

# INCOME TAX

## UNIT I BASIC CONCEPTS

### INTRODUCTION

The taxation structure of the country can play a very important role in the working of our economy. 'Tax' levied by the government is a 'multi dimensional instrument'. It helps resource mobilization, helps government to take up schemes and projects for economic development and solve the basic problems of the poor and under privileged.

Taxation is an instrumental tool to procure resources for the government to enable it to formulate policy schemes for the overall development of the economy. Moreover, taxation measures are relied upon for financing socio-economic development and also to check and reduce the monetary inequalities in the society.

Thus, taxation plays an important role as a source of revenue and an effective measure of removal of economic disparity.

### **Q. EXPLAIN THE BRIEF HISTORY OF INCOME TAX IN INDIA. ( 5 Marks)**

The history of income-tax dates back to 1860's when the British Government first levied income tax in India. A separate income tax act was passed in 1886 which remained in force till 1917 with suitable amendments from time to time. In 1918, a new income tax act was passed which was short-lived & replaced by income tax Act , 1922 which remained in force up to assessment year 1961 -1962.

The income tax Act 1961 came into force with effect from 1<sup>st</sup> April 1962. Every year the union budget makes several amendments in the income tax (Finance Bill).

The finance bill mentions the rate of income tax and other taxes, rebates and reliefs. The bill passes through both the houses of parliament and finally receives the consent of the president of India to become the finance act.

### **Q. EXPLAIN THE IMPORTANCE OF TAXATION. ( 5/10 Marks)**

The taxes levied by the government from a pool sources to be used for the collective benefit of the public. The taxation is an exercise in the collective solution of individual problems. The state takes upon itself the duty of solving the problems of underprivileged and needs finance for this purpose. The government can mobilize resources by imposing on the privileged ones.

The taxation structure of the country can play a very important role in the working of our economy. Some time back the emphasis was on higher rates of tax and more incentives. But recently the emphasis has shifted to decrease in rates of taxes and withdrawal of incentives. While designing the taxation structure it has to be seen that in is in conformity with our economic and social objectives. It should not impair the incentives to personal savings and investment flow and on the other hand it should not result into decrease in revenue for the state.

In our present day economic structure income-tax plays a vital role as a source of revenue and a measure of removal of economic disparity.

Our taxation structure provides for two types of taxes-direct and indirect; Direct tax is a payment directly made to the state by the person who bears it, the income tax, wealth tax and gift tax are direct taxes whereas Indirect taxes on other hand are a tax which is paid by one person and borne by another person, sales tax and excise duties are indirect taxes.

### **Q. ENUMERATE THE OBJECTIVES OF TAXATION. ( 5 Marks)**

The basic objective of taxation is to raise resources for the State. In fact, experts like David. A. wells contend that "Taxation is for revenue only and a so called tax which looks to anything besides the securing of revenue is not a tax, but an unconstitutional exercise of the taxing power".

However, all the modern States in the post second world war era have realized that taxation is a powerful instrument with multiple applications. It can be used to reduce inequalities, to accelerate economic development, as a tool to regulate consumption, imports and exports, in addition to its basic objective of raising revenues.

Different objectives of taxation may be summed up as under.

#### **I. Objective of raising revenue.**

## **II. Regulatory objectives.**

1. Regulating consumption.
2. Regulating production.
3. Regulating imports and exports.
4. Regulating the effects of inflation, depression etc.

## **III. Developmental objectives.**

1. Objective of economic development.
2. Objective of capital formation.
3. Objective of increasing employment opportunities.

## **IV. Objectives of reducing inequalities.**

1. Reduction in economic disparities.
2. Reduction in regional imbalances.

## **Q. WRITE SHORT NOTE ON CANONS OF TAXATION. ( 5 Marks)**

It refers to the principles of taxation. In other words it refers to the basis on which the income is taxed. These principles are essential for a good taxation policy. Adam Smith was the first economist who enunciated specific canons of taxation. His four canons of taxation have become 'Classical' in any literature of taxation and public finance. Some other western experts on Public Finance like Bastable have added a few more canons of Taxation of the four canons of AdamSmith. The following are the important principles (Canons) of taxation.

1. Canon of equality.
2. Canon of certainty.
3. Canon of economy.
4. Canon of convenience.
5. Canon of productivity.
6. Canon of simplicity.
7. Canon of diversity.
8. Canon of expediency.
9. Canon of coordination.

## **Q. EXPLAIN THE FOLLOWING DEFINITIONS: (A) AGRICULTURAL INCOME (B) ASSESSEE (C) DEEMED ASSESSEE (D)ASSESSEE IN DEFAULT (E) INITIATION OF PROCEEDING (F) AVERAGE RATE (G) MAXIMUM MARGINAL RATE (H) BLOCK OF ASSETS (I) CHARITABLE PURPOSE (J) CHILD (K) FAIR MARKET VALUE (L) COMPANY (M) PERSON (N) PREVIOUS YEAR (O) ASSESSMENT YEAR. ( 5 Marks)**

### **A) AGRICULTURAL INCOME [Sec.2 (1A)]**

Agricultural income is fully exempted for tax u/s 10(1). Agricultural income refers to

- (i) Any rent or revenue derived from land, which is situated in India and used for agricultural purposes
- (ii) Any income derived from such land, which is used for agricultural operations. It includes process by cultivator or receiver of rent in kind as well as in cash or receipt of sale of such produce.
- (iii) Any income from a farm house
- (iv) Any income derived from saplings or seedlings grown in a nursery will be deemed as agricultural income (w.e.f.AY 2009-10)

Agricultural income is a factor in determining the tax on non-agricultural income in the case of certain non-corporate assesses like individuals, H.U.F, unregistered firms, AOP's etc.

### **Non agricultural incomes from land**

Certain incomes are derived from land but they are not agricultural incomes because the basic conditions –land must be used for agricultural purposes and it must be the primary source of income are not satisfied in such cases. Sources of the incomes falling under such categories are as follows:

- (i) Income from sale of forest trees, fruits, wild grass and reeds of spontaneous growth.
- (ii) Income from fisheries.
- (iii) Royalty income of mines.
- (iv) Income from poultry farming, dairy farm etc.
- (v) Incomes from land used for quarries, ferries supply of water for irrigation, potteries or brick fields are not agricultural incomes.

- (vi) Income derived from land let out for storing crops.
- (vii) Income from interest on arrears of rent in respect of agricultural land.
- (viii) Income from sale of salt.
- (ix) Interest income of money lender received in the form of agricultural produce.
- (x) Income derived from sale of rubber.

**Partly agricultural income:**

Sometimes income may comprise both agricultural and non-agricultural components. In such cases, agricultural components of the total income are exempted, whereas non agricultural component of the total income should be chargeable to tax. This type of income is computed as per rules 7 and 8 of income tax, 1962.

**B) ASSESSEE [SEC. 2(7)]**

a. 'Assessee' means a person by whom any tax or any other sum of money is payable under this Act, and includes.

- a) Every person in respect of whom any proceedings under this Act has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable or loss sustained by him or by such other person, or of the amount of refund due to him or to such other persons;
- b) Every person who is deemed to be an assessee under any provision of this Act.
- c) Every person who is deemed to be an assessee-in-default under any provisions of this Act.

The above definition divides various types of assessee into three categories.

**ORDINARY ASSESSEE:** It Includes-

- a. Any person against whom some proceedings under this Act are going on. It is immaterial whether any tax or other amount is payable by him or not.
- b. Any person who has sustained loss and filed return of loss under section 139 (3).
- c. Any person by whom some amount of interest, tax or penalty is payable under this act. or
- d. Any person who is entitled to refund of tax under this act

**C) REPRESENTATIVE OR DEEMED ASSESSEE:** A person may not be liable only for his own income or loss but also on the income or loss of other persons e.g., guardian of minor or lunatic, agent of a non-resident etc. In such case the persons responsible for the assessment of incomes of such persons are called representative assessee. Such person is deemed to be an assessee.

- a. In the case of a deceased person who dies after writing his will the executors of the property of deceased are deemed as assesses.
- b. In case a person dies intestate(without writing his will) his eldest son or other legal heir are deemed as assessee.
- c. In case of a minor, lunatic or idiot having income, their guardian is deemed as assessee.
- d. Non-residents: In case of non residents having income in India, the person acting on his behalf is deemed as assessee.

**D) ASSESSEE-IN-DEFAULT:** A person is deemed to be an assessee-in-default if he fails to fulfill his statutory obligations. In case of an employer paying salary or a person who is paying interest it is their duty to deduct tax at source and deposit the amount of tax so collected in government treasury. If he fails to deduct tax at source or deduct tax but does not deposit it in the treasury, he is known as assessee-in-default.

**(E) INITIATION OF PROCEEDING**

The proceeding must be initiated under the provisions of the act. An enquiry letter is sent by the department to a person without reference to a specific section of the act, it is no proceeding under the act and the person cannot be said to be an assessee for the income tax purposes.

**F) AVERAGE RATE [SEC.2 (10)]**

“Average rate of income-tax” means the rate arrived at by dividing the amount of income-tax calculated on the total income by such total income.

$$\text{Average Rate} = \frac{\text{Total Tax}}{\text{Totl Income}} \times 100$$

### **G) MAXIMUM MARGINAL RATE (MMR) SEC.2 (29C)]**

It means the rate of tax for an individual, which is applicable on highest slab on income. At present for assessment year 2010 – 2011 it is 30%.

### **H) BLOCK OF ASSETS [SEC.2 (11)]**

It means a group of assets falling within a class of assets comprising:-

- a) Tangible assets being building, machinery, plant or furniture.
- b) Intangible assets being know-how, patents, copyrights trade marks licenses, franchises or any other business or commercial rights of similar nature.

In respect of which same percentage of depreciation is prescribed. This simply means that all assets of the same nature and having same rate of depreciation would form one block of assets. For example all machines having 15% rate of depreciation would form one block and all machines having 40% rate of depreciation would fall in another block of assets.

### **I) CHARITABLE PURPOSE [SEC.2 (15)]**

“Charitable purpose” includes- a. Relief of the poor; b. Education; c. Medical relief ;d. Advancement of any other object of general public utility.

It is further provided that any other object of general public utility shall not be a charitable purpose, if it involves the carrying on of any activity in the nature of trade, commerce or business or any activity of rendering any service in relation to any trade, commerce or business for a cess or fee or any other consideration irrespective of the nature of use or application or retention of income from such activity.

### **J) CHILD [SEC.2 (15A)]**

“Child” in relation to an individual, includes a step-child and an adopted child of that individual. It includes both male and female children.

### **K) FAIR MARKET VALUE [SEC.2 (22)]**

The “fair market value” in relation to a capital asset means-

- a. The price that capital asset would ordinarily fetch on sale in the open market on the relevant date; and
- b. Where the price referred to in sub-clause (i) is not ascertainable, such price as may be determined in accordance with the rules made under this act.

### **L) COMPANY [SEC. 2(17)]**

For all purposes of the Act the term ‘Company’, has a much wider connotation than that under the Companies Act. Under the Act, the expression ‘Company’ means:

- a. Any Indian company as defined in section 2(26); or
- b. Any body corporate incorporated by or under the laws of a country outside India.
- c. Any institution, association or body which is assessable or was assessed as a company for any assessment year under the Indian Income-tax Act, 1922 or for any assessment year commencing on or before 1.4.1970 under the present Act; or
- d. Any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of the CBDT.

### **(M) PERSON (SEC. 2(31))**

The word person is a very wide term & embraces in itself the following :-

**(i)Individual:** It refers to a natural human being whether male or female, minor or major.

**(ii)Hindu in divided family :** It is a relationship created due to operation of Hindu law. The manager of HUF is called “karta” and its members are called “coparceners”.

**(iii)Company:**

It is an artificial person registered under Indian companies act 1956 or any other law.

**(iv)Firm:**

It is an entity which comes into existence as a result of partnership agreement. The income tax act accepts only these entities as firms which are assessed as firms under Section 184 of the act.

The only condition for a partnership entity to be assessed as firm is that it must submit its instrument of partnership (partnership deed) duly authenticated by all partners except a minor partner and it must specify the shares of the partners. In case firm has not submitted its partnership deed it is assessed as firm u/s 185.

**(v) Association of persons or body of individuals :**

Co-operative societies, MARKFED, NAFED etc, are the examples of such persons. When persons combine together to carry on joint enterprise and they do not constitute partnership under the ambit of law, they are assessable as an association of persons. An AOP , can have firms, companies , associations and individuals as its members. A body of individuals (BOI) cannot have non-individuals as its members. Only natural human beings can be members of a body of individuals.

**Distinction between AOP and BOI**

- a. A BOI has to consist of individuals only. An AOP may consist of non-individuals also. If two or more person (like firm, company, HUF, individuals etc) joint together, it is called an AOP. But if only individuals join together, it is called a BOI.
- b. An AOP may be formed by voluntarily getting together for a common design or in combination, will be engaged in income producing activities, whereas a BOI may or may not have such common design or will

**(vi) Local authority:** Municipality, panchayat, cantonment board, port trust etc. are called local authorities.

**(vii) Artificial juridical person:**

A public corporation established under special Act of legislature and body having juristic personality of its own are known to be Artificial juridical persons. Universities are an important example of this category.

Association of persons or body of individuals or a local authority or artificial judicial persons shall be deemed to be a person whether or not such persons are formed or established or incorporated with the object of deriving profits or gains or income.

**(N) PREVIOUS YEAR (SECTION 3):**

The term previous year is very important because it is the income earned during the previous year which is to be assessed to tax in the assessment year. As the word 'previous' means 'coming before', hence it can be simply said that the previous year is the financial year preceding the assessment year e.g. for the assessment year 2010-2011 the previous year should be financial year ending 31<sup>st</sup> March 2010.

In simple words, it may be said that the year in which income is earned is called previous year and the next year in which such income is computed and put to tax is known as assessment year.

- a) **Previous year in case of a continuing business:** It is the financial year preceding the assessment year.
- b) **Newly setup business or profession:** The assessee is free to setup a new business or start a new profession on any day and the first previous year in case of a newly set up business/profession or newly created source of income shall on the day it is set up and end on 31<sup>st</sup> March next following. So the 1<sup>st</sup> previous year may be of 12 months or less than 12 months but all subsequent previous years shall be of 12 months duration and always be starting on 1<sup>st</sup> April each year.
- c) **In case of a newly created source of income:** In such case the previous year shall be the period between the day on which such source comes in to existence and 31<sup>st</sup> March next following.

**Current Previous Year- 1.4.2009-31.03.2010**

**(O) ASSESSMENT YEAR [SECTION 2(9)]**

“Assessment Year” means the period of 12 months commencing on the 1st day of April every year and ending on 31st March of the next year. The assessment year is the financial year of the government of India during which income of a person relating to the relevant previous year is assessed to tax. Every person who is liable to pay tax under this Act , files return of income by prescribed dates. These returns are processed by the income tax department officials and officers. This processing is called assessment. Under this income returned by the assessee is checked and verified.

**Q. WRITE SHORT NOTE ON INCOME [Section 2(24)] ( 5 Marks)  
INCOME [Sec. 2(24)]**

The definition of the term “income” in sec. 2(24) is inclusive and not exclusive. The term “income” not only indicates those things which are included in sec. 2 (24), but also includes such thing which the term signifies according to its general and natural meaning. The definition of “income” includes—

1. Profits and gains;
2. Dividend;
3. Voluntary contributions received by religious or charitable trust or institution;
4. Perquisite or profit in lieu of salary taxable under sec. 17(2) and (3);
5. Special allowance or benefit, other than perquisite as in sub-clause (4) above
6. Allowance granted to assessee
7. The value of any benefit or perquisite obtained from the company by a director or by a person having substantial interest in the company or by a relative of the Director of such person;
8. Any sum paid by a company in respect of any obligation which, but such payment would have been payable by the director or the person having substantial interest;
9. Value of any benefit or perquisite obtained by a representative assessee mentioned in sec. 160(1)(iii) or (iv) or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee.
10. Any compensation or other sum due to or received by any person referred to in sec. 28 (ii)
11. Business income includes—
  - a. Compensation money [sec. 28(ii)]
  - b. Income derived by a trade, professional or similar association for specific services performed for its members [sec. 28(iii)]
  - c. Export incentives [sec. 28(iii)a), (iii)b), (iii)c)]
  - d. Value of any benefit or perquisite arising from business or the exercise of profession
  - e. Any interest, salary, bonus, commission or remuneration received by a partner of a firm from such firm [sec. 28(v)]
  - f. Deemed business income and deemed income chargeable under the head other sources
12. Any capital gains chargeable u/s. 45;
13. Profits and gains of any insurance carried on by a mutual insurance company or by a cooperative society;
14. Winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort;
15. Sum received by the assessee from his employees as contributions to any provident fund or superannuation fund set up under the provisions of the Employees’ State Insurance Act, 1948
16. Any sum received under a key-men Insurance.

The above list given in sec. 2(24) of the income-tax Act is inclusive and not exhaustive.

### **Q. WHAT ARE THE FEATURES OF INCOME? (5/10 Marks)**

Features of income: The following are some important principles or features which explain the concept of “income”.

**(a) Sources of income:** The “income” connotes a periodic monetary return coming with some sort of regularity or expected regularity from definite sources. The source however need not necessarily be one which is expected to be continuously productive, but it must at any rate be one whose object is the production of a return.

**(b) Basis of income:** The income arises either on receipt basis or accrual basis. If the assessee has got a right to receive the income he is liable to be taxed on such income on accrual basis even if he may not have received the income.

**(c) Form of income:** Income may be realized in the form of money or money’s worth. i.e., in cash or in kind. When income is realized in kind, its valuation is made according to the prescribed rules.

**(d) Nature of income:** The income tax law does not make any distinction between legal income and income tainted with illegality. Illegal income is taxable like legal income to hold otherwise would be to put a premium on dishonesty and fraud.

**(e) Title of income:** Assessment of income cannot be held up because of any dispute regarding the title of the income. The recipient is taxable although there may be a rival claim to the source of income. Where money has been received, a rival claim or a threat of litigation cannot make the income contingent one. On the other

hand, a mere claim by a person against another who has actually received the money is not sufficient to make income accrue to the claimant and render him liable for tax.

**(f)Quantum of income:** A revenue receipt is always liable to tax whether it is received in lump-sum or in installments. For example, arrears in pay revision received in lump-sum, is income.

**(g)Tax free-income:** If some tax-free income is received by the assessee, it has to be grossed up for inclusion in his total income.

**(h)Real income alone is taxable:** "Income" should refer to real income and not fictional or technical income. Transactions entered into by commercial men must be looked at for income-tax purposes from a commercial point of view and in trying to determine whether a certain transaction resulted in profits, we have to see whether the transaction resulted in real profits.

**(i)Negative income:** Losses are negative profits. Both positive and negative profits are of a revenue character and both must enter into computation of total income.

**j) Surplus arising from mutual activity:** No person can trade with himself and make an assessable profit. If different persons combine themselves into distinct and separate legal entity for the purpose of rendering services to themselves, the resulting surplus is not assessable to tax if the surplus is to be refunded to the members. There should be complete identity between the contributors and the participators. Thus, a members club cannot be charged to tax on the profits it has made by overcharging its members for the supply of refreshments, beverages and other amenities.

#### **Q. EXPLAIN THE PROCEDURE FOR TAX TREATMENT OF INCOME(5 Marks)**

**Taxable Income:** These incomes form part of total income and are fully taxable. These are treated u/s 14 to 69 of the act. These are salaries rent, business profits, professional gain, capital gain, interest, dividend, winnings from lotteries, races etc..

**Exempted Income:** These incomes do not form part of total income either fully or partially. Hence no tax is payable on such incomes. These incomes are given u/s 10(1) to 10(32) of the act.

**Rebateable (Tax free) Income:** These incomes form part of total income and are fully taxable. Tax is calculated on total income out of which a rebate of tax at average rate is allowed.

#### **Q. EXPLAIN THE CONCEPT OF INCOME. ( 5 Marks)**

1. Income must be from a definite source in order to get it taxed.
2. Self generated income can not be taxed. Therefore income must be from outside.
3. Legal as well as illegal income is taxed.
4. It is not necessary that income should be in the form of money. It can also be in the form of kind.
5. Income earned may be temporary or permanent.
6. Pin money received by housewife is not considered as an income.
7. Any amount received due to devaluation of currency is taxable income.
8. If income is diverted without receiving, it is not taxable income.
9. If income is collected and then distributed that income will be taxable income.
10. Any loss is also included under the concept of income.
11. In case there is any dispute regarding the title of the income, the beneficiary will be taxed.
12. Income may be a lumpsum or in installment.
13. Revaluation of assets and excesses if any can not be considered as income.

#### **Q. WRITE SHORT NOTE ON CASUAL INCOME. ( 5 Marks)**

1. Any receipt which is of a casual and non-recurring nature is casual income. In other words, casual income is that income the receipt of which is accidental and without any stipulation. It is in nature of an unexpired wind-fall Winning from lottery, crossword puzzles, card games and other games of any sort are casual incomes. Receipts even from habitual betting are non-recurring receipts and assessable as casual income. The casual income does not include:
  - a. Capital gains, chargeable under the provisions of section 45;or
  - b. Receipts arising from business or the exercise of a profession or occupation; or
  - c. Receipts, by way of addition to remuneration of an employee, such as bonus, gratuity, perquisites etc.
2. Voluntary payments received in exercise of an occupation are not treated as casual income.
3. A gift from a relative is not income at all. Birthday and wedding gifts are simplest instances in point. A gift from a relative does not become income merely because it is repeated year after year.

4. Payment by husband to his wife under an agreement to live a part as maintenance allowance is neither casual income nor a personal gift. Hence, it is taxable.
5. Prize awarded for coin collection or stamp collection may be a casual income. This income is due to hobby.

**Q. WRITE SHORT NOTE ON GROSS TOTAL INCOME AND TOTAL INCOME ( 5 Marks)**

**Gross total income (Section 14)**- For the purpose of income tax and computation of total income shall be classified under the following heads of income:

- (i) Salaries;
- (ii) Income from house property;
- (iii) Profits and gains of business or profession;
- (iv) Capital gains;
- (v) Income from other sources;

The sum of income computed under the above five heads, after making adjustments for set off and carry forward of losses, is known as gross total income.

**TOTAL INCOME [Sec. 2(45)]**- “Total income” means the total amount of income as referred to in sec. 5 and computed in the manner laid down in the Act. Total income constitutes the tax with reference to which income tax is charged.

**UNIT II  
BASIS OF CHARGE  
RESIDENTIAL STATUS**

**INTRODUCTION**

The incidence of tax on any assessee depends upon his residential status under the Act. The taxability of a particular receipt would thus depend upon not only the nature of the income and the place of its accrual or receipt but also upon the assessee’s residential status. For all purposes of income-tax, taxpayers are classified into three broad categories on the basis of their residential status. Viz.,

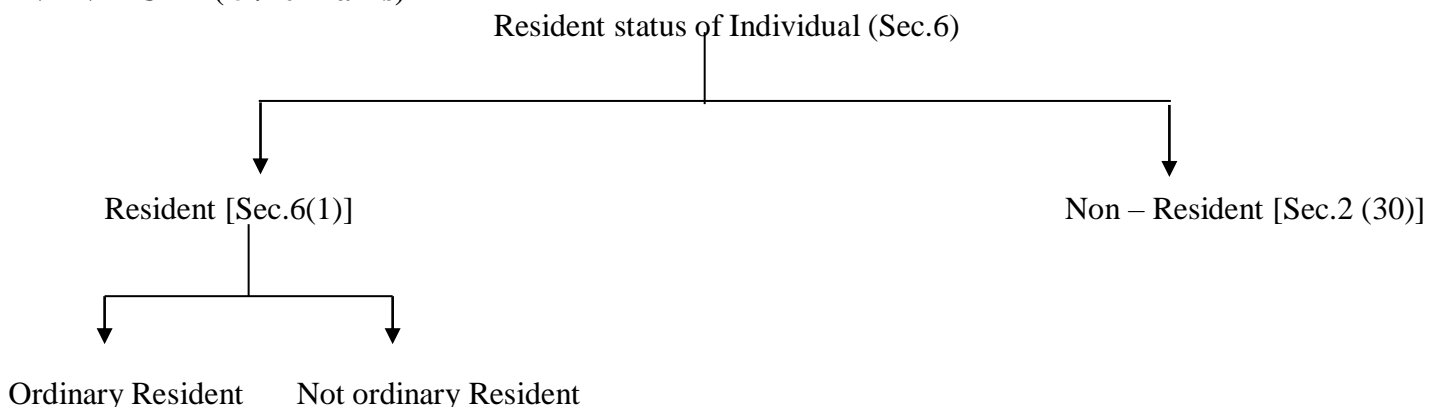
- (1) Resident and ordinarily resident;
- (2) Resident but not ordinarily resident;
- (3) Non-resident

The residential status of an assessee must be ascertained with reference to each previous year. A person who is resident and ordinarily resident in one year may become non-resident or resident but not ordinarily resident in another year or vice versa.

**Q. WHAT IS MEANT BY RESIDENTIAL STATUS? ( 5 Marks)**

Section 6 of the income tax Act deals with the residential status. The concept of residential status is no way connected to the nationality of a person. A person would have born in India but for tax purpose he may be a non-resident. Similarly a person who has born and brought up in a foreign country may be a resident Indian for tax purposes. The status of a person is identified by considering the number of days he has stayed in India in a particular previous year. Different rules are prescribed for the residential status of different kinds of assessee (say individual, HUF, firm, company, BOI, AOP, other personal. A person can be resident in more than one or two country in the same financial year. It is not necessary that the same status should be there every year. The status of a person may change from year to year.

**Q. EXPLAIN THE PROCEDURE TO DETERMINE THE RESIDENTIAL STATUS OF AN INDIVIDUAL ( 5 /10 Marks)**



**Determination of residential status of an individual-** Residential status of an individual depends upon the fulfillment of the following basic and additional conditions.

**Basic conditions[SEC 6(1)]**

1. His stay in India during the previous year should be at least 182 days.**(OR)**
2. His stay in India during the previous year should be at least 60 days **AND** at least 365 days in the four preceding year.

**Additional conditions [section 6(6)]**

1. He should be a resident for at least 2 years out of 10 years preceding the previous year[i.e., he should satisfy any one of the basic conditions for at least 2 years].
2. His stay in India in the 7 years preceding the previous year should be at least 730 days.

**Note:** first basic condition will only apply if:

1. An India citizen leaves India for employment outside India.
2. An Indian citizen leaves India as a member of a crew of Indian ship.
3. A person who is an Indian citizen or person of Indian origin living outside India comes to visit India.

For any one of the above cases, second basic condition should not be taken for calculation of residential status.

**While calculating number of days for stay in India both, day of departure from India and day of arrival in India are to be counted as stay in India.**

**WHEN AN INDIVIDUAL IS:**

**1. RESIDENT:** If an individual satisfies **any one or both of the basic conditions**, then he is said to be a 'resident'.

**2. RESIDENT AND ORDINARILY A RESIDENT[SEC 6(1)]:** After fulfillment of **any one or both of the basic condition if an individual fulfills both the additional conditions**, then he is said to be resident and ordinarily a resident.

**3. RESIDENT BUT NOT ORDINARILY A RESIDENT[SEC 6(6)]:** After **satisfying one or both of the basic conditions if an individual satisfies one or none of the additional conditions**, then he is said to be resident but not ordinarily a resident.

**4. NON-RESIDENT [SECTION 2(30)]:** If any individual **does not satisfy any one of the basic conditions** then he is said to be a non resident.

Important points to be considered while calculating residential status of an individual:

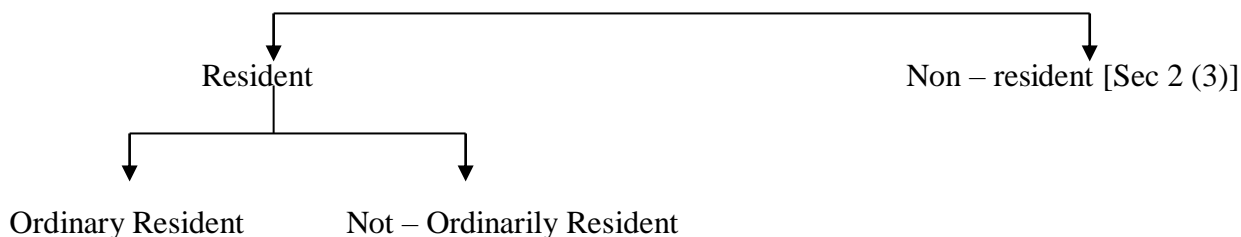
- a. The stay need not be for a continuous period.
- b. The stay need not be at a same place.
- c. It means stay any where within Indian geographical territory.
- d. If a person is in India only for a part of a day, the number of hours of his stay in India is taken for calculating of residential status. In absence of above information, then the dy he enters India and the day he leaves India is to be taken for computation.
- e. A person of India origin means he, or anyone of his parents or anyone of his grandparents should have been born in undivided India.
- f. It is immaterial whether he stays in India for business purposes or on a personal purposes or visits India as a tourists.

**Residential status of individual in a Nutshell**

STATUS	BASIC CONDITIONS	ADDITIONAL CONDITIONS
Resident	Satisfied	-
Resident and ordinary Resident [OR]	Satisfied	Satisfied
Resident and Not Ordinary Resident [NOR]	Satisfied	Not Satisfied
Non-Resident [NR]	Not Satisfied	-

**Q. WRITE SHORT NOTE ON RESIDENTIAL STATUS OF HUF ( 5 Marks)**

Residential status of HUF [ Section 6(2)]



### Residential status of HUF [section 6(2)]

Like an individual, a HUF can be

1. Resident and ordinarily resident
2. Resident but not ordinarily resident
3. Non-resident

#### 1. RESIDENT-

A HUF is a resident if control and place of management of affairs is wholly or partially in India. Once a HUF is found to be resident then in order to determine whether it is resident and ordinarily resident (or) resident but not ordinarily resident, the residential status of its karta is checked.

#### 2. RESIDENT AND ORDINARILY RESIDENT[SECTION 6(2)]-

If the karta satisfies both the additional conditions prescribed for computing residential status of an individual then the HUF is resident and ordinarily resident.

#### 3. RESIDENT BUT NOT ORDINARILY A RESIDENT[SECTION 6(6)(B)]-

If the Karta fulfills any one or none of the additional conditions prescribed in case of an individual then the HUF is resident but not ordinarily resident. This status is allowed only to HUF along with individuals. A HUF will be 'not ordinarily resident' if

- a. Its manger (Karta) has not been resident in India in nine out of ten previous years preceding the relevant accounting year (or)
- b. The manager had not during the seven previous years preceding the relevant previous year been present in India for a period or periods amounting in all to 730 days.

#### 4. NON RESIDENT[SECTION 2(30)]-

A HUF is nonresident if the place of control and management of affairs is situated wholly outside India. Note: Karta is the oldest male member in a HUF who normally manages and controls the HUF. If the karta manages and controls HUF outside India then the HUF is nonresident.

### Q. EXPLAIN THE CONCEPT OF RESIDENTIAL STATUS OF FIRM AND AOP, OR BOI ( 5 Marks)

A firm or an association of persons can be resident or nonresident'.

#### 1. RESIDENT:

If the place of control and management of affairs is wholly or partially situated in India then it is resident.

#### 2. NOT ORDINARILY RESIDENT

A firm, an association of persons (AOP) or body of individuals (BOI) cannot claim this status.

#### 3. NON RESIDENT:

If the place of control and management of affairs is situated wholly outside India then it is nonresident.

### Q. EXPLAIN THE CONCEPT OF RESIDENTIAL STATUS OF A COMPANY [ SEC 6(3)]. ( 5 Marks)

#### INDIAN COMPANY

Always treated as 'resident' even if control and management of affairs is situated in India or outside India.

#### FOREIGN COMPANY

**RESIDENTS** – If the control and management of affairs is situated wholly in India.

**NOT ORDINARILY RESIDENT-**

A company can not have this status. It can either be resident or non resident.

**NON RESIDENT** –

If the control and management of affairs is party in India or wholly outside India.

**Q. WRITE SHORT NOTE ON RESIDENTIAL STATUS OF EVERY OTHER PERSON. ( 5 Marks)**

Residential status of any other person like association of persons, body of individuals, local authorities, artificial and judicial persons can be either resident or non resident.

**RESIDENT**

Place of control and management of affairs situated wholly or partially in India then resident.

**NON RESIDENT**

Place of control and management of affairs situated out of India then non resident.

### INCIDENCE OF TAX (SCOPE OF TOTAL INCOME)

**Q. EXPLAIN THE SCOPE OF TOTAL INCOME (OR) EXPLAIN THE CONCEPT OF RESIDENCE AND TAX LIABILITY (OR) WRITE SHORT NOTE ON TAX INCIDENCE. ( 5/10 Marks)**

**Incidence of tax:** The incidence of tax depends upon the residential status of a person. Based on the residential status of a person, we must determine whether a particular type of income should be taken or left out while calculating his gross total income. Section 5 provides the scope of total income which varies on the basis of status.

**SCOPE OF TOTAL INCOME OF ‘A RESIDENT’ [SECTION 5(1)]**

Following are the specific incomes that are taxable in the hands of resident:

- Income received in India
- Income deemed to be received in India
- Income accrued in India
- Income deemed to be accrued in India
- Income received and accrued outside India from business/profession set up in India
- Income received and accrued outside India from business or profession set up outside India
- Any other income received and accrued outside India

**Scope of Income = Indian Income + Foreign Income**

**SCOPE OF TOTAL INCOME OF ‘NOT ORDINARILY RESIDENT’ [SECTION 5(1)]**

Following are the specific incomes that are taxable in the hands of resident but not ordinarily resident:

- Income received in India
- Income deemed to be received in India
- Income accrued in India
- Income deemed to be accrued in India
- Income received and accrued outside India from business or profession set up in India

**Scope of Income = Indian Income + One particular type of Foreign Income**

**SCOPE OF TOTAL INCOME OF ‘NON-RESIDENT’ [SECTION 5(2)]**

Following are the specific incomes that are taxable in the hands of non resident:

- Income received in India
- Income deemed to be received in India
- Income accrued in India
- Income deemed to be accrued in India

**Scope of Income = Indian Income**

**Summarized chart**

S.No	Different Kinds of Incomes	Different Types of Status		
		Resident	Not Ordinarily	Non

			<b>Resident</b>	<b>Resident</b>
1.	Income received or deemed to be received in India. It is immaterial whether it is earned in India or in a foreign country.	Taxable	Taxable	Taxable
2.	Income earned in India whether received, paid in India or outside India.	Taxable	Taxable	Taxable
3.	Income earned and received outside India from a business controlled or profession set up in India. Income may or may not be remitted to India	Taxable	Taxable	Not Taxable
4.	Income earned or received outside India from a business controlled or profession set-up outside India.	Taxable	Not Taxable	Not Taxable
5.	Income earned and received outside India from any other source (except income under point 3).	Taxable	Not Taxable	Not Taxable
6.	Income earned and received outside India in the years preceding the previous year in question and if the same is remitted to India during the current previous year.	Not Taxable	Not Taxable	Not Taxable

**Q. EXPLAIN THE DIFFERENT TYPES OF INCOME ( 5 Marks)**

**Indian income and foreign income:** For the purpose of understanding the concepts, the income may be classified into two types:

**(I) Indian Income:**

Following of the incomes comes under the meaning of Indian income:

- If income is received or deemed to be received in India during the previous year and at the same time it accrues or arises or is deemed to accrue or arise in India during the previous year.
- If income is received or deemed to be received in India during the previous year but it accrues or arises outside India during the previous year.
- If income is received outside India during the previous year but it accrues or arises or is deemed to accrue or arise in India during the previous year.

**(II) Foreign Income:**

If the following two conditions are satisfied, then such income is “foreign income”:

- Income is not received or not deemed to be received in India and
- Income does not accrue or arise or does not deemed to accrue or arise in India.

**Q. EXPLAIN THE INCOMES WHICH DO NOT FORM PART OF TOTAL INCOME ( 5/10 Marks)**

The following income is exempted from tax, as they do not form part of total income. The onerous proof lies with the assessee that a particular item of income falls within exempted income u/s.10

S.NO.	EXEMPTED INCOMES
1.	<b>Agricultural income [sec 10(1)]</b>
2.	<b>Receipt from Hindu undivided family [sec10(2)]</b>
3.	<b>Partner’s share in the firm [sec10(2A) ]</b>
4.	Interest on securities / bonds for non-residents [sec10(4)(i)]
5.	Interest on external account of a non-resident [sec10(4)(ii)]
6.	Interest on specific saving certificates [sec10(4B)]
7.	<b>Value of leave travel concession [sec10(5)]</b>
8.	Tax paid on behalf of a foreign company [sec10(6A)]
9.	Tax paid on behalf of non-residents / foreign companies in respect of other incomes. [sec10(6B)]
10.	<b>Royalty or free for technical services [sec10(6C)]</b>
11.	Allowances or perquisites for services rendered outside India [sec10(7)]
12.	Income in connection under a technical assistance programme [sec10(8B)]
13.	<b>Gratuity [sec10(10)]</b>
14.	<b>Commuted pension [sec10(10A)]</b>
15.	<b>Leave encashment [sec10(10AA)]</b>
16.	Any compensation to an employee [sec10(10B)]

17.	Payment under Bhopal gas leak disaster (processing of claims) act 1985 [sec10(10BB)]
18.	Voluntary retirement payment [sec10(10C)]
19.	Tax paid by employer on income by way of perquisites on behalf of an employee [sec10(10CC)]
20.	Provident fund payment including interest [sec10(11)]
21.	Accumulated balance of recognized provident fund [sec10(12)]
22.	Superannuation fund payment [sec10(13)]
23.	House rent allowance [sec10(13A)]
24.	Interest on capital investment bonds [sec10(15)(iib)]
25.	Interest payable to European investment bank [sec10(15)(iiic)]
26.	Interest on retirement benefits [sec10(15)(iv)(i)]
27.	Interest on securities and deposits [sec10(15)(v)]
28.	Interest on gold deposit bonds, 1999 [sec10(15)(vi)]
29.	Allowances to MPs and MLAs not exceeding Rs.2,500 p.m. [W.e.f. AY 2007-08, constituency allowance received is also exempted without any limit] [sec10 (17)]
30.	Amount in connection with cash or kind award instituted by central or state government. [sec10(17A)]
31.	Pension or family pension received by central or state government employee [sec10(18)]
32.	Annual value of one palace in the occupation of an ex-ruler [sec10(19A)]
33.	Income of local authorities [Municipality, Panchayat, District Boards] [sec10(20)]
34.	Income of an approved scientific research association [sec10(21)]
35.	Income of a news agency [sec10(22B)]

## Q.EXPLAIN THE PROCEDURE FOR COMPUTATION OF SALARY INCOME OR FORMAT FOR COMPUTATION OF TAXABLE INCOME FROM SALARY

### Basic salary:

Both Basic salary and wages means a payment or compensation for work done, or service rendered, except that ordinarily salary is paid in respect of non-manual work and wages , for manual work. Under the grade system basic salary is to be calculated by considering the date of appointment and annual increment.

### Bonus:

Bonus is included in gross salary. It is taxable on receipt basis. It is taxable on receipt basis. While ‘contractual bonus’ is regarded as salary’, gratuitous bonus’ is taxable as perquisites. If bonus is received in arrears, the assessee can claim relief in terms of section 89(1).

### Advance salary:

Advance salary is taxable on receipt basis in the assessment year for relevant to the previous year in which it is received. For the purpose of calculations it is not to be considered.

### Arrear salary:

It is taxable on receipt basis, if it has not been taxed earlier on due basis. Any amount of salary received from present or past employer during relevant previous year and which relates to some earlier previous years, is treated as arrears of salary. It is taxable on receipt basis and for the purpose of calculations it is not to be considered.

### Dearness allowance (DA):

It is always fully taxable, however inclusion of DA for the purpose of various calculations is depend upon the factor whether it form part of salary for retirement benefits or not. In the absence of specific information, it is assumed that D.A is not forming part of salary.

### Commission:

It is always fully taxable, however for the purpose of calculations it is to be considered only when it is based on the fixed percentage on sales.

Computation of income from salary of Mr..... For the assessment year

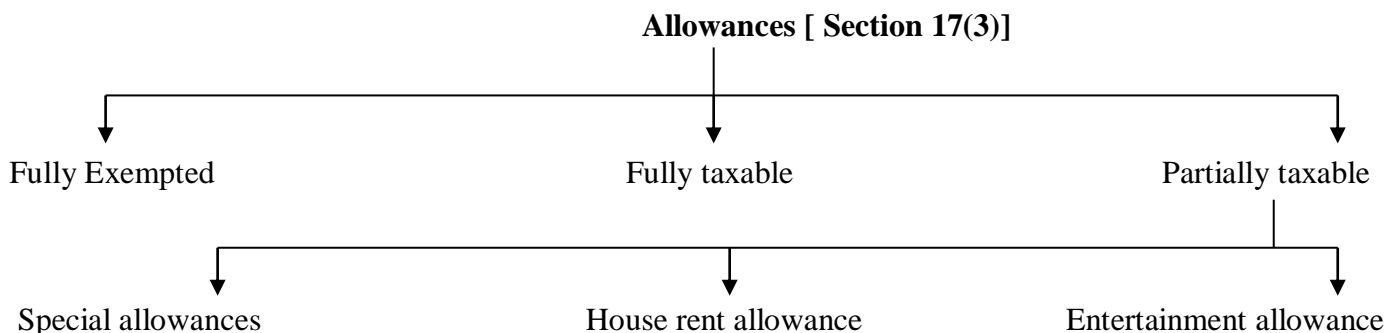
Particulars	Amount
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<b>Basic Items</b>	
a. Basic salary/wages/remuneration/pay	xxx
b. Special pay	xxx
c. Bonus[gratuitous/standard]	xxx
d. Fees	xxx
e. Commission	xxx
f. Advance salary	xxx
g. Arrear salary	xxx
<b>Allowances</b>	
1. Fully taxable allowance	xxx
2. Partly taxable/partly exempted allowances	xxx
3. Fully exempted allowances	Nil
<b>Perquisites</b>	
1. Taxable for all[specified and unspecified]	xxx
2. Taxable for specified employees only	xxx
3. Exempted for all[specified and unspecified]	Nil
<b>Special Items</b>	
1. Gratuity	xxx
2. Pension	xxx
3. Leave encashment	xxx
4. Provident fund	xxx
<b>Gross Salary</b>	
xxx	
<b>Deductions u/s 16</b>	
(i) Standard deduction-[Not applicable from AY 2006-07] [N.A]	
(ii) Entertainment allowances	xxx
(iii) Professional/employment tax	xxx
<b>Income from Salary</b>	
xxx	

### Q. WHAT IS MEANT BY ALLOWANCES?

An allowance is a cash payment to the employee on a regular basis in addition to basic salary to meet certain expenses required to be incurred by him in connection with duties of his office, or to compensate him for any expenditure which is owing to performance of his duty in particular circumstances or at a particular place. Allowances may be paid voluntarily or under any contractual obligations.

Allowances are generally taxable under section 15 on 'due' or receipt basis and are to be included in the gross salary unless a specific exemption is provided in respect of any such allowances.



<b>Fully exempted</b>	<b>Fully taxable</b>	<b>Partially taxable</b>
1. Foreign allowance only in case of Government employees posted	1. Dearness allowance, Additional Dearness Allowance, High Cost of living allowance.	1. House rent allowance. 2. Entertainment allowance for government employees. 3. Allowances covered U/S 10(14)

<p>out side India.</p> <p>2. House rent allowance given to judges of High court and supreme court</p> <p>3. Sumptuary allowance given to judges of High court and supreme court</p> <p>4. Allowances from U.N.O</p>	<p>2. City Compensatory Allowance.</p> <p>3. Capital Compensatory Allowance.</p> <p>4. Lunch Allowance.</p> <p>5. Tiffin Allowance</p> <p>6. Marriage Allowance</p> <p>7. Family Allowance</p> <p>8. Deputation Allowance</p> <p>9. Wardenship Allowance</p> <p>10. Non Practicing Allowance</p> <p>11. Project Allowance</p> <p>12. Overtime Allowance</p> <p>13. Fixed Medical Allowance</p> <p>14. Entertainment Allowance</p> <p>15. Water And Electricity Allowance</p> <p>16. Servant Allowance</p>	<ul style="list-style-type: none"> <li>☞ Helper Allowance</li> <li>☞ Uniform Allowance</li> <li>☞ Academic Allowance</li> <li>☞ Conveyance Allowance</li> <li>☞ Traveling Allowance</li> <li>☞ Any special Allowance in the nature of Composite Hill Compensatory Allowance or High Attitude Allowance or Uncongenial Climate Allowance or Snow Bound Area Allowance or Avlanche Allowance</li> <li>☞ Any Special Compensatory Allowance in the nature of border area or remote area or difficult area or disturbed area Allowance</li> <li>☞ Transport Allowance</li> <li>☞ Tribal Area Allowance</li> <li>☞ Running Allowance given to employees of transport sector.</li> <li>☞ Children Education Allowance</li> <li>☞ Hostel Expenditure Allowance</li> <li>☞ Compensatory Field Area Allowance</li> <li>☞ Compensa</li> <li>☞ tory Modified Field Area Allowance.</li> <li>➔ Special allowance in the nature of counter insurgency allowance given to the members of armed forces operating in the areas away from their permanent locations for a period of more than 30 days.</li> </ul>
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**Special Allowances Sec. 10 (14):**

S.No	Allowance	Amount of exemption
1.	Conveyance or traveling allowances (Expenses on transfer is also to be treated as official purpose)	Amount spent for the performance of official duties.
2.	Helper allowance	Amount spent for the performance of official duties.
3.	Uniform allowance	Amount spent for the performance of official duties.
4.	Academic allowance and research	Amount spent for academic and research purposes.
5.	Travailing / transfer / Daily allowance	Daily expenses incurred due absence from his place of work while on tour or journey in connection with transfer
6	Allowances to a transport employee to meet his personal expenses while running the vehicle	70% of such allowance or Rs. 6,000/-p.m. whichever is less.
7.	Children education allowance	Actual allowance (or) Rs.100 per month per child whichever is less (subject to a maximum of two children)
8.	Children Hostel allowance	Actual allowance or Rs.300 per month per child whichever is less (subject to a maximum of two children)

9.	Any special allowance in the nature of composite hill compensatory allowance / High altitude allowance / uncongenial climate allowance / snow bound area allowance / Avalanche allowance	Exemption allowed up to Rs. 300 p.m to Rs. 7,000 p.m.
10	Any special compensatory allowance in the nature of Border area allowance / Remote area allowance / difficult area allowance/ disturbed area allowance.	Exemption allowed up to Rs. 200 p.m to Rs. 1,300 p.m.
11	Compensatory field area allowance	Exemption allowed up to Rs. 2,600 p.m
12	Compensatory modified field area allowance	Exemption allowed up to Rs. 1,000 p.m
13	Counter insurgency allowance / compensatory field area allowance	Exemption allowed up to Rs. 3,900 p.m
14	Highly active field area allowance	Exemption allowed up to Rs. 4,200 p.m
15	Underground allowance given to coal mine workers.	Exemption allowed up to Rs. 800 p.m
16	Island duty allowance given to armed forces posted in Andaman & Nicobar and Lakshdweep group of islands	Exemption allowed up to Rs. 3,250 p.m
17	Tribal area allowance	Exemption allowed up to Rs. 200 p.m in the states of Madya Pradesh, Tamil nadu, Utter Pradesh, Karnataka, Tripura, Assam, West Bengal, Bihar and Orissa.
18	Transport allowance for the journey between office and residence.	Actual or Rs.800 per month whichever is less.
19	Transport allowance to a blind or handicapped employee for the journey between office and residence	Actual or Rs.1,600 per month whichever is less.

### Q. EXPLAIN DEARNESS ALLOWANCE

Dearness allowance is also termed as additional Dearness allowance, or High cost of living allowance or interim relief. These allowances are given by employer to the employees as compensation for rise in prices.

Dearness allowances, sometimes, is given under the terms of employment and sometimes without it. Therefore it may be mentioned that:

1. D.A. enters into pay for service benefits or (DASB)
2. D.A. enters into pay for retirement benefits or (DARB)
3. D.A. is given under the terms of employment or
4. D.A. forms part of salary
5. Dearness pay forms part of salary for super annuation benefits.

It is treated as part of salary for certain purposes such as provident fund, value of rent free house, house rent allowance, bonus, gratuity, leave encashment etc.

### Problem.No.3

Mr. Ram receives a salary of Rs.10,000 p.m. and DA @ Rs.2,000 pm ( Rs.100 p.m enters in to pay for service benefits) ,Advance salary for two months Rs.22,000.

Employer Contribution to R.P.F Rs.1600 p.m. Compute Gross salary from information given.

### Q. EXPLAIN ENTERTAINMENT ALLOWANCE (EA). [Section 16(ii)]

This allowance is fully taxable irrespective of any expenditure incurred on entertainment of guests or customers. But in case any amount is reimbursed against any expenditure incurred by employee on entertainment of guests or customers it shall be fully exempted.

U/s 16(ii) a deduction is allowed to those persons who receive this allowance. Till assessment year 2001-2002 this deduction was admissible both to government as well as private sector employees. But with effect from assessment year 2003-04 this deduction is admissible only to government employees for an amount equal to least of following:

- i. Statutory limit Rs.5,000; or
- ii. 1/5<sup>th</sup> of basic salary only; or
- iii. Actual entertainment allowance received during the previous year.

#### **Q. WHAT IS MEANT BY HOUSE RENT ALLOWANCE (HRA)? [Section 10(13 A)]**

##### **Employees living in hired (rented) houses**

An allowance granted to an employee by his employer to meet expenditure incurred on payment of rent in respect of residential accommodation occupied by him is exempt from tax to a certain extent as per Rule 2A: According to Rule 2A, the house rent allowance is exempted upto the least of the following amounts:

- (i) House rent allowance actually received by the assessee, or
- (ii) (a) if the accommodation is situated at Mumbai, Kolkata, Delhi or Chennai-An amount equal to 50 per cent of salary due to the assessee, and (b) if the accommodation is situated at any other place-40 percent of salary due to the assessee.
- (iii) The excess of rent paid over 10% of salary.

**Other relevant points:** the following points should also be kept in view:

Salary for the purpose of HRA means:

**Basic Salary**

**Dearness allowance if terms of employment so provide, and**

**Commission based on turnover.**

It excludes all other allowances and perquisites.

##### **Cases when HRA is fully taxable**

HRA is fully taxable in any of the following cases

- ☞ If employee is **living** in his **own house** or
- ☞ If employee is **living in a house for which he is not paying any rent** or
- ☞ If rent paid does not exceed 10% of salary.

##### **House rent allowance received by Judges of High court and Supreme court**

Fully exempted

#### **Q. EXPLAIN PROVIDENT FUND (PF) AND THEIR FEATURES.**

It is a scheme where the employee contributes a sum of money from his monthly salary towards savings. Similarly the employer will also contribute some amount to the account of employee.

The interest earned out of this contribution is also credited to his account itself. If an employee wants to get a loan during his service he can apply for and get the same from his account. The accumulated sum of money to the employee's account will be paid to him at the time of retirement. In case of death of the employee, the sum of money will be paid to his/her legal heirs.

#### **Q. EXPLAIN THE DIFFERENT KINDS OF PROVIDENT FUNDS AND THEIR TAX TREATMENT**

There are four types of provident funds.

##### **1. Statutory Provident Fund [SPF]**

SPF is set up under the provision of the provident fund ct, 1925. This fund was mainly started to promote savings habit among the government employees. This type of fund is maintained by the Government and Semi-government organizations, local authorities, railways, universities, insurance companies and recognized educational institutions.

##### **2. Recognized Provident Fund [RPF]**

It is a fund which is recognized by the commissioner of Income Tax. This type of fund is maintained by business houses, industrial undertakings and banks. Under this fund both employee and employer will

contribute. Employee's contribution qualifies for deduction u/s 80 C. employer's contribution over 12% of mentioned salary is taxable. Interest is exempted up to 9.5%.

### 3. Unrecognized Provident Fund [URPF]

It is a fund, which is not recognized by the commissioner of Income Tax. Under this fund both employee and employer will contribute. For employee's contribution there is no deduction u/s 80 C. Interest on employee's contribution will be taxed as "Other Source of Income". Contribution of employer and interest on such contribution will be taxed as "salary Income".

### 4. Public Provident Fund [PPF]

The above mentioned three funds namely SPF, RPF and URPF are for salaried people. In order to promote savings habit among those employees who are not salaried, PPF fund was started. This is mainly for self-employed people such as doctors, lawyers, accountants, pensioners etc.

Even a person who is a member of any other provident fund can open an account under this type of fund to have his own savings. The total contribution can be withdrawn after a period of 15 years. Contribution can be between Rs.500 and Rs.70,000 per year. Contribution towards this fund qualifies for deduction u/s 80 C.

## Q. COMPUTATION OF TAXABLE INCOME AS REGARDS PROVIDENT FUNDS

PARTICULARS	SPF	RPF	URPF	PPF
<b>Employee's own contribution</b>	Fully qualifies for Deduction U/S 80C	Fully qualifies for Deduction U/S 80C	Does Not qualify for Deduction U/S 80C	Qualify for Deduction U/S 80C
<b>Employer contribution</b>	Fully exempted	Employer's contribution over 12% of employee's salary –taxable.	Ignore for the time being	Not taxable
<b>Interest credited</b>	Fully exempted	Exempted upto rate prescribed by the Government. Excess over this amount is taxable(i.e. 9.5%)	Ignore for the time being	Fully exempt

**Salary= Basic + DA (if it is forming part of salary)+Commission(if it is fixed percentage on sales)**

## Q. EXPLAIN THE OTHER ITEMS INCLUDED IN SALARY (RETIREMENT BENEFITS)

- I. Gratuity.
- II. Pension.
- III. Earned leave.
- IV. Profits in lieu of salary.

## Q. WHAT IS MEANT BY EARNED LEAVE SALARY?

There are different types of leaves as per service rules. One type of is earned leave where employee can convert the leave into cash provided if he has not utilized the leave. Every employee can surrender the accumulated leave[standing to his credit] at the time of retirement or leaving job and can encash. Any amount from this type of surrendering leave is known as "Leave Salary". The tax treatment is as follows:

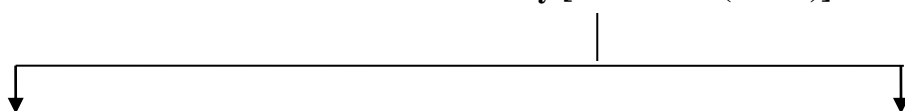
### 1. Meaning of salary:

Basic + DA (if it is forming part of salary)+Commission(if it is fixed percentage on sales)

### 2. Average salary

It means average of salary drawn by employee during 10 months immediately preceding his retirement.

### Leave salary [ Section 10(10AA)]



## Government Employees Fully Exempt

## Non Government Employees

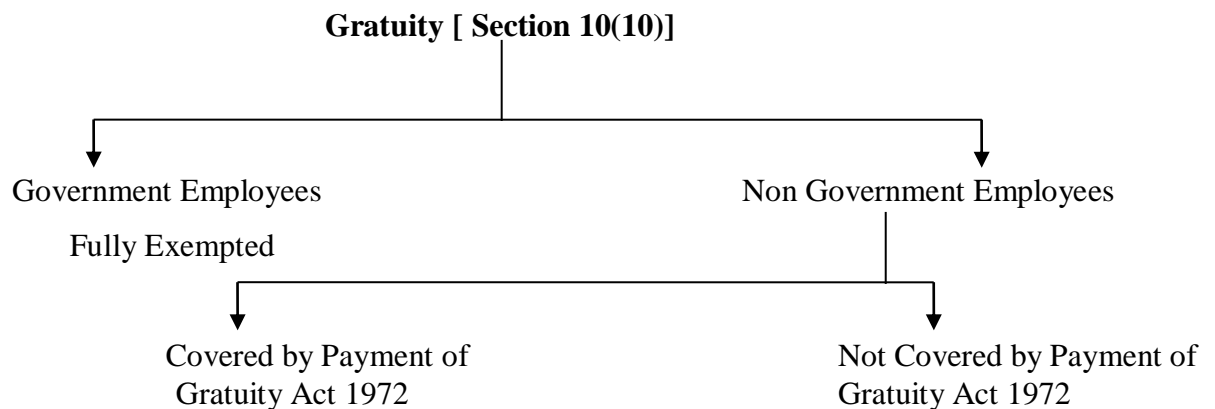
Any payment received as the cash equivalent of the leave salary to his credit at the time of superannuation or on leaving the service shall be **exempted** up to **least** of the following amounts.

- a. Actual amount received.
- b. Amount calculated at average salary for 10 months.
- c. Notified limit of Rs. 3,00,000
- d. The cash equivalent of the leave salary to his credit at the time of retirement. This amount is to be calculated by taking leave for one month (30 Days) for every one year of service less leave already availed of.

### Q. EXPLAIN THE TERM GRATUITY AND ITS TAX TREATMENT.

Gratuity is a retirement benefit. It is paid at the retirement/cessation of employment based on the service tax. For tax treatment the status of the employee is divided into two main categories as follows:

1. Government employees.
2. Non-Government employees
  - i. Employees covered by payment of Gratuity Act 1972
  - ii. Employees not covered by payment of Gratuity Act 1972



### GOVERNMENT EMPLOYEE:

Any death cum retirement gratuity received by government employee is fully exempt.

### Meaning of government employee:

Government employee includes

- Employees of central government.
- Employees of state government.
- Employees of local authority.
- Employees working in defence.
- Employees of statutory corporations .

### NON GOVERNMENT EMPLOYEES:

#### Non Government employees- Covered by Payment of Gratuity Act 1972

Any gratuity received by such an employee shall be **exempt to the extent of least** of the following.

- a) 15 days salary ( 7 days in case of employees working in seasonal factories) for each completed year of service or part thereof in excess of six months on the basis of monthly salary last drawn.
- b) Notified limit Rs.3,50,000.
- c) Gratuity actually received by the employee.

### Hints

- ☞ While calculating length of service period **exceeding 6 months is to be taken as full year**. Thus part of the year up to 6 months is to be ignored.

☞ **Calculation of 15 days salary**

$$\text{15 days salary} = \frac{\text{Monthly salary last drawn} \times 15 \text{ Days}}{26 \text{ Days}}$$

☞ **Meaning of salary:** Salary = Basic salary + DA( whether enters or not)

**Non Government employees- Not Covered by Payment of Gratuity Act 1972**

**Least** of the following three amounts shall be **exempt**

- a) ½ month salary for every completed year of service on the basis of average salary drawn during 10 months immediately preceding the month of retirement.
- b) Maximum notified limit Rs.3,50,000.
- c) Gratuity actually received by the employee.

**Hints**

- ☞ Employees not covered under POGA 1972 includes employees working in any shop or establishment in which less than 10 persons are employed or were employed on any day of the preceding 12 months.
- ☞ While calculating length of service only completed years are to be counted. Thus any fraction or part of the year is to be ignored.
- ☞ **Calculation of half month salary**

$$\frac{1}{2} \text{ Month salary} = \text{Average salary drawn during 10 months immediately preceding the month of retirement} \times \frac{1}{2}$$

☞ **Meaning of salary:** Salary = Basic salary + DA (Enters) + Commission on turnover.

**Q. WHAT IS MEANT BY PENSION?**

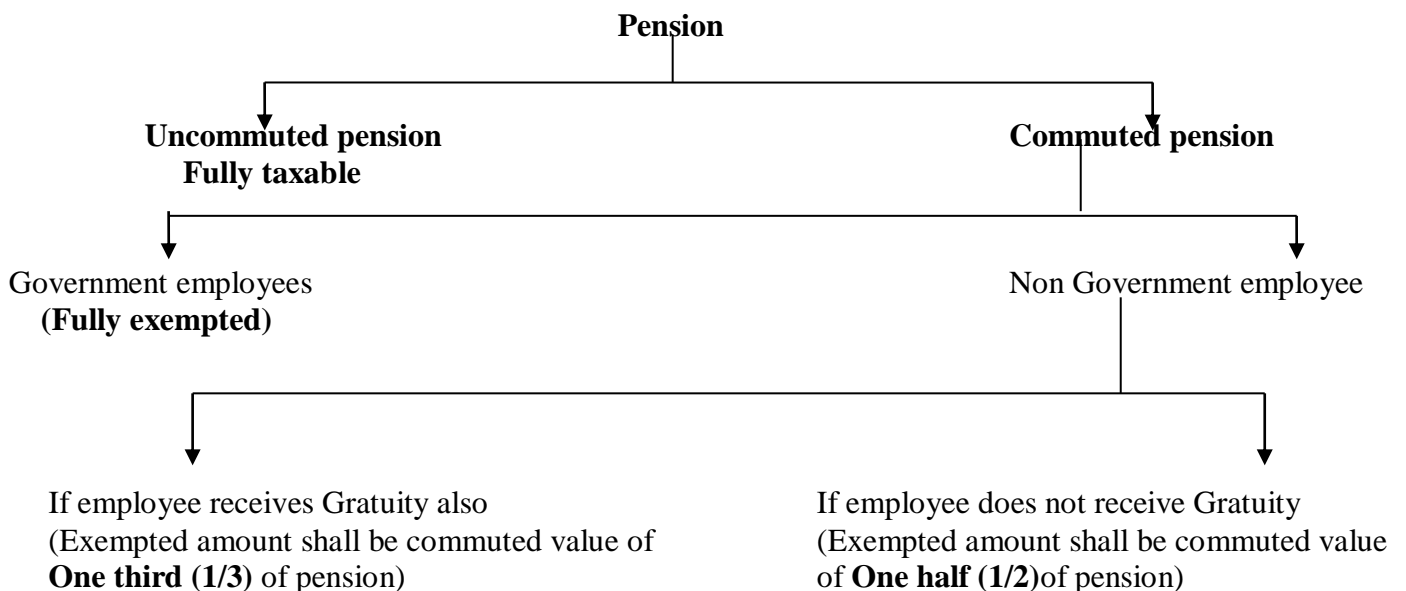
It is periodical payment received by an employee after his retirement. An employee cannot receive pension while he is in service. Any pension received is taxable as salary. There are two types of pension.

**1. Commuted Pension-**

It is a lump sum amount received at the time of retirement. It is a one time payment.

**2. Uncommuted pension-**

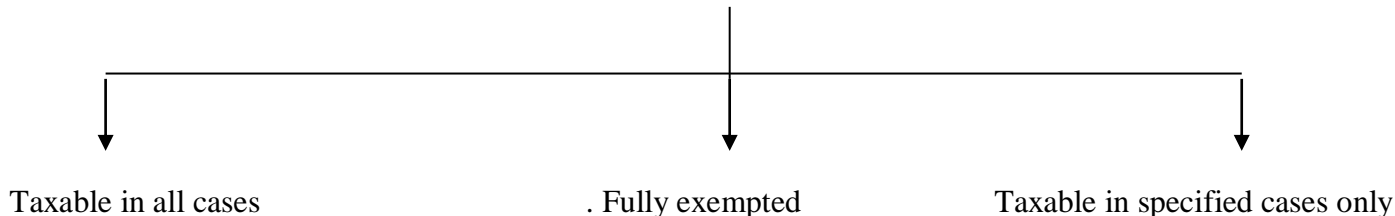
It is a periodical payment received by the employee after the date of retirement. It is the balance which he gets after commutation.



**Q. GIVE THE MEANING OF PERQUISITES [Section 17(2)]**

The term “perquisites” [termed as “perks”] means any benefit attached to an office or position in addition to salary or wages. Perquisite denotes a personal advantage. Perquisite may be in cash or in kind. Any perquisite given in kind should be in a position to be measured in terms of money.

### Perquisites



#### I. PERQUISITES TAXABLE FOR ALL EMPLOYEES.

S.No	PERQUISITES TAXABLE FOR ALL EMPLOYEES	Taxable value of perquisites
1.	Rent free accommodation	Refer page no .34
2.	Concessional accommodation	Refer page no. 35
3.	Obligation of employee met by employer (Gas and electricity bill, Education of children bills, Income tax , professional tax, Salary of domestic servants etc)	Actual expenses met by the employer
4.	Any amount of life insurance premium paid by employer on the life of employee during the previous year	Actual amount paid.
5.	Value of specified security or sweat equity shares allotted or transferred.	Fair market value of specified security or sweat equity shares on the date on which option is exercised by the employee <b>less</b> amount charged or recovered from the employee.
6.	Contribution to approved superannuation fund of the employee in excess of Rs. 1,00,000	Amount of contribution <b>LESS</b> Rs 1,00,000
7	<b>Other fringe benefits.</b>	
7. a	Interest free or concessional loan	The rate of interest charged by SBI as on the first day of the relevant previous year in respect of loan for the same purpose advanced by it.
7. b	Traveling, touring accommodation	<b>Where facilities provided to all employees</b> Amount spent by employer <b>LESS</b> amount recovered from employee <b>Where these facilities are not provided to all employees.</b> Value of facilities offered by other agencies <b>LESS</b> amount recovered from employee
7. c	Food or beverage facility	Amount spent by employer <b>LESS</b> Amount charged / recovered by employer from employee.
7. d	Gift or voucher or token facility	If gift is received in cash or convertible in to money is fully taxable If gift is in kind, then an excess of Rs. 5,000 is taxable.
7. e	Credit card facility	Expenditure incurred by employer <b>LESS</b> ( expenditure on its use for official purposes + any amount received or recovered from the employee)
7. f	Club facility	Amount spent or reimbursed by the

		employer.
7. g	Use of movable assets	10% of cost of that asset.
7. h	Transfer of movable assets	Actual cost minus depreciation at the following rates for each completed year of use by the employer. a. Electronic items ( 50% p.a on WDV basis) b. Motor car or other conveyance (( 20% p.a on WDV basis) c. Any other item (10% p.a on actual cost basis)

### RENT FREE ACCOMMODATION

#### Meaning of Accommodation

The term house or accommodation for this purpose will include a house, flat, farm, hotel accommodation, guest house, a caravan, ship etc. For the purpose of valuation of house, employees are classified under the following two categories

#### VALUATION OF RENT FREE ACCOMODATION

##### For unfurnished accommodation (Central and state Government employees).

The **taxable value of perquisite** in respect of accommodation provided to employees is **equal to the license fee** which would have been determined by the central or state government in accordance with the rules framed by the government for allotment of house to its staff.

##### For unfurnished accommodation (Private and other non government employees)

		Value of rent free house
<b>Owned by employer</b>	In cities the population of which is more than 25 Lakhs as per census of 2001	15% of salary
	In cities the population of which is exceeding 10 Lakhs but not exceeding 25 Lakhs as per census of 2001	10% of salary
	In cities and towns the population of which is 10 Lakhs or less than 10 Lakhs as per census of 2001	7.5 % of salary
	Hotel accommodation (For less than 15 days on transfer from one place to another)	Fully exempted
	Hotel accommodation (For more than 15 days on transfer from one place to another)	24% of salary or actual bill Which ever is less is taxable
<b>Hired by employer</b>	-	15% of salary or actual rent paid or payable by employer which ever is less is taxable in all cities.

##### For furnished accommodation. (For all employees)

The term furniture here includes radio sets, television sets, refrigerators, air conditioners and other house hold appliances.

<b>If furniture is owned by employer.</b>	Value of unfurnished house + 10% p.a of cost of furniture
<b>If furniture is hired by employer.</b>	Value of unfurnished house + Actual hire charges paid or payable by employer

##### For concessional accommodation.

**It means that employer has given a house to his employee for which he is charging a part of the rent.**

Value of concessional accommodation = Value of rent free accommodation **less** rent paid by employee

#### Meaning of salary

For the purpose of valuation of perquisite in respect of rent-free accommodation, salary includes:

1. Basic salary.
2. Dearness allowance/pay, if terms of employment so provide.
3. Bonus (Statutory)
4. Commission.
5. Fees
6. All other taxable allowances (Excluding amount not taxable)
7. Any monetary payment which is chargeable to tax.

## **II. PERQUISITES EXEMPTED FOR ALL EMPLOYEES.**

1. Free medical facilities.
2. Free refreshments during working hours.
3. Free recreational facilities.
4. **Provision of telephone whether basic or cellular exclusively for official use.**
5. Free meals provided in remote area or at offshore installation.
6. Free education, training or refresher course for employees.
7. Leave travel concession if given twice in a block of four years.
8. Free ration received by members of armed forces.
9. Perquisites allowed by government to its employees posted abroad.
10. Rent free house given to an officer of parliament, a union minister and leader of opposition in parliament.
11. Free residence and conveyance facilities to judges of Supreme Court and high court.
12. Free conveyance provided by employer to employee for going to or coming from place of employment.
13. Any amount contributed by employer towards pension or deferred annuity scheme.
14. Employer's contribution to staff group insurance scheme.
15. Computers, laptops given to an employee for official or personal use.
16. Transfer of a movable asset (Computer, car or electronic items) more than 10 years old without consideration.
17. Accident insurance premium paid by employer for his own benefit.
18. Interest free loan or loan at concessional rate of interest taken by employee from employer if amount of loan does not exceed Rs. 20,000 or loan is taken for medical treatment.
19. Value of any shares or debentures given free of cost or at concessional rate to employees under stock option scheme approved by the central government.
20. Tax on perks paid by employer.
21. Rent free accommodation given in remote or offshore areas.

## **III. PERQUISITES TAXABLE FOR SPECIFIED EMPLOYEES ONLY.**

### Meaning of specified employee

An employee is said to be a specified employee in any of the following cases

1. If he is director of the company. or
2. He has substantial interest in the affairs of the company i.e he holds at least 20% of the voting power (equity shares ) in the company or
3. His monetary salary is more than Rs. 50,000 p.a.

### Meaning of salary

1. Basic salary
2. D.A/D.P/A.D.A
3. Bonus, commission, fees and taxable portion of an allowance.
4. Any perquisites received in cash or in monetary form
5. Gratuity, pension, leave salary but arrears of salary and salary received in advance is to be excluded.
6. In case employee is working simultaneously with more than one employer, salary from all the employers is to be included.
7. Monetary salary of Rs.50,000 shall be calculated after allowing deduction u/s 16(ii) and 16(iii).

## **MOTOR CAR**

### **A. MOTOR CAR IS OWNED OR HIRED BY EMPLOYER AND ITS RUNNING AND MAINTENANCE EXPENSES ARE MET OR REIMBURSED BY EMPLOYER:**

**1. Car is fully used in the performance of official duties of the employee:**

Value of Perk = Nil

**2. Car is fully used for the private, personal or family purposes of the employee:**

**Value of Perk:**

Actual expenses incurred by the employer on running and maintenance of car	xxx
Add: Salary of chauffer	xxx
Normal wear and tear of car (10% of actual cost)	xxx
Less: Any amount paid or re-imbursed by employee	xxx
	xxx
<b>Value of Perk</b>	xxx

**3. Car is used partly in the performance of duties and partly for private or personal purposes:**

**The expenses on maintenance and running are met or reimbursed by the employer**

- (i) Where cubic capacity of engine does not exceed 1.6 litres Rs. 1,800 p.m
- (ii) Where cubic capacity of engine exceeds 1.6 litres Rs. 2,400 p.m

**The expenses on running and maintenance for private or personal use are fully met by employee himself**

- (i) Where cubic capacity of engine does not exceed 1.6 litres Rs. 600 p.m
- (ii) Where cubic capacity of engine exceeds 1.6 litres Rs. 900 p.m

**Facility of Chauffeur**

Value of perk = Amount specified for use of car + Rs. 900 p.m for drivers salary.

**B. CAR IS OWNED BY EMPLOYEE BUT ITS RUNNING AND MAINTENANCE EXPENSES ARE MET OR REIMBURSED BY EMPLOYER:**

**1. Car is fully used in the performance of official duties of the employee:**

No value to be taxed but proper log book for official purposes.

**2. Car is being used partly for official purposes and partly for personal or private purposes:**

Taxable value of perk = Find out the actual amount of expenditure incurred by employer **LESS**

Rs. 1,800 p.m for small car and Rs. 2,400 p.m for big car and Rs. 900 for driver

**Note:** A proper log book must be maintained

**C. WHERE THE EMPLOYEE OWNS ANY OTHER AUTOMOTIVE CONVEYANCE BUT THE ACTUAL RUNNING AND MAINTENANCE EXPENSIVE ARE MET OR REIMBURSED BY THE EMPLOYER:**

**1. Employee's conveyance is fully used in the performance of official duties of the employee:**

No value to be taxed but proper log book for official purposes.

**2. Employee's conveyance is being used partly for official purposes and partly for personal or private purposes:**

Taxable value of the perk shall be the actual amount of expenditure incurred by the employer as reduced by the amount of Rs. 900

**Note:** A proper log book must be maintained

**Other Points:**

☞ **Free use of car between office and residence:**

Use of employer's car to go the place of employee's work and come back to his residence is not a taxable perk and hence it is ignored.

☞ **Conveyance facility to high court and Supreme Court judges:** It is fully exempted.

☞ **Meaning of Month:**

Month means a complete calendar month and if there is a part of the month, the same shall be ignored.

☞ **Car at concessional rate**

Value of perk = value of car if car has been provided totally free of cost **LESS** any amount charged from the employee for the use of the car.

### **FREE DOMESTIC SERVANTS**

	<b>Taxable value of perquisite</b>
Sweeper, watchmen gardener (or) personal attendant	Actual cost to employer
Sweeper, watchmen gardener (or) personal attendant and if any amount is paid by employee	Amount spent by employer LESS Amount charged / recovered by employer from employee.

### **FREE SUPPLY OF GAS, ELECTRIC ENERGY AND WATER SUPPLY.**

	<b>Taxable value of perquisite</b>
Where the supply is from employer's own sources	Actual cost of these services to the employer.
Where the supply is from the purchases made by the employer from outside agencies.	Amount paid by the employer to the outside agency
In case employee pays some part of the cost to the employer	Amount spent by employer LESS Amount charged / recovered by employer from employee.

### **EDUCATION FACILITY FOR CHILDREN**

If employer provides free education to the members of the household of employee reasonable amount which employee would have spent on similar type of education in same or nearby locality is taxable.

### **FREE TRANSPORT ALLOWED BY EMPLOYER ENGAGED IN TRANSPORT BUSINESS**

If conveyance is hired or ticket is purchased by employer, actual expenses are taxable. It shall be reduced by any amount paid by the employee.

### **MEDICAL FACILITIES**

Medical facility other than exempted medical facility is a perk taxable in case of specified employees only. But if medical bills are in the name of employee and payment is made / reimbursed by employer then it is a perk taxable in case of all employees because it is an obligation met by employer.

### **Q. EXPLAIN DEDUCTIONS FROM SALARY INCOME [Section 16]**

**Entertainment allowance to government employees [Section 16(ii)]** Refer.Pg.No.24

### **Tax on employment [ Section 16(iii)]**

In case any amount of professional tax is paid by the employee or by his employer on his behalf it is fully allowed as deduction.

### **Q. EXPLAIN THE CONCEPT OF REBATE OF TAX**

#### **Q. Explain Deductions from Salary income.**

#### **Deduction**

**Standard Deduction Section 16 (i)** It is not allowed with effect from the assessment year 2006 – 07.

**Entertainment allowances: [16 (ii)]**

**Tax on Employment [Sec. 16 (iii)]** In case any sum is paid by the assessee on account of a tax on employment with the meaning of clause (2) of article 276 of the constitution leviable by or under any law, such amount shall be fully allowed as deduction. The example of this tax is professional tax levied by any State Government.

### **Q. EXPLAIN THE REBATE OF TAX.**

#### **Tax Rebate/Rebate of Tax (Section 88):**

To encourage savings, a rebate of tax for contributions towards provident funds (including Superannuation funds), payment of life insurance premium and depositing of money in the post office under Cumulative Time Deposit (CTD) Scheme etc. are allowed from total tax.

#### **Qualifying amount (Q.A) for Rebate of tax:**

1. Provident fund – Employee's own contribution to

2. Life insurance premium
3. Group Insurance premium
4. Unit Linked Insurance plan of U.T.I and LIC
5. Cumulative Time Deposit (C.T.D)
6. National Savings Certificate (VIII issue)
7. Any sum paid by an employee in an approved Super annuation fund, during the previous year.
8. Repayment of House Building Advance
9. Amount paid in any scheme of National Housing Bank
10. Any subscription to any deposit scheme of
11. Jeevan Dhara (or) Jeevan Akshay Policy
12. Any amount invested in notified units of UTI
13. Any amount invested in notified deposits scheme
14. Any amount deposited in pension funds
15. Any amount paid as tuition fees
16. Any amount subscribed under Home deposit Account
17. Amount paid as subscription to equity shares of debentures of any eligible issue.
18. Amount paid as subscription any units of any mutual fund.

**Limited of total savings (Qualifying amount)**

- i. In case of making savings in point (i) to point (xvi) above can save upto Rs. 70,000.
- ii. In case of those persons who have made savings under point (i) to (xvi) above and also in point (xvii) or point (xviii) above, such persons can save upto Rs. 1,00,000.
- iii. Total amount of savings cannot exceed total income of the assessee.

**Rate of Rebate of tax u/s 88**

- i. If Gross total Income of an individual or HUF does not exceed Rs. 1,50,000, Rebate shall be allowed @ 20% of qualifying amount.
- ii. If Gross Total Income of an individual or HUF exceeds Rs. 1,50,000 but does not exceed Rs. 5,00,000, rebate shall be allowed @ 15% of qualifying amount.
- iii. If Gross Total Income of an individual or HUF exceeds Rs. 5,00,000 – No rebate shall be allowed.

**Q. EXPLAIN THE RELIEF OF INCOME TAX U/S 89.**

**Relief of Income Tax (Sec.89 (i) and Rule 21 A**

Where an assessee receives arrears of salary or advance salary in any one financial year besides his regular salary for 12 months and thereby his income is taxed at a higher rate than that at which it would have otherwise been taxed, the Assessing Officer, shall, on an application received from the assessee, grant such relief as prescribed by Rule 21A.

- ☞ Relief in respect of Salary paid in arrears or in advance.
- ☞ Find out the tax on the total income as (including arrears or advance salary) of the PY.
- ☞ Find out the tax on the total income as reduced by the arrears or advance salary.
- ☞ From the amount – arrived at in (i) deduct amount arrived at in (ii)
- ☞ The resultant figure arrived at in (iii) is the tax on additional salary or arrears / advance salary.
- ☞ Ascertain the previous years to which the arrears etc. relate and add the respective amount of arrears in respective previous year.
- ☞ Find out the tax on the total income as arrived at in (v) in respect of each of such PY.
- ☞ Find out the tax on total income (without adding the arrears, etc.) of each of the said PY.
- ☞ From the amount arrived at in (vi), deduct the amount arrived at in (vii)
- ☞ The resultant figure arrived at in (viii) is the tax on arrears, etc.
- ☞ Find out the difference between (iv) and (ix). This will be the relief u/s 89 (i).