following propositions :

- *Transfer by book entries* - If a firm transfers its house property to its partners before dissolution, merely by book entries, annual value of the property is taxable in the hands of the firm—*Inder Narain Har Narain* v. *CIT* [1980] 3 Taxman 365 (Delhi).
- *Stalls permanently affixed* - Since the words "building" and "house property" are not defined under the Act, annual value of stalls permanently affixed to the ground is taxable under section 22—*CIT* v. *Kanaiyalal Nimani* [1979] 120 ITR 892 (Cal.).
- *Onus of proof* - In order to attract taxability, the onus is on the revenue to prove that an assessee is the owner of building in question—*CIT* v. *Fazalbhoy Investment Co. (P.) Ltd.* [1977] 109 ITR 802 (Bom.).

Principle of mutuality vis-a-vis section 22

88. Tax levied under section 22 is tax on income from house property and it is not tax on house property.

A club owns a house property and it provides recreational and refreshment facilities exclusively to its members and their guests. Its facilities are not available to non-members. The club is run on 'no profit no loss' basis in that the members pays for all their expenses and are not entitled to any share in the profit. Surplus, if any, is used for maintenance and development of the club.

The business of trust is governed by principle of mutuality. It is not only the surplus from the activities of the business of the club that is excluded from the levy of income-tax, even the annual value of the club house as contemplated in section 22 will be outside the purview of the levy of income-tax—*Chelmsford Club* v. *CIT* [2000] 109 Taxman 215 (SC).

Property income exempt from tax

89. Property income is exempt from tax in the following cases :

a. income from farm house [sec. 2(*1A*)(*c*) read with sec. 10(*1*)—*see* also para 278] ;

b. annual value of any one palace of an ex-ruler [sec. 10(*19A*)] ;

c. property income of a local authority [sec. 10(*20*)—*see* para 38.37] ;

d. property income of an approved scientific research association [sec. 10(*21*)] ;

e. property income of a university or other educational institutions [sec. 10(*23C*)—*see* para 38.53-2] ;

f. property income of a hospital or other medical institution [sec. 10(*23C*)—*see* para 38.53-3];

g. property income of a trade union [sec. 10(*24*)] ;

h. house property held for charitable purposes [sec. 11—*see* para 343] ;

i. property income of a political party [sec. 13A—*see* para 43] ;

j. property used for own business or profession [sec. 22—*see* para 86.3] ; and

k. one self-occupied property [sec. 23(2)—*see* para 91].

Besides the aforesaid exemptions, rental income of a co-operative society included in gross total income is subject to the following deductions :

- Income derived by a co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities, is wholly deductible under section 80P(2)(*e*).
- If the gross total income of co-operative society (not being a housing society or an urban consumers' society or a society carrying on transport business or a society engaged in the performance of any manufacturing operations with the aid of power) does not exceed Rs. 20,000, any income from house property is fully deductible under section 80P(2)(*f*).

Computation of income from a let out house property

90. Income from a let out house property is determined as under :

	Rs.
Gross annual value [*see* para 90.1]	xxxx
Less : Municipal taxes [*see* para 90.2]	xxxx
Net annual value	xxxx
Less : Deductions under section 24 [*see* para 90.3]	
- Standard deduction [*see* para 90.3-1]	xxxx
- Interest on borrowed capital [*see* para 90.3-2]	xxxx
Income from house property	xxxx

90.1 ***Gross annual value [Sec. 23(1)]*** - Tax under the head "Income from house property" is not a tax upon rent of a property. It is taxed on inherent capacity of a building to yield income. The standard selected as a measure of the income to be taxed is "annual value".

Gross annual value is determined† as follows—

Step I	Find out reasonable expected rent of the property [*see* para 90.1-1]
Step II	Find out rent actually received or receivable after excluding unrealized rent but before deducting loss due to vacancy [*see* para 90.1-2]

†The mode of computation of annual value given in this edition of the book is simpler and different from the computation mode given in earlier editions (*i.e.*, up to 40th edition). However, the amount of annual value of a property in any given case will be the same whether one follows the method given in this edition or one goes by the method given in earlier editions. One may also refer to the discussion given in Annex to this chapter.

Step III	Find out which one is higher - amount computed in *Step I* or *Step II.*
Step IV	Find out loss because of vacancy
Step V	*Step III minus Step IV* is gross annual value [*see* para 90.1-3]

90.1-1 *STEP I - FIND OUT REASONABLE EXPECTED RENT [SEC. 23(1)(a)]* - Reasonable expected rent is deemed to be the sum for which the property might reasonably be expected to be let out from year to year.

In determining reasonable rent, several factors have to be taken into consideration, such as, location of the property, annual ratable value of the property fixed by municipalities, rents of similar properties in neighbourhood, rent which the property is likely to fetch having regard to demand and supply, cost of construction of the property and nature and history of the property. These factors play a vital role in determining reasonable expected rent of a house property. In a majority of cases, however, reasonable expected rent can be determined by taking into consideration the following factors :

a. municipal valuation of the property [*see* para 90.1-1a]; or

b. fair rent of the property [*see* para 90.1-1b].

The higher of (*a*) or (*b*) is generally taken as reasonable expected rent.

If, however, a property is covered by a Rent Control Act, then the amount so computed cannot exceed the standard rent [*see* para 90.1-1c] determinable under the Rent Control Act.

90.1-1a MUNICIPAL VALUATION - For collecting municipal taxes, local authorities make a periodical survey of all buildings in their jurisdiction. Such valuation may be taken as a strong evidence representing the earning capacity of a building—*C.J. George* v. *CIT* [1973] 92 ITR 137 (Ker.). It cannot, however, be considered to be a conclusive evidence—*Jamnadas Prabhudas* v. *CIT* [1951] 20 ITR 160 (Bom.). Moreover, in some big cities (like Delhi, Mumbai, Chennai, Kolkata) municipal authorities determine net ratable value after deducting 10 per cent of the gross ratable value, on account of repairs, and an allowance for service taxes (such as sewerage tax and water tax). The net municipal valuation, therefore, requires an adjustment for determining reasonable expected rent for income-tax purposes.

90.1-1b FAIR RENT OF THE PROPERTY - Fair rent of the property can be determined on the basis of a rent fetched by a similar property in the same or similar locality. Though two properties cannot be alike in every respect, it has been observed in *Stocks* v. *Sulley* 4 TC 98 that the evidence afforded by transactions of other parties in the matter of other properties in the neighbourhood, more or less comparable with the property in question, is very relevant in arriving at reasonable expected rent.

90.1-1c STANDARD RENT UNDER THE RENT CONTROL ACTS - Standard rent is the maximum rent which a person can legally recover from his tenant under a Rent Control Act. The Supreme Court has observed in the cases of *Shiela Kaushish* v. *CIT* [1981] 7 Taxman 1 and *Amolak Ram Khosla* v. *CIT* [1981] 7 Taxman 51 that a landlord cannot reasonably expect to receive from a hypothetical tenant anything more than the standard rent under the Rent Control Act. This rule is applicable even if a tenant has lost his right to apply for fixation of the standard rent. This rule is also applicable to the owner himself. These judgments make it clear that if a property is covered under the Rent Control Act, its reasonable expected rent cannot exceed the standard rent (fixed or determinable) under the Rent Control Act.

90.1-1d PROVISION ILLUSTRATED - As mentioned earlier, the reasonable expected rent under *computation one* will be computed on the basis of three factors, namely—

a. municipal valuation (MV),

b. fair rent of the property (FR); and

c. standard rent of the property (SR).

The higher of (MV) and (FR), subject to maximum of (SR), is expected rent under *Step 1.*
The example given below illustrates the aforesaid propositions—

(*Rs. in thousand*)

	A	B	C	D	E
Municipal value (MV)	40	40	40	40	40
Fair rent (FR)	46	46	46	48	51
Standard rent (SR)	NA	45	35	45	63
Reasonable expected rent under Step I [MV or FR, whichever is higher, subject to maximum of (SR)]	46	45	35	45	51**

**Reasonable expected rent cannot exceed the amount of standard rent. Reasonable expected rent can, however, be lower than standard rent—*see Dr. Balbir Singh* v. *MCD* [1985] 152 ITR 388 (SC). In other words, standard rent is the maximum amount of reasonable expected rent. In the case of E, Rs. 51,000 (being higher of municipal valuation and fair rent) is the reasonable expected rent. Since this amount is lower than the maximum ceiling (*i.e.*, standard rent : Rs. 63,000), it is taken as reasonable expected rent.

90.1-2 *STEP II - FIND OUT RENT ACTUALLY RECEIVED OR RECEIVABLE* - For the purpose of *Step II*, rent received or receivable shall be calculated as follows—

Rent of the previous year (or that part of the previous year) for which the property is available for letting out	xxxx
Less : Unrealised rent if a few conditions are satisfied [*see* para 90.1-2a]	xxxx
Rent received/receivable before deducting loss due to vacancy	xxxx

The following points should be noted—

1. Loss due to vacancy shall not be deducted from the computation of rent received/receivable as given above. It shall be deducted under *Step IV.*

2. Sometimes a tenant pays a composite rent of property as well as certain benefits provided by the landlord. To determine rent received/receivable, composite rent must be disintegrated and it is only that part of it attributable to the let out of property which would form the basis for the aforesaid calculation.

3. Occupier's (*i.e.*, tenant's) share of municipal tax realised from the tenant cannot be added to actual rent as it is the occupier's duty to pay municipal tax—*CIT* v. *Gillanders Arbuthnot & Co. Ltd.* [1983] 142 ITR 598 (Cal.).

4. If the tenant has undertaken to bear the cost of repairs, the amount spent by the tenant cannot be added to rent received to arrive at the annual value—*CIT* v. *Parbutty Churn Law* [1965] 57 ITR 609 (Cal.).

5. A non-refundable deposit will be included in rent received or receivable on *pro rata* basis.

6. A refundable deposit cannot be included in rent received or receivable. To find out whether notional interest on refundable deposit can form part of rent received or the receivable, one has to examine the purpose for which refundable deposit/security is taken from a tenant. Such deposit/security is taken from a tenant generally for any of the following purposes —

- To ensure that tenant will vacate the property after the expiry of lease period.
- To ensure proper payment of rent on due dates.
- To check that the tenant will not misuse the property.
- To check that tenant will not damage the property, or will not make any unauthorized alteration.
- To compensate short payment or non-payment of rent (in such case it is paid in lieu of rent).

Only in the last case, notional interest on refundable deposit/security may form part of rent received or receivable.

7. Advance rent cannot be rent received/receivable of the year of receipt—***CIT*** v. ***Prince Rubber & Plastics*** [2004] 1 SOT 85 (Asr.).

8. Commission paid by the assessee-owner of property to a broker for rental income is not deductible—***CIT*** v. ***Piccadily Hotels (P.) Ltd.*** [2005] 97 ITD 564 (Chd.).

9. Payment to a municipal corporation for regularizing unauthorized construction is not deductible—***Radhaballabh Silk Mills (P.) Ltd.*** v. ***CIT*** [2007] 12 SOT 423 (Mum.).

10. Amount spent by an assessee towards stamp duty for drawing up lease deed and registration thereof, would not be deducted from rent received—***CIT*** v. ***Premnath Motors (Raj.) (P.) Ltd.*** [2007] 163 Taxman 383 (Raj.).

11. An assessee had taken a property on sub-lease for a period of 99 years. Since period of lease was not less than 12 years, rental income received by assessee shall to be assessed as 'Income from house property' by virtue of provisions of section 27(*iiib*), read with section 269UA(*f*). Lease rent paid by the assessee cannot be deducted from lease rental income received by it—***CIT*** v. ***D.B.S. Financial Services Ltd.*** [2007] 15 SOT 207 (Mum.).

12. The Delhi High Court in ***CIT*** v. ***Asian Hotels Ltd.*** [2008] 168 Taxman 59 held that in the absence of any specific provision similar to one under the Wealth-tax Act, 1957, it is not permissible to consider notional interest as income either under section 23 or as one which is chargeable under section 28(*iv*).

90.1-2a WHEN UNREALISED RENT SHALL BE EXCLUDED [EXPLN. TO SEC. 23(1)] - Unrealised rent (which the owner could not realise) shall be excluded from rent received/receivable only if the following conditions are satisfied—

Condition 1	The tenancy is *bona fide*.
Condition 2	The defaulting tenant has vacated, or steps have been taken to compel him to vacate the property.
Condition 3	The defaulting tenant is not in occupation of any other property of the assessee.
Condition 4	The assessee has taken all reasonable steps to institute legal proceedings for the recovery of the unpaid rent or satisfies the Assessing Officer that legal proceedings would be useless.

90.1-3 ***COMPUTATION WITH THE HELP OF ILLUSTRATIONS*** - To have better understanding, the following problems are given—

90.1-3P1 *X, Y, Z, A and B separately own the following properties—*

(Rs. in thousand)

	H1 X	H2 Y	H3 Z	H4 A	H5 B
Municipal value (MV)	*105*	*105*	*105*	*105*	*105*
Fair rent (FR)	*107*	*107*	*107*	*107*	*107*
Standard rent under the Rent Control Act (SR)	*NA*	*88*	*88*	*135*	*135*
Actual rent	*103*	*112*	*86*	*114*	*97*
Unrealized rent (conditions mentioned in para 90.1-2a are satisfied)	*1*	*2*	*1*	*2*	*1*
Period of the previous year (in months)	*12*	*12*	*12*	*12*	*12*
Period during which the property remains vacant	Nil	Nil	Nil	Nil	Nil

Find out the gross annual value for the assessment year 2009-10.

SOLUTION : In this case gross annual value shall be determined as follows—

(Rs. in thousand)

	X	Y	Z	A	B
Computation of gross annual value					
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	107	88	88	107	107
Step II - Rent received/receivable after deducting unrealized rent but before adjusting loss due to vacancy	102	110	85	112	96

	X	Y	Z	A	B
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	107	110	88	112	107
Step IV - Loss due to vacancy	*Nil*	*Nil*	*Nil*	*Nil*	*Nil*
Step V - Gross annual value is *Step III minus Step IV*	107	110	88	112	107

90.1-3P2 *X owns a house property (municipal valuation: Rs. 1,45,000, fair rent: Rs. 1,36,000, standard rent: Rs. 1,24,000). It is let out throughout the previous year (rent being Rs. 8,000 per month up to November 15, 2008 and Rs. 14,000 per month thereafter). X transfers the property to Y on January 31, 2009. Find out the gross annual value of the property in the hands of X for the assessment year 2009-10.*

SOLUTION : *Computation of gross annual value*	*Rs.*
Municipal value from April 1, 2008 to January 31, 2009 (Rs. 1,45,000 ÷ 12 x 10) (MV)	1,20,833
Fair rent from April 1, 2008 to January 31, 2009 (Rs. 1,36,000 ÷ 12 x 10) (FR)	1,13,333
Standard rent from April 1, 2008 to January 31, 2009 (Rs. 1,24,000 ÷ 12 x 10) (SR)	1,03,333
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	1,03,333
Step II - Rent received/receivable after deducting unrealized rent but before adjusting loss due to vacancy (Rs. 8,000 × 7.5 + Rs. 14,000 × 2.5)	95,000
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	1,03,333
Step IV - Loss due to vacancy	*Nil*
Step V - Gross annual value is *Step III minus Step IV*	1,03,333

90.1-3P3 *Find out the gross annual value in the case of the following properties let out throughout the previous year for the assessment year 2009-10—*

(Rs. in thousand)

	X	Y	Z	A	B
Municipal value (MV)	*60*	*60*	*60*	*112*	*112*
Fair rent (FR)	*68*	*68*	*68*	*117*	*117*
Standard rent under the Rent Control Act (SR)	*62*	*62*	*70*	*115*	*115*
Annual rent	*67*	*67*	*73*	*121*	*110*
Unrealised rent of the previous year 2008-09 which could not be realised and conditions of rule 4 are satisfied [see para 90.1-2a]	*2*	*6*	*5*	*50*	*40*
Loss due to vacancy	*1*	*1*	*1*	*1*	—
SOLUTION :					
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	62	62	68	115	115
Step II - Rent received/receivable after deducting unrealized rent but before adjusting loss due to vacancy	65	61	68	71	70
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	65	62	68	115	115
Step IV - Loss due to vacancy	1	1	1	1	—
Step V - Gross annual value is *Step III minus Step IV*	64	61	67	114	115

The following points should be noted—

1. Unrealised rent shall be deducted from rent received/receivable only if conditions of rule 4 are satisfied [see para 90.1-2a]. Conversely, if these conditions are not satisfied, then unrealised rent shall not be deducted from rent received or receivable.

2. If the conditions of rule 4 are satisfied, unrealised rent of the current previous year is deductible. In other words, unrealised rent of the earlier year(s) is not deductible.

90.1-3P4 *Find out the gross annual value in the case of the following properties for the assessment year 2009-10 (there is no unrealised rent)—*

(Rs. in thousand)

	X	Y	Z	A	B	C	D
Municipal value (per annum)(MV)	60	61	60	80	80	140	140
Fair rent (per annum) (FR)	65	66	64.5	78	78	150	150
Standard rent under the Rent Control Act (per annum) (SR)	59.5	59	63	85	76	120	120
Annual rent	72	57	72	72	NA	96	144
Property remains vacant (in number of month)	(1)	(1.5)	(5)	(3)	(12)	(10)	(10)
Loss due to vacancy	6	7.125	30	18	—	80	120
SOLUTION :							
Computation of gross annual value							
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	59.5	59	63	80	76	120	120
Step II - Rent received/receivable after deducting unrealized rent but before adjusting loss due to vacancy	72	57	72	72	*Nil*	96	144
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	72	59	72	80	76	120	144
Step IV - Loss due to vacancy	6	7.125	30	18	76	80	120
Step V - Gross annual value is *Step III minus Step IV*	66	51.875	42	62	*Nil*	40	24

90.1-3P5 - *Find out the gross annual value in the following cases for the assessment year 2009-10 (there is no unrealised rent)—*

	X Rs.	Y Rs.
Municipal value (per annum) (MV)	*61,000*	*61,000*
Fair rent (per annum) (FR)	*1,08,000*	*30,000*
Standard rent under the Rent Control Act (per annum) (SR)	*60,000*	*60,000*
Rate of rent		
- old tenant (from April 1, 2008 to June 30, 2008) (per month)	*5,000*	*2,000*
- new tenant (from July 1, 2008 to December 31, 2008) (per month)	*9,000*	*2,500*
Period when the property remains unoccupied because suitable tenant was not available	*January 1, 2009 to March 31, 2009*	*January 1, 2009 to March 31, 2009*
Actual rent received/receivable (if there is no vacancy)	*96,000*	*28,500*
Loss due to vacancy	*27,000*	*7,500*
SOLUTION : *Computation of gross annual value*		
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	60,000	60,000
Step II - Rent received/receivable after deducting unrealized rent but before adjusting loss due to vacancy	96,000	28,500
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	96,000	60,000
Step IV - Loss due to vacancy	27,000	7,500
Step V - Gross annual value is *Step III minus Step IV*	69,000	52,500

90.1-3P6 *Find out the gross annual value in respect of the following properties for the assessment year 2009-10—*

(Rs. in thousand)

	X	Y	Z	A	B
Municipal value (MV)	*140*	*180*	*180*	*140*	*231*
Fair rent (FR)	*145*	*185*	*185*	*145*	*262*

	X	Y	Z	A	B
Standard rent (SR)	142	175	175	142	241
Actual rent if property is let out throughout the previous year 2008-09	168	168	168	168	252
Unrealised rent of the previous year 2008-09	14	42	1	70	42
Unrealised rent of the previous year 2007-08	3	4	5	6	7
Period when the property remains vacant (in number of months)	(1/2)	(1)	(1)	(3)	(5)
Loss due to vacancy	7	14	14	42	105
SOLUTION :					
Computation of gross annual value					
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	142	175	175	142	241
Step II - Rent received/receivable after deducting unrealized rent of the current previous year but before adjusting loss due to vacancy (unrealized of earlier years is not considered)	154	126	167	98	210
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	154	175	175	142	241
Step IV - Loss due to vacancy	7	14	14	42	105
Step V - Gross annual value is *Step III minus Step IV*	147	161	161	100	136

90.2 ***Deduct municipal taxes*** - From the gross annual value computed above, deduct municipal taxes (including service taxes) levied by any local authority in respect of the house property. Municipal taxes are deductible only if (*a*) these taxes are borne by the owner, and (*b*) are actually paid by him during the previous year.

Municipal taxes levied by local authority but not paid by the assessee during the previous year, are not deductible. If property is situated in a foreign country, municipal taxes levied by foreign local authority are deductible (if such taxes are paid by the owner). Amount paid by an assessee to a municipality for regularisation of unauthorised construction is not deductible.

The remaining amount left after deduction of municipal taxes is net annual value.

90.3 ***Deduction under section 24*** - The following two deductions are available under section 24—

a. standard deduction [*see* para 90.3-1] ; and

b. interest on borrowed capital [*see* para 90.3-2].

The list of allowance of section 24 is exhaustive—*Indian City Properties* v. *CIT* [1965] 55 ITR 262 (Cal.), *CIT* v. *H.G. Gupta & Sons* [1984] 149 ITR 253 (Delhi). In other words, no deduction can be claimed in respect of that expenditure which is not specified in section 24. For instance, no deduction can be claimed in respect of expenses on insurance, ground rent, land revenue, repairs, collection charges, electricity, water supply, salary of liftman, etc.

90.3-1 STANDARD DEDUCTION [SEC. 24(*a*)] - 30 per cent of net annual value is deductible irrespective of any expenditure incurred by the taxpayer.

90.3-1P1 *Find out the income from property chargeable to tax for the assessment year 2009-10 in the following cases—*

	X Rs.	Y Rs.
Municipal value (MV)	1,20,000	1,20,000
Fair rent (FR)	1,30,000	1,30,000
Standard rent under the Rent Control Act (SR)	1,10,000	1,10,000
Actual rent if property is let out throughout the previous year	1,26,000	1,26,000
Unrealised rent of the previous year 2008-09	10,500	Nil
Period when the property remains vacant (in number of month)	(1)	(Nil)
Loss due to vacancy	10,500	Nil

	X Rs.	Y Rs.
Municipal taxes—		
Tax of the year 2008-09	*18,000*	*18,000*
- Paid by X and Y during 2008-09	*17,000*	*8,000*
- Paid by X and Y after March 31, 2009	*1,000*	*1,000*
- Paid by tenants during 2008-09	*-*	*9,000*

SOLUTION : *Computation of income under the head "Income from house property"*

	X Rs.	Y Rs.
Gross annual value		
Step I - Reasonable expected rent of the property [MV or FR, whichever is higher, but subject to maximum of SR]	1,10,000	1,10,000
Step II - Rent received/receivable after deducting unrealized rent but before adjusting loss due to vacancy	1,15,500	1,26,000
Step III - Amount computed in *Step I* or *Step II*, whichever is higher	1,15,500	1,26,000
Step IV - Loss due to vacancy	10,500	*Nil*
Step V - Gross annual value is *Step III minus Step IV*	1,05,000	1,26,000
Less: Municipal tax paid by X or Y during the previous year 2008-09	17,000	8,000
Net annual value	88,000	1,18,000
Less: Standard deduction under section 24(a) [30% of net annual value]	26,400	35,400
Income from house property	61,600	82,600

90.3-2 ***INTEREST ON BORROWED CAPITAL [SEC. 24(b)]*** - Interest on borrowed capital is allowable as deduction if capital is borrowed for the purpose of purchase, construction, repair, renewal or reconstruction of the property.

■ The following points should also be kept in view :

1. Interest on borrowed capital is deductible on "accrual" basis. It can be claimed on yearly basis, even if the interest is not actually paid during the year.

2. Deduction is available even if neither the principal nor the interest is charged on property.

3. Interest on unpaid interest is not deductible—*Shew Kissen Bhatter* v. *CIT* [1973] 89 ITR 61 (SC).

4. No deduction is allowed for any brokerage or commission for arranging the loan.

5. Interest on a fresh loan, taken to repay the original loan raised for the aforesaid purpose, is allowable as deduction—Circular No. 28, dated August 20, 1969. This rule is applicable even if the original loan was interest free.

6. If amount borrowed is not utilised for acquisition, construction, repairs, etc., of house property, deduction cannot be claimed for interest due. In such a case, any deduction already claimed will be withdrawn by reassessment under section 147.

7. Interest on borrowing can be claimed as deduction only by the person who has acquired or constructed the property with borrowed fund. It is not available to the successor to the property (if the successor has not utilised borrowed funds for acquisition, etc.). In other words, the relationship of borrower and lender must come into existence before it can be said that any amount or any other money is borrowed for the purpose of construction, acquisition, etc., of house property by one person from another and there must be a real transaction of borrowing and lending in order to amount to any borrowing.

8. The Board has clarified that in the case of Central Government employees, interest on house building advance taken under the House Building Advance Rules (Ministry of Works and Housing)

would be deductible on the basis of accrual of interest which would start running from the date of drawal of advance. The interest that accrues in terms of rule 6 of the House Building Advance Rules is on the balances outstanding on the last day of each month—Circular No. 363, dated June 24,1983.

9. The assessee obtained a non-refundable loan from his provident fund account for the purpose of constructing a house, and claimed deduction of deemed interest on such loan. On appeal, the Tribunal *held* that a man certainly loses interest if he withdraws his own provident fund which would be exempt from tax. However, since a part of the provident fund was contributed by the employer and to that extent the money did not belong to the assessee, the full benefit of payment of interest on the loan would not be available to the assessee himself. The matter was, therefore, restored to the Assessing Officer with directions to allow such part of the interest paid by the assessee as did not belong to him—*O.P. Sharma* v. *ITO* [1986] 17 ITD 45 (Jp.).

10. Any interest chargeable under the Act, payable out of India on which tax has not been paid or deducted at source, and in respect of which there is no person who may be treated as an agent, is not deductible, by virtue of section 25, in computing income chargeable under the head "Income from house property".

11. Where a buyer, instead of raising a loan from a third person, enters into an arrangement with a seller to pay sale price in instalments along with interest due thereon, by such arrangement seller becomes lender *qua* unpaid purchased price and purchaser becomes borrower. In such a case, unpaid purchase price can be treated as capital borrowed for acquiring property and interest paid thereon be allowed as deduction under section 24(*b*)—*CIT* v. *Sunil Kumar Sharma* [2002] 122 Taxman 159 (Punj. & Har.).

12. Interest on borrowed capital (according to rules given in this para and para 90.3-2a) is deductible fully without any maximum ceiling (in the case of a let out property).

13. A transaction of allotment of a property to an assessee on instalment basis does give rise to relationship of borrower and lender between the assessee and the estate officer and as such interest paid by the assessee on instalments constitutes interest on borrowed capital—***CIT*** v. ***Master Sukhwant Singh*** [2005] 196 CTR (Punj. & Har.) 122

14. Deduction of interest under section 24(*b*) cannot be denied on the ground that interest was paid on funds borrowed for acquisition of plot and not house property, since in section 24(*b*) the word 'property' is used and not the word 'house property'—***CIT*** v. ***Amrit Lal Adlakha*** [2007] 11 SOT 674 (Asr.) (SMC II).

90.3-2a INTEREST OF PRE-CONSTRUCTION PERIOD - Interest payable by an assessee in respect of funds borrowed for the acquisition or construction of a house property and pertaining to the period prior to the previous year in which such property has been acquired or constructed (to the extent it is not allowed as a deduction under any other provision of the Act) is deducted in five equal annual instalments commencing from the previous year in which the house is acquired or constructed.

■ *What is pre-construction period* - Interest of pre-construction period is deductible in five equal instalments. The first instalment is deductible in the year in which construction of property is completed or in which property is acquired. For this purpose "pre-construction period" means the period commencing on the date of borrowing and ending March 31 immediately prior to the date of completion of construction/date of acquisition or date of repayment of loan, whichever is earlier.

Provision illustrated - Suppose X takes a loan of Rs. 40,000 @ 15 per cent per annum for constructing a house on June 1, 2003. Construction of the house is completed on January 20, 2009.

Date of repayment of loan (*a*) January 31, 2014, or (*b*) June 30, 2010 or (*c*) October 31, 2006. In this case, the amount deductible is as follows :

If date of repayment of loan is January 31, 2014 or June 30, 2010, then pre-construction period ends on March 31, 2008 (being March 31 immediately prior to the date of completion of construction/acquisition).

Interest on Rs. 40,000 @ 15 per cent per annum from June 1, 2003 to March 31, 2008 is Rs. 29,000. Amount of instalment deductible in first 5 years is Rs. 5,800 (*i.e.*, Rs. 29,000 ÷ 5).

If date of repayment of loan is October 31, 2006, then pre-construction period ends on October 31, 2006 (being March 31 immediately prior to completion of construction or date of repayment of loan, whichever is earlier). Interest on Rs. 40,000 @ 15 per cent per annum from June 1, 2003 to October 31, 2006 comes to Rs. 20,501 (instalment deductible in first 5 previous years being Rs. 4,100). The table given below highlights the interest deductible in different previous years :

	Previous years						
	Ending on March 31, 2009 Rs.	2009-10 Rs.	2010-11 Rs.	2011-12 Rs.	2012-13 Rs.	2013-14 Rs.	2014-15 Rs.
If date of repayment of loan is January 31, 2014							
Current year's interest	6,000*	6,000	6,000	6,000	6,000	5,014	*Nil*
Pre-construction period's interest	5,800	5,800	5,800	5,800	5,800	*Nil*	*Nil*
Total deduction	11,800	11,800	11,800	11,800	11,800	5,014	*Nil*
If date of repayment of loan is June 30, 2010							
Current year's interest	6,000*	6,000	1,479	*Nil*	*Nil*	*Nil*	*Nil*
Pre-construction periods interest	5,800	5,800	5,800	5,800	5,800	*Nil*	*Nil*
Total deduction	11,800	11,800	7,279	5,800	5,800	*Nil*	*Nil*
If date of repayment of loan is October 31, 2006							
Current year's interest	*Nil*	*Nil*	*Nil*	*Nil*	*Nil*	*Nil*	*Nil*
Pre-construction period's interest	4,100	4,100	4,100	4,100	4,100		
Total	4,100	4,100	4,100	4,100	4,100	*Nil*	*Nil*

Computation of income from self-occupied property

91. Before steps for computation are explained, it would be advisable to highlight the following features which regulate tax incidence on self-occupied properties :

■ *A property occupied for own business purposes* - Where an assessee uses his property for carrying on any business or profession, no income is chargeable to tax under the head "Income from house property". The assessee, in such a case, is not entitled to claim any deduction on account of rent in respect of such house property in computing taxable profits of the business or profession [*see* para 86.3-1].

■ *When more than one property is occupied for own residential purposes* - Where the person has occupied more than one house for his own residential purposes, only one house (according to his own choice)[1] is treated as self-occupied and all other houses will be "deemed to be let out". In the case of "deemed to be let out" properties, the taxable income will be calculated in the manner explained in para 90 [gross annual value shall be taken as reasonable expected rent.

In the case of one self-occupied property (treated as such), the procedure for determining taxable income is as follows :

*Although the construction of the property is completed on January 20, 2009 (*i.e.*, during 2008-09), the interest of the entire financial year 2008-09 is treated as current year's interest. Interest prior to the year 2008-09 (*i.e.*, the year in which construction is completed) is pre-construction period's interest. The same rule is applicable if the construction is completed on March 31, 2009.

1. The option should be exercised in such a way that net income of the taxpayer is reduced to the minimum possible level. Moreover, the option may be changed every year [*see* problem 95-P1 for how to exercise the option in order to reduce the tax bill].

91.1 ***Computation of annual value of one self-occupied property*** - One self-occupied property, treated as such, may fall in any one of the following categories:

Different situations	*Para No.*
■ If such property is used throughout the previous year for own residential purposes, it is not let out or put to any other use	91.1-1
■ If such property could not be occupied throughout the previous year because employment, business or profession of the owner is situated at some other place	91.1-2
■ When a part of the property (being independent residential unit) is self-occupied and the other part is let out	91.1-3
■ When such property is self-occupied for a part of the year and let out for the other part of the year	91.1-4

91.1-1 *A HOUSE PROPERTY FULLY UTILISED THROUGHOUT THE PREVIOUS YEAR FOR SELF-RESIDENTIAL PURPOSES [SEC. 23(2)(a)]* - Where the property consists of one house in the occupation of the owner for his own residence, the annual value of such house shall be taken to be *nil*, under section 23(2)(*a*), if the following conditions are satisfied—

Condition 1	The property (or part thereof) is not actually let during whole (or any part) of the previous year.
Condition 2	No other benefit is derived therefrom.

■ *Examples*—The following are some of the examples where the above conditions are satisfied—

1. X owns a property. Throughout the previous year 2008-09, it is used by him (and his family members) for own residential purposes. No part of the property is let out or put to some other use.

2. Y owns a property. He sells the property on December 1, 2008. Between April 1, 2008 and December 1, 2008 it is used by Y and his family for residential purpose. It is neither let out nor put to any other use.

3. Z purchases a property on June 1, 2008. Since then it is occupied by Z for his residential purposes. Neither it is let out nor it is put to some other use.

4. A owns house property. During the previous year 2008-09, he retains exclusive control over the possession of the house owned by him. Though he may not be actually present in house, when he is away from it, he is still in constructive possession of his residential house—***CIT*** v. ***Deepak Seth*** [2005] 1 SOT 35 (Delhi).

■ *Computation of income* - In the case of one property (which is not let out nor put to any other use) used throughout the previous year by the owner for his residential purpose, income shall be determined as follows—

Gross annual value	*Nil*
Less: Municipal tax	*Nil*
Net annual value	*Nil*
Less: Deductions under section 24	
Standard deduction	*Nil*
Interest on borrowed capital	Deductible [*see* para 91.1-1a]
Income from one self-occupied property	xxxx

91.1-1a INTEREST ON BORROWED CAPITAL [SEC. 24(*b*)] - Interest on borrowed capital [of the current year and pre-construction period] is deductible as explained in para 90.3-2. However, it is deductible subject to a maximum ceiling given below—

91.1-1a[1] *Maximum ceiling if capital is borrowed on or after April 1, 1999* - If the following three conditions are satisfied, interest on borrowed capital is deductible up to Rs. 1,50,000—

Condition 1	Capital is borrowed on or after April 1, 1999 for acquiring or constructing a property.
Condition 2	The acquisition or construction should be completed within 3 years, from the end of financial year in which the capital was borrowed.
Condition 3	The person extending the loan certifies that such interest is payable in respect of the amount advanced for acquisition or construction of the house or as re-finance of the principal amount outstanding under an earlier loan taken for such acquisition or construction.

- One should also keep in view, the following points—

1. If capital is borrowed for any other purpose (*e.g.* if capital is borrowed for reconstruction, repairs or renewals of a house property), then the maximum of deduction on account of interest is Rs. 30,000 as given in para 91.1-1a² (and not Rs. 1,50,000).

2. There is no stipulation regarding the date of commencement of construction. Consequently, the construction of the residential unit could have commenced before April 1, 1999 but, as long as its construction/acquisition is completed within 3 years, the higher deduction of Rs. 1,50,000 would be available. Moreover, there is no stipulation regarding the construction/acquisition of the residential unit being entirely financed by the loan taken on or after April 1, 1999. It may be so in part. However, the higher deduction of Rs. 1,50,000 towards interest can be claimed only in relation to that part of the loan which has been taken and utilised for construction/acquisition after April 1, 1999. The loan taken prior to April 1, 1999 will carry deduction of interest up to Rs. 30,000 (as is explained in para 91.1-1a² given below) only—Circular No. 779, dated September 14, 1999.

91.1-1a² *Maximum ceiling in any other case* - If the above three conditions [*i.e.*, conditions (*1*), (*2*) and (*3*) given in para 91.1-1a¹] are not satisfied, then interest on borrowed capital is deductible up to a maximum of Rs. 30,000. In the following cases, interest on borrowed capital is deductible up to Rs. 30,000—

Case 1	If capital is borrowed before April 1, 1999 for purchase, construction, reconstruction, repairs or renewals of a house property.
Case 2	If capital is borrowed on or after April 1, 1999 for reconstruction, repairs or renewals of a house property.
Case 3	If capital is borrowed on or after April 1, 1999 but construction is not completed within 3 years from the end of the year in which capital was borrowed.

91.1-1P1 *X owns a house property. It is used by him throughout the previous year 2008-09 for his (and his family members) residence. Municipal value of the property is Rs. 1,66,000, whereas fair rent is Rs. 1,76,000 and standard rent is Rs. 1,50,000. The following expenses are incurred by X—repairs: Rs. 20,000, municipal tax : Rs. 16,000, insurance: Rs. 2,000; interest on capital borrowed to construct the property: Rs. 1,36,000; interest on capital borrowed by mortgaging the property for daughter's marriage: Rs. 20,000 (in either case capital is borrowed before April 1, 1999). Income of X from business is Rs. 7,10,000. Find out the net income of X for the assessment year 2009-10.*

SOLUTION :	Rs.
Gross annual value	*Nil*
Less: Municipal tax	*Nil*
Net annual value	*Nil*
Less: Interest on borrowed capital (maximum: Rs. 30,000)	– 30,000
Property income	– 30,000
Business income	7,10,000
Net income	6,80,000

91.1-2 ***A HOUSE PROPERTY, WHICH IS NOT ACTUALLY OCCUPIED BY THE OWNER OWING TO EMPLOYMENT OR BUSINESS/PROFESSION, CARRIED ON AT ANY OTHER PLACE [SEC. 23(2)(b)]*** - Section 23(2)(*b*) is applicable if the following conditions are satisfied -

Condition 1	The taxpayer owns a house property, which cannot actually be occupied by him by reason of the fact that owing to his employment, business or profession, carried on at any other place.
Condition 2	He has to reside at that other place in a building not owned by him.
Condition 3	The property mentioned at (*a*) (or part thereof) is not actually let out during whole (or any part of the previous year).
Condition 4	No other benefit is derived from the above property by the owner.

If the above conditions are satisfied, income from the property shall be determined according to the method given in para 91.1-1.

91.1-2a OTHER POINTS - The following points should also be kept in view—

■ Some nexus between the fact of residing in a building not belonging to the assessee and his employment, business or profession must be shown before the benefit of section 23(2)(*b*) can be availed in respect of residential house which is not occupied by the assessee. Examine the case given below—

X owns a house but he resides with his father in the same town in a house two miles away. He is a bachelor and, therefore, for his own convenience resides with his father. His own house is lying vacant. Since X has not left his house vacant on account of business compulsion but on account of personal convenience, he will not be entitled to the benefit of section 23(2)(*b*). Gross annual value in this case cannot be taken as equal to zero. Income from house property shall be calculated as if the house is deemed to be let out.

■ Section 23(2)(*b*) would apply in all those cases where officials and dignitaries, under the Constitution of India and even otherwise had to reside in official residences instead of their own residences by reason of their office — *CIT* v. *Justice Avadh Behari Rohtagi* [1985] 21 Taxman 409 (Delhi).

91.1-3 ***WHEN A PART OF PROPERTY IS SELF-OCCUPIED AND A PART IS LET OUT*** - If a house property consists of two or more independent residential units, one of which is self-occupied for own residential purposes and other unit(s) are let out, income is computed as follows—

1. Unit self-occupied for residential purpose throughout the previous year (which is not let out nor put to any other use)	*See* para 91.1-1
2. Let out units	*See* para 90
3. Unit self-occupied for residential purpose for a part of year and lying vacant for remaining part because of business profession is situated at some other place	*See* para 91.1-2

91.1-3P1 *X owns a residential house property. It has two equal residential units—Unit 1 and Unit 2. While Unit 1 is self-occupied by X for his residential purpose, Unit 2 is let out (rent being Rs. 6,000 per month, rent of 2 months could not be recovered). Municipal value of the property is Rs. 1,30,000, standard rent is Rs. 1,25,000 and fair rent is Rs. 1,40,000. Municipal tax is imposed @ 12 per cent which is paid by X. Other expenses for the previous year 2008-09 being repairs: Rs. 250, insurance: Rs. 600, interest on capital (borrowed during 1997) for constructing the property: Rs. 63,000.*

Find the income of X for the assessment year 2009-10 on the assumption that income of X from other sources is Rs. 1,80,000.

SOLUTION :

	Rs.
Unit 1 - Self-occupied	
Gross annual value	*Nil*
Less: Municipal tax	*Nil*
Net annual value	*Nil*
Less: Interest on borrowed capital [1/2 of Rs. 63,000 or Rs. 30,000 whichever is lower]	30,000
Income of Unit 1	(-) 30,000
Unit 2 - Let out	
Municipal value (50% of Rs. 1,30,000) (MV)	65,000
Fair rent (50% of Rs. 1,40,000) (FR)	70,000
Standard rent (50% of Rs. 1,25,000) (SR)	62,500
Annual rent (Rs. 6,000 x 12)	72,000
Unrealised rent	12,000