

# **Master of Commerce Programme Regulations 2025-26**

## **Direct Tax Law & Accounts Or Income Tax Law & Accounts**

**Paper Code: MCCC-03**

### **Unit II**

#### **INCOME FROM SALARIES**

##### **Salary**

Salary is the remuneration received by or accruing to an individual, periodically, for service rendered as a result of an express or implied contract. The actual receipt of salary in the previous year is not material as far as its taxability is concerned. According to Income Tax Act there are certain conditions where all such remuneration is chargeable to income tax:

1. When due from the former employer or present employer in the previous year, whether paid or not
2. When paid or allowed in the previous year, by or on behalf of a former employer or present employer, though not due or before it becomes due.
3. When arrears of salary are paid in the previous year by or on behalf of a former employer or present employer, if not charged to tax in the period to which it relates.

Section 17(1) of the Income Tax Act gives an inclusive and not exhaustive definition of “Salaries”, which includes:

- (i) Wages
- (ii) Annuity or pension
- (iii) Gratuity
- (iv) Fees, Commission, allowances perquisites or profits in lieu of salary
- (v) Advance of Salary
- (vi) Amount transferred from unrecognized provident fund to recognized provident fund
- (vii) Contribution of employer to a Recognized Provident Fund in excess of the prescribed limit
- (viii) Leave Encashment
- (ix) Compensation as a result of variation in Service contract etc.
- (x) Contribution made by the Central Government to the account of an employee under a notified Pension scheme.

##### **Pension**

Pension is a payment made by the employer after the retirement or death of employee as a reward for past service. It is normally paid as a periodical payment on monthly basis but certain employers may allow an employee to forgo a portion of pension in lieu of lump sum amount. This is known as commutation of pension. The treatment of these two kinds of pension is as under:

**Periodical pension** (or uncommuted pension): It is fully taxable in the hands of all employee, whereas government or non-government.

### **Commuted pension**

For employees of government organizations, local authorities and statutory corporations, it is fully exempted from tax, hence not included in gross salary.

For other employees, commuted value of half of the total value of pension is exempted from tax. Any amount received over and above this amount is taxable, so included in gross salary. If, however, the employee is also receiving gratuity (another retirement benefit along with pension, then one third of the total value of pension is exempted from tax. Amount received in excess of this is taxable, so included in gross salary.

Pension received by employee is taxable under the head "Salaries". However, family pension received by legal heirs after death of employee is taxable under 'Income from other sources' for Central Government Employees joined on or after 1-1-2004, 10% of Salary is compulsory deducted towards Pension with a matching contribution from the Govt. and is Non-Taxable u/s 80CCD. Only Terminal Benefit is charged to tax.

### **Gratuity**

Gratuity is the payment made by the employer to an employee in appreciation of past services rendered by the employee. It is received by the employee on his retirement. Gratuity is exempted up to certain limit depending upon the category of employee. For the purpose of exemption, employees are divided into 3 categories:

- (i) Government employees and employees of local authority: In case of such employees, the entire amount of gratuity received by them is exempted from tax. Nothing will be added to gross salary.
- (ii) Employees covered under Payment of Gratuity Act, 1972 In case of employees who are covered under Payment of Gratuity Act, the minimum of the following amounts are exempted from tax:
  - Amount of gratuity actually received.
  - 15 days of salary for every completed year of service or part thereof in excess of six months. ( $15 / 26 \times [\text{basic salary} + \text{Dearness Allowance}] \times \text{No. of years of service} + 1$  [if fraction > 6 months]).
  - Rs.20, 00,000 (amount specified by government).
- (iii) Other employees. In case of employees not falling in the above two categories, gratuity received from the employers is exempt to the extent of minimum of following amounts:
  - Actual amount of gratuity received.
  - Half month average salary for every completed year of service ( $1/2 \times \text{average salary of last 10 months} \times \text{completed years of service}$ ).
  - Rs. 20, 00,000 (amount specified by government).

Salary = 10 months average salary preceding the month of retirement. = Basic Pay + Dearness Allowance considered for retirement benefits + commission (if received as a fixed percentage on turnover).

### **Leave Salary**

Employees are entitled to various types of leave. The leave generally can be taken (casual leave/medical leave) or it lapses. Earned leave is a kind of leave which an employee is said to have earned every year after working for some time. This leave can either be availed every year, or get encashment for it. If leave is not availed or encashed, it is allowed to be carried forward. This leave keeps getting accumulated and is encashed by employee on his retirement.

The tax treatment of leave encashment is as under:

(i) Encashment of leave while in service. This is fully taxable and so is added to gross salary.

(ii) Encashment of leave on retirement. For the purpose of exemption of accumulated leave encashment, the employees are divided into two categories. They are Govt employees and Other employees.

\*State or Central Government employees: Leave encashment received by government employees is fully exempted from tax. Nothing is to be included in gross salary

\*Other employees: Leave encashment of accumulated leave at the time of retirement received by other employees is exempted to the extent of minimum of following four amounts:

1. Amount specified by Central Government (3,00,000).
2. Leave encashment actually received.
3. 10 months average salary (10 x average salary of 10 months preceding retirement).
4. Cash equivalent of unavailed leave

(Leave entitlement is calculated on the basis of maximum 30 days leave every year, cash equivalent is based on average salary of last 10 months).

Salary = Basic Pay + Dearness Allowance (forming a part of salary for retirement benefits) + Commission (if received as a fixed percentage on turnover).

### **Retrenchment Compensation 10(10B)**

Retrenchment compensation is the compensation is received by a workman at the time of (i) closing down of the undertaking. (ii) Transfer (irrespective of by agreement/compulsory acquisition) if the following conditions are satisfied:

1. Service of workmen interrupted by transfer
2. Terms and conditions of employment after transfer are less favourable
3. New employer is not under a legal obligation whether under the terms of transfer or otherwise to pay compensation on the basis that the employee's service has been continuous and has not been interrupted by transfer. The exemption is granted to the least of the followings:

(i) Actual amount received

(ii) Amount determined under the Industrial Disputes Act, 1947

(iii) Maximum Limit Rs 5,00,000

## **Voluntary Retirement Compensation 10(10c)**

The following Conditions are to be met for claiming exemption:

- (i) An individual, who has retired under the Voluntary Retirement scheme, should not be employed in another company of the same management.
- (ii) He should not have received any other Voluntary Retirement Compensation before from any other employer and claimed exemption.
- (iii) Exemption u/s 10(10C) in respect of Compensation under VRS can be availed by an Individual only once in his lifetime.

Exemption is allowed to the least of the followings:

- (i) Actual amount received
- (ii) Maximum Limit Rs.5,00,000
- (iii) The highest of the following: 1. Last drawn salary  $\times$  3  $\times$  No. of fully completed years of service 2. Last drawn salary  $\times$  Balance of no. of months of service left.

Taxable Value of Allowances Allowance is a fixed monetary amount paid by the employer to the employee (over and above basic salary) for meeting certain expenses, whether personal or for the performance of his duties. These allowances are generally taxable and are to be included in gross salary unless specific exemption is provided in respect of such allowance.

For the purpose of tax treatment, we divide these allowances into 3 categories:

- i. Fully taxable cash allowances
- ii. Partially exempt cash allowances
- iii. Fully exempt cash allowances.

### **Fully Taxable Allowances**

- a) Dearness Allowance and Dearness Pay
- b) City Compensatory Allowance
- c) Tiffin / Lunch Allowance
- d) Non practicing Allowance
- e) Warden or Proctor Allowance
- f) Deputation Allowance
- g) Overtime Allowance
- h) Fixed Medical Allowance
- i) Servant Allowance

**Other allowances:** - There may be several other allowances like family allowance, project allowance, marriage allowance, education allowance, and holiday allowance etc. which are not covered under specifically exempt category, so are fully taxable.

Partly Exempted Allowances

### **House Rent Allowance or H.R.A. [Sec. 10(13A)Rule 2A]**

Conditions for claiming exemption:

1. Assessee is in receipt of HRA.

2. He has to pay rent.
3. Rent paid is more than 10% of salary.

An allowance granted to a person by his employer to meet expenditure incurred on payment of rent in respect of residential accommodation occupied by him is exempt from tax to the extent of least of the following three amounts:

- a) House Rent Allowance actually received by the assessee
- b) Excess of rent paid by the assessee over 10% of salary due to him
- c) An amount equal to 50% of salary due to assessee (If accommodation is situated in Mumbai, Kolkata, Delhi, Chennai) 'Or' an amount equal to 40% of salary (if accommodation is situated in any other place).

Salary for this purpose includes Basic Salary, Dearness Allowance (if it forms part of salary for the purpose of retirement benefits), Commission based on fixed percentage of turnover achieved by the employee.

While claiming exemption the following points are considered:

1. The exemption shall be calculated on the basis of where the accommodation is situated.
2. If the place of employment is the same for the whole year, then exemption shall be calculated for the whole year.
3. If there is a change in place during the previous year, then it will be calculated on a monthly basis.
4. Exemption should be calculated in respect of the period during which rental accommodation is occupied by the employee during the previous year.
5. Salary for the period during which rental accommodation is not occupied shall not be considered.

### **Entertainment Allowance**

This allowance is first included in gross salary under allowances and then deduction is given to only central and state government employees under Section 16 (ii).

### **Special Allowances for meeting official expenditure**

Certain allowances are given to the employees to meet expenses incurred exclusively in performance of official duties and hence are exempt to the extent actually incurred for the purpose for which it is given. These include travelling allowance, daily allowance, conveyance allowance, helper allowance, research allowance and uniform allowance.

### **Special Allowances to meet personal expenses**

There are certain allowances given to the employees for specific personal purposes and the amount of exemption is fixed.

- i. Children Education Allowance: This allowance is exempt to the extent of Rs.100 per month per child for maximum of 2 children (grand children are not considered).

- ii. Children Hostel Allowance: Any allowance granted to an employee to meet the hostel expenditure on his child is exempt to the extent of Rs.300 per month per child for maximum of 2 children.
- iii. Transport Allowance: This allowance is generally given to government employees to compensate the cost incurred in commuting between place of residence and place of work. An amount uptoRs.800 per month paid is exempt. However, in case of blind and orthopedically handicapped persons, it is exempt up to Rs.1600 p.m.
- iv. Running Allowance (Out of station allowance): An allowance granted to an employee working in a transport system to meet his personal expenses in performance of his duty in the course of running of such transport from one place to another is exempt up to 70% of such allowance or Rs.10000 per month, whichever is less.
- v. Tribal area allowance: Exemption is available as Rs.200 p.m.
- vi. Under-ground allowance: Exempted up to Rs.800 p.m.

### **Fully Exempt Allowances**

- (i) Foreign allowance: This allowance is usually paid by the government to its employees being Indian citizen posted out of India for rendering services abroad. It is fully exempt from tax.
- (ii) Allowance to High Court and Supreme Court Judges of whatever nature are exempt from tax.
- (iii) Allowances from UNO organization to its employees are fully exempt from tax.

### **Perquisites**

Perquisites are defined as any casual emolument or benefit attached to an office or position in addition to salary or wages. Perquisites are taxable and included in gross salary only if they are:

- (i) Allowed by an employer to an employee,
- (ii) Allowed during the continuation of employment,
- (iii) Directly dependent on service,
- (iv) Resulting in the nature of personal advantage to the employee and
- (v) Derived by virtue of employer's authority.

### **As per Section 17 (2) of the Act, perquisites include:**

1. Value of rent free accommodation provided to the employee by the employer.
2. Value of concession in the matter of rent in respect of accommodation provided to the employee by his employer.
3. Value of any benefit or amenity granted free of cost or at a concessional rate in any of the following cases:
  - a) By a company to an employee who is a director thereof
  - b) By a company to an employee who has substantial interest in the company

- c) By any employer to an employee who is neither a director, nor has substantial interest in the company, but his monetary emoluments under the head 'Salaries' exceeds Rs.50, 000.
4. Any sum paid by the employer towards any obligation of the employee.
  5. Any sum payable by employer to affect an assurance on the life of assessee.
  6. The value of any other fringe benefit given to the employee as may be prescribed.

### **Classification of Perquisites**

For tax purposes, perquisites specified under Section 17 (2) of the Act may be classified as follows:

- (1) Perquisites that are taxable in case of every employee, whether specified or not
- (2) Perquisites that is taxable in case of specified employees only.
- (3) Perquisites that is exempt from tax for all employees

### **Perquisites Taxable in case of all Employees**

The following perquisites are taxable in case of every employee, whether specified or not:

1. Rent free house provided by employer
2. House provided at concessional rate
3. Any obligation of employee discharged by employer e.g. payment of club or hotel bills of employee, salary to domestic servants engaged by employee, payment of school fees of employees' children etc.
4. Any sum paid by employer in respect of insurance premium on the life of employee
5. Notified fringe benefits (on which fringe benefit tax is not applicable) – it includes interest free or concessional loans to employees, use of movable assets, transfer of moveable assets.

Perquisites taxable in case of Specified Employees only

### **Specified Employee:**

An Individual will be considered as a Specified Employee if:

- He is a director of a company, or
- He holds 20% or more of equity voting power in the company,
- Monetary salary in excess of 50,000: His income under the head salaries, (from any employer including a company) excluding non-monetary payments exceeds 50,000. For the above purpose, salary should be arrived at after making the following deductions:

- (a) Entertainment Allowance
- (b) Professional Tax

### **The following perquisites are taxable in case of such employees:**

1. Free supply of gas, electricity or water supply for household consumption
2. Free or concessional educational facilities to the members of employees household
3. Free or concessional transport facilities
4. Sweeper, watchman, gardener and personal attendant
5. Any other benefit or amenity

### Perquisites which are tax free for all the employees

This category includes perquisites which are tax free for the employees and also other perquisites on which employer has to pay a tax (called Fringe Benefit Tax) if they are given to the employees and so are not taxable for them.

The following perquisites are exempt from tax in all cases and hence not includible for the purpose of tax deduction at source under section 192 during the financial year 2022-23:

1. Provision for medical facilities subject to limit
2. Tea or snacks provided during working hours
3. Free meals provided during working hours in a remote area or an offshore installation
4. Perquisites allowed outside India by the Government to a citizen of India for rendering service outside India.
5. Sum payable by an employer through a recognized provident fund or an approved superannuation or deposit-linked insurance fund established under the Coal Mines Provident Fund or the Employees Provident Fund.
6. Employer's contribution to staff group insurance scheme.
7. Leave travel concession subject to Sec.10 (5)
8. Payment of annual premium by employer on personal accident policy affected by him on his employee
9. Free educational facility provided in an institute owned/maintained by employer to children of employee provided cost/value does not exceed ` 1,000 per month per child (no limit on no. of children)
10. Interest-free/concessional loan of an amount not exceeding 20,000
11. Computer/laptop given (not transferred) to an employee for official/personal use.
12. Transfer without consideration to an employee of a movable asset (other than computer, electronic items or car) by the employer after using it for a period of 10 years or more.
13. Traveling facility to employees of railways or airlines.
14. Rent-free furnished residence (including maintenance thereof) provided to an Official of Parliament, a Union Minister or a Leader of Opposition in Parliament.
15. Conveyance facility provided to High Court Judges u/s22B of the High Court Judges (Conditions of Service) Act, 1954 and Supreme Court Judges u/s 23A of the Supreme Court Judges (Conditions of Service) Act, 1958.
16. Conveyance facility provided to an employee to cover the journey between office and residence.
17. Accommodation provided in a remote area to an employee working at a mining site or an onshore oil exploration site, or a project execution site or an accommodation provided in an offshore site of similar nature.
18. Accommodation provided on transfer of an employee in a hotel for not exceeding 15 days in aggregate.
19. Interest free loan for medical treatment of the nature given in Rule 3A.
20. Periodicals and journals required for discharge of work.
21. Tax on perquisite paid by employer [Sec.10 (10CC)]

22. Other Exempted Payments:

- i. Bonus paid to a football player after the World Cup victory to mark an exceptional event
- ii. Payment made as a gift in appreciation of the personal qualities of the employee.
- iii. Payment of proceeds of a benefit cricket match to a great cricket player after he retired from test match.
- iv. Trust for the benefit of employee's children

### **Valuation of Perquisites**

#### **Valuation of Medical Facilities**

##### **Medical facilities provided to employee are exempt from tax.**

##### **A. Medical benefits within India which are exempt from tax include the following:**

- a) Medical treatment provided to an employee or any member of his family in hospital maintained by the employer.
- b) Any sum paid by the employer in respect of any expenditure incurred by the employee on medical treatment of himself and members of his family:
  - (i) In a hospital maintained by government or local authority or approved by the government for medical treatment of its employees.
  - (ii) In respect of the prescribed diseases or ailments in any hospital approved by the Chief Commissioner.
  - (iii) Premium paid by the employer on health insurance of the employee under an approved scheme.
- c) Premium on insurance of health of an employee or his family members paid by employer  
Limited Exemption: If the ordinary medical treatment of the employee or any member of his family is done at any private hospital, nursing home or clinic, the exemption is restricted to Rs.15, 000.

##### **B. Medical Treatment outside India which is exempt from tax includes the following:**

- a) Any expenditure incurred by employer on the medical treatment of the employee or any member of his family outside India.
- b) Any expenditure incurred by employer on travel and stay abroad of the patient (employee or member of his family) and one attendant who accompanies the patient in connection with such treatment, shall be exempt to the following extent:
  - (i) The expenditure on medical treatment and stay abroad shall be exempt to the extent permitted by the Reserve Bank of India.
  - (ii) The expenditure on travel shall be exempt in full provided the gross total income of the employee (including this expenditure) does not exceed Rs.2,00,000.

### **Valuation of rent free accommodation**

For the purpose of valuation of house, employees are divided into 2 categories:

a) Central and State Government employees: If accommodation is provided by the State or Central Government to their employees, the value of such accommodation is simply the amount fixed by the government (called the license fees) in this regard.

b) Other Employees: The valuation of accommodation for this category of non-government employees depends upon whether the accommodation given to the employee is owned by the employer or taken on lease.

1. Accommodation owned by employer

In cities having population exceeding 25 lakhs as per 2021 census: 15% of Salary Less Rent actually paid by employee

In cities having population exceeding 10 lakhs but not exceeding 25 lakhs as per 2021 census: 10% of Salary Less Rent actually paid by employee

In other places: 7.5% of Salary Less Rent actually paid by employee.

2. Accommodation is taken on lease / rent by the employer Rent paid by the employer or 15% of Salary whichever is lower Less Rent recovered from employee.

3. Accommodation in a hotel 24% of salary paid/payable or actual charges paid/payable whichever is lower Less Amount paid or payable by the employee.

4. Valuation of accommodation in case of Employees on transfer:

(a) For the first 90 days of transfer: Where accommodation is provided both at existing place of work and in new place, the accommodation, which has lower value, shall be taxable.

(b) After 90 days: Both accommodations shall be taxable.

Valuation of furnished accommodation where the accommodation is furnished, 10% per annum of the original cost of furniture given to the employee shall be added to the value of unfurnished accommodation. If the furniture is taken on rent by employer, then actual hire charges are to be added to the value.

Definition of salary for rent free accommodation:

Basic Salary + Taxable cash allowances + Bonus or Commission + any other monetary payment.

(It does not include dearness allowance if it is not forming part of basic salary for retirement benefit, allowances which are exempt from tax, value of perquisites specified under Section 17(2), employer's contribution to provident fund account of employees).

### **Sweeper, gardener or watchman provided by the employer**

The value of benefit of provision of services of sweeper, watchman, gardener or personal attendant to the employee or any member of his household shall be the actual cost to the employer. The actual cost in such a case is 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. If the above servants are engaged by the employer and facility of such servants are provided to the employees, it will be a perquisite for specified employees only. On the other hand, if these servants are employed by the employee and wages of such servants are paid / reimbursed by the employer, it will be taxable perquisite for all classes of employees.

### **Free Supply of Gas, Water and Electricity**

The value of these benefits is taxable in the hands of specified employees, if the connection is taken in the name of the employer, and is determined according to the following rules:

- a) If the employer provides the supply of gas, electricity, and water from its own sources, the manufacturing cost per unit incurred by the employer shall be the value of perquisite.
- b) If the supply is from any other outside agency, the value of perquisite shall be the amount paid by the employer to the agency supplying these facilities.
- c) Where the employee is paying any amount in respect of such services, the amount so paid shall be deducted from the value of perquisite calculated under (a) or (b).

### **Free Education**

- a) Cost of free education to any member of employees' family provided in an educational institution owned and maintained by the employer shall be determined with reference to reasonable cost of such education in a similar institution in a nearby locality. For education facilities provided to the children of employee (excluding any other member of house hold), the value shall be nil, if the cost of such education per child does not exceed Rs.1, 000 per month.
- b) Where free education facilities are allowed to any member of employees' family in any other educational institution by reason of his being in employment of that employer, the value of perquisite shall be determined as in (a).
- c) In any other case: The value of benefit of providing free or concessional educational facilities for any member of the house hold (including children) of the employee shall be the amount of expenditure incurred by the employer.
- d) Where the connection for gas, electricity, water supply is in the name of employee and the bills are paid or reimbursed by the employer, it is an obligation of the employee discharged by the employer. Such payment is taxable in case of all employees under Section 17 (2) (iv).
- d) While calculating the amount of perquisite in all in above cases, any amount paid or recovered from the employee in this connection, shall be deducted.

### **Free Transport**

The value of any benefit provided by any undertaking engaged in the carriage of passengers or goods to any employee or to any member of his household for private journey free of cost or at concessional rate in any conveyance owned or leased by it shall be taken to be the value at which such benefit is offered by such undertaking to the public as reduced by the amount, if any, paid by or recovered from the employee for such benefit. In case of employees of the Railways and airlines, the value of transport facility shall be exempt.

### **Use of any movable asset other than computer or laptops or other assets already mentioned**

10% of Actual Cost if owned by the employer; or Actual rental charge paid/payable by the employer less Amount recovered from employee.

### **Leave Travel Concession (LTC)**

Leave Travel Concession is a non-taxable perquisite available for salaried class. An Employee with his dependent family members can avail of this facility to travel anywhere in India / native place. Exemption is limited to the amount actually spent. The amount exempt is the value of any travel concession or assistance received or due to the assessee.

1. Journey by Air: Economy Class Airfare of India Airlines by the shortest route or the actual amount spent, whichever is lower.
2. Journey by Rail: A/C 1st Class rail fare by the shortest route or actual amount spent, whichever is lower.
3. Where the place of destination is connected by Rail: Air-conditioned first class Rail fare by the shortest route or the actual amount spent for the journey performed by road whichever is lower.
4. Where the place of destination is NOT connected by Rail:
  1. If Recognized public transport exists: First Class or Deluxe Class fare by the shortest route or the actual amount spent whichever is lower.
  2. If No recognized public transport exists: Air-conditioned first Class Rail fare by the shortest route or the actual amount spent whichever is lower.

These exemptions are available only for 2 journeys performed in a block of 4 calendar years.

Family of an Individual means:

- Spouse and children of the individual, and
- Parents, brothers and sisters of the individual or any of them, wholly or mainly dependent on the Individual

### **Free meals during office hours**

Actual cost to the employer in excess of Rs 50 per meal less: amount recovered from the employee. Tea or non-alcoholic beverages and snacks during working hours are not taxable.

### **Gifts**

Value of any gift or voucher or taken other than gifts made in cash or convertible into money (e.g. gift cheques) on ceremonial occasion. In this case if the aggregate value of gift during the previous year is less than Rs 5,000, then it is not a taxable perquisite.

### **Profit in lieu of salary**

Profit in lieu of salary means any amount received by the employee from the employer due to its employee employer relationship other than normal compensation what he receives from employer.

### **Provident Fund**

Provident Fund Scheme is a welfare scheme for the benefit of employees. Under this scheme, certain amount is deducted by the employer from the employee's salary as his contribution to

Provident Fund every month. The employer also contributes certain percentage of the salary of the employee to the Fund. The contributions are invested outside in securities. The interest earned on it is also credited to the Provident Fund Account. At the time of retirement, the accumulated balance is given to the employee.

**(i) Statutory Provident Fund**

This is set up under the provisions of Provident Fund Act, 1925. Contribution is made by Employer and Employee.

Assesses Contribution: will get Deduction u/s 80C

Employer's Contribution- Not taxable

Interest credited- Fully exempted

Withdrawal at the time of retirement/resignation/termination, etc. - Exempted u/s 10(11)

**(ii) Recognized Provident Fund**

This is set up under the Employee's Provident Fund and Miscellaneous Provisions Act, 1952 (PF Act, 1952) and is maintained by private sector employees.

Assesses Contribution- will get Deduction u/s 80C

Employer's Contribution-Amount exceeding 12% of salary is taxable

Interest Credited-Exempted up to 9.5% p.a. Any excess is taxable.

Withdrawal at the time of retirement/ resignation/termination, etc.-Exempted u/s 10(12) Subject to conditions.

**(iii) Unrecognized Provident Fund**

If a provident fund is not recognized by the Commissioner of Income Tax, it is known as unrecognized PF.

Assesses Contribution: will not get Deduction u/s 80C.

No Income Tax Benefit

Employer's Contribution- Not taxable at the time of contribution

Interest credited- On Employee's contribution taxable under the head "Other Sources" and, on Employer's contribution not taxable at the time of credit.

Withdrawal at the time of retirement/resignation/termination, etc. - Employee's contribution thereon is not taxable.

Interest on employees share is taxable under the head income from other sources.

Employer's contribution and interest thereon is taxable as Profits In lieu of Salary, under "Salaries"

**(iv) Public Provident**

Fund The Central Government has established the Public Provident Fund for the benefits of general public to mobilize personal savings. Any member of general public (whether salaried or self-employed) can participate in this fund by opening a Provident Fund Account at the State Bank of India or its subsidiaries or other nationalized banks.

A salaried employee can simultaneously become member of employees provident fund (whether statutory, recognized or unrecognized) and public provident fund.

Any amount may be deposited (subject to minimum of Rs.500 and maximum of Rs.70,000 per annum) under this account. The accumulated sum is repayable after 15 years.

Assesses Contribution: will get Deduction u/s 80C

Interest credited- Fully exempted

Withdrawal at the time of retirement/resignation/termination, etc.-Exempted u/s 10(11)

### **Deductions:**

The income chargeable under the head salaries is computed after making the following deductions under Section 16:

**1. Entertainment Allowance** [section 16(ii)] of the Act as given earlier, entertainment allowance received from employer is first included in gross salary and thereafter, a deduction is allowed to government employees (State or Central Government) to the extent of least of following 3 amounts:

(i) Rs.5000

(ii) 20% of basic salary

(iii) Amount of Entertainment Allowance actually received during the year.

**2. Professional Tax** [Section 16(iii)] of the Act.

Professional tax or tax on employment levied by a State under Article 276 of the Constitution is allowed as a deduction only in the year when it is actually paid. If the professional tax is paid by the employer on behalf of the employee, it is first included in gross salary as a perquisite (since it is an obligation of employee fulfilled by employer) and then the same amount is allowed as deduction on account of professional tax from gross salary.

## **INCOME FROM HOUSE PROPERTY**

The annual value of a property, consisting of any buildings or lands appurtenant thereto, of which the assessee is the owner, is chargeable to tax under the head 'Income from house property'. However, if a house property, or any portion thereof, is occupied by the assessee, for the purpose of any business or profession, carried on by him, the profits of which are chargeable to income-tax, the value of such property is not chargeable to tax under this head.

Thus, three conditions are to be satisfied for property income to be taxable under this head:

1. The property should consist of buildings or lands appurtenant thereto.
2. The assessee should be the owner of the property.
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.

## **Ownership of house property**

It is only the owner (or deemed owner) of house property who is liable to tax on income under this head. Owner may be an individual, firm, company, co-operative society or association of persons. The property may be let out to a third party either for residential purposes or for business purposes. Annual value of property is assessed to tax in the hands of the owner even if he is not in receipt of the income. For tax purposes, the assessee is required to be the owner in the previous year only.

### **Deemed Owner [Section 27]**

1. Owner: An Individual shall be considered as owner of a property when the document of title to the property is registered in his name.

2. Deemed Owner: Under the following circumstances, Income from House Property is taxable in the hands of the Individual, even if the property is not registered in his name-

Where the Property has been transferred to spouse for inadequate consideration other than in pursuance of an agreement to live apart.

- Where the Property is transferred to a minor child for inadequate consideration (except a transfer to minor married daughter)
- Where the Individual holds an impartible estate.
- Where the Individual is a member of Co-operative Society, Company, or other Association and has been allotted a house property by virtue of his being a member, even though the property is registered in the name of the Society / Company / Association.
- Where the property has been transferred to the individual's name as part-performance of a contract u/s 53A of the Transfer of Property Act, 1882. (i.e. Possession of the Property has been transferred to Individual, but the Title Deeds have not yet been transferred).
- Where the Individual is a holder of a Power of Attorney enabling the right of possession or enjoyment of the property.
- Where the property has been constructed on a leasehold land.
- Where the ownership of the Property is under dispute.
  - A) Where the property is taken on a lease for a period of not less than 12 years, then the lessee shall be deemed as the owner of the property.

### **House Property Income Is Exempt from Tax to Certain Persons**

1) An Ex-Ruler for his occupation (palace)

- 2) Local Authority.
- 3) Approved Scientific Research Association.
- 4) Institution for the development of Khadi and Village Industries.
- 5) Khadi and Village Industries Boards.
- 6) A body or authority for administering religious or charitable Trust or endowments.
- 7) Certain Funds, educational institutions, hospitals etc.
- 8) Registered Trade Union.
- 9) Statutory Corporation or an institution or association financed by the Government for promoting in the interests of members of SC or ST.
- 10) Co-operative Society for promoting the interest of the members of SC or ST.
- 11) Charitable Trust.
- 12) Political Parties

#### **DETERMINATION OF ANNUAL VALUE**

The basis of calculating Income from House property is the 'annual value'. This is the inherent capacity of the property to earn income and it has been defined as the amount for which the property may reasonably be expected to be let out from year to year. It is not necessary that the property should actually be let out. The municipal value of the property, the cost of construction, the standard rent, if any, under the Rent Control Act, the rent of similar properties in the same locality, are all pointers to the determination of annual value.

#### **Gross Annual value**

The Gross Annual Value is the municipal value, the actual rent (whether received or receivable) or the fair rental value, whichever is highest. If, however, the Rent Control Act applies to the property, the gross annual value Fair rental value or municipal value whichever is higher or Standard rental value whichever is less. If the property is let out but remains vacant during any part or whole of the year and due to such vacancy, the rent received is less than the reasonable expected rent, such lesser amount shall be the Annual value.

#### **The principle of determining GAV is:**

Expected Rental Value

OR

Actual Rent received for full year, whichever is more.

Here, Expected Rental Value is calculated as follows:

**If the let out property is not subject to Rent Control Act ERV is:** FRV or MRV whichever is higher.

**If the let out property is subject to Rent Control Act ERV is:**

FRV or MRV whichever is higher

OR

Standard Rental Value, whichever is less.

### **Municipal Tax Municipal**

Tax includes services tax like Water Tax and Sewerage Tax levied by any local authority. It can be claimed as a deduction from the Gross Annual Value of the Property.

Conditions:

- a) Paid by Owner. The tax shall be borne by the owner and the same was paid by him during the previous year.
- b) Property let out: Municipal Tax can be claimed as a deduction only in respect of let out or deemed to be let out properties (i.e. more than one property self-occupied).
- c) Year of payment: Municipal Tax relating to earlier previous years, but paid during the current previous year can be claimed as deduction only in the year of payment.
- d) Advance Taxes: Advance Municipal Tax paid shall not be allowed as deduction in the year of payment, but can be claimed in the year in which it falls due.
- e) Borne by Tenant: Municipal taxes met by tenant are not allowed as deduction.

### **Unrealized Rent**

Unrealized Rent means the rent not paid by the tenant to the owner and the same shall be deducted from the Actual Rent Receivable from the property before computing income from that property, provided the following conditions are satisfied:

- a) The tenancy is bonafide
- b) The defaulting tenant should have vacated the property
- c) The assessee has taken steps to compel the defaulting tenant to vacate the property
- d) The defaulting tenant is not in occupation of any other property owned by the assessee
- e) The assessee has taken all reasonable steps for recovery of unrealized rent or satisfies the Assessing Officer that such steps would be useless.

Deduction from Net Annual Value

### **A. Standard Deduction u/s 24**

(a): Standard deduction of 30% of NAV (Net Annual Value) shall be allowed to the assessee.

**B. Interest on Loan u/s 24(b):**

1. Purpose of loan: The loan shall be borrowed for the purpose of acquisition, construction, repairs, renewal or reconstruction of the house property.
2. Accrual basis: The interest will be allowed as a deduction on accrual basis, even though it is not paid during the financial year.
3. Interest on interest: Interest on unpaid interest shall not be allowed as a deduction.
4. Brokerage: Any brokerage or commission paid for acquiring the loan will not be allowed as a deduction.
5. Prior period interest: Prior Period Interest shall be allowed in five equal installments commencing from the financial year in which the property was acquired or construction was completed.

*Note: Prior period interest means the interest from the date of borrowal of the loan up to the end of the financial year immediately preceding the financial year in which acquisition was made or construction was completed.*

6. Interest on fresh loan to repay existing loan: Interest on any fresh loan taken to repay the existing loan shall be allowed as a deduction.
7. Inadmissible interest: Interest payable outside India without deduction of tax at source and in respect of which no person in India is treated as an agent u/s 163 shall not be an allowable expenditure. [Section 25]
8. Certificate: The assessee should furnish a certificate from the person from whom the amount is borrowed.

**Income from Self – Occupied House Property** The annual value of one self-occupied house property is taken as 'Nil'.

From the annual value, only the interest on borrowed capital is allowed as a deduction under section 24. The amount of deduction will be:

1. Either the actual amount accrued or Rs. 30,000/- whichever is less
2. When borrowal of money or acquisition of the property is after 31.3.1999 - deduction is Rs.1,50,000/- applicable to A.Y 2002-03 and onwards.

However, if the borrowal is for repairs, renewals or reconstruction, the deduction is restricted to Rs.30, 000. If the borrowal is for construction/acquisition, higher deduction as noted above is

available. If a person owns more than one house property, using all of them for self-occupation, he is entitled to exercise an option in terms of which, the annual value of one house property as specified by him will be taken at Nil. The other self-occupied house property/is will be deemed to be let-out and their annual value will be determined on notional basis as if they had been let out.

**Annual Value of a house property which is partly self-occupied and partly let out:** If a house property consists of two or more independent residential units, one of which is self-occupied and the other unit(s) are let out, the income from the different units is to be calculated separately.

## **Income from Business or Profession**

### **Business: Sec 2 (13)**

Business includes any trade, commerce, or manufacture or any adventure or concern in the nature of trade, commerce, or manufacture. Or practical purpose business means the purchase and sale or manufacture of a commodity with a view to make profit. Business includes banking, transport business or any other adventure. Profit of an isolated transaction is also taxable under this head.

### **Profession**

A profession is a vocation founded upon specialized educational training, the purpose of which is to supply objective counsel and service to others, for a direct and definite compensation, wholly apart from expectation of other business gain. For example, the work of lawyer, doctor auditor engineer and so on. Vocation means activities which are performed in order to earn livelihood. For example, brokerage, music, dancing etc.

The following items are chargeable under the head income from business or profession.  
(section28)

- The profits and gains of any business or profession, which was carried on by the assessee at any time during the previous year;
- Any compensation or other payment, due or received by the following:-
- Any person, by whatever name called, managing the whole or substantially the whole of the affairs of an Indian company, at or in connection with the termination of his management or the modification of the terms and conditions relating thereto;

- Any person, by whatever name called, managing the whole or substantially the whole of the affairs in India of any other company, at or in connection with the termination of his office or the modification of the terms and conditions relating thereto;
- Any person, by whatever name called, holding an agency in India for any part of the activities relating to the business of any other person, at or in connection with the termination of any agency or the modification of the terms and conditions relating thereto;
- Any person, for or in connection with the vesting in the Government, or in any corporation owned or controlled by the Government, under any law for the time being in force, of the management of any property or business;
- Income, derived by a trade, professional or similar association from specific services performed for its members;
- Profits on sale of a license granted under the Imports (Control) Order, 1955, made under the Imports and Exports (Control) Act, 1947;
- Cash assistance (by whatever name called), received or receivable by any person against exports under any scheme of the Government of India;
- Any duty of customs or excise repaid or repayable as drawback to any person against exports under the Customs and Central Excise Duties Drawback Rules, 1971;
- The value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession;
- Any interest, salary, bonus, commission or remuneration, by whatever name called, due to, or received by, a partner of a firm from such firm.
- Income from speculative transactions.
- Any sum received under a key man insurance policy including bonus.
- Any sum whether received or receivable in cash or in kind, under an agreement for:

(A) Not carrying out any activity in relation to nay business

Or

(B) Not sharing any know how, patent, copyright, trade mark, licence franchise or any likely to assist in the manufacture or processing of goods or provision of services.

## **Income from Capital Gains (Sections 45 to 54)**

### **Introduction**

You know '**capital gains**' is a separate head of income and any income arising out of **sale or transfer of a capital asset** is charged to tax under this head. In this unit, you will study the meaning of capital gains, items included in capital gains, capital gains exempt from tax and the deductions allowed from capital gains. You will also study how the taxable income from capital gains is calculated.

Any profits or gains arising from the transfer of a capital asset effected in the previous year shall be chargeable to income-tax under the head 'Capital Gains', and shall be deemed to be the income of the previous year in which the transfer took place.

The above definition can be split up into three parts: (a) Capital Asset (b) Transfer of Capital Asset (c) Profits or Gains

### **Section 45(1): Basis of Charge**

Any profit or gain arising from transfer of a capital asset shall be charged to tax under the head 'Capital Gains' in the same previous year in which the transfer took place.

**Capital Asset + Transfer = Capital Gain / Loss (Accrual Basis)**

### **Section 2(14): Capital Asset**

Concept of Capital Asset Capital asset means property of any kind held by an assessee whether or not connected with his business or profession. The asset may be movable, immovable, tangible or intangible. But the term capital asset does not include:

Capital asset means:

1. Any kind of property held by an assessee, whether or not connected with business or profession.
2. Any securities held by a Foreign Institutional Investor (FII) in accordance with SEBI regulations.

### **Examples of Capital Assets:**

Land, building, plant, machinery, investments, goodwill, leasehold rights, jewellery, shares, manufacturing licence, etc.

### **Jewellery includes:**

- Ornaments made of gold, silver, platinum or other precious metals.
- Precious or semi-precious stones, whether or not set in furniture or apparel.

### **Agricultural Land (Not a Capital Asset):**

Land in India not situated within:

- Municipality/Cantonment limits with population >10,000

Distance limits:

- 2 km: Population >10,000 up to 1 lakh

- 6 km: Population >1 lakh up to 10 lakh
- 8 km: Population >10 lakh

**Securities:**

- As Stock-in-Trade: Taxable under PGBP
- As Capital Asset: Taxable under Capital Gains
- For FIIs: Always taxable under Capital Gains

**Section 2(47): Concept of Transfer of Capital Assets**

Transfer in relation to a capital asset includes (i) sale, exchange or relinquishment of the assets, or (ii) the extinguishment of any rights therein, or (iii) the compulsory acquisition by the Government under any law, or (iv) where the asset is converted by the owner thereof into stock in-trade of a business carried on by him, such conversion. Further, where a business is converted into a limited company, there is a transfer of capital assets, or (v) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in the Transfer of Property Act, 1882, or (vi) any transaction which has the effect of transferring or enabling the enjoyment of any immovable property.

**Transfer includes:**

- Sale, exchange, relinquishment
- Extinguishment of rights
- Compulsory acquisition
- Conversion into stock-in-trade
- Conversion of firm into company
- Allowing possession of immovable property
- Maturity of zero coupon bonds

**Kinds of Capital Assets:**

Short Term Capital Asset (STCA):

Held for not more than 36 months before transfer.

Long Term Capital Asset (LTCA):

Held for more than 36 months before transfer.

**Exceptions:**

12 months instead of 36:

- Listed securities
- Units of UTI
- Equity oriented mutual funds
- Zero coupon bonds

24 months instead of 36:

- Unlisted securities
- Land or building or both

**Depreciable assets (WDV method): Always treated as STCA.**

**Section 47: Transactions Not Regarded as Transfer:**

- Partition of HUF
- Gift or will
- Holding to subsidiary (100% holding, Indian company)
- Subsidiary to holding (Indian company)
- Amalgamation/Demerger (Indian company)
- Conversion of debentures into shares
- Transfer to Government of art, manuscripts, etc.
- Transfer of land of sick industrial company

**Section 48: Computation of Capital Gains**

**Short Term Capital Gain** = Full value of consideration - Transfer expenses - Cost of acquisition - Cost of improvement

**Long Term Capital Gain** = Full value of consideration - Transfer expenses - Indexed cost of acquisition - Indexed cost of improvement

**Indexed Cost Formula:**

Cost  $\times$  CII of year of transfer / CII of year of acquisition or 2001-02 (whichever later)

**Note:**

- No indexation for bonds or debentures
- Improvement before 1.4.2001 not allowed

**Set-off:**

- STCL can be set-off against STCG or LTCG
- LTCL can be set-off only against LTCG

**Section 50: Depreciable Assets**

Capital gain on depreciable assets is always STCG/STCL.

No depreciation allowed in year of sale if block ceases to exist.

**Special Cases:**

**Section 45(1A):** Insurance compensation on destruction of asset  
Taxable in year of receipt. FMV is full value of consideration.

**Section 45(2):** Conversion of capital asset into stock-in-trade

- Capital gain taxable in year of sale of stock
- FMV on conversion date is consideration
- Excess sale price taxed as business income

**Section 45(5):** Compulsory acquisition

- Taxable in year compensation is received

- Enhanced compensation taxed in year of receipt
- Cost of acquisition/improvement taken as nil for enhanced amount

**Section 45(3):** Capital contribution to firm/AOP/BOI  
 Consideration = value recorded in books

**Section 45(4):** Distribution of assets by firm/AOP/BOI  
 Consideration = Fair Market Value

### **Exemptions from Capital Gains:**

#### **Section 54: Capital gains arising on the transfer of property used for residence**

##### **Residential House Property**

Conditions:

- Individual or HUF
- Residential house
- LTCG only
- Purchase: 1 year before or 2 years after transfer
- Construction: within 3 years

##### **Exemption:**

Lower of LTCG or amount invested

#### **Section 54B: Capital gain arising from the transfer of agricultural land**

##### **Agricultural Land**

- Individual or HUF
- Urban agricultural land
- Used for agriculture for 2 years
- New agricultural land within 2 years
- Applicable to STCG/LTCG

#### **Section 54D: Capital gain arising on Compulsory Acquisition of Lands or Buildings used as Industrial Undertaking**

- Compulsory acquisition
- Used for industrial purpose for 2 years
- New land/building within 3 years

##### **Exemption from Tax:**

##### **Capital Gains Account Scheme, 1988:**

- Deposit before due date of return
- Unutilized amount taxed after expiry of specified period

## **Section 54EC: Capital Gain arising from the transfer of long-term Capital Asset invested in long-term specified assets**

Any capital gain on the transfer of a long-term capital asset is exempt if the following conditions are satisfied:

- The assessee has transferred a long-term capital asset.
- The net consideration (i.e. net sale proceeds) has been invested in specified new asset by initially subscribing to such new asset within six months from the date of transfer of the asset.
- If a part of net consideration is invested, proportionate part of the capital gain will be exempt from tax.
- If the assessee receives some money as earnest money or advance and invests in the specified assets before the date of transfer of asset, the amount so invested will qualify for exemption under section 54E.

### **Conclusion**

Any profits or gains arising from the transfer of a capital assets affected in the previous. year shall be chargeable to income-tax under the head 'Capital Gains'. Capital asset means property of any kind held by an assessee whether or not connected with his business' or profession, but does not include stock-in-trade, personal effects and, agricultural land in India. Capital assets are of two types-long-term and short-term. Long-term capital assets are those which are held by the assessee for more than 36 months before transfer and short-capital assets are those which are held by the assessee for not more than 36 months before transfer. Capital gains arising from the transfer of short-term capital assets are called short-term capital gains and capital gains arising from the transfer of long-term capital assets are called long-term capital gains. Transfer of a capital asset means sale, exchange or extinguishment of any rights therein, or its compulsory acquisition under any law or its conversion into stock-in-trade etc. The income chargeable under the head 'Capital Gains' shall be computed by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital assets: (i) expenditure incurred wholly and exclusively in connection with the transfer, and (ii) the cost of acquisition of the capital asset and cost of any. improvement thereto. Only long-term capital gains are exempt from tax under Section 53,54,54E, and 54F, subject to the fulfilment of certain conditions. Similarly, capital gains are also exempt under sections 54B, 54D and 54G subject to fulfilment of certain conditions. In the case of long-term capital gains an initial deduction of Rs. 10,000 is made and thereafter on the balance of such capital gain deduction at specified percentage will be allowed on specified nature of capital gains. The net balance left thereafter shall be taxable capital gain.